CHAPTER 3

Integrated Firms in a Dual Market

Introduction

Between 1912 and 1937, the Yangzi Delta experienced a process of rapid industrialization. At the eve of the Japanese occupation, the regional economy of the Jiang-Zhe area (covering the provinces of Jiangsu, Zhejiang, and the city of Shanghai) was only comparable to Japan and was the second most industrialized region of East Asia. However, the rest of China did not follow the same path and, despite the efforts of Republican China to modernize its economy, it remained rural and poor. In 1933, per capita GDP of China was USD 578 while Japan’s was 2,129. One of the most striking elements of this process of industrialization is that the largest contributor to China’s industrial growth—a growth rate that averaged 8 percent annually between 1912 and 1936—was the textile sector of the Yangzi Delta. Ironically, cloth consumption per capita for the Chinese population fell during this same period. The fragmentation in the Chinese market explains this “dual economy,” where regional industrialization contrasted with the rest of the country.

The Chinese official history attributes this unequal development to speculation and the imperialistic character of the compradore class, while the rest of the country remained under a feudalistic yoke. Other literature, however, tries to find institutional constraints in the state, or in the structure of Chinese firms, to explain the lack of development and the failure of strong spillover effects. Surprisingly, interfirm relations and the situation of consumer markets have received scarcer attention, although both are fundamental to the economic performance of a modern industry. Industrial production requires regular supplies and expansive markets, so that costs of production and sales can be predicted. These conditions can be secured outside the country, as in the case of the British cotton industry, or by expanding domestic markets, as it happened in the United States. But the existence of regular supplies and an expanding consumption market is a sine qua non condition for sustaining
economic growth that is driven by industrialization. However, in China it became very difficult for industrial entrepreneurs to consolidate supply chains and develop stable consumer markets. During this period they vacillated between a fragmented domestic market, foreign trade, and the urban consumers of the Yangzi Delta.

The fragmentation in the Chinese market hindered the penetration of all industrial goods to the interior of the country, where domestic traditional handicraft proved to be very flexible and adaptable. This explains why, in 1937, traditionally made yarn still represented one fourth of the total Chinese market—despite machine spinning being 44 times more efficient than manual spinning—whereas domestically made clothes still had a dominant share. In the poorer areas, peasant families kept spinning and weaving for self consumption, whereas industrial goods were neither available nor competitive. The fragmentation in the Chinese market can also be assessed by the price divergence between regions of staple products, such as raw cotton or rice. Therefore, industrial goods were concentrated in Shanghai and the Yangzi Delta region, while it was difficult to move them beyond the framework of the treaty ports and the Yangzi river basin.

Meanwhile, in the Yangzi Delta, the war on prices, raw cotton shortages, cut-throat competition, and speculation created recurrent crisis that affected margins, liquidity, and solvency of cotton firms during the 1920s and 1930s. In 1920, imports of cotton goods to China reached their historical peak, coinciding with the rise of the machinery trade and the world’s cotton industry climacteric. Due to its geography, Shanghai and the Yangzi Delta had easy access to both foreign and domestic trade, so most of the industries, importers, and distributors were concentrated there, especially in Shanghai. Therefore, competition was fierce in highly volatile markets and the benefits were more the result of the changing conditions of the domestic and international markets than the outcome of productivity or of a long term rational strategy.

According to a foreign expert, the perspective of Chinese textile firms in the region was hazardous: “it will depend upon the luck or otherwise in the purchase of the raw material whether the mill makes a profit or a loss.” Despite being the world’s third largest producer, the supplies of Chinese raw cotton to the Yangzi Delta region were uncertain and the short staple of the domestic cotton forced Chinese firms to combine local cotton with imported one. Raw cotton represented around 80 percent of the production cost of a cotton yarn. The price of raw cotton almost doubled between 1913 and 1930, creating huge cost pressures upon textile companies. The price of yarn also doubled but not without strong fluctuations and setbacks. Vertical integration was a way of avoiding the volatility of prices by producing more