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# **Competitiveness of enterprises in Kaliningrad region: analysis of macro - and micro-economic factors**



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## **“Economic Bulletins” series**

This work **“Competitiveness of enterprises in Kaliningrad region: Analysis of macro- and micro-economic factors”** offered for your attention is a follow-up of a series of Economic Bulletins, issued in the framework of joint activities of the Fund “Regional Economic Development Agency” (Kaliningrad) and the EuropeAid /114287/C/SV/RU project "Support for Regional Development of Kaliningrad".

At present, enhancement of competitiveness of Kaliningrad enterprises is one of the main challenges of the region's development. The central place in this matter belongs to identification of principal causes of Kaliningrad enterprises' low competitiveness compared with similar indicators of foreign and mainland Russian companies. This Bulletin contributes to the search of solutions of the competitiveness enhancement problem by example of Kaliningrad region.

In the centre of the study carried out by experts of the Regional Economic Development Agency, the results of which were used in this issue in the series of economic bulletins, was a comparative analysis of competitiveness of Kaliningrad enterprises and development - on its basis - of practical recommendations for regional companies and authorities for enhancing competitiveness of Kaliningrad business.

The study was based on the available statistical data and on the information collected in the process of implementation of the EuropeAid project “Support for regional development of Kaliningrad”. The work is addressed to a broad audience of experts.

The Bulletin has been prepared by experts of the European Union project "Support for Regional Development of Kaliningrad" (EuropeAid/114287/C/SV/RU) and of the Regional Economic Development Agency G. Bunatian, A. Vialkin, A. Yershov, S. Klessova, A. Usanov, and A. Kharin.

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## Introduction

The subject of enhancement of competitiveness of Russian economy and of the country as a whole has recently gained popularity. It has been repeatedly brought up in Russian leaders' the speeches. At the same time, among politicians, broad public, and even experts there is no clear understanding of what competitiveness is and what measures should be taken by the authorities to enhance it.

This bulletin is to contribute to solving of this problem by the example of Kaliningrad region. The issue of enhancement of competitiveness has special significance for Kaliningrad region. Firstly, the region is a Russian enclave surrounded by the European Union and regional enterprises are facing the strongest competition with the EU companies. Secondly, the current Special Economic Zone regulations have greatly influenced the structure of the regional economy and companies' investment decisions. Possible changes to these regulations (e. g. as a result of adoption of a new law on Special Economic Zone in Kaliningrad region or as a consequence of Russia's accession to the WTO) may have serious impacts on the economy of the region. That's why an assessment of the competitiveness level of Kaliningrad enterprises is very important for making well-considered and justified decisions both in the context of public policy and on the level of individual enterprises.

At present, politicians and experts haven't got adequate information, to thoroughly analyze the competitiveness. The data of the State statistics are incomplete and unreliable, and enterprises even on anonymity terms are reluctant to provide information about them. All this causes difficulties for such studies and explains its eventual weaknesses. Nevertheless, even based on the limited information at the disposal of independent experts, it is possible to get quite clear understanding of the competitive level of Kaliningrad companies in various economic sectors.

The present work is one of the first attempts to carry out a comprehensive analysis of Kaliningrad companies' competitiveness. The work is based on the available statistical data and on information collected in the course of implementation of the EuropeAid project "Assistance for Regional Development of Kaliningrad" (the Project).

In the first chapter, we differentiate between the concepts of competitiveness of goods, of a company, and of a country/region, and consider different approaches to assessment of competitiveness.

In the second chapter results of various estimates of competitiveness of the Russian economy and of the factors interfering with its growth are summarized.

The third chapter is devoted to a detailed analysis of competitive advantages of Kaliningrad region and of the competitiveness of Kaliningrad companies in terms of utilisation of resource factors.

The fourth chapter contains a detailed analysis of internal microeconomic factors of Kaliningrad companies' competitiveness.

The fifth chapter presents the main results of the study of competitiveness of enterprises in Central- and East-European countries - closest Kaliningrad region's neighbours – and competitiveness enhancement programmes.

And finally, general conclusions and recommendations are given for enhancement of Kaliningrad companies' competitiveness, based on the results of the performed study.

### 1. What is competitiveness?

In the environment of globalisation, the conditions for competitive struggle are essentially changing. Thus, competitiveness, both on the world market and on the national market is determined by an increasing number of factors.

In the most general sense competitiveness is an ability to outstrip others in market competitions, using the advantages for achievement of objects in view. Usually, special emphasis is laid on four levels of competitiveness:

- competitiveness of goods,
- competitiveness of a company,
- competitiveness of a sector,
- competitiveness of a country.

In the latter case, regional sub-level can also be considered. The more specific and independent is the economic complex of the region, the more grounds there are for considering the bases of its competitiveness. This can be fully attributed to Kaliningrad region – a unique subject of the Russian Federation isolated from the basic part of the country by other states' territories.

All four levels of competitiveness are interconnected and supplement each other so that frequently it is impossible to speak about any one of its kinds outside of the context of others.

**Competitiveness of goods** is traditionally characterized mainly by its price and quality, including their correlation. However, in length of time, the interpretation of those notions is getting broader. Thus, the concept of price frequently includes the economy of the article in use. This is especially applicable to technologically sophisticated products. In this case, it is important for the company not only to make its product marketable, but also to support the product as long as possible after sale. Such competitiveness can be provided only by utilisation of advantages at the technological level of manufacture, which can be achieved, primarily, by maintaining an adequately high level of investments, financing of its own R & D or by purchasing licenses, etc.

Thus, today, competitiveness of goods is in a broad sense defined as a combination of different kinds of consumer properties (price, quality, economy in use, reliability, etc.), providing stable advantages on the market in comparison with similar goods of other producers.

**Competitiveness of a company** is its ability to take a leading position on the market, while providing the required level of profitability..

Usually, the major factors determining companies' competitiveness, include the company strategy, the availability and efficiency of use of basic kinds of resources, the technical and innovative potential, the management efficiency, the administrative technologies, and the organisational system. Thus, competitiveness of a company is determined not only by the company's ability to create competitive goods and to support their competitiveness, but also by the entire organisation of the company's activities providing for their manufacture and marketing.

According to the M. Porter, the solution of the problem of support and enhancement of company competitiveness is provided through a system of interdependent kinds of activity that forms a so-called 'company value chain'<sup>1</sup> (Fig. 1).

|                      |  |                         |                 |                     |                      |
|----------------------|--|-------------------------|-----------------|---------------------|----------------------|
| Auxiliary activities | Company infrastructure<br>(financial organisation, planning, etc.) |                         |                 |                     | Positional profit    |
|                      | Management of human resources                                      |                         |                 |                     |                      |
|                      | Development of technologies  |                         |                 |                     |                      |
|                      | Supply   |                         |                 |                     |                      |
|                      | Supply of raw materials, etc.                                      | Manufacture of products | Sales promotion | Marketing and sales | After-sale servicing |
| Core activities      |  |                         |                 |                     |                      |

Fig. 1 Company value chain (according to the M. Porter)

Such kinds of company activity as organisation of its financial management, planning, management of human resources, production technology, and supply development concern the upkeep of competitiveness of all kinds of production output. Marketing and sale methods are also of great importance. No commodities, even those with unique properties, can find their buyers if the methods are inadequate. This issue is often critical for medium-size and small businesses. To settle this problem, small firms having no means for creation of their own marketing/sale network and for research of foreign markets, unite into some form of clusters.

It should be noted, that, in the opinion of M. Porter and his adherents, the problem of enhancement of national competitiveness is more and more often solved on the micro-economic level. The surveys conducted by M. Porter's group in the recent years covered about 4,000 company managers in 60 countries. The analysis of the survey results confirms close dependence between the micro-economic conditions and economic development. The influence of 'traditional' manufacture factors, including human resources and physical infrastructure, on the national features of per-capita GDP parameters

<sup>1</sup> M. Porter "International competition", 1993.

is decreasing compared, for example, with the influence of availability of business information or introduction of new information technologies. As it is stated in M. Porter group's *Report on global competitiveness in 1999*: "Micro-reforms are becoming the central challenge for the world economy".

**Competitiveness of a sector** – in contrast with two previous levels – is considered exclusively in the context of competitive struggle on the world market. The initial prerequisite is availability of certain production factors. And not only their availability, but also their efficient use, are of growing significance. Other important factors to ensure competitiveness of the sector are training of skilled workforce and own R & D basis. Although improvement of technologies is originally carried out within individual companies, the transfer of knowledge and expertise inside national industrial sectors proceeds more intensively, than between countries.

An important factor of formation of competitive sectoral advantages on the world market is the nature of demand for its products inside the country. In this case the question is not only the internal market capacity, but also the sector specialisation, determined by specific national features.

One of the factors, supporting economic sectors' competitiveness, is the competition between the companies within the sectors on the home market. In the process of rivalry, companies adopt each other's forms of work organisation, technical solutions, etc. Another important element of sectoral competitiveness on the global scale is the status and development of congenial and supportive branches. If the latter sectors are competitive, the level of the core sector also rises. Taking up the term suggested by M. Porter, such a group of interconnected branches can be named a *cluster*. As a rule, it is the development of clusters that determines export specialisation of the country.

**Competitiveness of a country, or national competitiveness**, is defined as capability – in the environment of free competition – to produce commodities and services (meeting world market requirements), realisation of which enhances the welfare of the nation and the well-being of the citizens. Despite the increasing role of the micro-level, national competitiveness retains enormous significance for ensuring competitiveness of goods, companies, and sectors of national economy on the world market. The factors that determine national competitiveness can be divided in several groups:

1. Availability of production factors in the country
2. Technological level of manufacture and national labour productivity level, which is determined by both the condition of the general commercial culture in the country, and workers' skills.
3. National level of vocational training and scientific/technological potential of the country. High level of these parameters on the national scale allows to successfully develop not only traditional sectors, but also to create new, fairly competitive branches.
4. The combination of the general economic situation in the country, opportunities for financing of development, operational efficiency of the banking system and other financial institutions determines the level of capital investments.
5. The standard of living of the population. High effective demand promotes the output of new goods onto domestic market, which is very important for their subsequent promotion to the world markets.
6. Public economic policy: stimulation of investments and innovations, financing of development programmes, new technologies and new branches, etc.

Historically, national (regional) competitiveness has been determined by availability of a source of raw materials. So, countries possessing rich stocks of natural resources, in comparison with the competitors, possessed big capital and therefore it had an opportunity to use high technology and more skilled labour. However with development of scientific and technical progress the availability of traditional factors have no more value. National or regional competitiveness in modern understanding mainly depends on the authorities' capability to create an efficient system of production of commodities and services, responsive to innovations.

Thus, competitiveness of goods and companies of a country on the world market is determined by a wide range of factors on several levels. In addition, according to M. Porter's theory, national competitiveness passes through a number of development stages (see Fig. 2).

|   |                                  |                                  |                             |
|---|----------------------------------|----------------------------------|-----------------------------|
| Economic upturn                         |                                  |                                  | Recession                   |
| →                                       |                                  |                                  | →                           |
| Competition based on production factors | Competition based on investments | Competition based on innovations | Competition based on riches |

Fig. 2. National economy competitiveness development stages (according to the M. Porter)

Practically all countries entered the competition on the world markets, leaning on available *production factors*. At the *stage of investments*, new branches were formed and employment was quickly growing. Development of competition *on the basis of innovations* assumes continuous improvement of manufacture, introduction of new products and technologies. Primary production factors are not so important any longer. Alongside with the core branches, related and supporting branches are quickly developing. Sectoral clusters are formed. R & D expenditures are growing in the country. At the final stage – *competition based on riches* – the country supports its competitiveness only at the expense of achievements gained at previous stages. The interest in creating new products and production facilities is decreasing.

## 2. Factors interfering with the growth of competitiveness of Russian economy

### 2.1. Competitiveness support policy in the Russian Federation

In the forthcoming years, the RF government undertakes to shift from isolated actions to a comprehensive policy of enhancement of national competitiveness, which will allow fulfilling the task of acceleration of economic growth, diversification of the economy and formation of modern production, competitive on the world and domestic markets. At present, the level of Russian economy's competitiveness does not correspond to its macroeconomic dynamics, scientific/technological and educational potential. This is stated in the draft Programme of social and economic development of the Russian Federation in the medium-term prospect (2005-2008), published on 14.12.2004.

The Programme states that according to the estimates of the World Economic Forum (WEF), Russia holds the 56<sup>th</sup> place in terms of macroeconomic dynamics indicators, but 67<sup>th</sup> in technological development and innovations, and 89<sup>th</sup> in institutional/legislative regime. As it is noted in the document "with all the subjectivity of the estimates, they do reflect not only the low degree of international experts' and business' confidence in Russian economy, but also the real lagging of our institutional and innovational framework behind the macroeconomic growth, primarily based on the favourable external economic conjuncture". The MED&T experts believe that, after the year 2010, Russia can easily take the 30<sup>th</sup> - 36<sup>th</sup> place in terms of technological/innovative development, and at least 40<sup>th</sup> - 45<sup>th</sup> place by institutional conditions, which would match the European level.

As it is stated in the programme, the leading new part of the competitiveness enhancement policy and structural transformations is setting up of a system of strategies for development of some advanced economic sectors and creation of territorial and production 'clusters' (including the use of special economic zone regimes), based on the mechanisms of private/public partnership. Strengthening of the national competitiveness grows out of a whole complex of economic, legal and institutional changes and of the effect of actions of internal competition forces. At the same time, this also is an independent direction of public policy including regulation of individual sectors of economy by ways of taxation, customs policy, legislative acts, crediting and budgetary support.

### 2.2. Factors interfering with the growth of competitiveness of Russian economy

In modern conditions, where Russian economy has to overcome negative consequences of the systemic crisis of the 90-s and of the structural/technological biases of the former planned management system, it is difficult to precisely identify the key factors, which are critically interfering with enhancement of competitiveness and economic growth quality. Many of them are well-known: the low technical/technological production level, the high degree of physical wear and obsolescence of the production equipment, the chronic shortage of investments for rehabilitation of outdated facilities, the deepening of the innovative manufacture lagging behind world trends, etc. A number of other, equally important factors are outlined below.

**a) Insufficient volumes and low "innovative" quality of investments in development of national competitive advantages:**

- According to the WEF estimates, Russia occupies 27<sup>th</sup> place in the world in terms of the volume of total internal investments and 46<sup>th</sup> place for this parameter per capita (the degree of deterioration of fixed assets in the industry has exceeded 50 %, and the average actual age of industrial equipment is 37 years); and 41<sup>st</sup> place for the GDP share of public expenditures on education.
- 25<sup>th</sup> place by total expenditures on research and development; and 41<sup>st</sup> place by this parameter per capita.
- Low degree of absorption of resources, saved in the economy, for the needs of investment in outdated plants.
- Remaining high rate of outflow of capital from the country.

***.b) Gradual objective exhaustion of the potential of certain competitive advantages with the increase of the level of national economic development:***

- growth of specific labour costs in the manufacturing industry, which increases production costs (10<sup>th</sup> place for growth rates);
- deterioration of conditions for extraction of minerals, which increases the extraction costs;
- growth of the costs of services in the infrastructural sector of Russian economy;
- the use of environmental resources is becoming more expensive and burdensome.

***c) Insufficient development of important components of national competitiveness, which affects the availability of existing competitive advantages:***

- poor quality of the infrastructure, especially in the field of telecommunications and modern information technologies (39<sup>th</sup> place for the level of development of the telephone system and 47<sup>th</sup> place for the level of cellular communication development, 39<sup>th</sup> place for the number of computers per capita, 35<sup>th</sup> place for the level of using of the Internet facilities);
- poor quality of corporate governance, especially in the field of corporate ethics, reliability, relations with shareholders, marketing and work with consumers, social responsibility (last places in respective rating lists);
- non-transparent structure of corporate and public ownership – as factors constraining the inflow of domestic and foreign capital to manufacture sectors;
- low efficiency of the financial system (45<sup>th</sup> place for specific weight of the bank system assets in the GDP; 47<sup>th</sup> place for quantity of issued credit cards, and an extremely low volume of operations with them; limited access to credit resources and venture financing; 29<sup>th</sup> place for the volume of capitalisation of the equity market, and 48<sup>th</sup> place for the volume of operations in the equity market per capita; 32<sup>nd</sup> place for the number of participants of the equity market; a great number of insider stock trading transactions, a high degree of non-transparency of financial institutions, and poor use of modern financial mechanisms).

Equally negative impact on the condition of national competitiveness is caused by the systemic factors relating to low efficiency of public regulation methods, and by the lack of competitive market environment and of an appropriate market infrastructure, by the high transaction costs in the economic and investment activities of Russian enterprises. The elimination of those constraints would immediately unblock enterprise initiatives and open broad opportunities for development of the competitiveness potential of domestic production facilities.

***d) Inefficient system of customs administration*** (similar to the low level of efficiency of all tariff regulation system) which does not ensure protection of domestic manufacturers against both the 'organised' importers, and against actually legalised dumping on the part of the unregistered shuttle trade. As a result, due to the strong competitive pressure on the part of the import expansion, involuntarily reproduced by the State (even regardless of the existing system of tariff barriers), many domestic products in the consumer sector are naturally affected.

According to the available data, in middle/end nineties, because of numerous infringements of the customs regime, of the wide range of privileges, and the large volume of unregistered trade, approximately 60 % of all import (official and shuttle trade) and more than 90 % of consumer commodities were imported by-passing standard customs duties or even without paying any customs charges at all. As a result domestic manufacturers are unfairly put in equal competitive conditions with big foreign firms that possess far larger financial, technological, and other opportunities.

***e) The factors originated by the undeveloped market infrastructure, lack of efficient mechanisms for inter-sectoral transfer of capital, and low capacity of banking/credit system in Russia***, that directly interfere with the implementation of competitive advantages of domestic production. In the current circumstances, first of all, domestic production entities with long-cycle



manufacturing processes, which require 'freezing' of significant working capital at the production stage, are losing their competitive positions. This mainly concerns producers of power equipment and mechanical engineering articles, shipbuilding, aircraft construction, and other industries, whose products are selling best in the markets of many less developed countries.

The State's efforts to fill the said 'vacuum' in the market might in many respects contribute to overcoming of the weakness of Russian capital-transfer system infrastructures, however the lack of a distinct public policy for development of hi-tech export manufactures is at least surprising. In many countries, including industrially developed ones, possessing an advanced infrastructure and provision of support to their national hi-tech export-oriented enterprises has long been usual practice and a component of implemented economic strategy. And this was done not only with the use of initial market tools, but also with the help of export grants, 'covert' tax privileges, guarantees, diplomatic support of national business abroad, and other similar mechanisms.

**f) Monopolised domestic economy, high administrative barriers on the way to implementation of economic activities**, poor taxation administering, inefficient protection of property rights and its non-transparent structure, intricate legislation, etc. As a natural result, transaction expenditures of Russian producers are high, and the factors are constraining the benefits, provided by their competitive pricing advantages and the inflow of capital investments in the production facilities.

To do justice to the RF government, it should be noted, that efforts were made lately for overcoming of the said biases and for creating of 'a field' of equal competitive opportunities in the country. The main efforts were as follows:

- elimination of administrative constraints and barriers, hindering formation of open space for unimpeded business activities and for inflow of investments,
- implementation of measures to liberate the economy from bureaucracy;
- improvement of the tax and depreciation systems; cancellation of numerous 'turnover' taxes, alleviation of the tax burden, etc.;
- improvement of the system of import tariffs and of customs administration rules, creation of new customs legislation;
- work on shaping of a new system of technical standards (over 30 thousand various sub-law documents have been enacted); unification of sectoral technical legislation which should directly determine the requirements to technical parameters of all kinds of manufacture.

However, the problem is that the efforts undertaken in this direction have not been effectual, and many of the systemic constraints to development of a competitive environment and business activities still remain, hindering liberation of business initiatives and exercise of existing competitive advantages of national producers. In its turn, the Russian economy is not only losing the momentum of the post-crisis surge in economic activities and investments, but also missing the chance for consolidation of national manufacturers' positions on both internal, and external markets, which had arisen in the post-devaluation period.

It is obvious that overcoming of the above-mentioned structural/systemic constraints on the improvement of economic growth quality is a direct prerogative of the State, and it will finally have to tackle the problem in a serious way. The accession to the WTO is an additional impetus for the Government to focus its efforts on this direction.

### **2.3. Overview of competitiveness of Russian economy, based on results of survey of producers**

One can treat national competitiveness degree in different ways, however, it would be unfair to challenge the fact that in today's Russia there are some individual spheres of manufacture capable of competing recognized world manufacturers' products on equal terms.

The available results of studies aimed at evaluation of the degree of competitiveness of domestic products are rather inconsistent, and by virtue of principles of averaging, used in them, they cannot claim to be properly reflecting the integral and objective picture. Some data describing the vision of the degree of Russian manufacturers' competitiveness were obtained, based on the results of the surveys carried out by the Centre of Economic Conjuncture (CEC) at the Government of the Russian Federation and the Russian Union of Commodity Producers (see Tables 1 - 3).

Table 1

**Estimation of competitiveness of industrial products, % of total number of respondents**

| Region                      | Level of competitiveness of products |        |        |               |                                |
|-----------------------------|--------------------------------------|--------|--------|---------------|--------------------------------|
|                             | High                                 | Medium | Low    | Uncompetitive | Could not give an exact answer |
| On domestic market          | 34-38                                | 60-57  | 4      | max. 1        | max. 3                         |
| On CIS markets              | 23-16                                | 38-46  | max. 7 | max. 2        | up to 30                       |
| On other countries' markets | 8-5                                  | 46-41  | 17-19  | 5 -7          | 25 -30                         |

Source: CEC at RF Government.

Other surveys of Russian enterprises yield different results, which in many respects is not only the result of different representativeness of the surveys, but also the result of the use of different sampling and data collection techniques. Thus, in particular, according to the data of another survey, carried out by the Institute of World Economy and International Relations, only 34% of Russian enterprises consider themselves competitive on the Russian market; 24% on CIS markets, and only 7% on the world market at large.

Tables 2 and 3 show the degrees of Russian enterprises' sectoral competitiveness on external and internal markets.

Table 2

**Estimation of the level of competitiveness of products by industries on the foreign market, % of total number of respondents**

| Industries                                     | Level of competitiveness of products |          |          |               |                                |
|--|--------------------------------------|----------|----------|---------------|--------------------------------|
|  | High                                 | Medium   | Low      | Uncompetitive | Could not give an exact answer |
| Fuels  | up to 15                             | up to 60 | up to 12 | -             | up to 15                       |
| Ferrous metallurgy                             | 7-13                                 | 13-60    | 7-73     | до 30         | up to 53                       |
| Non-ferrous metallurgy                         | 20-44                                | 17-25    | 25-60    | до 30         | up to 50                       |
| Chemical and petrochemical industries          | 15-20                                | 35-46    | 11-23    | max. 5        | max. 6                         |
| Машиностроение и металлообработка              | 6-2                                  | 22-29    | 28-31    | 10-5          | up to 30                       |
| Timber, woodworking, pulp and paper industries | 4-10                                 | 25-30    | 14-18    | 12-8          | up to 40                       |
| Production of construction materials           | max. 2                               | 1-4      | 5-8      | 10-4          | up to 80                       |
| Light industry                                 | 8-5                                  | 21-15    | 9-20     | 14-11         | up to 50                       |
| Food industry                                  | up to 4                              | 5-12     | 6-3      | 6-2           | up to 80                       |

Source: CEC at RF Government.

Table 3

**Estimation of the level of competitiveness of products on the internal market, by industries, % of total number of respondents**

| Industries                            | Level of competitiveness of products |        |         |               |                                |
|---------------------------------------|--------------------------------------|--------|---------|---------------|--------------------------------|
|                                       | High                                 | Medium | Low     | Uncompetitive | Could not give an exact answer |
| Fuels                                 | 32-64                                | 12-31  | -       | -             | max. 7                         |
| Ferrous metallurgy                    | 10-83                                | 90-14  | 18-3    | -             | -                              |
| Non-ferrous metallurgy                | 66-79                                | 33-21  | 20-30   | -             | -                              |
| Chemical and petrochemical industries | 29-32                                | 49-65  | 4-2     | 0             | -                              |
| Машиностроение и                      | 28-38                                | 64-55  | up to 6 | up to 2       | -                              |

|  |       |       |         |         |         |
|--|-------|-------|---------|---------|---------|
| металлообработка                               |       |       |         |         |         |
| Timber, woodworking, pulp and paper industries | 19-12 | 71-79 | 9-4     | up to 2 | up to 3 |
| Production of construction materials           | 8-14  | 71-73 | 15-10   | up to 3 | -       |
| Light industry                                 | 21-24 | 66-57 | 5-12    | up to 4 | up to 3 |
| Food industry                                  | 24-26 | 67-64 | up to 5 | up to 2 | up to 1 |

Source: CEC at RF Government.

A similar survey, carried out by Regional Economic Development Agency (RDA) experts in the summer of 2004 among Kaliningrad meat-processing enterprises, showed that 40% of respondents consider their products highly competitive and nearly 30% fairly competitiveness on the internal market. In addition, most Kaliningrad meat processors (over 80%) do not consider foreign companies as their main competitors. Such estimates are an objective testimony of availability of a competitive sector in this industry.

The Russian Union of Commodity Producers (RUSP) has carried out a survey on issues relating to accession to the WTO among 506 enterprises of different industries: in the mechanical engineering and metal working industries (255 enterprises or 50 % of the total number), chemical and petrochemical industries (31 enterprise or 6 %), production of construction materials (42 enterprises or 8 %), light industry (14 enterprises or 3 %), food-processing industry (140 enterprises or 28 %), and enterprises of other branches, including ferrous metallurgy, fuels, wood and woodworking industries and other (24 enterprises or 5 %) located in territories in 66 subjects of the Russian Federation. The analysis of the data, received as a result of the survey, testifies that in spite of the difficult financial situation the real sector in Russia has a potential for development, and products of many enterprises surpass foreign analogues. According to the survey the share of competitive products is over 70 % at 28 % of the surveyed enterprises of mechanical engineering, 35 % in the chemical and petrochemical industry, and 42 % in the food-processing industry (Table 4).

Table 4

**Grouping of enterprises, based on their shares of competitive products in total amount of manufacture according to the results of the RUSP survey**

| Industries   | Number of enterprises | Enterprises with a share of competitive products, % |       |       |       |         | Not specified |
|--|-----------------------|---|-------|-------|-------|---------|---------------|
|  |                       | up to 10  | 11-30 | 31-50 | 51-70 | over 70 |               |
| Total number of respondents                        | 506                   | 61  | 61    | 70    | 75    | 178     | 61            |
| Mechanical engineering and metalworking industries | 255                   | 39  | 35    | 44    | 33    | 70      | 34            |
| Chemical and petrochemical industries              | 31                    | 3   | 6     | 6     | 5     | 11      | -             |
| Production of construction materials               | 42                    | 3   | 3     | 4     | 7     | 24      | 1             |
| Light industry                                     | 14                    | -   | -     | -     | 7     | 7       | -             |
| Food industry                                      | 140                   | 14  | 13    | 14    | 23    | 58      | 18            |
| Construction                                       | 17                    | 2   | 3     | 2     | -     | 4       | 6             |
| Other  | 7                     | -   | 1     | -     | -     | 4       | 2             |

Source: Russian Union of Commodity Producers.

At the same time, the key sectors of economy are facing serious problems relating to accelerated accession to the WTO. Answering the question about acceptable timing of the accession to the WTO, 73 % of the enterprises named 2006 or later time and about half of them said it should not be before 2008-2010. Only 10.6 % surveyed (47 enterprises) believe that they are ready for accession to the WTO in the nearest years, out of which 14 mechanical engineering enterprises, 7 enterprises in the chemical/petrochemical industry, 8 in the industry of construction materials, 13 in the food industry, 1 in the ferrous metallurgy, and 1 in the fuel industry. As to the problems obstructing the development manufacture competitiveness, 39% of the respondents indicated that the outdated equipment and technologies. However such assessment seems slightly underestimated, because in 43% of the enterprises surveyed depreciation of fixed assets exceeds 70%, and in other 38% of enterprises the depreciation ranges from 51% to 70%. The respondents considered the low quality of components and articles to be of less importance.

The fact, that 45 % of the respondents indicated the high prices for services and products of natural monopolies as the basic problem connected with the accession to the WTO, testifies that most of the respondents ignore that the energy prices within Russia are obviously underrated compared with the world prices of energy carriers. This circumstance testifies that Russian manufacturers do not realize the full consequences of accession to the WTO for themselves.

Even being aware of the tentative nature of the adjusted estimates of the level of competitiveness, one should underestimate their value. They surely are averaged characteristics and experts very well know that most Russian manufacturing industries are only partly or negligibly competitive on the external market. However today there are already a number of industrial manufacturers whose products can easily compete with those of foreign manufacturers' products, and, in addition, a considerable part of manufactures has a potential to increase their competitiveness.

The above-mentioned consolidated sectoral estimates are considerably corrected by the analysis of the real state of affairs in the industries. For example, according to the data, collected by the International Chamber of Commerce, because of the high rate of obsolescence and physical wear of the industrial assets and its low technical/technological level, in reality, not all products of the named branches are competitive, but only those of some of their sub-sectors, such as enterprises engaged in low-degree transformation processes, for example, initial production of steel in the ferrous metallurgy, primary aluminium production in the non-ferrous metallurgy, intermediate products in the chemical industry, etc.

This is equally applicable to a wide range of mass-scale goods produced by the Russian manufacturing complex (from knitted articles to basic elements in the electronic industry) which are competitive in terms of their quality and prices and, in practice, are fairly well selling in the markets of industrially advanced countries with an average level of development. However further enhancement of the sectors' export potential is closely connected with solution of the general Russian economic development problems, extension of public support to export activities, implementation of measures to improve the trade, insurance, and credit services, improvement of conditions for R&D, and adaptation of their achievements to concrete manufacturing processes.

A summarized overview of competitiveness of the some individual goods of Russian export on the world markets is presented in the form of data prepared by experts of the VNICI institute (see the Annex). As to the position of Russia on the world market of high technologies, according to experts' opinion, the country is capable of successfully competing in about 10-15 out of 50 knowledge-intensive production directions. None of the world countries can afford supporting scores of large scientific and technical programmes in all directions of development of high technologies today. In experts' view, a correct choice of priorities might allow Russia to claim for 3-4% of the volume of knowledge-intensive production in the foreseen future, which could result in earning about \$100 billion a year. The country has a potential for creating competitive export products in such knowledge-intensive and hi-tech branches (excluding military defence industries) as optoelectronics, telecommunication equipment (in particular optic fibre); new materials, nuclear technologies, optical devices, and geodesic equipment for oil and gas prospecting, and software products.

### **3. Kaliningrad specificity and traditional competitiveness factors**

The favourable geographical position of Kaliningrad region with regard to the main trading partner of the Russian Federation – to the European Union – and the free customs area regime, established by the Federal law “About the Special Economic Zone in Kaliningrad region” create specific external conditions, in many respects distinct from conditions for economic activities in other Russian regions. Although the effects of the factors are not unequivocal and not only positive, in combination with such traditional factors of competitive advantages as relatively low cost of labour and development of the industrial/transport infrastructure, they have actually decisively influenced the formation of economic specialisation of Kaliningrad region at the present stage of development.

Let us briefly consider the factors, underlying the competitiveness of the current Kaliningrad economy.

#### **3.1. Features of geopolitical position of the region**

Kaliningrad region is the only subject of the Russian Federation geographically advanced to the West from the basic part of the country and isolated from the mainland of the country by territories of foreign states. These features of geopolitical position render both positive and negative influence on

conditions and opportunities for conducting enterprise activities in region, acting as external factors of Kaliningrad enterprises' competitiveness.

The location of the region placed in the geographical centre of Europe, on the crossing of traditional trading routes, near to main Western and East-European markets, predetermines possible economic gains. Obvious and undisputable advantages of the geographical situation of the region from the point of view of opportunities for development of business are <sup>2</sup>:

- proximity of its territory to the markets of western and eastern Europe,
- availability of direct connections with the all-European systems of transport and communication infrastructures,
- availability of the only Russian ice-free port complex on the Baltic sea in the territory of the region.

These advantages, on the one hand, provide easy enough (and, hence, economically attractive) passage of western goods through the territory of the region onto the extensive Russian market. The proximity of the region to western markets существенно облегчает развитие внешнеэкономических связей для российских (калининградских) предприятий significantly facilitates development of foreign economic relations for the Russian (Kaliningrad) enterprises. The influence of these factors creates favourable preconditions for the use of the territory of the region as an intermediate industrial platform – some kind of a link between foreign manufacturers of materials and accessories and consumers of finished goods, made of them in Russia.

By virtue of remaining low technological complexity of Russian products, potentially available but not yet widely demanded, is the alternative connected with the use of the geographically favourable location of the territory as a place for finishing and promotion of Russian goods onto export markets. Thus, the favourable geographical position is a natural factor providing the Kaliningrad region competitive advantages in comparison with other Russian regions in the sphere of foreign trade and in business support activities.

Another feature of the geopolitical situation of the region is its exclave position with regard to the main part of Russia. The consequence of this feature is the inevitability of transit of the most part of the Kaliningrad and export-import Russian cargoes through the territories of foreign states, which makes the Kaliningrad region's trading with other Russian regions more complicated and expensive. In addition, considerable uncertainty is caused by the lack of an agreement between Russia and the EU about the conditions of transit of Russian goods from the Russian Federation to Kaliningrad region and vice versa via the territories of European member countries.

The legislation of the European Union regulating transit transportation does not take into account all specific aspects of Kaliningrad region's position. In particular, it is not taken into account in any way, that Kaliningrad region is a part of the Russian customs territory, separated from it by EU customs territory, and Kaliningrad cargo transit, as a matter of fact, represents moving goods within uniform Russian market, carried via EU customs space for only a limited time interval. As Russia cannot influence the contents of the EU customs legislation of concerning transportation between two parts of the Russian territory, nor its application procedure, this generates an essential element of unpredictability in the conditions for conducting economic activities in the territory of Kaliningrad region.

Even today, delivery of cargoes from Kaliningrad region to the other part of Russia is a multistage procedure with each stage adding extra time and financial expenditures which are not proper to internal transportation within Russian territory

.This is usually caused by additional by more rigid EU requirements to freight insurance and carrier's liabilities, to veterinary and phyto-sanitary control, to transportation of dangerous products, to characteristics of motor vehicles and rolling stock. Moreover, in the course of time, these requirements (and, therefore, the time and financial losses of Kaliningrad companies and their Russian partners) will become even more stringent<sup>3</sup>. At the same time, the costs of transit formalities themselves and the complexity and uncertainty of the transit conditions are not so substantial as to critically affect Kaliningrad products' competitiveness.

A much more serious negative consequence of the region's exclave position, that renders direct influence on the inter-regional competitiveness of Kaliningrad companies, is the specific additional

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<sup>2</sup> Kaliningrad region: cooperation strategy / Administration of Kaliningrad region – M.: Olma-Press, 2004 p. 13.

<sup>3</sup> To do justice, we should note, that the additional costs of freight transit formalities, that are not proper to formalities for inter-regional transportation of goods within mainland Russia, the so-called 'expert examination' is paid by the entrepreneurs on the Russian side.

transportation costs – the shipment of cargoes to the region costs much more than transportation of goods through similar distances within the basic part of the Russian Federation. Let's remember, that the basic transport link connecting the region with the other part of Russia is the railway. The railway provides the overwhelming part of shipments to and from the region. Other modes of transport are not only less economical but also are physically unable to fully provide for the required volume of the trade flows between the region and other parts of Russia. In absence of real alternatives, the higher costs of railway transportation – compared with transportation between other Russian regions - inevitably result in extra transport expenditures, charged on Kaliningrad companies.

There are several reasons of higher (than in other regions of the country) costs of the railway services. The main of them are: the inflexible tariff policy of the State-controlled commercial structure OJSC "Russian railways" <sup>4</sup> and the result of actions by Lithuania and Belarus, aimed at gaining more profits from their transit position.

The consolidated expenditures on organisation of transit and additional transport costs form the so-called 'exclave-generated costs'. Their influence leads to "unfair" rise of prices of both Kaliningrad goods on Russian markets and of mainland-Russian goods on Kaliningrad market. For example, according to the Administration of Kaliningrad region, the cost of delivery of energy carriers by rail through similar distances across Russia and to Kaliningrad region through territories of other states in May - June, 2004 differed by 70-150 rubles (depending on the kinds of energy carriers). Therefore, today, the prices of the main kinds of energy carriers, delivered by railway, are 10-15% higher for Kaliningrad consumers compared with average prices for consumers in mainland Russia. Similarly, Kaliningrad-made goods are becoming more expensive on the Russian markets. Thus, the extra costs - compared with the costs borne by other Russian manufacturers – resulting from the exclave position of the region are directly and quite negatively influencing the competitiveness of commodities manufactured in the region.

### **3.2. Special Economic Zone in Kaliningrad region**

The status of the special (free) economic zone (SEZ) in the territory of Kaliningrad region was introduced in the second half of 1991. Since 1996, the principal document regulating economic activities in Kaliningrad region is the Federal law "About the Special Economic Zone in Kaliningrad region". In economic terms this law was called primarily to compensate, the additional costs caused by the isolation of the region from the basic territory of Russia. Another purpose of adoption of the law was creation of favorable investment environment, to facilitate accelerated social and economic development of the region.

According to the Law, a special regime was established in the Special Economic Zone, set up «within the whole territory of the region», except for territories of the sites having of defence and strategic significance for the Russian Federation, – military bases, defence industry sites as well as oil/gas production sites on the continental shelf" . The SEZ regime envisages special, preferential treatment of entrepreneurship, investment and foreign trade activities. However the 'special' regime was limited to creation and functioning of a free customs zone in the territory of the region, and that became the basic feature of economic/legal conditions for doing business in Kaliningrad region compared with other regions of the Russian Federation.

The essence of the special customs regime in the free economic zone in Kaliningrad region is that goods made in the SEZ territory, or imported into its territory from other countries are exempted from customs duties and charges. The commodity is considered to be made in the SEZ, if the value added as a result of its processing is at least 30% (for some kinds of goods it should be at least 15%), and the processing entails a basic change to the code of the commodity in conformity with the customs classification.. The order of identification of the origin of goods originated in the SEZ is established by the Administration of the region together with the State Customs Committee of Russia.

Customs privileges are the key component of the SEZ mechanism. They are a powerful incentive for business development and, primarily for foreign trade activities in the region. However, this law has produced rather one-sided effects. Under its influence the region's economy has become distinctly

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<sup>4</sup> The price-list working in Russia № 10-01 « Tariffs of transportation of cargoes and the services of an infrastructure which are carried out by the Russian railways » does not take into account position of the Kaliningrad area – by virtue of break of a uniform tariff field in territory of Belarus and Lithuania, the basic part of regional cargoes is transported on the Russian railways on short distances (less than 1000 km), accordingly, under higher tariffs.

specialised in providing an alternative way for penetration of foreign goods (not subjected to usual customs procedures) to the Russian market. As a rule, Kaliningrad import-substituting enterprises are actually assembly lines, specialised in final, technologically not complicated operations for production of consumer goods out of imported materials and components. On providing of the minimal processing criteria, the goods can be freely delivered to the Russian market.

The SEZ regime has given serious advantages to Kaliningrad enterprises concerning their Russian competitors. Due to it a number of new, but increasingly well-known outside the region manufacturing enterprises appeared in Kaliningrad region. These, in particular, are the assembly lines for producing cars, TV sets, and sophisticated home appliances, manufacture of furniture, a powerful meat-processing sector, etc. According to the data provided by the Regional Administration, about 60% of industrial products made in the region (and this share is even higher in the sphere of import substitution) are new kinds of products, which were previously not made in the region.

A direct consequence of fast development of new manufactures was the change in the structure of industrial production.

During recent years, indisputable leaders in terms of growth of the production volume were mechanical engineering and metal working (in the last 6 years, the share of the output by enterprises of this branch increased almost 2-fold.) and the food industry (1.44-fold growth in comparison with the level of 2000). At the same time, the share of the fuel and energy industries decreased from 35 % in 2000 to 23 % in 2003 (see Fig. 3).

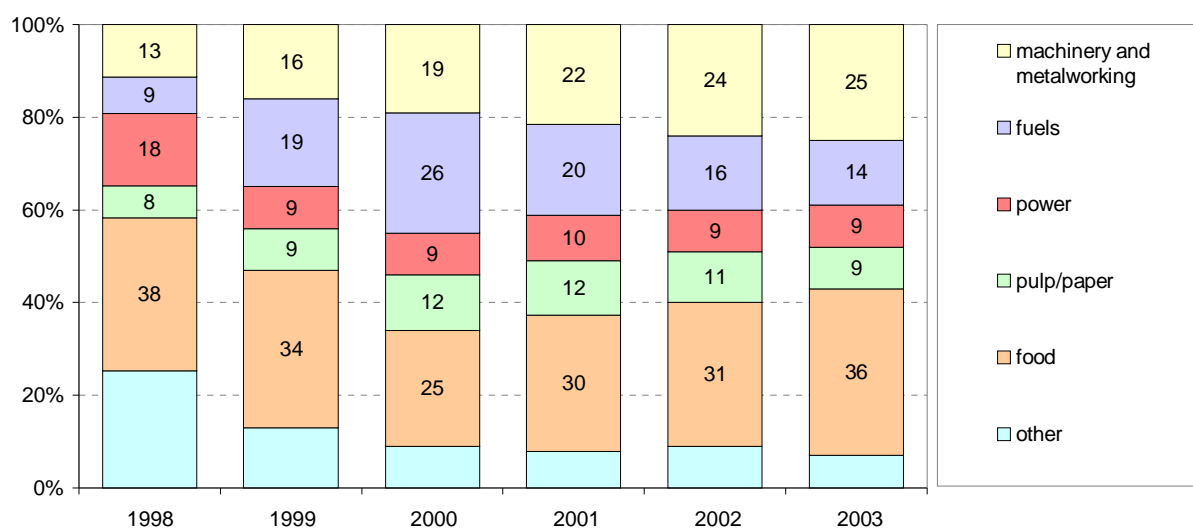


Fig. 3. Shares of basic industries in the total industrial output in Kaliningrad region in 1998-2003 in value terms, percentage of total output

Source: Kaliningrad Regional State Committee of Statistics

Rather high average annual rates of the output growth (in the range of 25-35 % / year, see Fig. 4) that remained during recent 6 years in the mechanical-engineering industry testify to a high demand for products of this branch and, hence, can form the basis for a conclusion that the companies have a certain competitiveness potential. According to the results of activities in 2003, the volumes of manufacture of automobiles and high-tech home appliances in the region sharply increased by 61.4% and 81%, respectively. The region occupies the leading position in the country by the volume of production of those commodities. In particular, the share of Kaliningrad region is over 1/3 of all TV sets and vacuum cleaners assembled in Russia.

Since 1998 to 2001-2002 inclusive, the fast rates of output were also characteristic of the food-processing industry, whose development was in many respects due to the effects of the SEZ law<sup>5</sup>. According to expert estimates, the rates of growth of the volume of production in the food-processing industry during those years essentially exceeded the growth of the Russian market, by which Kaliningrad manufacturers are basically guided. Now, almost 1/3 of the volume of all canned fish and 1/5 of canned meat in Russia are of Kaliningrad origin.

<sup>5</sup> A down trend of the rates of growth observed in 2002-2003 in this sector was probably caused by subjective reasons, for example, such as re-distribution of the spheres of influence in the hard-drinks industry, and can be only partly explained by imperfection of the existing SEZ mechanism, manifested, in particular, by the inability to find weighed approaches to settlement of the problem of raw materials supply to the growing meat industry.

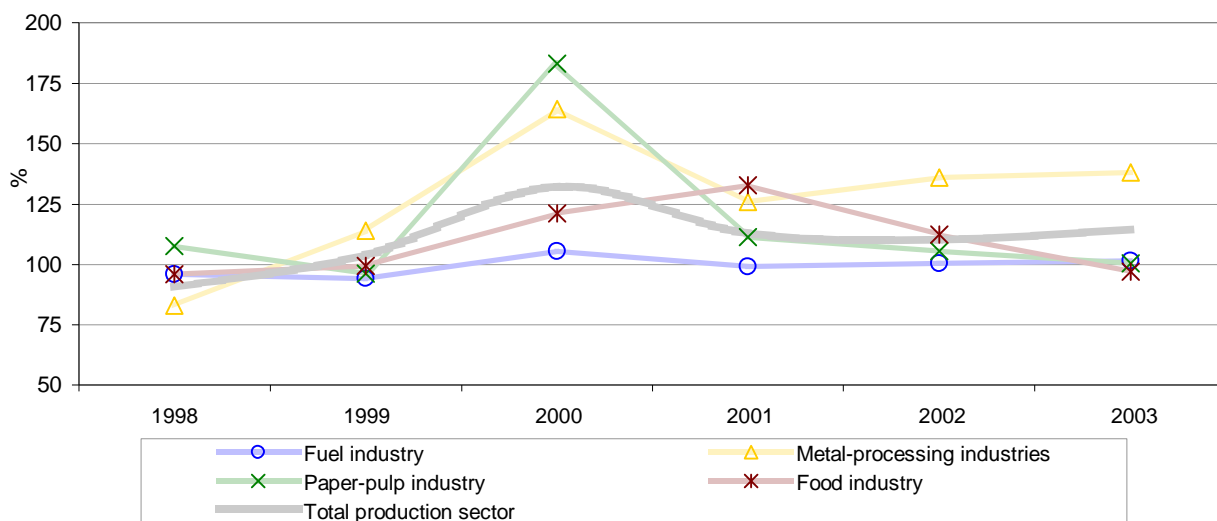


Fig. 4. Physical indices of industrial production per industry, percentages of previous years  
 Source: Kaliningrad Region State Committee for Statistics

In contrast to the import substitution support, the SEZ law practically does not provide any influence on the export-focused branches of Kaliningrad economy. The manufacture in these branches is growing at lower rates, than in import-substituting industries. The low rates of growth of the fuels industry, could be explained by the shortage of natural raw-materials base and the limited technological opportunities of the infrastructure, because products of this branch (basically – crude oil) are in great demand. In many respects, the situation is similar in the pulp/paper industry. But unlike the fuels industry, it is in an unfavourable phase of the business cycle. In 2003, after a long period of decreasing growth rates, for the first time in the last 5 years, this industry closely approached the zero growth level.

A specific feature of the «new industry» in Kaliningrad region is its orientation to the Russian market and its clearly import-substituting character. Due to the specialisation of the regional economy, established under the influence of the SEZ law, the rates of growth of deliveries of goods from Kaliningrad region to mainland Russia in the last years was considerably exceeding the dynamics of Kaliningrad export abroad, and the share of the deliveries in the total volume of export of Kaliningrad own products was promptly increasing (up to 75 % in 2003). The accelerated growth of import-substituting industries resulted in the growth of import of materials and components in the region – its share in the total volume of Russian imports increased from 2% in 2000 to 3.1% in 2003 (Fig. 5). In addition, about 40 % of the Kaliningrad import are goods of machine-building group (basically they are accessories for manufacture of import-substituting products), and more than 25 % are various kinds of raw materials for the food industry and production of fodders in Kaliningrad region.

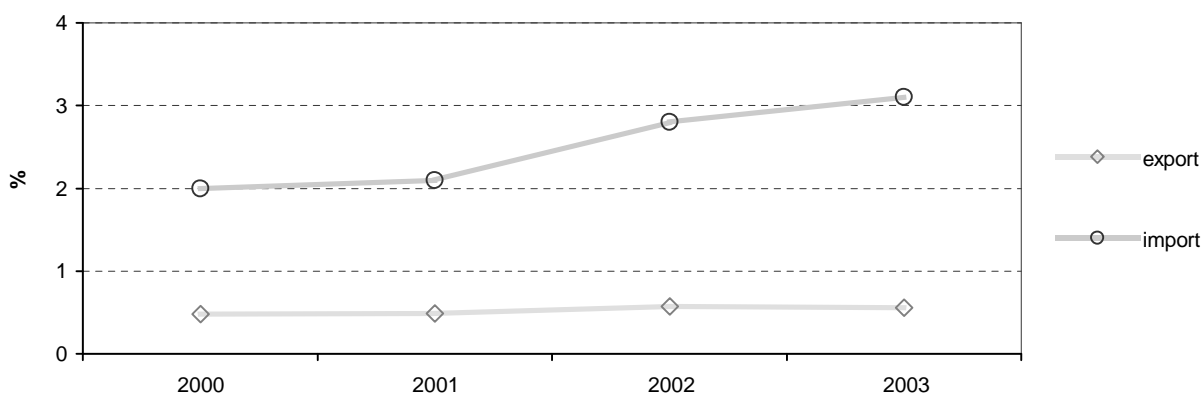
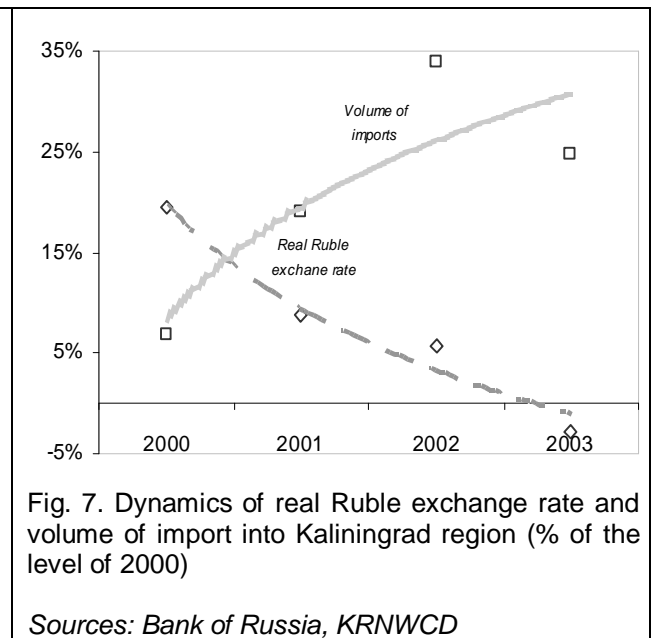
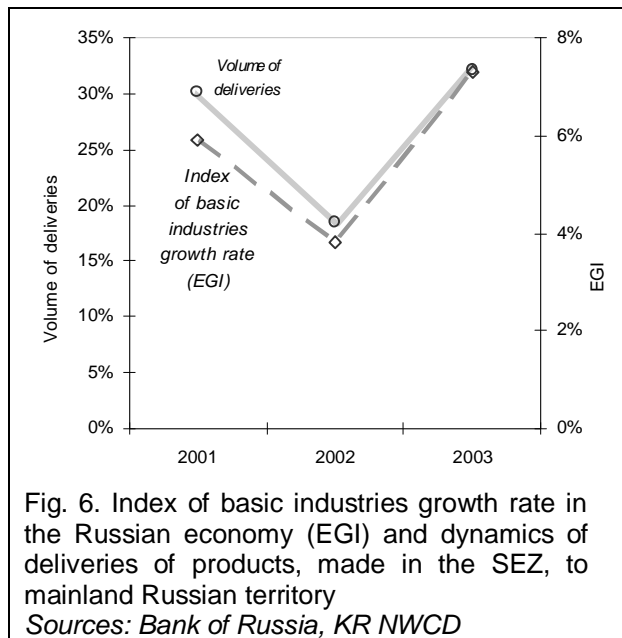


Fig. 5. Kaliningrad region's shares in the export and import of the Russian Federation in 2000-2003, %  
 Source: State Committee of Statistics of Russia

It is necessary to dwell upon one more external factor of general economic nature, which is of increasing importance in special conditions of Kaliningrad region. It is the strong dependence of the region on the status and rates of development of Russian economy. The growth of import-substitution



in the region during the last years was largely conditioned by the general economic growth in the country and by the upswing of demand, in particular, on the part of Russian consumers. This is confirmed by the obvious dependence of the parameters describing the development rates of Kaliningrad import-substituting sector on the rates of growth of basic Russian macroeconomic parameters (Fig. 6, 7).



The improvement of macroeconomic conjuncture in Russia has created good background which has strengthened the positive action of specific external factors considered above, which, in its turn, has led to fast growth of commercial attractiveness of the import-substituting sector of the Kaliningrad economy focused, first of all, on the needs of consumers in mainland Russia.. The above-mentioned results of effects of the SEZ law can be interpreted in different ways. Thus, according to the estimates by the heads of regional administration and by some known regional scholars<sup>6</sup>, «the SEZ mechanism has contributed to significant structural transformation of the regional economy». Since 2000, the economic growth rate in Kaliningrad region by many indicators, including the dynamics of investments and industrial production are above average Russian levels. The changes of the technologies, variety, and quality of production, influencing the competitiveness of Kaliningrad industry are also estimated as positive. This, in the experts' opinion, «testifies to the importance of the role carried out by the region in the strategy of import-substitution».

On the other hand, in the opinion of independent experts<sup>7</sup>, the SEZ regulations make a suppressive impact on some industries and agriculture, putting them in obviously unequal conditions compared to import. From this point of view, the existing system of privileges directly discriminates domestic enterprises while import of goods territory OЭЗ the import VAT because, purchasing domestic analogues of foreign goods, Kaliningrad enterprises have to pay the internal VAT. As the VAT is compensated to foreign exporters by their countries' governments - with other conditions being equal - Russian-made products will be always more costly for Kaliningrad enterprises, than imported ones. Such implicit subsidising of imported goods for the SEZ residents by the Russian government has to a large degree determined the overgrown import-substituting specialisation of the regional economy to the detriment of export-oriented manufacture, for the development of which conditions are available in the region. In addition, the well-being of the 'new' import-substituting sectors of the Kaliningrad economy, whose growth is considered to be the main proof of efficiency of the existing SEZ mechanism, is not stable as its dependence on customs privileges are only growing with time<sup>8</sup>.

<sup>6</sup> Kaliningrad region: Strategy of cooperation / Administration of Kaliningrad region. – M.: Olma Press, 2004, pages. 23-27, 66.

<sup>7</sup> Assistance to transformation of Kaliningrad region in a pilot region of cooperation of Russia and the European Union. – Kaliningrad: East - West Institute, the Kaliningrad Regional Development Agency. 2003, p. 23.

<sup>8</sup> More details concerning the conservation of the existing regional economic development model can be found in the «Economic bulletin No. 1. Prospects of the external trade regime in Kaliningrad region. – Kaliningrad, project "Support for Regional Development of Kaliningrad" (EuropeAid/114287/C/SV/RU), 2004.

As a whole, the majority of the most authoritative researchers of regional economy agree, that the consequences of implementation of the SEZ mechanism turned out to be different from those expected by the developers. It has proved impossible to completely overcome the drawbacks of the exclave position of the region and to provide sustainable development of its economy<sup>9</sup>. In the existing form the SEZ law could not radically fulfill the task of enhancement of competitiveness of Kaliningrad companies.

The main problem in the SEZ operation in Kaliningrad region is its legal framework. Despite the availability of general generally favorable legislation, the legal conditions of economic activity in Kaliningrad region are not stable. During the period of existence of the FEZ/SEZ, over twenty regulatory documents have been adopted (basically presidential decrees and government directives), now enacting, now cancelling those or other privileges. The fact of adoption of such a large number of documents and continuous changes of conditions for the SEZ operation are an extremely negative factor, as stability of the legislation is one of the basic conditions of usefulness of the economic environment. At the next stage of the law-making process concerning the SEZ, attempts were made in 2002-2004 to develop and adopt a new SEZ law, and the framework conditions of most of the proposed versions of the law took into account the specificity of the region and did not fully respond to the region's specific features and to real needs of Kaliningrad enterprises..

The principal cause of the legal instability, that currently is one the major problems of the Kaliningrad SEZ functioning, will consist in the remaining contradiction between the norms of the Federal law «About the Special economic zone in Kaliningrad region», on the one hand, and the Tax and Customs Codes, on the other. The essence of the contradictions consists in the fact that the Tax and Customs Codes do not specify the regime of the free customs zone which is actually effective in Kaliningrad region. There is a serious conflict between the law on the SEZ and the mass of other federal laws. As a result, most of the federal authorities represented in the region issue instructions and administrative orders which frequently do not correspond to the SEZ law.

The lack of certainty with the federal authorities with regard to the preferences given to businessmen in the region and the continuous threats of essential changes to the rules, existing since the moment when the SEZ Law was adopted, or a full or partial cancellation of the preferences are the primary factor of instability of development of Kaliningrad region's economy.

As a whole, the assessment of the basic external factors, influencing on competitiveness of the industrial sector of Kaliningrad economy, gives ground to speak of an unstable balance, currently existing between positive and negative effects (probably with positive effects slightly prevalent in some branches). The benefits of the region's geographical position and the customs privileges stipulated by the SEZ law, on the one hand, are in many respects are neutralised by the drawbacks caused by the exclave location of the region as well as the uncertainty of the SEZ's future and the conditions of forthcoming membership of Russia in the WTO. In these conditions, the main arguments determining the character of business decisions are not the region's specific features but the internal economic factors of competitive advantages both traditional (resource).and microeconomic ones.

Alongside with the external geopolitical and economic/legal conditions which are not subject to the will of regional authorities and business, the formation of the «principal direction of Kaliningrad regional economic development» was also influenced by such factors of competitive advantages as availability of cheap and skilled labour as well as relatively well developed technological and transport infrastructure. Nevertheless, at the initial stage of economic transformations, those traditional factors in a combination with external favorable conditions, have in many respects determined the current specialisation of Kaliningrad regional economy.

Let's consider, what differences of the region from territories competing with it exist in the use of such traditional resource factors as labour and industrial potential.

One of the main characteristics of enterprise competitiveness, reflecting in a general form both its production and organisational structure and, indirectly, the enterprise's position in the market usually is the index of the share of cost in the output, determined as a combined correlation of production/sale costs and gross revenues from its core activity.

As statistics of production costs in the context of sectors on the regional level had not been quite trustworthy, we have used the information obtained in the course of selective surveys of enterprises

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<sup>9</sup> A region of cooperation. Issue .8 (33): Concepts of development of Kaliningrad region in the context of the Russian - European interaction in the Baltic region: Analytical report / Edited by A. P. Klemeshev. – Kaliningrad: KSU Publishing House, 2004, p. 19.

in the main Kaliningrad industries, carried out by the RDA and the EuropeAid Project in 2003-2004, to calculate this parameter within the framework of our study.

Fig.8 shows comparative figures of the share of costs in the prices of the saleable products manufactured by enterprises of some industries in the Kaliningrad region

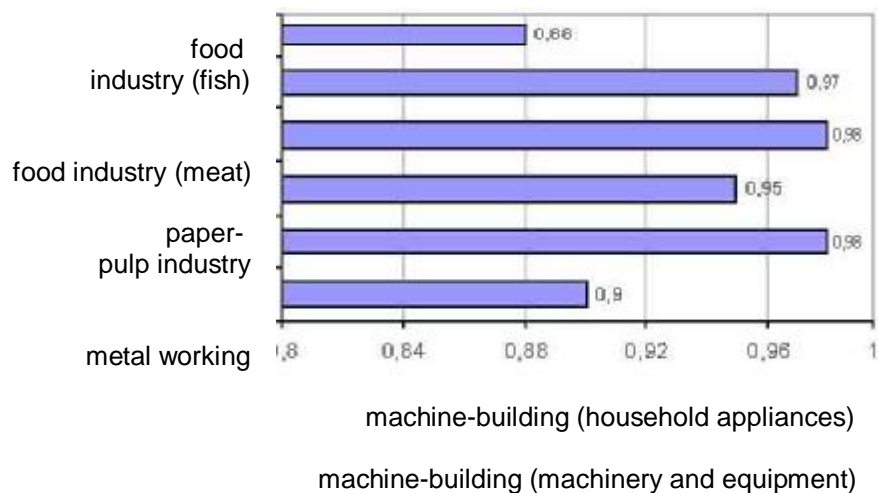


Fig. 6. Index of the share of costs in the output of major industries in Kaliningrad region in 2003.

*Calculated, based on the RDA database*

The comparison of the indices of the share of costs in the output, reached by Kaliningrad industries to similar indices of developed industrial countries allows us to draw preliminary conclusions on general efficiency of Kaliningrad enterprises. The costs/output ratio of most industries, surveyed by us, generally corresponds to the indices of 'old' EU member countries<sup>10</sup>. This index of the food industry enterprises in Kaliningrad region is 0.96 in 2003, the average for the EU countries it is 0.97 in 2001, this index in the metal-working industry is 0.95 in Kaliningrad region, and 0.94 in EU countries. The share of costs in the revenues of Kaliningrad machine-building enterprises is lower than that of their west-european analogues (0.93 in Kaliningrad region and 0.96 in the EU countries).<sup>11</sup> However, the said differences are not so important to have a crucial effect on differences in competitiveness of Russian and foreign enterprises.

It is difficult to compare Kaliningrad enterprises with their Russian analogues because of the lack of accessible systematized information about the financial and economic status of Russian companies in open sources. The comparative estimation of efficiency of the Russian and Kaliningrad companies can be executed only on separate industries. So, for example, the information available to us shows relatively low efficiency of paper/pulp industry in the region. In particular, in 2003 the share of costs in the amount of paper/pulp enterprises' revenues Kaliningrad region was 0.98, while the average index throughout the country was 0.85, and 0.88 in the North-Western Federal Area (NWFA) enterprises.<sup>12</sup> This circumstance limits Kaliningrad paper-pulp enterprises' competitiveness in the home market to which they supply their high-tech commodities. However this does not affect their international competitiveness as the main export commodity is low-technological wood pulp, and it is in great demand on the world market.

The additional information about the influence of individual components of the factor of costs on Kaliningrad companies' competitiveness can be received, based on the data on the structure of production costs in the industries.

<sup>10</sup> Here and hereinafter the indicators for «EU countries» are calculated as average for 6 countries of the European Union – Germany, France, Great Britain, Netherlands, Italy, and Luxembourg.

<sup>11</sup> It should be reminded that the calculations are made only for Kaliningrad enterprises, included in the RDA's database, which, probably, are the most successful.

<sup>12</sup> [www.bumprom.ru](http://www.bumprom.ru)

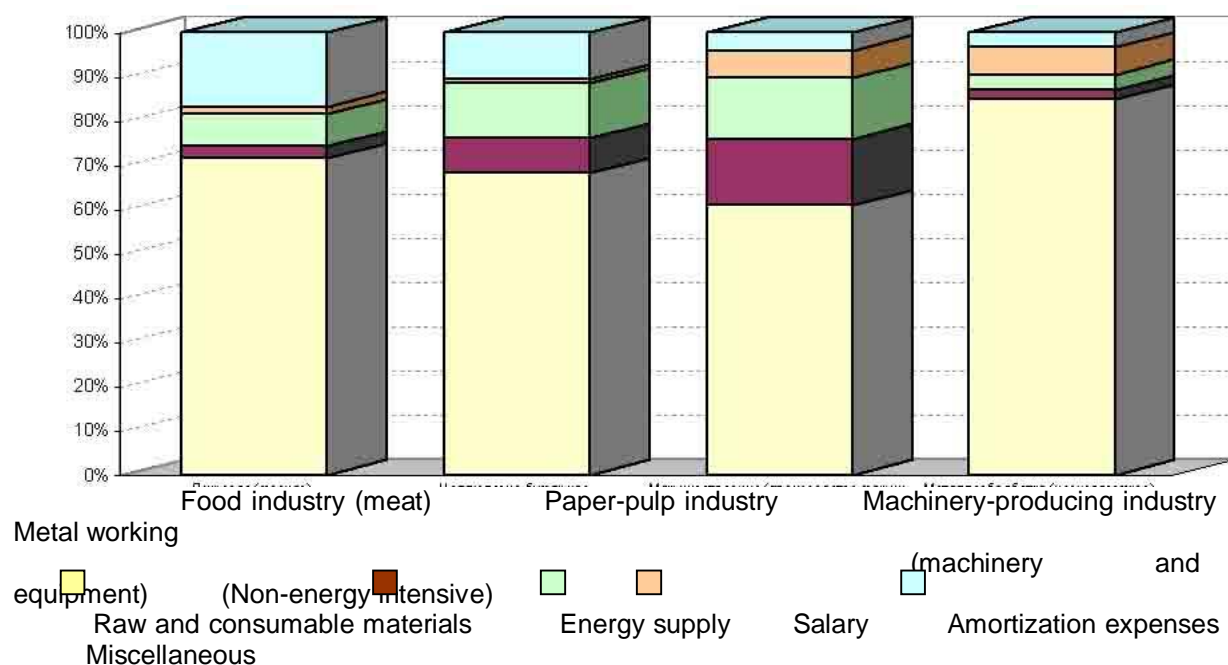


Fig. 9. Composition of production costs of some industries in Kaliningrad region in 2003, 100% - full costs. The calculations are based on the RDA's database.

The analysis of the cost structure has allowed us to identify the following general peculiarities influencing Kaliningrad companies' competitiveness with regard to costs. Thus, the enterprises, receiving raw materials from Russia, have to bear a relative level of costs for the components that significantly exceed the average indices across the country. For example, the average share of costs of materials in the NWFA does not exceed 53% in the paper/pulp industry and 60% in the metal-working industry. The indices of Kaliningrad enterprises are 68% and 84%, respectively. At the same time, the share of material costs in the structure of aggregate production costs in companies, oriented to foreign markets of raw materials and components (meat-processing, mechanical engineering), is comparable to the indices typical for foreign companies. On the one hand, this can be explained by the remoteness of Kaliningrad companies from Russian raw material resources, which leads to an increase of the costs of delivery of the components, spare parts, and materials to Kaliningrad region. Another reason is the effect of the Law on the Special Economic Zone, making the specialisation of Kaliningrad companies more profitable in operations with low value marginally sufficient for obtaining SEZ customs benefits (i. e. getting the certificate of origin of their products).

The power consumption of Kaliningrad industry is higher than that in neighboring countries. In particular, in 2003, the average power capacity of Kaliningrad food industry production was 22 kWh/\$1,000, while, in 2001, it did not exceed 13-15 kWh/\$1,000 in the EU member states. It can probably be explained by low electricity prices (though its price for industrial users is \$0.05/kWh, this price is comparable to the price of power in Lithuania), by the lack of advanced technologies and, which is more important insufficient energy-saving awareness and traditions.

It is noteworthy that the share of depreciation expenses is low even by low Russian standards. So, in the pulp-and-paper industry in the region, the share of depreciation charges in production costs is 1%, while the average in the NWFA it is 3.7%, and in western companies of this industry normal rates are 8 to 12%. This might rather be largely conditioned by the low value of Kaliningrad enterprises' fixed assets, than by inflexible depreciation policy of the government. In the majority of new Kaliningrad enterprises the rate of depreciation charges reaches 12-15% of all costs. In the year 2003, the average book value of fixed capital stock of surveyed enterprises (mostly «champions» in the industry) was: in the food industry \$2.8 million and in the mechanical-engineering \$1.6 million per 1 enterprise. In 2001, the average value of the food-processing enterprises' assets in EU countries amounted to \$6.3 million and in the mechanical-engineering (machine-building) enterprises \$4.1 million.

The matter which should be considered more thoroughly is the relation between the level of labour costs and the payoffs compared with the costs. The use of the advantages of the labour cost and efficiency, alongside with external factors, has played an important role at the stage of shaping of the

current specialisation of the regional economy. It is also important that the labour efficiency factor, in contrast to most other resource factors, is in many respects controllable by the companies' management.

Though the expenditures on labor remuneration in Kaliningrad companies are lower than those of neighboring countries (Fig. 9), in order to clarify the degree of influence of this factor on competitiveness, it is necessary to consider the efficiency and quality of the workforce.

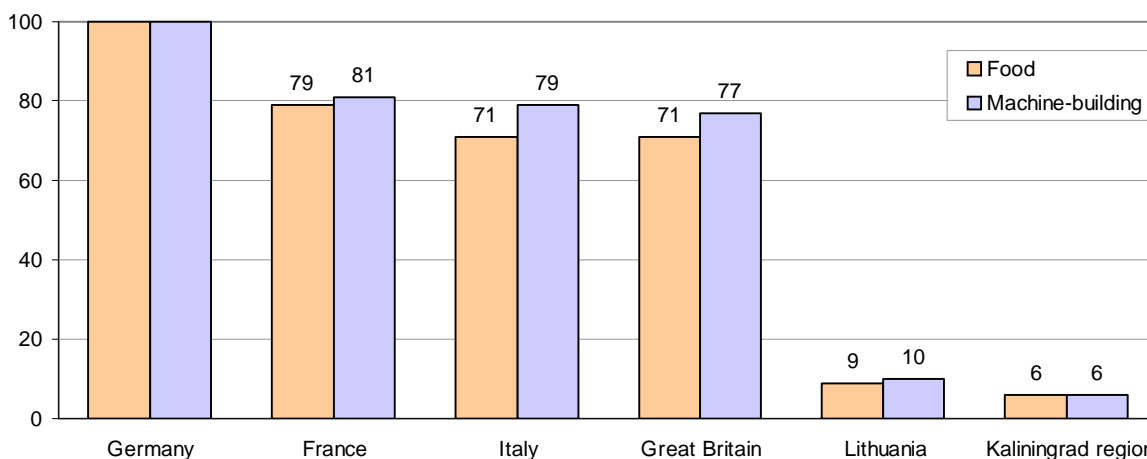
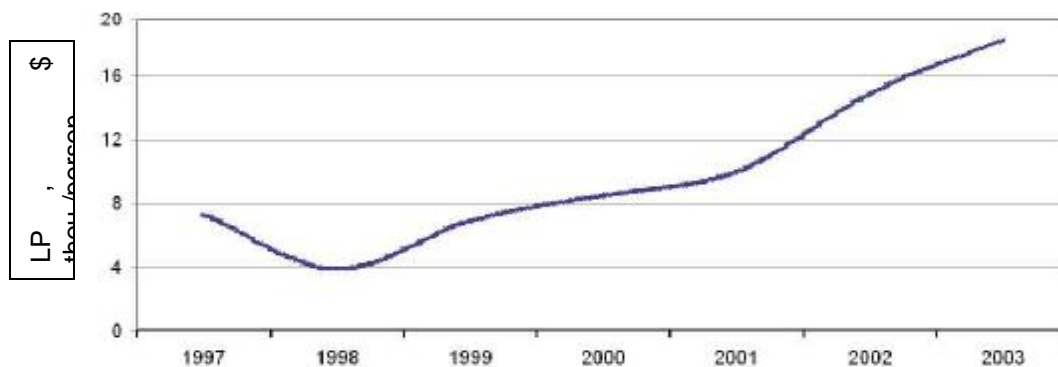


Fig. 9. Comparison of labour costs per worker in EU countries (2002), Lithuania (2002), and in Kaliningrad region (2003). Germany = 100%.  
 Source: KPMG (Germany, France, Italy, Great Britain), Lithuanian Department for Statistics (Lithuania), Kaliningrad Region State Committee for Statistics.

It is clear that the changes in the production and employment directly result in changes of the labour productivity level<sup>13</sup>. Since 1998, the labour productivity in the regional industrial sector is growing at a high rate, and the growth dramatically accelerated in 2001-2003 (Fig. 10). The main reason that caused this growth was the decrease in the number of employed in industrial sectors, while the production volume was steadily increasing.



Calculated, based on the data from Kaliningrad Regional State Committee for Statistics  
 Note: in 1995-1998 – thousand denominated rubles.

According to the state statistics data, in 2001-2003, the labour productivity level in most industrial sectors in the region corresponded to similar indices across the country. Taking into account the economic growth, compared with other Russian regions, the region retains certain labour productivity advantages only in the food and paper-pulp industries. However the absolute value of this index in 2002-2003 was much lower than that in the neighboring countries, especially in 'old' EU countries (Table 5).

Table 5

<sup>13</sup> The parameter of labour productivity level (LP) is calculated as the relation of total receipts (production volume) in real terms to mid-annual number of employees working in the enterprise of the industry. In order to compare this index to the indices of other countries' enterprises, it is calculated in US dollars.

**Labour productivity, thou. USD per employee**

| Branches of industry       | Kaliningrad region |      | Russia,<br>2001 | Lithuania,<br>2002 | EU,<br>2002 |
|----------------------------|--------------------|------|-----------------|--------------------|-------------|
|                            | 2002               | 2003 |                 |                    |             |
| Whole production sector    | 15                 | 19   | 12              | 30                 |             |
| including:                 |                    |      |                 |                    |             |
| - electric-power industry  | 14                 | 20   | 20              |                    |             |
| - fuel industry            | 34                 | 40   | 34              |                    |             |
| - metal-working industries | 11                 | 15   | 10              | 25                 | 142         |
| - paper-pulp industry      | 17                 | 19   | 8               | 45                 |             |
| - light industry           | 4                  | 5    | 3               | 22                 |             |
| - food industry            | 17                 | 26   | 18              | 44                 | 240         |

Source: RF Committee of Statistics, Lithuanian department of statistics, KPMG.

As mentioned above, the level of wages in most industrial sectors in Kaliningrad region is much lower than that in the neighboring countries. For example, in 2002, according to the data of the State Committee of Statistics, the average monthly wages (without extra fees) in the food industry were \$127, in the machine-building sector \$124, in the light industry \$97. At the same time, the wages in Lithuania were 340, 374, 282 USD, respectively<sup>14</sup>. The use of the data obtained as a result of the RDA survey does not change this picture.

One can assume that the low level of wages compensates the low labour productivity at Kaliningrad enterprises, thus supporting their competitiveness. Unit labour costs<sup>15</sup> indicator showing the relation between labor costs and labour output is used to verify this assumption.

The lower is the value of this index the more intensively (and more efficiently from the employer's point of view) the workforce is used. The results of the ULC calculation for some industrial sectors in Kaliningrad region, Russia as a whole, Lithuania, and 'old' EU countries are shown in Table 6.

Table 6

**Unitary labour costs (ULC) in industrial sectors**

| Sectors                               | Kaliningrad region             |                                   | Russia,<br>2001 | Lithuania<br>, 2002 | EU,<br>2002 |
|---------------------------------------|--------------------------------|-----------------------------------|-----------------|---------------------|-------------|
|                                       | According to SCS<br>data, 2002 | According<br>to RDA data,<br>2003 |                 |                     |             |
| Fuel industry                         | 0.16                           |                                   | 0.17            |                     |             |
| Machine-building and<br>metal-working | 0.14                           | 0.10                              | 0.18            | 0.23                | 0.37        |
| Paper-pulp industry                   | 0.13                           | 0.17                              | 0.2             | 0.16                |             |
| Light industry                        | 0.29                           |                                   | 0.29            | 0.2                 |             |
| Food industry                         | 0.09                           | 0.07                              | 0.11            | 0.12                | 0.23        |

Source: RF Committee of Statistics, Lithuanian department for statistics, KPMG, RDA database.

NOTE: the index «Machine-building and metal-working», based on RDA data, is calculated as the average indicator of sub-sectors «Manufacture of machinery and equipment», «Manufacture of household appliance», and «Metal-working».

The table shows that the wages/labour productivity ratio in Kaliningrad region, Russia as a whole, and Lithuania (except for mechanical engineering) is approximately the same. At the same time, the relation between the specific costs of labour force and labour productivity in the regional industry is less than that in 'old' EU countries. This means that Kaliningrad worker's wages of are 2.5 times the wages at west-european enterprises with similar output. This feature determines the current specialisation of Kaliningrad industry and, under certain conditions, can be one of the factors ensuring competitiveness of Kaliningrad products exported to foreign markets.

<sup>14</sup> Lithuanian Development Agency ([www.lda.lt](http://www.lda.lt)).

<sup>15</sup> Unit labour cost (ULC) is calculated as relation of general costs for labor remuneration (direct and indirect)/labour productivity level. ULC show the share of labour remuneration costs in the total revenue of the enterprise.

More detailed information on efficiency of utilisation of the workforce is provided in the report on the RDA's study of the machine-building, metal-working, paper-pulp and food industries in Kaliningrad region. As it could be expected, the best parameters of utilisation of labour in Kaliningrad companies, which participated in the survey, are in the enterprises with a high share of labour in the technological process (manufacture of home appliances, metal working, and meat-processing industry). Relatively high specific costs of labour in the paper-pulp industry can probably be explained by the unfavorable conditions of work in this sector.

Figures 12 and 13 show summarised results of comparison of labour costs, labour productivity and unitary labour costs in some industrial sectors of Kaliningrad region, Lithuania, and 'old' EU countries. The comparisons were made, based on 2002 data. The comparison was based on average EU countries' indices.

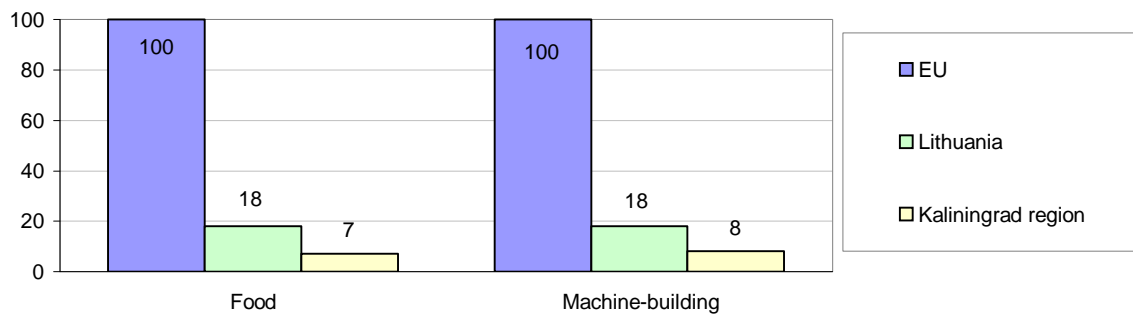


Fig. 12. Comparison of wages (W), labour productivity (LP), and unit labour costs (ULC) in Kaliningrad region, Lithuania, and EU countries. EU countries = 100 %.

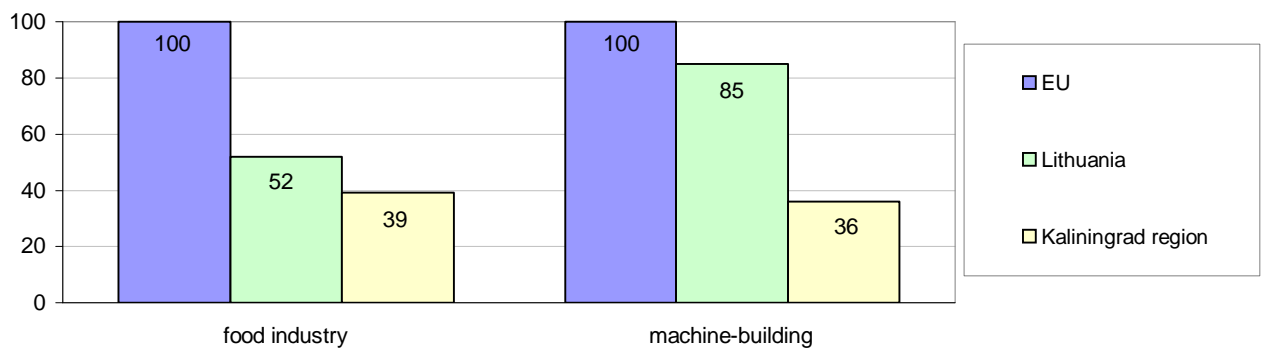


Fig. 13. Comparison of unit labour costs (ULC) in Kaliningrad region, Lithuania, and EU countries. EU countries = 100.

Source: Kaliningrad Regional Committee of Statistics, Department of Statistics of Lithuania, KPMG.

The low international competitiveness of Kaliningrad companies is often thought to be one of the results of poor professional skills of Kaliningrad workers. Labour quality issues were indirectly considered in the course of the survey of Kaliningrad companies' demand for labour resources in different economic sectors, carried out by the Project experts in the spring-autumn of 2004. The results of the survey have shown that the majority of the companies (especially those having industrial sites outside the regional centre) experience difficulties with selection of personnel. The employers experience the greatest problems in selecting managers and skilled workers of various trades. In the opinion of the employers, while there is no shortage of supply on the labour market in the region as a whole, most candidates are not adequately skilled and have exorbitant expectations with regard to wages. One of the conclusions of this survey was as follows: «The difficulties in selection of skilled workers are explained by their shortage on Kaliningrad labour market and disbalanced systems of vocational training». The problems of Kaliningrad labour market will be covered in detail in the next issues of Economic Bulletins.

Given that one of the bases of market economy is high labour mobility, it can be assumed that in addition to the above-mentioned level of work organisation and quality of management at the enterprises, the differences in the efficiency of use of this factor in many respects are also determined by the technical equipment of production facilities.

A generalized characteristic that allows estimating the level of technical level of Kaliningrad enterprises is the capital/labour ratio<sup>16</sup>. Table 7 shows the results of comparison of the capital/labour ratio in Kaliningrad and in West-European companies.

Table 7

**Capital/labour ratio at industrial enterprises, \$ thou./person**

| Industries                             | Kaliningrad region, 2003 | EU countries, 2002 |
|--|--------------------------|--------------------|
| Manufacture of machinery and equipment | 3,4                      | 79,3               |
| Manufacture of household appliances    | 0,9                      |                    |
| Metal-working                          | 2,5                      | 41,0               |
| Paper-pulp industry                    | 3,7                      |                    |
| Food industry                          | 8,0                      | 57,3               |

The calculations are based on RDA and KPMG data

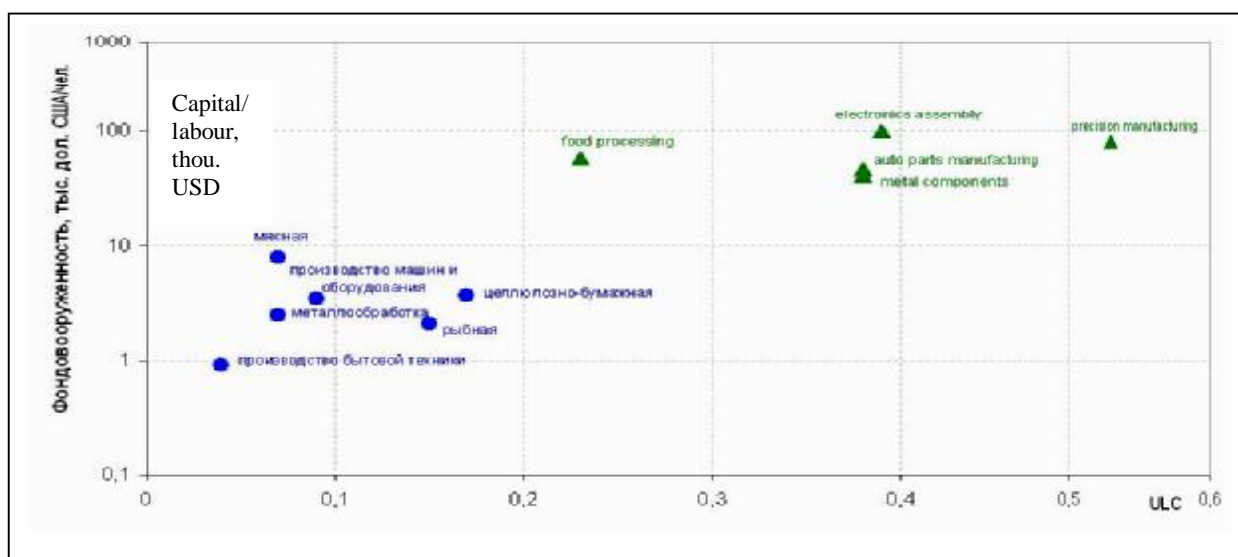
NOTE: Selected analogous industries in EU countries are as follows: *Precision manufacturing for Manufacture of machinery and equipment*, *Metal components for Metal-working*, and *Meat-processing factories for Food industry in Kaliningrad region*.

The comparison of the technological level of Kaliningrad enterprises reveals the main reason of a significant gap of the labour productivity in Kaliningrad and West-European companies. In spite of the fact the survey involved advanced Kaliningrad enterprises which are, as a rule, well equipped and use up-to-date equipment, their technological level is on average 12 times worse, than their western analogues'. And the greatest backlog (over 20 times) is in the machine-building, and the least in the food industry<sup>17</sup>.

Comparing the capital/labour and ULC parameters of Kaliningrad and foreign companies of similar industries, makes it possible to assess the relative Kaliningrad companies' competitiveness from the point of view of their use of labour productivity factor. The results of the comparison are shown in Fig. 14.

Having certain advantages over foreign companies in terms of involved labour cost, Kaliningrad companies considerably yield to them in technological equipment. The consequence of it is much lower labour productivity of Kaliningrad enterprises. Low technological equipment can be considered one of the reasons of non-competitiveness of Kaliningrad enterprises, compared to their western competitors. The most obvious way to overcome the drawback can be accelerated innovative technological development of Kaliningrad industries. The regional economic policy should envisage special measures to stimulate introduction of new equipment and technologies, probably, with the use of international technical assistance.

**Capital/labour ratio, thou. USD/person**



investments in fixed assets, declared in the enterprises' business-plans, as approximate values of their fixed assets.



● – Kaliningrad region (2003) ▲ – average for EU countries (2002)

Fig. 14. Relation of unitary labour cost (ULC) and capital return in Kaliningrad region industries and in EU countries

*The calculations are based on RDA and KPMG data*

NOTE: *The capital/labour scale is logarithmical.*

Selected analogous industries are as follows: *Food processing for Food industry, Electronic assembly and automobile parts manufacturing for Manufacture of components for electronic and motor industry, metal components for metalworking, precision manufacture for precision manufacture.*

Among Kaliningrad companies, which have taken part in the survey, the best combination of capital/labour ratio and specific labour cost is characteristic of enterprises in the meat-processing and metal-working industries as well as the enterprises engaged in manufacture of machinery and equipment.<sup>18</sup>

This conclusion does not mean, that all companies of those industries possess equal international competitiveness, but to a greater degree this concerns the companies, involved in the survey. It should also be understood that competitiveness of this or another company is in many respects the result of its own efforts and only partly determined by external and uncontrollable circumstances. Our study, as rapid-diagnostics of some, apparently prominent aspects of competitiveness in a sectoral cross-section, provides Kaliningrad company managers with certain reference points, which can be used for business development.

#### 4. Microeconomic competitiveness of Kaliningrad enterprises

In modern economy, centres of business activity are economic entities, independently managing manufacture factors, using them, and distributing received products. Therefore, in the process of development of market relations in our country, the interest in competitiveness issues is shifting directly to enterprises. The shifting of centres of economic process control from macro-level to micro-level requires making use of certain mechanisms for adoption of internal corporate decisions. In market economy conditions, a manufacturer, delivering goods to external and home markets, cannot retain a steady position for long time, basing its strategy exclusively on traditional resource factors of competitiveness, without taking into consideration other competitiveness aspects. Entering a new market, making decisions on expansion or reduction of manufacture, and making investments for modernisation of process equipment or for updating existing production necessarily requires assessment of microeconomic competitiveness of the enterprises.

The basis for increasing profitability and survival of a company in the competitive struggle, especially in modern conditions of sharp acceleration of scientific/technological progress, is growth of production efficiency. Speaking of an individual company, it is necessary to distinguish its potential production efficiency and real, actual performance. If the level of potential efficiency depends on external conditions of economic activities (availability of labour, raw materials, power resources, etc.) and, first of all, from the general technological level of the country, the real productivity in the company is primarily determined by the level of organisation of manufacture. It can grow as a result of reduction in production costs due to organisational or technological innovations. A significant reserve for achieving real production efficiency is also expansion of knowledge and growth of administrative personnel skills of the company about the markets, equipment and technologies, as well as methods of management. Another factor is improvement of the structure of manufactured products, its continuous renovation as well as optimization and diversification of the structure of the production resources.

All above-listed factors also fully influence the competitiveness of Kaliningrad enterprises. This was confirmed by the results of the survey, carried out in the framework of the Project in August-

<sup>18</sup> As is shown by the studies, the listed industries are also the most competitive in most CEE countries – close or distant neighbours of Kaliningrad region (see Chapter 5). This confirms the idea developed by us about the common nature of problems and concurrence of the paths of development of the region and of the territories surrounding it.

September 2003<sup>19</sup>, and of the special study of competitiveness conducted by the RDA experts in summer of 2004. According to the studies, among the main reasons of low competitiveness of local enterprises alongside with the resource factors are: the low level of technological and innovative potential, the inefficiency of the enterprise management and organisational systems.

Thus, the integrated assessment of competitiveness of Kaliningrad companies from the point of view of use of microeconomic factors can focus on the following basic directions:

- organisation of business activities and level of administrative technologies;
- innovative potential and innovative activity;
- provision of information to business.

#### **4.1. Business organisation of and administrative technologies**

Elaborate organisation of manufacture and competent planning in the enterprise are major elements of competitiveness. On the one hand, a well organised control system allows providing an increase of efficiency of use of industrial resources available to the company. On the other hand, it creates necessary administrative and organisational preconditions for successful application of new process equipment and technologies and for ensuring steady and long-term productivity growth.

Although it is traditionally considered, that not enough attention is given to innovations in the sphere of management of Russian enterprises' activities, nevertheless, Kaliningrad businessmen already have realized the importance of high-quality and efficient management. According to the study carried out by the EuropeAid Project in autumn of the year 2003, the overwhelming majority of Kaliningrad companies carry out regular planning of their activities. The data of this study shows that approximately 2/3 of the enterprises develop their business plans annually or once in several years, and about 20% of the enterprises, which have not got a business plan yet, are going to create one. As a rule, business plans are developed by the enterprises themselves, without involvement of foreign experts, which testifies to a high administrative potential of Kaliningrad companies. The issues relating to the quality of strategies, developed by the enterprises, one of the parameters of which can be the degree of implementation of the goals and objectives planned, are left beyond the framework of our study. However, it is evident that Kaliningrad entrepreneurs are willing to improve their business organisation.

A part of the task of improvement of the business organisation system, especially important for export-oriented companies consists in standardization of their activities and products. European countries are skillfully using the legitimate opportunities for protection of their home markets. Alongside with tariff barriers, export of Kaliningrad goods to EU countries is obstructed by non-tariff restrictions (so-called *technical barriers*). First of all, they are the differences between the standards and systems of conformity of goods to obligatory requirements in the Russian Federation and in the European Union. This seriously limits the access of domestic goods to EU countries' markets. Therefore, one of the major tasks for supporting the competitiveness of the majority of Kaliningrad export-oriented companies is introduction of international standards of quality management and environment protection management systems – ISO 9000 and ISO 14000. At present, there are only a few companies having international certificates in Kaliningrad region – basically, they are the largest enterprises in the region. While, according to the International Standardization Organisation (ISO), the share of certificated firms in Germany in 2002 was 2 % of the total number of companies, out of which about 2/3 are small and medium-size enterprises.

The studies show that another component of business organisation and the production management system, which has a strong influence on competitiveness of Kaliningrad companies, is organisation of marketing activity.

According to the data of the survey, carried out in the autumn of 2003, just slightly over half of Kaliningrad enterprises have a marketing department or a section with similar responsibilities, engaged in promotion of products. And if one takes into consideration that the sampling had been carried out among the most active and competitive Kaliningrad companies, this parameter is extremely low.

The survey has shown that even though only a half of Kaliningrad enterprises have a marketing department or a similar section in their structures, over 70% of enterprises are aware of the importance of marketing studies and do carry them out. However, many businessmen often understand 'marketing' as usual advertising, and not as an entire marketing complex including

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<sup>19</sup> Support to export in Kaliningrad region. Economic Bulletin No. 2. EuropeAid /114287/C/SV/RU project "Support for Regional Development of Kaliningrad". – Kaliningrad, 2004.

exploration of customers needs and market requirements. In addition, as a rule, heads of those enterprises try to carry out the marketing by themselves instead of assigning the job to marketing experts. Hence, the extremely limited range of methods and ways of marketing used in practice by Kaliningrad enterprises. The existing marketing departments (82% of the total number of enterprises which have marketing services) usually hire a small staff, which does not exceed 5 persons.

It should be noted, that one of the mainstreams of the Project activities in 2003-2004 was technical support and assistance to Kaliningrad enterprises on all above-listed aspects of improvement of business management systems. The activities in this direction - of both methodological, and practical nature - are planned for the year 2005, too.

#### 4.2. Innovative potential and innovative activity

In modern market economy innovations are one of the major factors of companies' competitiveness. Without continuous updating of the equipment, technologies, and improvement of manufactured products, it is impossible for a company to provide a stable market position. At the same time, during all recent years, innovative activity of Kaliningrad companies remains on the lowest level, even by Russian standards. After rather fast growth of during 1996-2002, considerable reduction of innovative activities in the industries took place in 2003 (Fig. 15). In 2003, compared to the previous year, the volume of innovative products was 1.53 times less.

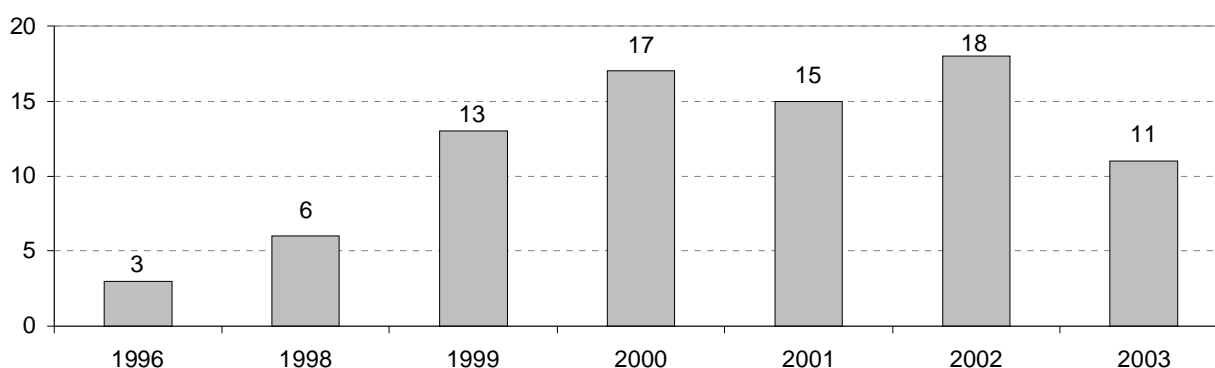


Fig. 15. Number of active innovative enterprises in Kaliningrad region  
 Source: Kaliningrad Regional State Committee of Statistics

It should also be taken into account, that the official statistical data about the number of innovative enterprises overestimates it. In reality, according to expert estimates, their number is no more than 1/3 to 1/4 of the total number of innovatively active enterprises, indicated as such by the State Statistical Committee. Thus, even according to the considerably overestimated official data, the share of innovative companies in Kaliningrad region does not exceed 0.01 % of the total number of registered enterprises. For comparison, in 'old' EU countries this parameter makes at least 50%, and in Poland and Lithuania 15-17% from the total number of enterprises.<sup>20</sup>

The share of hi-tech products in the total amount of industrial output in Kaliningrad region in 2002 did not exceed 0.03 %, and in 2003 below 0.01%. For comparison, in 'old' EU countries this parameter made 12-15%, in Poland and Lithuania it was 3-4%.

The region's share in the total volume of innovative products manufactured in the Russian Federation remains extremely low and obviously inadequate, compared with the scale of Kaliningrad economy. In particular, the share of Kaliningrad innovative production in the total Russian output in 2002 was far less than 0.01 %, and in 2003, according to preliminary estimates, it decreased even more - approximately 2-2.5 fold.

As the study has shown, with extremely rare exceptions the majority of enterprises in Kaliningrad region do not allocate any funds for research and development, while in the 'old' EU countries R&D costs reach 2% of the companies' expenditures. Nevertheless, the survey carried out in the autumn of 2003, has shown, that about 15 % of Kaliningrad enterprises possess unique and patented products, equipment or technology. However by virtue of different reasons, the overwhelming majority of them

<sup>20</sup> More details can be found in Chapter 5.

are not using these assets in their operational activity. In this connection, one of the basic ways to increase the technological competitiveness of Kaliningrad companies is transfer of technologies providing fast and effective introduction (diffusion) of innovations. Such companies are the most perspective for investments and support, including that on the part of the EuropeAid project.

According to the results of the study carried out by RDA experts, actively innovating enterprises in Kaliningrad region are basically focused on the home market (practically all products manufactured by them are shipped from Kaliningrad region to the larger Russia). The internally-oriented innovative business is not unique, it is characteristic for Russia as a whole, where according to selective studies<sup>21</sup>, no more than 20 % of the total number of innovatively active enterprises are export-oriented.

Over two thirds of Kaliningrad enterprises experience the need of assistance in the procurement of equipment or technologies. The survey carried out in the autumn of 2003 has revealed that even though the majority of the enterprises covered by the survey possess imported equipment, their general technical potential is low. So, on the average, at the end of 2003, the level of physical depreciation of fixed assets in Kaliningrad region industries was 49.8 % and stably growing by 1-2 % annually during several recent years. As a rule, the enterprises are using 10-15-year old equipment and technologies. Therefore, today, the technical and technological backwardness is one of the principal causes of non-competitiveness of Kaliningrad industrial products on the world markets.

The equipment and technologies, making the basis of industrial potential of the processing branches of economy in the region, are not capable of providing the required quality of finished goods. This circumstance has determined the choice of assistance to the Kaliningrad enterprises in their search for foreign partners and investors as one of the priority directions of the Project's and the RDA's activities. The Project has already implemented - and is planning to implement in the near future - a series of meetings of Kaliningrad businessmen with potential partners from Lithuania, Poland, Germany, and Italy.

#### **4.3. Informational support to business**

In modern, dynamic economy, the provision of information for business activity, alongside with administrative and innovative / technological potentials, is an important factor of company competitiveness. However the level of the organisation of access of Kaliningrad enterprises to information resources remains unsatisfactory. As a rule, the following circumstances are its principal causes:

- *The lack of systematized information in widely accessible information resources in the region.* Incompleteness, irrelevance, different formats of the sources, and, frequently, full absence of necessary information, as well as poor quality of consulting services, reduce the enterprise management efficiency, interfere with making optimum decisions, which, finally, impact on the enterprises' competitiveness.

- *Low solvency of many Kaliningrad companies* makes qualitative information and services inaccessible to them. This, in its turn, limits the opportunities for further development of information and consulting markets, thus narrowing the information field of regional business.

As shown by the results of the studies carried out by the Project and RDA experts, in 2003-2004 the majority of Kaliningrad companies experienced a significant need of high-quality information/consulting services (over 50 % of answers). Among the most required services are primarily:

- consulting on innovations (introduction of new products and technologies).
- assistance in search of partners/ investors.
- assistance in search of customers/suppliers.
- conducting of seminars for managers of companies on quality management issues in the sphere of trade, services and manufactures.
- conducting of training sessions for managers of companies on management issues and quality control.

Besides, as the study results have shown, the majority of companies realize the necessity of increasing their intellectual capital by means of training of their employees.

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<sup>21</sup> "Innovations", No.4, 1997, p. 11

The study has confirmed the correctness of the strategy chosen by the RDA, of which one of the priority activities from the moment of its creation and to-day is consulting and informational assistance to Kaliningrad businessmen. With the support of the *Project*, in 2003-2004 the Agency carried out a series of important actions. The RDA experts are completing the creation of a systematized Internet-resource platform, including an extensive database of Kaliningrad enterprises. They are developing formalized procedures of search for business partners. In future, it is planned to connect the RDA database to the RTTN network and to similar business networks in the countries, adjacent to the region. The implementation of these actions will allow to substantially improve the information/consulting support to Kaliningrad business and will thus contribute to the growth of competitiveness of enterprises in the region.

## **5. Competitiveness of enterprises in the neighbouring countries and their competitiveness enhancement programmes**

The process of enhancement of business competitiveness in the countries, adjacent to Kaliningrad region, is of great practical interest not only from the point of view of the experience accumulated by them. Many industries, transport, and spheres of services in those countries occupy approximately the same niches, as Kaliningrad enterprises. They are operating in similar conditions, and are competing with them not only on the national markets, but also in third countries.

After the transformation shock of the beginning of 1990-ies fairly steady economic growth accompanied with an increase of labour productivity was observed in Central and East-European countries. Industries in Hungary and Poland were growing at especially fast rates (approximately 2-fold in the last 10 years). Nevertheless, the level of competitiveness of enterprises in all Central European and East-European countries are still lagging behind the 'old' European Community countries .

Among the factors determining the rather low competitiveness of enterprises in the Central European and East-European countries, the most frequently referred to are:

1. *The structural dispersion.* The small size of enterprises with short own capital in combination with the costliness and inaccessibility of bank credits sharply reduces their investment and innovative activity. A serious barrier to the development of enterprises in the Central European and East-European countries is inaccessibility of external sources of financing. In the majority of them, the share of bank credits in investments does not exceed 20%, whereas in the 'old' fifteen EU members it is 70 to 80 %.

2. *Low profitability.* It also reduces the investment activity of enterprises, and in the context of increased physical deterioration and obsolescence of fixed assets it is the main factor that impacts competitiveness.

3. *Slow development of hi-tech sectors.* The share of hi-tech production in the export of 'old' EU members makes 12-15%, and in the neighbouring countries, nearest to the Kaliningrad region, it is 3-4 %.

4. *Low level of R & D expenditures, and the poor connection between the R & D and manufacture.* The average specific weight of expenditures on research and development in the gross national product of 'old' members of the European Community reaches 2 %, while in the majority of the Central European and East-European (CEE) countries is 2 times lower. Another weakness is the unfairly high share of basic research in the general costs of research and development and, accordingly, a low share of applied research work. While in the 'old' EU member countries the share of innovative firms, i. e. firms engaged in developing new technologies, based on the R & D activity, in the total number of economic entities is over 50%, it does not exceed 30 % in CEE countries, including Poland and Lithuania, where it is 15-17 %.

5. *The backlog in the process of creation of informational society, including the economic sphere.* For example, only 5% of companies in Poland are using Internet for transactions.

An integrated parameter of competitiveness backlog of enterprises in CEE countries can be characterized by the level of certification in the ISO quality system (series 9000 and 14000). In the beginning of the year 2002, about 45 thousand enterprises had got such certificates in Germany, over 70 thousand in Great Britain, and not more than 3 thousand enterprises in Poland.

One of the main consequences of low competitiveness of enterprises in the Central- and East-European countries is the chronically growing negative balance of foreign trade in most of the countries. The primary factor for promotion of their goods to the EU markets is the price competition, including that related to the deliberately diminished exchange rates of national currencies. This is

testified by the gradually decreasing but still significant difference between export prices of similar goods made in new and old members of the European Community. The greatest gap in the price/quality ratio concerns the production of high-tech industries, and also the production requiring highly skilled labour. There is not much difference between the prices of products of capital-intensive sectors and those using unskilled labour.

Once embarked on the course for accession to the European Union, the CEE countries focused their attention on competitiveness of their enterprises. Particular accent was made on attraction of direct foreign investments, and this became one of the major factors of their national competitiveness growth. The arrival of large transnational corporations has facilitated their access to financial, material and intellectual resources and accelerated the introduction of technological, organizational, and managerial innovations. Most of the largest private companies' assets in the CEE countries mainly or completely belong to foreign – West-European - capital. And it's those companies that demonstrate the highest profitability indicators, investment activity, share of exported products – including high-tech commodities, and so forth.

Direct foreign investments have played an important role in the creation of a modern market infrastructure (telecommunications, banking and insurance services, trading). In Poland and Lithuania those sectors took up to 40-45 % of the total amount of direct foreign investments, i. e. approximately as much, as the manufacturing industry.

A real proof of the enhancement of national competitiveness of the CEE countries can be the fairly fast growth of their exports, from most of them. Companies with foreign participation in Poland and Lithuania deliver over half of all exported goods. In many of them, the share of export deliveries makes up to 80-100% of their total production. The most typical examples are the enterprises engaged in the assembly of automobiles and TV sets in Poland, woodworking enterprises, furniture factories, and electronic industry in Lithuania as well as some light and food industry enterprises in both countries. It should be noted that despite a certain increase in the share of production of hi-tech industries, as a whole, the export from the CEE countries on the markets of EU countries is basically specialized on labour-consuming branches. The main part of the most competitive companies, determining the growth of export-generated revenues, is concentrated in those sectors.

An additional impetus for enhancement of national competitiveness of the CEE countries was the accession of some of them to the European Community in 2004. On the one hand, the last technical barriers and restrictions on access to EU markets were removed. On the other hand, opportunities of financing of competitiveness enhancement programmes, including those on the micro-level, were extended.

One of such programmes in Poland has started the programme "Enhancement of enterprises' competitiveness for the years 2004-2006", one of the seven so-called sectoral operative programmes, focused on implementation of the goals of the National development plan for the years 2003 – 2006.<sup>22</sup> The programme stipulates the purposes, priorities and actions of policy in the sphere of business and innovations. At the same time, special attention is given to small and medium-size enterprises (SME), and there is a good reason behind it. At present, over 67% of the workforce employed in Polish economy (excluding agriculture, forestry, and fishery) are engaged in small and medium-size business. The number of really operating small and medium-size enterprises is over 1.8 million (3.4 million enterprises are registered), and their share in the total number of those employed in the economy (without taking into account agriculture and forestry) exceeds 2/3.<sup>23</sup> Only 14 thousand of the SME export their products, and their share in the Polish export in recent years reduced (to 43 % in 2003).

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<sup>22</sup> Sektorowy Program Operacyjny "Wzrost konkurencyjności przedsiębiorstw, lata 2004 – 2006", Warszawa, 01.07.2004.

<sup>23</sup> Since 2005 in the majority of the CEE countries, including Poland, adopted a new classification of SME. It defines three groups of enterprises: micro-, small and medium-size enterprises. A businessman who - during one of two last years - employed no more than 10 workers, and also had annual volume of sale of the goods, services and financial operations within 2 million euro (or the sum of items of his annual balance did not exceed 2 million euro) is referred to as owner of a *micro-enterprise*. For the *small enterprise* category the respective limits are 50 workers and 10 million euro. For the category of *medium size* the limits are 250 workers and 50 million euro, respectively. The enterprises, meeting the above-stated conditions but differing by a high (over 25 %) share of the State's or municipal capital in the distributed profit or in the number of voices of general meeting of shareholders, are not considered as micro-, small and medium-size enterprises.

It is planned to allocate 1,251 million euro from the European Regional Development Fund for implementation of this programme in 2004-2006. Financing from national sources will make 440 million euro (including 52 million euro from the National Fund for Environment Protection and Water Management).

The goal of the Programme consists in enhancement of enterprises' competitiveness, operating in the territory of Poland in the context of the common European market. The achievement of this purpose is called to reduce economic, social and technological backlog of Poland from the most advanced EU countries.

It is necessary to note, that the Programme of enhancement of enterprises' competitiveness is integrated into the general strategy of development of Polish national economy and is linked with other economic programmes, such as the Integrated operative programme of regional development, the operative programme "Development of human resources", etc.

Expected outputs of the Programme of enhancement of enterprises' competitiveness are as follows:

- an increase the number of new workplaces, especially in branches with a high share of added value;
- intensification of enterprises' investment activities of;
- improvement of performance of the real sector of economy;
- improvement of commodity supply structure and upgrading of the technological level of production;
- an increase of the volumes of export and development of international industrial cooperation;
- adaptation of enterprises to the European Union directive requirements;
- adaptation of enterprises to operation in the sphere of high technologies;
- an increase in the number of innovative enterprises;
- more efficient use of information technologies with a view to improve the environment for business activities;
- an increase of the enterprises' expenditures on research and development;
- adaptation of enterprises to new requirements to environment protection;
- upgrading of the quality of services to business.

The assistance, envisaged by the Programme, shall be provided to all enterprises meeting the strict pre-set criteria. However the preference will be given to branches with a high share of added value. The implementation of the Programme is called to improve the quality of the enterprises' structure, to enhance their competitiveness on the national, European, and world markets, to ensure integration in the science-intensive economy, to facilitate the access to financial resources, and to stimulate their investment activity and creation of new jobs.

The Programme stipulates some of the quantitative parameters of expected outputs (see Table 8 below).

**Quantitative estimate of basic expected outputs of implementation of the Programme of enterprises' competitiveness enhancement**

| Measurable indicators   | Initial indicator, 2001 | Planned value, 2008 |
|---|-------------------------|---------------------|
| Share of expenditures on R & D at industrial enterprises (with the number of employees above 49persons) in the total of investment costs, % | 9.5                     | 12                  |
| Share of innovative enterprises in the total number of enterprises, %   | 16.9<br>(1998-2000)     | 17.5                |
| Share of small and medium-size enterprises engaged in export activities, %  | 46.1                    | 48                  |
| Enterprises' share in R & D expenditures, %   | 24.3                    | 35                  |
| Number of the new workplaces created as a result of implementation of research and development activities, units.                           | 0                       | 44,150              |

The Programme of enhancement of enterprises' competitiveness stipulates two priorities:

1. Development of business and upgrading of innovative activities by means of development of the sphere of services to business.
2. Direct support to enterprises.

The implementation of *Priority 1* implies creation of a network of organisations (enterprises) to provide high-quality services to business. This means, first of all, strengthening of interaction between business and the sphere of research and development. It is envisaged to render support to specialized credit institutions, in order to facilitate access to financial resources. Besides it is planned to extend the availability of information services. In 2004 – 2006, it is planned to allocate about 44 % of the European Regional Development Fund, directed to implementation of the whole Programme or 547 million euro for financing of priority actions. In addition, 169 million euro from Polish public/municipal funds is directed to these purposes as well as \$97 million from private national funds.

As an example we can consider one of the directions of implementation of Priority 1, namely Direction 1.2 "Improvement of availability of external sources of financing of investments". Three groups of activities are implemented within this direction:

- 1.2.1. Auxiliary financing of micro-crediting funds, i. e. non-banking establishments providing credits amounting up to € 25 thousand;
- 1.2.2. Auxiliary financing of credit guarantee funds;
- 1.2.3. Support to creation of seed capital funds, i. e. funds for financing of projects at the earliest stages of their implementation.

In all above-mentioned cases, support is provided on the competitive basis in the form of irrevocable financial aid. Its beneficiaries are regional and municipal foundations. In many cases, the activities of this direction are mainly financed by the European Regional Development Fund (ERDF). Thus, the maximum amount of financial support to Direction 1.2.1 can reach 70% of the project cost, and for Directions 1.2.2. and 1.2.3. 80% and 50%, respectively. The absolute size of assistance to any kind of fund cannot be less than 5 million or more than 50 million Polish zloti (approximately 1.3 and 13.0 million euros). 174 million euro is allocated from the ERD, 45 million from the national State and municipal sources, and € 35 million from private sources.

For some of the expected outputs of implementation of Priority 1 quantitative parameters have been set (see Table 9)

Table 9

**Quantitative estimate of expected outputs of implementation of Priority 1 of the Programme  
"Development of business and enhancement of innovative activities through development of  
the sphere of services to business"**

| Measurable indicators  | Initial indicator, 2001 | Planned value, 2008 |
|--|-------------------------|---------------------|
| Amount of guaranteed investment credits, million euro  | 0                       | 150                 |
| Total amount of investments in the projects which have received support from micro-crediting foundations, million euro | 0                       | 150                 |
| Number of new jobs at enterprises created in industrial parks, units.  | 0                       | 1800                |
| Number of hi-tech enterprises created with the support of seed capital funds, units                                    | 0                       | 30                  |
| Share of basic services provided by the State and municipal organisations through the Internet, %                      | 18.6                    | 57                  |

The implementation of *Priority 2* is called to upgrade the technological level and quality of the goods and services offered by the enterprises. Support to investment projects and provision of assistance to companies in entering foreign markets is envisaged. Within the framework of this priority, special attention will be given to small and medium-size enterprises. It is envisaged, that they can receive consulting and investment assistance in a single package for increasing their competitiveness in the conditions of the Common European market. It is also envisaged to assist them in adaptation to the EU requirements in the sphere of environment protection. In 2004 – 2006, it is planned to allocate about 55 % of the ERDF directed to implementation by the entire Programme, or 683 million euro for financing of actions of this priority. It is necessary to note, that in contrast to the first Priority, the leading role in the implementation of Priority 2 is to be played by internal sources of financing. Thus,



€1,050 million (92% of private funds, allocated for implementation of the whole Programme) are provided from national private sources. In addition, € 286 million is provided from the State and municipal funds.

As an example, we can consider the most costly direction of implementation of Priority 2, namely Direction 2.2 "Enhancement of industrial and technological competitiveness of enterprises". Two groups of activities are implemented within this direction:

2.2.1. Provision of support to enterprises, which are carrying out new investment projects (creation of new and expansion of existing enterprises, introduction of new kinds of production and technological processes and creation of new workplaces).

2.2.2. Provision of assistance to enterprises in the process of internationalisation of their activity (partial financing of their participation in international exhibitions and fairs).

In both cases support is provided on the competitive basis in the form of grants for compensation of a part of investment and other charges. Such assistance can be provided to any enterprise in the territory of Poland, but preference is given to small and medium-size enterprises. For this reason, 3/4 of financing from the ERDF and national budgetary sources will be directed to this sector. Another priority criterion is innovative character of investment projects. The maximum amount of financial aid to both directions can reach 50 % of the project costs (65% for small and medium-size enterprises according to Item 2.2.1). In 2004-2006, € 253 million is allocated to financing of this direction from the ERDF funds, €116 million from the national State and municipal sources, and €354 million from private sources.

Quantitative parameters are established for some of expected outputs of implementation of Priority 2 (Table 10).

Table 10

**Quantitative estimate of expected outputs of implementation of Priority 2 of the Programme  
"Rendering of direct support to enterprises"**

| Measurable indicators  | Initial indicator, 2001 | Planned value 2008 |
|--|-------------------------|--------------------|
| Number of created workplaces, units.   | 0                       | 28 000             |
| Number of enterprises, that concluded export / import contracts within the framework of implementation of the Programme, units.  | 0                       | 2250               |
| Number of enterprises with hi-tech manufacture processes, created within the framework of implementation of the Programme, units | 0                       | 200                |
| Specific weight of sales of new or modernised types of products in the total volume of sales, %                                  | 18.0                    | 21.0               |
| Average number of employees in small and medium-size enterprises, persons  | 3.3                     | 4.5                |

As we see, the Programme developers realize that enhancement of business competitiveness is a costly, long, and multifarious process, which cannot be expected to yield prompt results. Nevertheless, according to the available forecasts, in the nearest years, in many sectors and sub-sectors (including hi-tech industries) of the economy of the countries, adjacent to Kaliningrad region, the price/quality ratio will reach the average level of the European Community. Those 'islets of competitiveness' will continue extending, mostly in the sectors receiving direct foreign investment. At the same time, in the CEE countries, shrinking of the previously available opportunities for price competition is inevitable, for reasons including gradual alignment of the cost of labour. In its turn, the latter circumstance will objectively stimulate even faster development of non-price competition and gradual alignment of its conditions in 'old' and 'new' members of the European Community.

## Conclusion

Based on the study, we can make the conclusion, that, at present, the greatest advantages among Kaliningrad industrial companies are the costs and productivity, estimated by criteria of international competitiveness belong to the enterprises with a high share of labour in the technological process and good production equipment. It is found that the main competitive advantage of Kaliningrad companies in cost terms is based on the relative cheapness of labour, and, due to that, specific productivity (the relation of costs per one worker to productivity of his work) at Kaliningrad enterprises turns out to be 1.7-2.5 times above that in Lithuania and other EU countries. This factor, given such external conditions, as the convenient transport/geographical position and the privileges of the Special Economic Zone, in many respects leads to current specialisation of Kaliningrad industries. Taking into account the competitiveness of the overwhelming majority of Kaliningrad industrial goods on the western markets, specialisation of the regional industries in the international division of labour has been based on labour-intensive, mainly low-tech production (simple processing and assembly manufactures), and their basic competitors are similar Russian enterprises. At the same time, occupying an intermediate position between western manufacturers and Russian market, and experiencing strong and constantly growing pressure on the part of Russian competitors, калининградские компании вынуждены использовать иные Kaliningrad companies have to use other factors than cheap workforce. Besides in the conditions of Kaliningrad region, the influence of this factor will decrease much faster, than in other Russian regions.

Therefore, given the growth of labour costs, one of the few opportunities for preservation of Kaliningrad enterprises' costs competitiveness is an increase of labour productivity, the level of which is currently considerably below that in western companies. The analysis of available technical equipment has allowed revealing of the main reason of the significant gap in the labour productivity of Kaliningrad and West-European companies. The technological level of the Kaliningrad industrial companies appears now (even in view of probable underestimation of their fixed capital) many times lower, than at their western analogues. Therefore, the most competitive Kaliningrad companies - both currently and in the long run – are those which combine the use of available advantages of relative labour cheapness with advanced technological equipment.

The analysis of the changes of industrial output growth and investments into fixed capital has allowed establishing, that, at present, the most attractive from the point of view of effects from the investments among the Kaliningrad industries that took part in survey are enterprises in the field of mechanical engineering. In fact, a synergetic effect has developed in this industry where the investments attracted by the high competitiveness of this industry contribute to further enhancement of the industry's competitiveness.

The recommendation directly relevant to this conclusion, addressed to public authorities, is to consistently implement the regional development strategy and to elaborate on its basis a stable and sustainable industrial investment policy, oriented to clearly set industrial development priorities, which must include the mechanical engineering industry.

It has been noted in our previous studies<sup>24</sup> that providing support to existing Kaliningrad companies with a high growth potential (the most competitive companies) produces the best effect. Given the limited resources at the disposal of Kaliningrad region and the rigid recommended goals (at least 2-2.5-fold increase of the GRP), it is necessary to concentrate the efforts on the most promising companies. The choice of this priority implies that, based on objective criteria, the most promising companies should be selected, which under certain conditions – for example, co-financing – can expect getting public support (e. g., assistance in the organisation of marketing abroad, in training of their personnel, and so forth). Ideally, such support should not be provided to individual companies but to a group of regional companies, having united in an informal consortium on a voluntary basis. The consortium can include companies participant in the “contractors – suppliers” chain, companies of a similar profile, being members of an association, as well as just the companies, whose managers maintain strong friendly relations among themselves. The European experience proves that such formal and informal connections between companies produce much stronger effects of the actions.

In their previous works, the Project experts have proposed the following directions, on which it is desirable to focus regional efforts for support of the companies “with a high growth potential”. The directions are:

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<sup>24</sup> “Priorities of the programme of economic development of Kaliningrad region: Recommendations”. EuropeAid/114287/C/SV/RU project “Support for regional development of Kaliningrad”.

- Upgrading of employees' skills
- Introduction of innovations, technological modernisation
- Introduction of quality management systems
- Intensification of marketing activities, including, those in Russia and abroad (stimulation of export).

These directions can make the basis for subsequent technical assistance projects in Kaliningrad region. The aggravation of competition, the changes in the consumer preferences and the growth of costs resulting from the exclave position of the region require that Kaliningrad enterprises apply quite different approaches to the quality of their products. It is important that quality should be understood as rather a wide scope of consumer characteristics (from stability of technological parameters in the process of manufacture and exact execution of contractual obligations to the characteristics of finished goods), but Kaliningrad companies are not yet capable to completely ensure such quality. .

That is why assistance to improvement of the quality of production at Kaliningrad enterprises is becoming one of the basic directions of further Project's and RDA's activities. For this purpose, it is envisaged to carry out a complex of actions within the framework of *the Project*, one of which will be creation of a Regional public council on quality in Kaliningrad region and the organisation of its interaction with international technical assistance projects.

The Project will continue the work, aimed at support to the activities and development of the Quality Centre and application of mechanisms of quality guarantee in Kaliningrad region. Certain support for an increase of competitiveness of Kaliningrad companies will also be rendered within the framework of the organisation of actions for promotion of Kaliningrad business, including, the assistance in the search of business partners and in establishment of commercial ties between Kaliningrad and foreign companies. It is envisaged to continue the consulting support to regional authorities and local self-management bodies with a view of improvement of the legislation, directed at improvement of the business environment in the region.

## Estimation of competitiveness of individual kinds of Russian products

| Commodity   | Competitive on large world markets | Competitive on some countries' markets | Uncompetitive |
|---|------------------------------------|--|---------------|
| Crude oil   | X                                  |  |               |
| Oil-products                                      | X                                  |  |               |
| Natural gas                                       | X                                  |  |               |
| Coal  | X                                  |  |               |
| Coke and chemical coke products                   |                                    | X                                      |               |
| Pig iron  | X                                  |  |               |
| Rolls (flat and profiles), ferrous alloys         | X*                                 |  |               |
| Copper, nickel, aluminium, and articles thereof   | X                                  |  |               |
| Titanium, magnesium, cobalt, and products thereof | X                                  |  |               |
| Composite materials and alloys, cutting tools     |                                    | X                                      |               |
| Ammonia, phosphates, mineral fertilizers          | X**                                |  |               |
| Spirits, acids, hydrocarbons                      |                                    | X                                      |               |
| Paint and varnish materials, chemical fibres      |                                    |  | X             |
| Synthetic rubber                                  | X**                                |  |               |
| Tires, technical rubber products                  |                                    | X                                      |               |
| Polymers  | X**                                |  |               |
| Passenger cars                                    |                                    |  | X             |
| Cargo lorries, trucks                             |                                    | X                                      |               |
| Ball/roller bearings                              |                                    | X                                      |               |
| Civil aviation aircraft                           |                                    |  | X             |
| Electro-technical industry products               |                                    | X                                      |               |
| Electronic industry products (finished articles)  |                                    |  | X             |
| Electronic industry products (components)         |                                    | X                                      |               |
| Incandescent filament lamps                       |                                    | X                                      |               |
| Electrodes for furnaces                           | X                                  |  |               |
| Power engineering machines                        |                                    | X                                      |               |
| Machine-tools                                     |                                    |  | X             |
| Tractors  |                                    |  | X             |
| Nuclear industry products                         | X*                                 |  |               |
| Motors and Diesel engines                         |                                    |  | X             |
| Complex equipment                                 |                                    | X*                                     |               |
| Geodesic instruments                              |                                    | X                                      |               |
| Timber  | X                                  |  |               |
| Lumber  |                                    | X                                      |               |
| Veneer, plywood                                   | X**                                |  |               |
| Wood pulp   | X**                                |  |               |
| Newsprint paper, cardboard                        | X**                                |  |               |
| Cement  |                                    | X                                      |               |
| Glass   |                                    | X                                      |               |

|  |  |   |  |
|--|--|---|--|
| Fabrics                                      |  | X |  |
| Knitted, sewn, leather garments,<br>footwear |  | X |  |
| Hard alcoholic drinks                        |  | X |  |
| Printed matter                               |  | X |  |

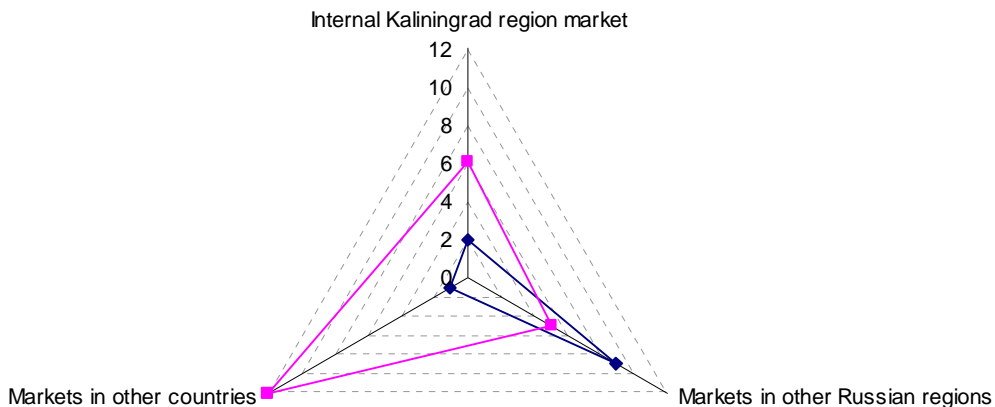
*\*Promotion of Russian products requires public assistance.*

*\*\* The facilities capable of manufacturing export-oriented products are limited.*

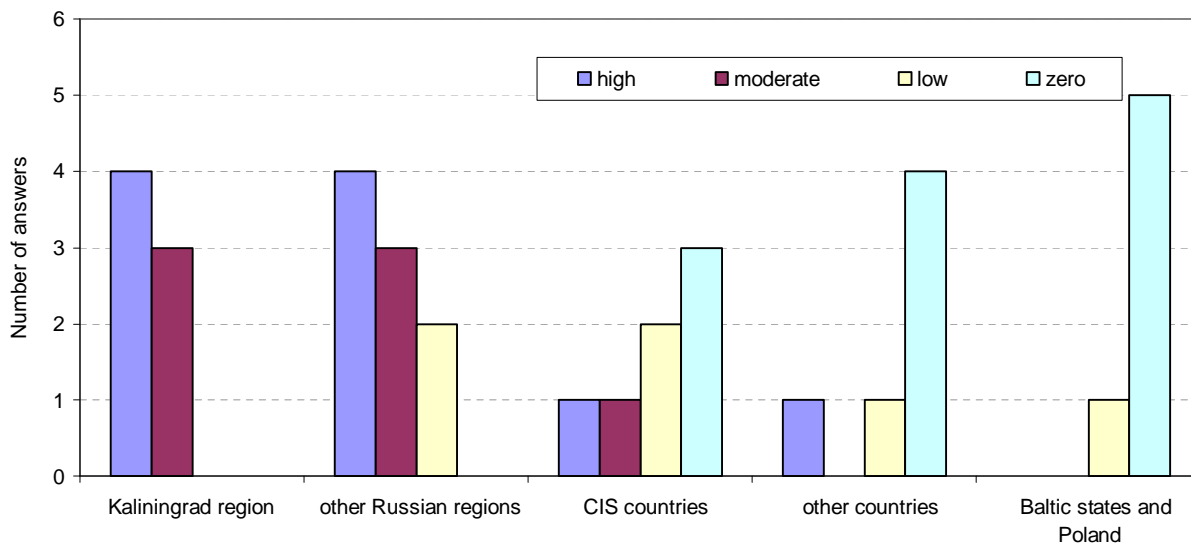
*Source: VNIKI experts' estimates.*

Selective data from the survey conducted in the summer of 2004 by *the RDA* experts for analysis of enterprises' competitiveness in Kaliningrad region

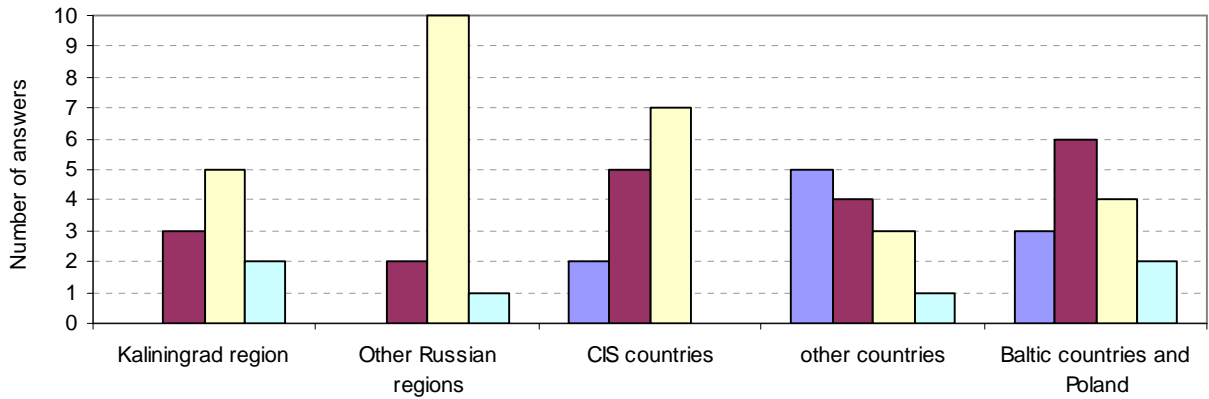
1. Main sales markets of Kaliningrad enterprises



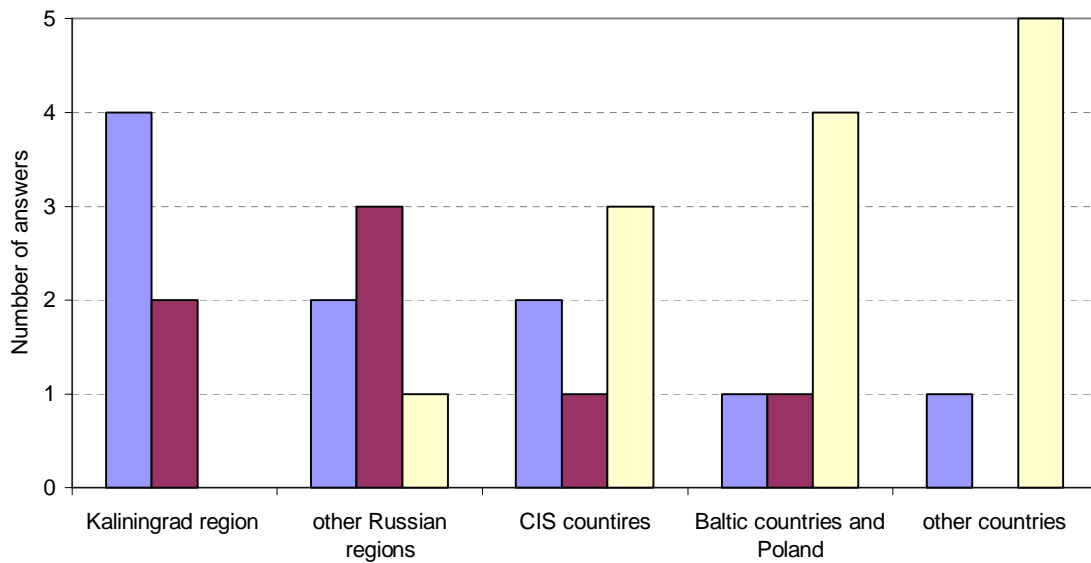
2. Kaliningrad enterprises' estimation of the level of competition on the part of other enterprises (meat-processing industry)



3. Kaliningrad enterprises' estimation of the level of competition on the part of other enterprises (furniture industry)



4. Estimation of own products competitiveness by Kaliningrad enterprises compared with other manufacturers' products (meat-processing industry)



5. Estimation of own products competitiveness by Kaliningrad enterprises compared with other manufacturers' products (furniture industry)

