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NEP Timber Concessions in the 1920s: on the Lack of Profitability Problem

1. Introduction

The Bolshevik Revolution of November 7 1917 (the new calendar) led to civil war and a type of regime referred to as war communism. Economically, war communism was a catastrophe. In facing this, men in power landed on what was called New Economic Policy (NEP), including mechanisms such as found in a market economy. In cross-

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border operations, beyond what were simpler market transactions, western business interests were welcomed in being offered concessions. Concessions were contractual arrangements by which western parties, given specific obligations, were offered concessional favors. In two classic contributions by Sutton (1968) and Jungar (1974), overviews over NEP timber concessions are included. Sune Jungar pointed to the problem of profitability, and came with the observation (translated) that "the circumstances behind the lack of profitability are less than clear". The aim of the paper offered is to contribute with elements of an analysis of this problem.

In Section 2, the necessary background on the general setting, and on the mixed concession companies Russangloles, Russhollandoles and Russnorvegøles that are focused, are included. In Section 3, a presentation is offered of how, soon after starting up, it became clear that lack of sufficient profitability was a problem that had to be faced with, in some way or other. In Section 4, sales prices and the costs of operation are discussed. Export sales were in foreign currency, and most of the costs were in ruble, and in Section 5, the exchange rate problem is discussed. In Section 6, some concluding remarks are included.

2. Background

On the 10th Congress of the Russian Communist Party held March 8-16 1921 in Moscow, Lenin officially introduced NEP. Due to all what came along with the Bolshevik Revolution, foreign trade relations suffered, and it was an ambition of NEP to bring about some sort of normalization. The prominent Bolshevik Leonid B. Krasin (1870-1926) was in late 1918 appointed People's Commissar for Trade and Industry and became important in what was to come¹. Our focus is on the timber business and its role in early NEP due to that priority was given to a restart of the timber export. Semyon Lieberman (1881-1946), who in 1926 decided to stay in the west and westernized to Simon Liberman, was central in this. Under war communism, even not a Bolshevik, Lieberman became a very influential timber expert based in particular on his ability to organize and secure provisions of firewood. Without access to coal from Donbas, this was important to keep trains running. Krasin was also People's Commissar for Transport and this brought Lieberman into contact with Krasin. August 17 1921, Severoles (State Timber Trust of the Northern White Sea District) was established². According to the memoirs of Liberman (1945:99), Lieberman played an important role in this. Severoles was the first trust established

and a model for other and later establishments of state trusts in the Soviet Union. In Danishevsky (1923a) (President of Severoles), and in Lieberman (1923a) (Managing Director of Severoles), optimistic pictures of the company's prospects were presented. In addition, Saitzev (1923) (board member of Severoles) came with interesting observations on Onega operations. Concessions such as Russangloles, Russhollandoles and Russnorvegoles were mentioned and they are focused on in what is offered in the present work.

With Severoles, an entity was established that could enter into partnership with western parties. This was the idea behind the so-called mixed companies that were offered concessions. These companies were formed in the west and jointly owned by Soviet and western interests, often at a 50/50 percent basis. Most likely, Russangloles was the first company of this kind³. The western partner of Russangloles was London & Northern Trading Co., in what comes simply referred to as L&N. L&N was controlled by the brothers Lipman and Mark (Morduch) Schalit⁴. According to Sutton (1968), L&N was formed September 20 1919 with 1 million pound in owner's capital. The history, brought forward to our days, is that this impressing amount was proceeds from export sales from before the Schalits were forced to flee from Riga due to the Bolsheviks. After much trouble arriving in London, all this waited for them at their London bank. In a similar manner as Russangloles, Russhollandoles was formed in the spring of 1922 with Dutch Altius & Co. as main western party⁵.

For several reasons, such as discussed by Lundesgaard and Tevlina (2015), Russnorvegoles is of particular interest. Important is the richness of sources, first explored by Astrup (2011/2012) and then by Lundesgaard and Tevlina (2015). In the history of Russnorvegoles, the Norwegian officer and businessman Frederik Prytz (1878–1945) played an important role. From 1909 to 1917, Prytz established himself as a central person of Norwegian based timber interests in the White Sea area. Important for this is Russia based Prytz & Co. that he successfully built up. On a stay back in Norway, he saw the possibilities that flotation could bring about, given a booming stock market. Prytz & Co. became Norway based and listed Russian Forest Industry/RFI (Russisk Skogindustri A/S). With Prytz as director, the company was floated with success in April 1917. With the Bolshevik Revolution, the prospects of RFI were fundamentally altered. Under challenging circumstances, operations went on until that the delayed nationalization of March 1920 came about in the north⁶. What followed for Prytz was a

period of wait and observe. Central in working for Norwegian interests in Russia, he was invited in to take part as delegate to international conferences. Prytz was able to bring himself into contact with prominent representatives on the Russian side such as Krasin⁷.

In the summer of 1922, in bundling their interests in what was named the Onega Combine (1922), part taking western interests established an understanding on what they were faced with. In the autumn, a detailed declaration of intentions was signed between Severoles represented by Lieberman, and the western interests represented by Prytz, see Severoles/Onega Combine (1922). During the summer of 1923, the Soviet Government sanctioned an extensive concession contract with Russnorvegoles (1923a), formally concluded with the Main Concession Committee (here referred to as Main CC). The company was formally formed in August as a Norwegian LLC (Limited liability company). This with constituent assembly and seat in Oslo (then Kristiania), see Russnorvegoles (1923b/1923c). In English, the company was named Russo-Norwegian Onega Wood Company Ltd. As natural for the kind of activities planned, perspectives were long term. In the concession contract, it was said that the concession is for twenty years with prolongation mentioned as an eventuality. In forming Russnorvegoles, Russangloles and Russhollandoles functioned as models. At the time of the establishment, the distribution of interests among the western parties was unsettled. After a painful arbitration process, interests were equally divided. That is, between Altius & Co. of Amsterdam, Bache & Vig/Bache & Wager jointly of Norwegian Drammen, and RFI⁸.

Stipulated in pound sterling (British pounds), the shareholders' capital was set to 300,000 pound. The capital was provided in kind, being previously nationalized stocks of timber. What in modern accounting terminology is plant, property and equipment/PPE (i.e. physical capital invested with more than a short term perspective) continued to be nationalized and was placed at the disposal of Russnorvegoles on a rental basis. This amounted, quite favorably, to 0.5 percent of proceeds from sales. In Section 6 of the concession contract, a complex scheme based on stumpage fees was included, stating what had to be paid for logs. In addition, we have the costs of logging and floating timber, operating the sawmills, shipping, expenses associated with taxes and more. Obviously, the presence of variable costs was more important than what is the case under more ordinary circumstances.

Russnorvegoles started out more or less void of cash. The need for this was met with loans obtained in the City of London from what seems

to be a medium-sized, respected merchant bank house. That is, Wm. Brandt's Sons & Co. to which Prytz established contact⁹. L&N's later close contact to Russnorvegoles, and to Prytz, started out with L&N's contribution to an introduction to the Brandts and with a loan guarantee against commission¹⁰. As we see, Russangloles, Russhollandoles and Russnorvegoles were interlinked. In addition, toward the end of the history of Russnorvegoles, the owner of Russangloles L&N became the major and almost single western owner¹¹.

3. Soon, profitability was a problem

Prytz was the natural candidate to the managing director position of Russnorvegoles. Soon, he was faced with a situation very different from that of his pre Soviet experience. That is, a lack of profitability that was sufficiently serious to threaten the existence of the venture. Obviously, Russangloles and Russhollandoles were faced with the same problem. In May 1925, Krasin is jointly approached, first in meeting Krasin in Paris and then in written. For this, see Prytz (1925:4-6) including a letter to Krasin dated May 19 1925, from the three concession companies focused in this work. A personal relation established on international conferences at which Prytz was present, must have contributed to that Krasin was approached¹².

The approach of Krasin was less well directed, due to that concession companies were overseen by the Main CC. Nevertheless, Prytz (1925) is of interest in including a presentation of the profitability problem. After 18 months of operations, and as more than a problem associated with starting up, Russnorvegoles was more or less massively unprofitable¹³. What could amount to a loss around 20 percent was suggested, and a discussion of the factors contributing to this was presented. That is, factors such as sales prices, the exchange rate, productivity in operations, and other factors determining costs of production¹⁴. In the next two sections, elements of an analysis of this are offered.

4. Sales prices and costs of operations

First, sales prices of imported sawn good at the important British market are analyzed. Material from the Forestry Commission (1930:64-67) is taken advantage of and what is found are the sums of three categories of sawn softwood volumes for 1920 to 1929 reported in loads (50 cubic feet). In addition we have the corresponding values for these volumes in loads. In dividing values by volumes, we have a price series in decimal pounds per load of

11.68 (1920) 6.59 (1921) 5.24 (1922) 5.70 (1923) 5.35 (1924)
4.87 (1925) 4.59 (1926) 4.69 (1927) 4.65 (1928) 4.55 (1929).

Loads multiplied with 3.3 gives the (St. Petersburg) standard (4.672 cubic meters), see Jennings (1955). In taking advantage of this (with full decimals), pounds per standard are

38.55 (1920) 21.74 (1921) 17.28 (1922) 18.80 (1923) 17.24 (1924)
16.06 (1925) 15.16 (1926) 15.46 (1927) 15.36 (1928) 15.02 (1929).

For 1920-25, this corresponds pretty well with the picture reported by Prytz (1925). His pessimistic views are confirmed by what comes after 1925. Prytz refers to a pre-war price of 10 pound per standard. In taking advantage of price index series published by the House of Commons Library (1999), a picture of relative prices in Great Britain is established. A pre-war price level of 10 pound is set equal to hundred. This leads to (again with full decimals, with pounds per standard price level adjusted)

15.00 (1920) 9.24 (1921) 8.55 (1922) 9.86 (1923) 9.35 (1924)
8.47 (1925) 8.08 (1926), 8.43 (1927), 8.37 (1928) 8.28 (1929).

A generally held opinion is confirmed, after the post-war boom comes a lasting downturn.

In addition, labor relations were something else than what the western concessioners were used to, see for instance classics such as Zagorsky (1930) and Carr (1958) Chapter 7. Important for the Soviet regime, what had to do with labor relations now included trade unions and complex regulations such as described by Abrahamsen (1964). This led to added costs in ruble of operating in the Soviet Union. For costs associated with operations, important is what a given output needed of input factors. That is, the more technical aspects of the value creation process such as including productivity characteristics. It is registered that Saitzev (1923) pointed to that the Onega location was demanding. Next, we have the question of what was paid for input factors. For the kind of activity focused, the workforce factor played an important role. Of course, in addition and as part of the total cost picture, came all sorts of costs of more indirect character. It is interesting that from Danishevsky (1923b) and Lieberman (1923b) it is clear that Severoles was faced with the same sort of challenges as those pointed to by Prytz (1925). Whether costs in ruble were per se (as such) high, or less high, is a difficult question. Anyway, given net proceeds from sales in pound, and costs in ruble, profit/deficit and thus profitability, was something that in the end was determined by the exchange rate.

5. *The monetary reform and the exchange rate*

In the letter to Krasin referred to, it was pointed to “[t]he high rate of exchange of the Tchervonetz [chervonetz], which is not in any reasonable proportion to the purchasing power of the Tchervonetz in Russia”¹⁵. This contributed to high costs of production, and the problem was an important one. This has to do with how the currency issue was faced with by the authorities in implementing NEP. Under war communism, the sovznak (the first ruble of the regime) was printed when needed with all this led to. The currency circulated did not efficiently fill the function of medium of exchange, unit of account and store of value. That is, with damaging effects for the functioning of the economy. In facing this, inspired by its imperial, Tsarist forerunner, but not copied, elements of central banking were reintroduced in establishing the Gosbank (Gosudarstvenny bank) October 3 1921. In creating a new currency, a prestigious coinage/currency unit from Imperial Russia was taken advantage of. That is the chervonetzy, from end of November 1922 on brought out into the economy¹⁶. The chervonetzy was given the appearance of being gold-backed in some way or other¹⁷. Russnorvegoles was formed 1922-23, and Russangloles and Russhollandoles before that. That is, it is unlikely that the western parties were able see what all this could lead to. Most interestingly, for some time the chervonetzy and the sovznaks functioned in parallel with an exchange rate between the two that varied.

As part of the reform, a new ruble was introduced so that 10 rubles were equal to one chervonetz. In May 1924, with the end of the monetary reform, the history of the sovznak came to an end and was so fixed so that this led to what Prytz pointed to. That is, investment by foreigners, and exports, were made less profitable, or even unprofitable. Whether this came about intentionally, or simply were a secondary effect of the monetary reform process adopted, is an interesting question¹⁸. Anyway, and as documented among others by Barnett (1993) and Goland (1994/2007), after the fact, the exchange rate question was intensively discussed in the Soviet Union.

6. *Concluding remarks*

Of course, for a business it is not possible to live on with deficits. The concession companies focused were loss making due to a series of factors. The relative importance of these factors raises the question of relevant reference points. A reference point could be conditions before the war. Along all dimensions, conditions were less favorable, and it

is registered that the study of this can be carried further than what is offered.

An obvious speculation is whether the involved parties, and in particular the western ones, would have established the venture, given what Prytz (1925) reports. The specifics of forming Russnorvegoles were worked out over a short period from the summer of 1922 to the next summer. For Russangloles and Russhollandoles, the forming process could have been even shorter. It was difficult to establish a clear picture of the economy of what was planned. Moreover, it is an observation that given the booming expansion of the White Sea pre-war timber business, in addition to that NEP pointed in direction of more normal business conditions, it is likely that the problem of profitability was not examined more intensively.

In the literature concerned with NEP timber concessions, the importance of these concessions has been discussed. Much points in the direction of a limited importance. However, and mentioned in the literature, and in being the first out, the timber concessions contributed the sort of normalization between the Soviet Union and the west that came about.

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Notes

1. Krasin is portrayed in Liberman (1945). This in addition to by his wife Lubov Krasina (1929), read with advantage in having Watson (1989) at hand.
2. See, Jungar (1974) p. 162.
3. In *Financial Times* on February 13 1922, it was announced that Russangloles has been registered with an owner's capital of 150,000 pound. Registration came as a result of an agreement of December 31 1921 between Krasin, Severoles and London & Northern Trading Co. See, Sutton (1968) pp. 151-152 for added details.
4. Mark Schalit died in 1935 (see, *Financial Times* February 26 1935) and Lipman Schalit died in 1939 (see, *Financial Times* February 9 1939). Mark was referred to as managing director and Lipman as chairman (former).
5. See, Sutton (1968) p. 154. The stipulated owner's capital of Russhollandoles is not mentioned and is difficult to find in other sources.
6. All along, as seen from discussions of Goldin (1993/2000a/2000b), the situation in the Russian North is difficult and complex.
7. Notes by Prytz' wife Caroline Prytz (1888-1972) are interesting in shedding light on the life of Prytz, see Prytz (1978/91). A personal relation to Krasin dating back to the Genoa conference April-May 1922 is pointed to.
8. After the Onega Combine agreement of June 6 1922, and before Lieberman and Prytz on October 21 1922 concluded on intentions, Dutch Altius & Co. entered the picture. Altius & Co. took over Onega Wood Company owned by the Clark brothers, see Astrup (2011:29).
9. It is clear from both Soviet and western sources that the Brandts in addition acted as sales agent for Russnorvegoles. The Brandts came from Germany and the bank's origins went back to the beginning of the 19th century. As to lines of activity, the house was oriented in direction of Russia and Eastern Europe including activities associated with the timber business.
10. For this see a draft or copy of a letter in the spring of 1924 from Prytz to L&N in the Prytz Archive.
11. 12 This was associated with intricate currency arrangements that brought L&N and Prytz into intimate contact which each other. For documentation of this, see Lundesgaard and Tevlina (2015).
12. For several reasons, the approach of Krasin was somewhat misdirected. First, Russangloles, Russhollandoles and Russnorvegoles were overseen by the Main CC and this authority was the correct addressee for an approach. In accordance with this, Krasin sent the problem over to the Main CC with a short note dated June 1 1925, see Xromow (2006:169). Second, at the time of the approach, Liberman (1945:168-169) was of the opinion that Krasin's political

position was less secure, and as well known, this was associated with being faced with very demanding and time-consuming questions of both foreign and internal trade. Third, ill with leukemia Krasin was hospitalized in Moscow in the autumn of 1925. October 30 1925, his mission to Paris came to an end. Confronted with additional hardships in living up to a position, he was again appointed to London. According to Lieberman, in returning to the west "he resumed none of his old activities". Krasin died November 24 1926 in London.

13. 14 Astrup (2011:41) includes an interesting summary of financial reports of Russnorvyeoles. It is clear that the less favourable factors such as referred to by Prytz (1925), all the way, led to a very difficult financial situation for the company.

14. It is clear that Prytz was of opinion that working conditions would have to be repositioned politically. Understanding that Main CC had to be addressed directly, this was done in August 1925.

15. See, Prytz (1925) p. 4.

16. See, Carr (1952) p. 358.

17. See, Barnett (1994) for a discussion of this.

18. The analysis of this is more demanding. Even Arnold (1937) does not have a clear answer to the question.