CHAPTER 6

SOVIET STRATEGY OF OIL EXPORTS

As oil is an important export commodity, the Soviets have evolved an effective strategy to promote their exports of oil. This chapter is an attempt to assess the effectiveness of this strategy, and to consider whether the strategy is singularly lacking in commercial integrity as alleged by the multinational oil companies. It subjects the much-maligned price discounts and price differentials of Soviet exports to critical analysis. Finally, it seeks to quantify the "hypothetical loss" which a few markets have allegedly incurred by not buying oil from the Soviet Union. As Eastern Europe is the major market for the USSR, the energy requirements of that region are calculated with a view to finding out whether and how far the Soviet Union would be able to meet its oil needs. If the Soviet Union should emerge as the sole supplier of oil to Eastern Europe, would it discriminate against Eastern Europe? In order to answer this question we shall test an "oil dependence" hypothesis that might help determine whether the prices charged by the Soviet Union have any relation to the "degree of oil dependence" of the buyers. Finally, we shall discuss, albeit cursorily, the plausible attitude of the Organization of Petroleum-Exporting Countries (OPEC) towards Soviet oil.

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The Soviet Union has been exporting oil for more than a century now, and it is a traditional exporter of oil. The oil industry in Russia developed originally as essentially an export industry. Its entry into the international market as an exporter of oil in the late fifties was more a comeback than a debut. In the early sixties, Soviet oil was, to use the phrase of Michael Tanzer, "an operative factor" at best in the world market. It was not yet a decisive element. In spite of their modest scale, the Soviet oil exports came in for various kinds of interpretation and criticism. A typical reaction to Soviet oil was that "the Soviet Union is not out simply to sell oil but to disrupt, undermine, and, if possible, destroy the position of the private oil industry". This seems to have been a grossly simplistic view of the intricacies of both political and economic motivation and skill.

It would be a good idea to go into the past record of Soviet exports of different commodities in order to understand the meaning of the Soviet oil drive. It is true that whenever the Soviets went into the international market with any commodity, they provoked cynical remarks and hostile criticisms. Take, for example, the active participation of

the Soviet merchant fleet in the world market. In seeking to
gain admittance in trade, the Soviets sometimes used tactics
that made their competitors charge them with unfairness and
question their ultimate objectives. The same thing happened
when the Soviets wanted to sell diamonds and gold. In
1957, when aluminium was in surplus in the world market, the
Soviet metal appeared in the United Kingdom at a price far
below the price being quoted by the Canadians. The Soviets
had supplied only 8 per cent of the requirements of the
United Kingdom, and yet the Canadians applied for anti-
dumping duties on the Soviet supplies and reduced their
own price by 2 per cent. However, by late 1958 the Soviets
agreed to limit their sales to the United Kingdom during the

3 See "USSR Making Steady Inroads in Shipping", Shipping
and Trade News (Tokyo), 1 January 1970, pp. 3-4. In
mid 1960, when the Soviet Union emerged as a signifi-
cant maritime power, Edvin H. Hood, President of the
Ship Builders Council of America Inc., expressed the
view that the Soviet Union "will be on the road to
economic domination of the world". Ref. Marine
Engineering Log (New York, N.Y.), vol. 31, no. 2,
February 1960, p. 51. Similarly the "Foreword" to a
report on the Soviet Merchant fleet by the Committee on
Commerce of the US Senate begins with the assertion
that the emergence of the Soviet Union as a maritime
power is "committed to disrupting and ultimately
dominating world trade". Committee on Commerce, United
States Senate, The Growing Strength of the Soviet

4 Alec Nove, "Soviet Trade and Soviet Aid", Lloyd's Bank

5 Oscar L. Altman, "Russian Gold and the Ruble", IMF Staff
Also Business Week (New York), 10 November 1962, p. 53.
following year and moved up their prices close to the Canadian. In 1957 they increased their exports of tin to the United Kingdom, which imposed an import quota. However, in 1959, the international Tin Council admitted the USSR to its circle with a quota of 13,500 tonnes, which was less than the Soviet exports achieved in 1958. None the less, the Soviets willingly accepted the reduced scale. Thus it is clear that they only behave in the classical manner by lowering the price to elbow their way into a market for a given product but settle for a share eventually. As a matter of fact, they have often evinced a keen interest in having commodity agreements in the international market, so that, for a given commodity, a definite share may be ensured. For instance, on 1 January 1969, when the International Commodity Agreement for sugar was concluded, a Soviet author commented that it was “a victory for the forces in favour of international co-operation in the raw material trade.”

As their oil trade was rapidly expanding, the Soviets argued on several occasions that they were entitled to their “historic” share of 14 per cent in the European


market and that their aim was to regain that position. When questioned at the Second Arab Oil Congress held in Beirut in 1960, P. Guriev, Chairman of Sovzavod claimed that the Soviet Union was only "renewing its legal place among the exporting countries which belongs to it in the pre-war years". He said in a different context that "we sell oil in order to buy goods in return". Juan Pablo Perez Alfonzo, Venezuela's Minister of Mines, was not, therefore, far wrong when he observed that the Soviet oil threat was really "more of an emotional problem than an economic one". Thus it seems fair to assume that the intention of the oil drive is not primarily to disrupt the market but to take advantage of it on a secure basis. To attribute exclusively political motives to the Soviet oil trade would be to misconstrue the situation. There is no doubt that political considerations play a role in the trade decisions of the Soviet Union, but it is possible to explain the oil-export policy of the Soviets essentially in economic terms. The Soviets are hard business men who do not generally enter into a business deal unless it is commercially advantageous to them. Soviet oil exports are not big enough


10 Oil and Gas Journal (Tulsa, Okla), 26 November 1960, p. 36.
to constitute a significant percentage of world consumption and to warrant apprehension of a master plan for Soviet domination of world markets.

**Business Integrity**

In order to enter into the world petroleum market and to achieve a secure share in it, the Soviets have evolved a strategy of their own. The effectiveness of their strategy is brought out by the fact that whatever the volume of oil they decide to export, they are to be able to export it in an oligopolistic market controlled by multinationals. Although the volume is small, the impact of the drive speaks for the efficiency of the strategy.

Now a question arises: Does this strategy lack business integrity as has been widely alleged? Different interpretations of the Soviet strategy are possible, depending upon which side the critic's interests or emotions lie. The unceasing flow of criticism and the vehemence with which different allegations have been made have only clouded the issue. As there is no absolute yardstick of integrity applicable to international oil business, the strategy of the Soviet Union can only be compared with the strategies of its rivals. Before, however, we go on to discuss the ethics of the Soviet strategy, let us review the characteristics of the world oil market — the milieu in which the Soviets operate.
There are seven international oil firms which account for about half of the world's oil production. They are vertically integrated and participate in all stages of the oil industry, from exploration and extraction of oil to transporting, refining, and marketing. Because of the dominance of these seven firms, the market is oligopolistic, with about thirty smaller firms called "independents" on the fringe. These firms share the market either territorially (as in the 1909 agreement) or by percentages (as in the 1923 "as is" agreement). In recent years the agreements between these firms have remained largely unwritten in view of the US anti-trust legislation. Yet there is an unwritten code of conduct among them to ensure that they do not encroach upon one another's territories. A firm dissatisfied with its market share wages a price war and enforces a redistribution of shares that is favourable to it. History is replete with such price wars. The "majors" adhere to a commonly-agreed price formula to avoid price wars among themselves. Since the entry into the market of a number of big "independents", such as ENI,

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Occidental, Philips, and Standard Oil of Indiana, the "price" quoted by the "majors" has been weakened to a considerable extent.

In the late fifties, when the Soviet Union re-entered the market, the control of the "majors" on the market was almost complete; they accounted for 84 per cent of the oil production outside the Socialist world, 74 per cent of the refining, and 70 per cent of the marketing. When, therefore, the Soviet Union re-emerged as an exporter of oil, it employed two marketing tactics to sell its oil abroad. It offered to barter its oil for commodities of the importing countries, and it offered discounts to "sweeten" the deals.

Barter is quite an unorthodox way of carrying on international trade in oil. One may almost call it an invention of the Soviet Union, for there is only one instance of the international oil companies engaging in barter. 13 The Soviet Union bartered its oil to the developing countries very frequently and almost as a rule. India paid for oil with tea; Brazil, with coffee; Cuba, with sugar; Israel, with citrus fruit; Iceland, with fish; and Egypt, with cotton. Often the Soviets accepted payment from the developing countries in their respective currencies. It

13 Jersey made a deal in 1963 with ENI of Italy to sell it crude partly in exchange for oil equipment. See Tanzer, n. 1, p. 336.
was almost as though the Soviets told them: "Just tell us what you want and we will sell it to you and we will accept repayment in whatever commodities you normally export."\textsuperscript{14} As the international oil companies were without such multiple options, they resented the Soviet deals.

The barter deals were mutually beneficial to the Soviet Union and the importing developing countries; for many of the commodities bartered by the developing countries, were suffering from inelastic demand. If the exports of those commodities had been increased beyond a certain level in order to earn foreign exchange, it would have reduced the unit value realization of those commodities.\textsuperscript{15} Besides in view of their limited resources, the developing countries were hardly in a position to buy oil from the international companies by paying for it in foreign exchange. There may well be certain political motives behind the Soviet Union accepting barter deals from selected countries, but the economic benefits accruing to it from such deals were by no means inconsiderable. Owing to its limited "convertible currency" and the large number of pressing claimants on it, the Soviet Union was finding it difficult to import consumer goods.


Moreover, in the face of stiff competition from the international oil companies, it was no easy matter for it to sell oil outside the developing countries. This was how barter deals, which are in essence "limited bilateral trade", offered economic benefits to the Soviet Union. Barter became an effective marketing technique in selling oil. Besides, it generated a lot of good will and political influence for the Soviet Union. Being convinced about oil being "the foundation of the entire edifice of Western political influence in the less developed world", the Soviets attached much importance to barter deals.

Price Discounts

Another marketing technique that the Soviet Union used was to give a discount on the posted price of the international "majors". This was a conventional technique, practised in international business by many Western countries also. None the less, when the Soviets started giving discounts to make their oil "sweet" and to wean the "independents" and the Government companies away from the "majors", it stirred up a controversy. The then prevalent

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16 Quotation from an authoritative article in Russian, reported in Impact of Oil Exports from the Soviet Bloc (Washington, D.C., 1962), vol. 1, p. 37.

Cold War, the "hang-over" of the Cuban missile crisis, and the U-2 incident sharpened the controversy.

There are many cases of the Soviet Union offering "discounts" to push its oil deals in the "free-market countries". Two representative cases may be cited here. In July 1960, the Soviets offered to supply oil to India on a delivered basis at $1.81 a barrel c.i.f. Bombay, which was, notwithstanding the long haul from the Black Sea to India, $0.25 a barrel cheaper than the c.i.f. prices of the international companies. This would have saved India about $5 million annually. The offer was really very attractive for India because payment was to be made in rupees. However, the deal fell through because the international companies refused to refine Soviet oil in their refineries. But when an almost similar thing happened to Cuba, Castro nationalized the oil companies.

In November 1960 the Soviets agreed to supply five million tonnes of oil to Italy annually over the next five years, reportedly at a price equivalent to $1.00

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a barrel, in return for forty-inch pipe. This was the most sensational deal that the Soviets had ever struck. According to an American spokesman of the oil industry, the price of $1.00 a barrel f.o.b. Black Sea was equivalent to 75 cents f.o.b. Persian Gulf ports. This price, he contended, would not cover taxes and the royalties due to the oil-producing states of the Middle East.

If the Soviets had really sold oil at $1.00 a barrel, there would have been reasonable ground to accuse them of triggering a price war, i.e. of selling below cost with the intention of driving their competitors out of business; for, taking the cost data as given by the Soviets, Campbell estimates that the cost of production of the Volga oil at the Black Sea ports in 1960 was $1.00 to $1.10 a barrel f.o.b. On this estimate, if we add 40 per cent for the neglected costs of capital, the cost per barrel would work out to about $1.40 to $1.44 - which is above the


21 R.W. Campbell, The Economics of Soviet Oil and Gas (Baltimore, Md, 1963), p. 239.
Before passing judgement, let us examine the authenticity of the price reportedly charged by the Soviets. Trade journals like *Petroleum Intelligence* and *Petroleum Times* did not give the price with any degree of certainty. *Petroleum Press Service* said at one place that the price was believed to have been "advantageous"; at another place it was silent about the exact price. According to Hartshorn, the price was about £1.40 a barrel. If so, the Soviets cannot fairly be held guilty of having tried to sell below the cost price. Adelman wonders if the price of £1.00 a barrel had "achieved recognition" by repetition. Moreover, unless one examines the price of the pipes which the Italians were willing to barter for oil, one cannot be sure whether the Soviets were reciprocating with a "special" price for their oil any "special" price that the Italians might have charged for their pipes. In a barter deal, to talk of one side of the trade in isolation from the other is not fair.

Even if the price of £1.00 a barrel was the actual price at which the barter deal with the Italians was settled, it is the only such transaction ever to have been made by the Soviets. It is, besides, wrong to infer that the Soviets indulged in a distress sale of their oil. The Soviet export market was politically limited. Also, the buyers of Soviet oil could only be the "independsents". The Soviets were, therefore, in no position to expand the market beyond a certain limit by quoting lower prices. All that they could be expected to do was to maximize their returns by giving just a small discount. If the Soviets had continuously indulged in price-cutting, they would have provoked retribution at the hands of their competitors. As a matter of fact, the British Petroleum Company underbid the Soviets by a nickel a barrel for supply of oil for the Moroccon refinery at Mohammedia. On another occasion, the Soviets complained that the US oil companies were quoting "cut-throat prices" and dumping the markets. Thus, once a price war starts, it hurts the Soviets as much as it hurts others. We may, therefore, conclude that the Soviets would employ the technique of price discounts as part of the conventional market strategy only with great caution.

26 Oil and Gas Journal, 12 February 1962, p. 97.
and strictly up to a certain limit, but to accuse them of persistently indulging in distress sales to gain some unfair advantage would be highly unfair. Though such an argument is attractive, it obscures the most important objective behind the Soviet export of oil, viz. to earn foreign exchange.

**Degree of Price Differentials**

Thus distress sale—i.e. selling at a price far below the cost for singularly political considerations or driving the competitors out of the market with the intention of exploiting it in a monopolistic fashion after that—cannot be attributed to the Soviets. All that the Soviets do is to give attractive discounts initially to secure markets. The discounts may of course vary according to the characteristics of the markets. Offering discounts (or, in other words, practising differential prices) is not new; nor is it unique to the Soviets. Rather it is an integral part of the oil business.

Table 1 indicates the weighted average prices charged by both Soviet and other suppliers who total about twenty in number. For want of non-availability of c.i.f.

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Table 1

PRICES CHARGED BY THE SOVIET UNION
(Dollar per Barrel, c.i.f.)

<table>
<thead>
<tr>
<th>Year</th>
<th>West Germany</th>
<th>France</th>
<th>Yugoslavia</th>
</tr>
</thead>
<tbody>
<tr>
<td>1966</td>
<td>1.77</td>
<td>1.93</td>
<td>1.96</td>
</tr>
<tr>
<td></td>
<td>2.01*</td>
<td>2.49*</td>
<td>2.08*</td>
</tr>
<tr>
<td>1968</td>
<td>1.74</td>
<td>2.04</td>
<td>2.12</td>
</tr>
<tr>
<td></td>
<td>2.32*</td>
<td>2.51*</td>
<td>1.69*</td>
</tr>
<tr>
<td>1969</td>
<td>1.79</td>
<td>1.79</td>
<td>2.15</td>
</tr>
<tr>
<td></td>
<td>2.32*</td>
<td>2.22*</td>
<td>2.76*</td>
</tr>
<tr>
<td>1970</td>
<td>1.87</td>
<td>1.93</td>
<td>2.13</td>
</tr>
<tr>
<td></td>
<td>2.28*</td>
<td>2.33*</td>
<td>2.16*</td>
</tr>
</tbody>
</table>

* Price charged by suppliers other than the Soviet Union.

Sources: Platt's Oilgram Price Service (New York, N.Y.), various issues.

Note: Data are annual weighted averages.
price data, we have taken only four years as representative of the sample. We have assumed that the quality of the oil supplied by the Soviet Union and others is identical. Even if we play safe by assuming that the differentials if any in the specific gravity and sulphur content of the oil would not be so much as to neutralize the price differences, it would not wholly invalidate the following conclusions.

In the years under review the prices charged by the Soviet Union in West Germany and France were lower than the price charged by the other suppliers. The position in Yugoslavia does not lend itself to any firm conclusions. During 1966 and 1969 the Soviet prices were lower; during 1968 and 1970 they were higher. The Soviets charged the highest price in Yugoslavia and the lowest in West Germany.

It is clear that in each of the three markets both the Soviet Union and the other suppliers maintained price differentials during all the four years under review. No particular side can, therefore, be held especially guilty. The Soviet prices were higher in Yugoslavia than in West Germany and the prices charged by the others were lower in Yugoslavia than in France except in 1969. In 1968 the Soviet prices were the lowest in West Germany, with a discount at 53 cents per barrel; during the same year the prices charged by the other suppliers were the lowest in Yugoslavia, giving a discount at 43 cents per barrel. If
the Soviets may be accused of any political motivation, the others are also equally vulnerable to the same charge.

On the basis of our limited data, we may make the following observations. None of the three markets - viz. West Germany, France, and Yugoslavia - was a "captive" market wholly dominated by a monopolist, though the degree of the competition might have differed. That the competition was intense is clear from the number of suppliers in each of those markets. West Germany had about twelve suppliers of oil; France, about fifteen; and Yugoslavia, eight. As price is decided by the interplay of competitive forces, it must needs behave differently in consonance with the differences in the market forces. If the sheer number of suppliers is taken as a "proxy" for competition, West Germany was the most competitive market and Yugoslavia the least. The Soviet prices were the lowest in West Germany because, like others, the Soviets have always sought to gain entry into a market by means of an attractive discount. Similarly, Yugoslavia can be interpreted as the least competitive market. It was also a market which the Soviet Union was probably not very keen to cultivate. In 1962, by giving an attractive discount the other suppliers captured the Yugoslavia market (99.82 per cent) and pushed the Soviet Union out of it.

All this only goes to show the price differentials in the different markets. To find out price differentials
for every year in the same market, it would be necessary for us to work out the parallelogrammic forces of both the Soviet Union and the others.

**Effects of Price Differentials**

We have already examined the degree of price differentials in different markets. In this section we shall confine ourselves to the effects of the price differentials in the markets already mentioned.

The effects of the price differentials can be studied broadly from two angles — from the angle of the exporters and, more importantly, from the angle of the importing countries. In this section we are concerned with the latter.

One way of measuring the impact of the price differentials is to quantify the loss or gain that a given market has incurred by not purchasing oil from the Soviet Union.

**Difficulties of Data**

To attempt the above exercise, we need c.i.f. price data on all the suppliers. From the viewpoint of the importing countries, it is only the total cost of oil, i.e. cost inclusive of freight and insurance, that matters. We are, therefore, obliged to use only the c.i.f. prices. Taking the f.o.b. price and then adding to it cost of freight and insurance would not always be correct. For one thing
the freight structure of Soviet shipping is different. Secondly, addition of freight by Intascale for other suppliers may yield us at best an approximation of the real price. There are numerous suppliers for every market, and for a country like West Germany there are about twenty suppliers of oil. The quantity and price data relevant to every transaction made between the buyer and the various sellers need to be collected. Generally it is difficult to get authentic price data. In oil business Platt's Oilgram Price Service is the most respected monthly. It specializes in the prices of oil transactions made outside the centrally planned economies. However, as it records every individual transaction month-wise, the data available also are month-wise. If trade statistics of the importing countries are collected at the Customs level, we may get annual data. But Platt's Oilgram Price Service gives more authentic data, and it gives them more consistently, than the other source. So for price, quantity and source of purchase, we preferred Platt's Oilgram Price Service although the data it supplies are month-wise, necessitating a lot of additional labour to arrive at year-wise data. Thus, we took price and quantity data month-wise for all the suppliers. The number of these suppliers sometimes exceeded twenty. To illustrate the magnitude of the labour we may mention here that for the

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three markets, we had to collect more than 6,500 figures. As there was no tangible advantage in computerizing these data for this exercise, we processed them manually.

After assigning appropriate weights to both quantity and price, we placed all the suppliers except the Soviet Union generally in one category as "non-Soviet suppliers". We then calculated the annual weighted average quantity and price of the non-Soviet suppliers accordingly. Then we applied the following formula:

$$
\sum_{t=1}^{t} \sum_{j=1}^{k} p_{ij}q_{ij} - \sum_{i=1}^{t} p_{is}q_{is}
$$

- $t$ = time period;
- $k$ = the given market;
- $p$ = weighted average price;
- $q$ = quantity;
- $s$ = the Soviet Union
- $j$ = non-Soviet supplier; and
- $i$ = base year.

Owing to the non-availability of C.I.F. price data consistently for all years, we were able to make calculations just for a few years. The results are given in Table 2.
Table 2

LOSS OR GAIN DUE TO NOT-TRADING WITH RUSSIA

<table>
<thead>
<tr>
<th>Markets</th>
<th>Period</th>
<th>Import from non-Soviet source (in millions of tonnes)</th>
<th>Loss (−) or gain (+) (in millions of dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>West Germany</td>
<td>1960 to 1973</td>
<td>731.22</td>
<td>− 3,129.41</td>
</tr>
<tr>
<td>France</td>
<td>1966 to 1970</td>
<td>346.94</td>
<td>− 137.20</td>
</tr>
<tr>
<td>Yugoslavia</td>
<td>1966, 1968, 1969, 1970</td>
<td>7.02</td>
<td>+ 0.54</td>
</tr>
</tbody>
</table>

Source: Platt's Oilgram Price Service (New York, N.Y.)

The results of the exercise indicate that by importing 731.22 million tonnes of oil during 1960-73 from non-Soviet sources, West Germany incurred a loss of $3,129.41 million; the loss suffered by France was smaller. During the period under review Yugoslavia imported 7.02 million tonnes of oil from non-Soviet sources and gained about $0.54 million.

The above results should be treated with great caution. When we say that there occurred a loss because of imports from non-Soviet sources, we do not mean that the market concerned would have gained by importing only from the Soviet Union. We say so because the Soviet prices were lower, or because the Soviet Union wanted to sell at
lower prices in the context of a given competitive situation created by non-Soviet sources. If non-Soviet sources had not existed, the Soviet Union would have become a monopoly supplier. Under a monopolistic situation, price is always higher than marginal cost, and there is no reason to believe that the Soviet Union would not have increased its prices above the marginal cost. Moreover, as we shall indicate in the latter part of this chapter, there is a significant correlation between the prices charged by the Soviet Union in a given market to the degree of that market's dependence on the Soviet Union. This would invalidate the claim that the markets we have discussed would really have gained by depending fully on the Soviet Union for their oil.

Exports to Eastern Europe

As discussed earlier, the East European countries constitute the biggest market for the Soviet oil exports. The Soviet Union is their biggest supplier of oil. In view of the importance of the East European markets to Soviet oil and vice versa, we may study the Soviet oil exports to Eastern Europe in some detail.

Unlike the Soviet Union, the East European countries are not well endowed with energy resources. Romania, which is better endowed with oil reserves than the other Comecon countries, is not able to expand its oil output. Indeed,
since 1974, its production has almost stood still at 14.7 million tonnes. 31 Hungarian oil production has peaked at 2 million tonnes. 32 Consumption of oil in these countries grew from less than 16 million tonnes in 1960 to over 75 million tonnes in 1974. 33 Barring Romania, domestic production in all the other countries accounts for less than 5 per cent of all oil and 75 per cent of all natural gas consumed in 1973. 34

As Table 3 indicates, because of an increase in consumption and stagnant production, all East European countries barring Romania had to take recourse on a large scale to imports. Even Romania was obliged to reduce its exports, and at present it is also practically an importer. It is estimated that by 1980 these countries will need to import about 108.9 million tonnes of oil. This means

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31 World Oil (Houston, Tex.), 15 August 1975, p. 134.
33 Ibid., August 1975, p. 302. Until 1960, energy-GNP elasticity coefficients was above unity for Hungary (1.25), Romania (1.14) and Bulgaria (1.73). Since 1960s, it was at unity for Romania; and, except for Bulgaria (1.49), it was below unity for other countries. Vaclav Smil and Tony Kuz, "European Energy Elasticities", Energy Policy (Sussex), June 1976, p. 171.
Table 3

OIL PRODUCTION, CONSUMPTION AND IMPORT OF EAST EUROPE
(In Millions of Tonnes)

<table>
<thead>
<tr>
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<tbody>
<tr>
<td></td>
<td>Pro-</td>
<td>Con-</td>
<td>Im-</td>
<td>Pro-</td>
</tr>
<tr>
<td></td>
<td>duction</td>
<td>sump-</td>
<td>por-</td>
<td>duction</td>
</tr>
<tr>
<td>Poland</td>
<td>0.2</td>
<td>2.5</td>
<td>2.3</td>
<td>0.3</td>
</tr>
<tr>
<td>Czechoslovakia</td>
<td>0.1</td>
<td>2.8</td>
<td>2.7</td>
<td>0.2</td>
</tr>
<tr>
<td>GDR</td>
<td>0.1</td>
<td>2.7</td>
<td>2.6</td>
<td>0.2</td>
</tr>
<tr>
<td>Romania</td>
<td>11.5</td>
<td>5.5</td>
<td>+6.0</td>
<td>12.6</td>
</tr>
<tr>
<td>Hungary</td>
<td>1.2</td>
<td>2.1</td>
<td>0.9</td>
<td>1.8</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>0.2</td>
<td>1.2</td>
<td>1.0</td>
<td>0.2</td>
</tr>
</tbody>
</table>

East European production as a percentage of the production of the Soviet Union

<table>
<thead>
<tr>
<th></th>
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<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>9.0</td>
<td>6.2</td>
<td>4.6</td>
<td>3.3</td>
</tr>
</tbody>
</table>

+ = export.

that imports will rise to the vulnerable level of 85.1 per cent of their total domestic consumption. (See Table 4.)

Table 4

ESTIMATED PRODUCTION, CONSUMPTION AND DEFICIT OF OIL IN EAST EUROPE IN 1970

(In Millions of Tonnes)

<table>
<thead>
<tr>
<th>Countries</th>
<th>Production</th>
<th>Consumption</th>
<th>Deficit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poland</td>
<td>0.4</td>
<td>25</td>
<td>24.6</td>
</tr>
<tr>
<td>Czechoslovakia</td>
<td>0.5</td>
<td>25</td>
<td>24.5</td>
</tr>
<tr>
<td>GDR</td>
<td>0.2</td>
<td>22</td>
<td>21.8</td>
</tr>
<tr>
<td>Romania</td>
<td>15.5</td>
<td>22</td>
<td>6.5</td>
</tr>
<tr>
<td>Hungary</td>
<td>2.0</td>
<td>15</td>
<td>13.0</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>0.5</td>
<td>19</td>
<td>13.5</td>
</tr>
</tbody>
</table>


The USSR is the biggest supplier of oil to the Comecon countries. In 1965 it accounted for about 91.4 per cent of their total imports. In the same year, exports to the Comecon countries constituted 33.3 per cent of the total oil exports of the USSR. This rose to 51.0 per cent
in 1975, when the USSR supplied about 85 per cent of the import requirements of the East European countries.

Within the East European countries, the dependence of the various countries on Soviet oil differs. It is as high as 100 per cent in the case of Czechoslovakia. It is least for Poland, at 83 per cent. (See Tables 5 and 6.) Romania is of course an exception.

The Soviet Union has been persuading these countries to diversify their sources of import. East Germany imported about 1.2 million tonnes in 1970. It concluded a contract with the West Berlin Company, Rex-Handelgesellschaft, for purchase of 0.7 million tonnes of oil a year. Poland entered into a ten-year contract with the British Petroleum Company, providing for the delivery of 3 million tonnes of Persian Gulf oil, starting from 1975, for a new refinery on the Baltic coast at Gdansk. Bulgaria obtained about 5 million tonnes of oil from Iraq and Syria. Romania imported about 2 million tonnes from Iran in 1972. It is estimated that these countries thus imported about 12 million tonnes outside the Soviet Union.

36 Ibid.
38 Ibid., August 1975, p. 302.
Table 5

SOVIET EXPORTS TO EAST EUROPE

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>118.1</td>
<td>221.4</td>
<td>3,449.2</td>
<td>7,049.7</td>
<td>10,000</td>
</tr>
<tr>
<td>Czechoslovakia</td>
<td>560.9</td>
<td>2,643.4</td>
<td>6,363.2</td>
<td>10,466.3</td>
<td>15,500</td>
</tr>
<tr>
<td>East Germany</td>
<td>653.4</td>
<td>2,136.9</td>
<td>5,428.3</td>
<td>9,342.2</td>
<td>15,500</td>
</tr>
<tr>
<td>Hungary</td>
<td>202.6</td>
<td>1,393.8</td>
<td>2,492.1</td>
<td>4,759.3</td>
<td>6,500</td>
</tr>
<tr>
<td>Poland</td>
<td>663.0</td>
<td>1,366.9</td>
<td>3,702.6</td>
<td>8,641.9</td>
<td>12,500</td>
</tr>
</tbody>
</table>

| Total         | 2,198.0 | 8,417.4 | 21,485.4 | 40,259.4 | 60,000 |

As a percentage of total Soviet exports

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>27.5</td>
<td>25.3</td>
<td>33.3</td>
<td>42.0</td>
<td>51.0</td>
</tr>
</tbody>
</table>

Sources: Handbook of Foreign Trade (Moscow), various issues.
Table 6

EAST EUROPEAN IMPORTS OF OIL FROM THE SOVIET UNION AS PERCENTAGE OF TOTAL OIL IMPORT

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Poland</td>
<td>84</td>
<td>85</td>
<td>91</td>
<td>88</td>
</tr>
<tr>
<td>Czechoslovakia</td>
<td>100</td>
<td>94</td>
<td>97</td>
<td>100</td>
</tr>
<tr>
<td>GDR</td>
<td>85</td>
<td>95</td>
<td>89</td>
<td>91</td>
</tr>
<tr>
<td>Romania</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Hungary</td>
<td>83</td>
<td>89</td>
<td>91</td>
<td>94</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>80</td>
<td>92</td>
<td>92</td>
<td>92</td>
</tr>
<tr>
<td>Total</td>
<td>83.5</td>
<td>91.4</td>
<td>87.3</td>
<td>83.5</td>
</tr>
</tbody>
</table>

The East European countries have tried but have not succeeded in diversifying their oil imports and have depended mainly on the Soviet Union. Since 1974, with the oil price hike, it has become virtually impossible for these countries to buy oil from outside the Soviet Union by paying in hard currency. For instance, if we calculate the cost of their import bill for oil on the basis of a CIA report, we shall find that these countries would have had to pay about $5,300 million (f.o.b. price) if they had imported their oil in 1973 from outside the Soviet Union. This would represent more than 65 per cent of Eastern Europe's entire imports in 1973 from the non-Communist world. The oil import bill of the countries of Eastern Europe must have gone up to about $13,000 million in 1976.

Thus, for the countries of Eastern Europe, it is not merely a question of finding oil outside the Soviet Union; it is a question of finding the means needed to pay the bill. For instance, Poland spends 13.5 per cent of its export earnings on debt repayments and interest. If it decides to import its oil from outside the Soviet Union, it will find it just impossible to pay for the oil in hard currency. As the countries of Eastern Europe have not secured significant firm orders enabling them to secure supply of oil on a

barter basis, they have to pay mainly in convertible currency.

Hence, despite the increase in the price of Soviet oil from 16 to 50 rubles per tonne since January 1975, Eastern Europe may still prefer to import oil from the Soviet Union. Thus Soviet oil is indispensable for the economic viability and political stability to the Comecon countries.

In exchange for oil, the Soviet Union has persuaded the countries of Europe to invest in the infrastructure of the Soviet oil industry within the Soviet Union which will remain fully under Soviet ownership. The bid to harness East European industries to the exploitation of Soviet resources is exemplified by the Adria pipeline and the Orenburg natural gas pipeline. The Adria oil pipeline is a joint venture of Czechoslovakia, Hungary, and Yugoslavia, and the total cost is estimated to amount to £500 million. Similarly, the Orenburg gas pipeline would be constructed by Bulgaria, Czechoslovakia, the German Democratic Republic, Hungary, Poland, and Romania, besides the USSR. This pipeline is to run from the natural gas deposits in Orenburg in the Urals to Uzgorod on the Soviet-Czech border. Thence it will split into two, with one branch going on into Czechoslovakia and linking up with the second and third strings of the transit pipeline and the other running south to Bulgaria and Romania. It is

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the biggest joint venture ever undertaken by the Comecon members and so represents a major step towards further Comecon integration.

The massive joint venture of pipelines, which is encouraged by the Soviets themselves, indicate that the Soviet Union is strongly committed to supply oil to the East European countries in future. In the past also the Soviet Union had stood by its allies in providing oil to them. The year 1974 can be taken as a test case. The year was a very critical one for the Soviet Union, in the sense that, because of a series of unfavourable harvests, it had been obliged to buy about 15.9 million tonnes of grain from the West by paying for it in convertible currency. As a result, its overall trade balance, which was surplus to the tune of some 2,000 million rubles in 1974, showed a deficit of about 2,700 million rubles in 1975. On top of this, following a steep increase in domestic oil consumption, unmatched by production, it was also forced to reduce its oil exports, albeit marginally. Even then the Soviet Union did not increase its oil exports to the Western countries by reducing its exports to Eastern Europe. Indeed, what it did was exactly the other way about; it reduced its exports to the convertible market by 6 million tonnes but increased its exports to the East European market by 4 million tonnes. 41

41 Oil and Gas Journal, 15 July 1974, p. 25.
This shows that the Soviet Union is committed to the East European countries. As a matter of fact Eastern Europe's increasing demand for oil has been instrumental in reducing net Soviet exports to other countries over the past seven or eight years. This belies the expectations of many Western scholars that the Soviet Union would be inclined towards the convertible currency market rather than to a "captive" market like Eastern Europe. Indeed it looks as though, instead of Eastern Europe being a "captive" market for Soviet oil, the Soviet Union had become a "captive" source for Eastern Europe.

Eastern Europe is assured of considerable supplies of Soviet oil and gas in the future. At the Comecon conference in June 1975, the Soviet Union promised to step up oil supplies to Eastern Europe, perhaps to 70 million tonnes by 1980. It also undertook to make available to Eastern Europe over 21 million cubic metres of gas annually.


44 *Christian Science Monitor* (Boston, Mass.), July 1, 1975, p. 11.
The dependence of Eastern Europe on Soviet oil has brought about closer integration within Eastern Europe. The Soviet Union has been supplying more than three-fifths of the total intra-bloc imports of fuels and raw materials and has imported about half of all East European exports of machines and equipment. For the first time in the history of Comecon, the national plans of individual members are being adjusted at the Comecon level prior to their final approval.

Eastern Europe's total dependence on the Soviet Union for oil underscores the pre-eminence of the Soviet Union. In a limited sense, Soviet oil is to Comecon what food aid under PL-480 of the United States of America is to the developing countries. Thanks to oil, the Soviet Union has gained immense leverage, both political and economic, in Eastern Europe.

We have already discussed how the Soviet Union behaves in a monopoly situation. We have also seen how its woeful dependence on the Soviet Union for its oil has placed Eastern Europe in a vulnerable position. Eastern Europe is vulnerable because monopoly invests the Soviet Union with power to control the supply, which in its turn means power


to stop the supply. Thus Soviet monopoly means insecurity
for Eastern Europe, and absolute monopoly would mean
absolute insecurity.

This leads to an interesting question: Does the
Soviet Union discriminate against Eastern Europe because
of its near-monopoly position?

Monopolistic Discrimination

Karl Marx regarded discrimination as an inexorable
"effect of monopoly capitalism". Lenin looked upon it as
a "product of the anarchy of production". Discarding emotive
ideology for a moment, theoretically speaking, discrimination
is a "product of an imperfection in the market". Owing
to its insulation from the rest of the world and the absence
of free play of market forces the Comecon market is far from
perfect. Thus, prima facie, there is ground enough to
assume the existence of discrimination.

Jacob Viner contends that discrimination is inherent
in State trading. Wassily Leontief argues that State

47 Karl Marx, Das Capital (Moscow, 1959), vol. 3, pp. 563-75.
64-67.
49 P. J. D. Wiles, Communist International Economics (London,
50 Jacob Viner, "International Relations Between State
Controlled National Economics", American Economic Review
(Menasha, Wis.), March 1944, pp. 315-23.
monopolies are identical with "discriminating monopolists". The bargaining strength of a "discriminating monopolist" is, by and large, a function of the magnitude of the resources at his command.

There are certain determinants of the bargaining position, depending on the traded commodity. If a given commodity has inelastic demand for the importing countries and if it is a basic necessity for their industries, that would enhance the bargaining capacity of the exporter. This is so because, in the words of Hirschman, stoppage of trade in such a commodity would inflict upon the importing countries a "total impoverishment". If the given commodity is a hard commodity, and if an alternative export market can be found without difficulty, it reduces the bargaining capacity of the importers. If the cost of not exporting is lower for the exporter than the cost of not importing is for the importer, the exporter is less vulnerable than the importer.

Within this frame, let us examine whether and how the USSR can discriminate against the Comecon buyers. Among the members of Comecon, the Soviet Union is the strongest monopolist with the largest resources. As it is the only

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major exporter of oil within the bloc and oil is an indispensable commodity, the bargaining capacity is very high.

Many authors have done empirical research to prove that the Soviet Union does discriminate against the Comecon countries. They include Pryor, Michal, and Spulber. With the help of massive data J. Wszelaki argues that the Comecon members were held "captive" by their dependence on the Soviet Union for raw materials. However, Mendershausen, who has done a good deal of work on this subject, statistically proves that the Soviet Union has, by virtue of its monopolistic-monopsonistic power, discriminated against the East European countries.

In an analysis of trade data relating to Bulgaria, Hungary, Poland, and the USSR, Frederic Pryor correlates the discrimination practiced by the USSR with dependence


factor. In other words, according to him, the greater the degree of dependence, the higher the discrimination. 56

Amacher is the first author to test the "trade dependence" hypothesis with reference to Yugoslav-Comecon trade. He reports the existence of a significant correlation between the level of discrimination and the degree of dependence. 57

All these authors examine price discrimination at a macro-level, via the aggregate export and import transactions of selected countries. No attempt seems, however to have been made at a micro-level to study price discrimination and correlate it with the degree of dependence. Owing to its importance, oil is an ideal commodity for testing the "trade dependence" hypothesis. In the pages that follow here, therefore, we have made an attempt to test such a hypothesis.

Before we go on to examine price discrimination, however, we may mention that "price...is a boiling stew of propaganda, ideology, economic forces, and self-delusion". 58 Researchers like William Moskoff link price differentials with political factors. 59 However, in this study, we have

56 Pryor, n. 53, p. 147.

57 Ryan C. Amacher, Yugoslavia's Foreign Trade (New York, 1972), pp. 113-16.

58 Pryor, n. 53, p. 131.

assumed for analytical purposes that economic factors over- 
ride political forces. We have analysed the discrimination 
being practised by the USSR to find out whether there is any 
discernible pattern in it and how far economic forces offer 
adequate explanation for it.

The markets chosen by us are Czechoslovakia, 
East Germany, West Germany and Yugoslavia, and the period 
covered is 1960-67. These countries depend on Soviet oil 
in different degrees, and the prices charged to them by 
the Soviet Union are also different. The hypothesis is; 
the more these countries depend on Soviet oil, the more the 
Soviet Union discriminates against them. In other words, 
the extent of discrimination is limited by the market 
dependence.

The "oil dependence" hypothesis is tested by 
calculating a least squares regression of the form

\[ Z = a + b_1 X_1 + b_2 X_2 \]

where

- \( Z \) = the level of discrimination;
- \( X_1 \) = the oil dependence of the given country on 
  the Soviet Union; and
- \( X_2 \) = dependence of each country \( \text{via-a-via} \) 
  Czechoslovakia, East Germany, West 
  Germany, and Yugoslavia.
Results of the Regression

After trying three forms, Log-log, semi-log, and linear, it is found that $R^2$ is the best in the case of linear and so it is taken as the best fit.

In the case of West Germany, t value is less than 2.13 (the table value of t at 5 per cent level of significance), and t score is less than 2.13 (at 4 degree freedom). This means that the hypothesis that price increases in direct proportion to dependence does not hold good. The inference is that West Germany cannot be considered a country that is dependent on Soviet oil.

However, for the other three markets - viz. Czechoslovakia, East Germany, and Yugoslavia—as their t values are higher than 2.13, it should be taken that for them the "oil dependence" hypothesis holds good.

Within these three countries, the hypothesis holds good more for East Germany and less for Yugoslavia. Czechoslovakia comes in between.

Regression results are given in Table 7. They indicate that in all countries except West Germany, the "oil dependence" hypothesis, viz. that the level of discrimination is a function of oil dependence, holds good.
Table 7

DEPENDENCY HYPOTHESIS, 1960-1967

<table>
<thead>
<tr>
<th>Countries</th>
<th>Linear</th>
<th>$X_{1t}$ scores</th>
<th>$X_2$</th>
<th>$r^2$</th>
</tr>
</thead>
<tbody>
<tr>
<td>West Germany</td>
<td>$Z = 0.107+1.52$</td>
<td>1.84</td>
<td>-1.07</td>
<td>0.741</td>
</tr>
<tr>
<td></td>
<td>$X_1 - 0.62 X_2$</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>East Germany</td>
<td>$Z = -19.31+5.53$</td>
<td>27.83</td>
<td>14.36</td>
<td>0.999</td>
</tr>
<tr>
<td></td>
<td>$X_1 + 1.86 X_2$</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yugoslavia</td>
<td>$Z = -27.85+23.07$</td>
<td>3.31</td>
<td>1.33</td>
<td>0.808</td>
</tr>
<tr>
<td>Via</td>
<td>$X_1 - 3.14 X_2$</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Czechoslovakia</td>
<td>$Z = -4.46+8.81$</td>
<td>12.41</td>
<td>-2.41</td>
<td>0.999</td>
</tr>
<tr>
<td>Slovakia</td>
<td>$X_1 - 1.12 X_2$</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Mutual Discrimination

We find that the Soviet Union indulges in price discrimination at a micro-level, i.e., at the level of a commodity. While admitting that the East European trade of the Soviet Union may contain "micro-discrimination", Wiles asserts that this does not necessarily culminate in "macro-discrimination". Franklyn D. Holzman, who conceives the Soviet bloc of nations as "a type of customs union", argues that "each member of the bloc tends to discriminate against every other member of the bloc in comparison with treatment accorded to non-bloc nations". Hewett and Boltbo also agree with this argument. It is, however, beyond the scope and intent of the present study to examine this argument in any detail.

Selling to Eastern Europe is one prong of Soviet oil exports; and exporting to the Western markets is another. Though the Soviets lose valuable convertible

60 Wiles, n. 49, p. 227.
currency by selling oil to Eastern Europe, they do derive many economic and political advantages from it. They can use oil as a means by which to further their interests in Comecon. As they attach greater weight to economic and political gain, they may well be content to forgo in some measures the convertible currency that would accrue to them in the event of their selling the same oil to the Western markets instead. There may be another reason why the Soviets are circumspect about stepping up their exports to the Western markets at the expense of their exports to Eastern Europe. It is that any oil that goes into the Western markets may be viewed with suspicion by OPEC, which has a vital interest in controlling the various supply sources of oil. As the Soviet Union is not a member of OPEC, and as it is also a Communist country, many members of OPEC are not friendly in their disposition towards it. However, being the biggest oil-producer and also basically an exporter of raw materials, the Soviet Union is extremely happy about the emergence and functioning of an effective "producer-cartel like OPEC whose avowed objectives include maintenance of vigilance to ensure that there is no decline in the price of oil. It has also benefited from the price hike brought about by OPEC, and it is very cautious lest its export activities should in any way weaken OPEC or attract any retaliatory action on the part of OPEC. It would, therefore, be interesting to examine how Soviet oil is orbiting obsequiously around OPEC.
Soviet Oil and OPEC

Soviet oil was a contributory factor, though rather indirectly, in the birth of OPEC. When the Soviets entered the international oil market in the late fifties, they exerted pressure on the world oil price structure. In order to contain Soviet oil, some of the major international oil companies offered "attractive cuts" in the posted price, causing a decline in the price. The oil-producing countries, unhappy over the fall in the price, decided to prop up the price by concerted action. They formed OPEC with a view to preventing the price from declining further.

Not all members of OPEC are cordial towards the Soviet Union. Whereas Algeria, Iraq, and Libya have friendly relations with the Soviet Union, countries like Abu Dhabi, Kuwait, and Saudi Arabia are conservatives noted for their pronounced anti-Communist stance. Some members have not even cared to establish diplomatic relations with the Soviet Union. The Soviet Union has never been invited to become a member of OPEC, though three exporters not belonging to the Middle East have so far been taken as members.

63 For details, see S. Anochar, The Oil Crisis: End of an Era (New Delhi, 1974), pp. 45-54.
Apart from safeguarding its strategic interests in the Middle East, the Soviet Union is interested in importing Middle Eastern oil. It imports gas from Iran across the frontier at Astara. It has helped Iraq in building the North Rumaila field, which is expected to produce about 40 million tonnes of oil in 1980. Since 1972 the Soviet Union has been buying oil from Iraq and shipping it to the Schwedt refinery in East Germany and the Plock refinery in Poland.

Moreover, in spite of vast industrialization, the Soviet Union is still a major exporter of raw materials and the biggest producer of oil and coal. Hence it stands to benefit from any system that boosts the prices of raw materials, especially of oil.

In 1973, thanks to the price hike, the oil revenues of the Soviet Union increased by nearly $1,000 million. \(^64\) In 1974, the gain was as high as $1,500 million to $2,000 million. \(^65\) In 1976 the total revenues earned by the Soviet Union amounted to $6,700 million. This was double the revenues earned in 1973 although the increase in the total exports was a mere 5 per cent. \(^66\)

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However, the Soviet Union is fully aware that it cannot serve as an alternative to OPEC as a supplier of oil. For one thing, its cost of production is higher than it is in many other oil-exporting countries. Secondly, its reserves are not as enormous as those of the leading members of OPEC. Above all, it has nothing to gain by undercutting the OPEC price. One, therefore, doubts that the Soviet Union would use its sales outside the Comecon to push down the oil price. Prior to the birth of OPEC, whenever the Soviet Union resorted to price-cutting, it justified it in ideological terms, saying that it was doing so to meet the challenge of capitalism. If it does the same thing in the present context, it would find itself involved in a direct clash with the national Governments of OPEC members. It cannot convincingly justify such a step in ideological terms.

The price hike brought about by OPEC has introduced an element of uncertainty in the price. The price is no longer stable, and this renders it extremely difficult for the Soviet Union to make decisions regarding investment for the future. The price hike has increased the spread between marginal cost and price. As the Soviet Union is a high-cost producer at the current price level, it finds it economical to develop some of the oil-fields in West Siberia which were uneconomical in the period prior to the price hike. An OPEC member like Saudi Arabia, which has immense oil reserves and which is not under too much of an economic compulsion to
ensure a high level of oil revenue, can depress the present price level at one stroke. Hence, it is an extremely difficult task for Soviet planners to make any firm assumptions about future price trends in their investment planning. Whether the centripetal force of monopoly profits will override the centrifugal forces of OPEC is another uncertainty. Any collapse of OPEC would totally weaken the newly formed price structure. If the Soviets make investments on the assumption of a high price, they would lose heavily in the event of a precipitous fall in the price.

To provide for the risk the Soviets are seeking long-term contracts with loan guarantees, joint equity participation, and repayment in oil. Loan guarantees are an insurance against being forced to repay loans out of a reduced cash flow in the event of a decline in the price. Joint participation would spread out the "down-side" risk thinly. Repayment of loans in oil in stipulated quantities would implicitly assume the present price for a future delivery.