Trade revives in former Soviet bloc, but imbalance raises concern

By Judy Dempsey

Published: December 27, 2007

BERLIN: The Skoda, a Czech-made car that was long the butt of unflattering jokes across Eastern Europe, has become a success on the streets of Moscow in its new incarnation - one more sign that trade between Russia and its former satellites is picking up again as consumer spending and economies in the region grow apace.

During communist times, the region's economies were closely linked in the Comecon trade pact, but those ties broke down completely after the collapse of the Iron Curtain in 1989.

Now a turnabout is under way, to the benefit of companies in Eastern Europe selling not only affordably priced cars but household appliances, food and agricultural products and machinery.

In the other direction, it is a different story.

Eastern Europe is buying mostly Russian gas and oil, as strong economic growth has led to greater demand for energy to power new household appliances and cars.

Workers assembling engines at the Skoda plant in Mlada Boleslav, Czech Republic. More than 28,000 Skodas sold in Russia this year. (Vladimir Weiss/Bloomberg News)

The imbalance illustrates how slow Russian companies have been to diversify their exports; they still rely on commodities and energy-related products.

It also shows that Eastern Europe is cementing its almost complete dependence on Russia for its energy - something Poland and the Baltic States have been trying to reduce for political and security reasons.

Those efforts intensified after Russia briefly stopped sending gas to Ukraine in late 2005, and again the following winter to Belarus, because of price disputes. But they have had little success, mainly because of the lack of viable alternatives, according to Poland's economics ministry.

Still, both sides are benefiting. "There is now a kind of contradiction in the relationship between Eastern Europe and Russia," said Vasily Astrov, regional economic expert at the Vienna Institute for International Economic Studies (wiiw). "While political relations have been poor, trade is definitely improving."

Skoda, the Czech company that was bought and redesigned by Volkswagen of Germany in the 1990s, is one example.

It was hardly ever seen on roads in Russia, either before the collapse of the communist regimes or indeed a decade later, when Russia was in economic turmoil. It took until 2005 for 7,500 of the redesigned Skodas to be exported to Russia. But during the first 11 months of this year, sales topped 28,200 cars.

Overall exports from Eastern Europe to Russia have increased to more than $10 billion last year, from $2.3 billion in 2000, according to Natalya Volchkova, economist at the Center for Economic and Financial Research, an independent think tank in Moscow.

The rise in trade has become so important to the region that when Russia imposed an embargo on Polish meat products 18 months ago, claiming they did not meet the EU's own strict standards, there was real concern by Polish meat producers. They faced losses of up to €350 million, or $512 million, a year, according to the Polish Trade Ministry. That would be about a third of annual meat exports from Poland.

With the embargo lifted this month, the new center-right government in Warsaw is hoping to improve trade and political ties, which were strained under the previous, conservative-nationalist leaders.

Regardless, Russian companies like Gazprom and Lukoil are already benefiting from the general economic growth. Newly flush Eastern Europeans are buying cars and electrical goods at home, pushing energy consumption to new levels just as energy prices reach record highs.

Russian exports to the region surged to $24.1 billion in 2006 from $14.5 billion in 2000.

"For once, it seems there are winners on both sides," Astrov said. "The rise in consumer spending in Eastern Europe and Russia helps both sides."

The increase in trade has little to do with the countries of Eastern Europe becoming members of the EU in 2004. Once they joined the now 27-nation bloc, the tariff regime between Russia and the region actually increased for certain products - which suggests that trade should have declined as a result. But it did not.

"Enlargement itself did not improve the access by Russia to the new members states of the EU," said Maryla Maliszewska, economist at the Center for Social and Economic Research in Warsaw. "What explains the revival of trade since 2004 is the higher oil and gas prices in the case of exports from Russia to Eastern Europe and higher economic growth in Russia in the case of imports from Eastern Europe."

Indeed, trade within the region could make another leap during the next few years once Russia joins the World Trade Organization, analysts said. That would spur Russian companies to invest and become more competitive. They expect even more positive effects from the planned strategic partnership between Russia and the EU which Brussels and Moscow hope to conclude in 2008.

In the meantime, the EU and organizations like the European Bank for Reconstruction and Development are urging East European countries to do more to promote energy conservation and independence.

Little progress has been made across the former Warsaw Pact toward modernizing infrastructure so as to improve efficiency, or to introduce some kinds of diversification, such as developing renewal energy options, according to the EBRD.

What improvements there have been have come in the new manufacturing plants set up in recent years - mainly by West European and U.S. companies.

They are also the reason why Skoda, for example, has been able to shake off its image as an unreliable car.

"The quality of the goods have improved markedly," said Astrov. "The Russian consumers know they are buying quality goods. They know that Skoda, for example, really is made by Volkswagen."