Globalization, Market Transition, and Variety of Developmental Models: A Comparison of
Four Automakers in the Chinese Car Industry

by

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Department of Sociology
Duke University

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Nan Lin

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David Soskice

Dissertation submitted in partial fulfillment of
the requirements for the degree of Doctor
of Philosophy in the Department of
Sociology in the Graduate School
of Duke University

2009
ABSTRACT

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Abstract

The Chinese automobile industry has been experiencing some profound changes during the market transition and globalization. Regarding to the ownership structure and technological upgrading strategies of the domestic assemblers, there have emerged four major developmental models. Transitional theoretical perspectives have limitations in face of these differing models. In this study, a perspective of social construction is proposed to resolve this research question. This dissertation explores four representative cases including FAW, SAIC Group, Chery and Geely. The major argument is that the local political structure, developmental ideas and agencies as necessary components of local social construction have resulted in the divergent paths among these Chinese car makers.
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List of Abbreviations

Beijing Automobile Factory (BAF)
Beijing Automobile Industry Holding Corporation (BAIC)
Center of Development Research of the State Council (CDRSC)
Changchun Automobile Research Institute (CARI)
China Association of Automobile Manufacturers (CAAM)
China Automotive Industry Federation (CAIF)
China Automotive Technology and Research Center (CATRC)
China Central Television (CCTV)
China National Automotive Industry Corporation (CNAIC)
Committee of Shanghai Automobile Industry History (CSAIH)
Committee of Shanghai Automobile Industry Record (CSAIR)
Committee of Shanghai Local Record (CSLR)
Committee of Shanghai Fiscal and Taxation Record (CSFTR)
Committee of Shanghai Yearbook (CSY)
Communist Party of China (CPC)
Completely Knock Down (CKD)
Daimler Chrysler (DC)
Department of Land and Resource (DLR)
Development Research Center of the State Council (DRCSC)
Dongfeng Motor Corporation (DMC)
Economic and Trade Commission (ETC)
Editorial Committee of History of China Automotive Industry (ECHCAI)
Factory Director Responsibility System (FDRS)
First Auto Works (FAW)
Five Year Plan (FYP)
General Motors Corporation (GM)
Great Wall Motor Corporation (Great Wall)
Guangzhou Automobile Industry Group Corporation (GAIG)
Hafei Automobile Group (HAG)
History and Record Office (HRO)
Jiangxi Changhe Automobile Corporation (JCA)
Leading Team of the Development of Shanghai Car Industry (LTDSCI)
Ministry of Heavy Industry (MHI)
Ministry of Machinery Industry (MMI)
National Economic Commission (NEC)
National Planning Commission (NPC)
National Development and Reform Commission (NDRC)
Original Brand Manufacture (OBM)
Original Design Manufacture (ODM)
Original Equipment Manufacture (OEM)
Peugeot Citroën (PSA)
Proper Glory Corporation (PG)
Research and Design (R&D)
Second Auto Works (SAW)
Shanghai Automotive Corporation (SAC)
Shanghai Automobile Factory (SAF)
Shanghai Automobile Industry Corporation (SAIC)
Shanghai Automobile Industry Corporation Motor Corporation (SAIC Motor)
Shanghai Automobile Industry (Group) Corporation (SAIC Group)
Shanghai Automobile Industry Technology Center (SAITC)
Shanghai Economic Committee (SEC)
Shanghai State-owned Asset Supervision and Administration Commission (SSASAC)
Shanghai Tractor and Automobile Industry Corporation (STAIC)
Shanghai Tractor and Automobile Industry Coordination Corporation (STAICC)
Sino-Soviet Friendship Association (SSFA)
Sport utility vehicle (SUV)
State-owned Asset Supervision and Administration Commission (SASAC)
Research Team on Taizhou Private Economy (RTTPE)
Tianjin Automobile Industry Corporation (Tianjin Auto)
Volkswagen (VW)
Wuhu Construction and Investment Corporation (WCIC)
Wuhu Economic and Technological Development Zone (WETDZ)
Yuejing Automobile Group (YAG)
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1. Introduction

The recent rise of China in the global economy has attracted growing attention among social scientists. Since the start of market reform and economic opening in the early 1980s, the Chinese economy has maintained high and persistent rates of growth. Behind this fast economic development lie close connections to increasing globalization and great transformations of economic institutions in China. With respect to these profound changes, one of best illustrative examples might be the automobile sector.

The Chinese automobile industry in the post-reform period indeed presents a very impressive picture of structural transformation and economic growth. In early 1980s, the national output of automobiles in China was only 0.2 to 0.3 million; Output reached over one million by 1992. As can be seen from Table 1.1, Chinese automobile output has increased over four times, from 1.63 million in 1998 to 7.19 million 2006. Of special note, from 2001 to 2006, the annual increase was approximately as many as one million vehicles (CATRC and CNAIC 2007). This quick output growth led China to a global position as the third largest automobile-making country, following only Japan and United States (Table 1). This burgeoning production is mainly driven by passenger cars. In the early 1980s, cars occupied less than 1% of total production. By comparison, in 2006 the proportion of cars increased to over half of automobile production. Additionally, in 2006, with a total sale about 7 million vehicles, China replaced Japan as the world’s second largest automobile market, following only the United States.

The growth of the Chinese automobile industry not only mirrors the rise of China in the global economy since the 1980s, but also points to some essential characteristics of Chinese economic development during this period.

On the one hand, the development of the Chinese automobile industry is closely associated with the globalization of the world automobile industry. With regards to the global
automobile trade, a pattern of “large import and large export” has taken form in China since the late 1990s (Figure 1). In 2006, automobile imports and exports exceeded 20 billion US dollars. By comparison, total imports and exports in 1981 were less than 4 billion (CNAIC 1991; CATRC and CNAIC 2007). In terms of foreign investment, after VW first established a Chinese joint venture in 1985, all of the other “6+3” international automakers have come to China in succession: GM, PSA, and Honda came in 1990s, while Ford, Toyota, Nissan, BMW, and DC followed in the new century. Accompanying these assemblers are the international suppliers, which follow their major clients for new business opportunities provided by automakers in China. With the increasingly active export of auto-parts recently, China appears to be becoming more broadly integrated into the global automobile production network.

<table>
<thead>
<tr>
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<td>11,024,978</td>
<td>12,472,826</td>
<td>USA</td>
<td>12,279,582</td>
<td>USA</td>
<td>12,114,917</td>
<td>USA</td>
</tr>
<tr>
<td>2</td>
<td>Japan</td>
<td>10,049,792</td>
<td>9,895,478</td>
<td>9,771,191</td>
<td>Japan</td>
<td>10,237,315</td>
<td>Japan</td>
<td>10,286,218</td>
<td>USA</td>
</tr>
<tr>
<td>3</td>
<td>Germany</td>
<td>5,726,762</td>
<td>5,687,692</td>
<td>5,691,677</td>
<td>Germany</td>
<td>3,469,309</td>
<td>Germany</td>
<td>5,506,629</td>
<td>USA</td>
</tr>
<tr>
<td>4</td>
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<td>2,874,864</td>
<td>3,180,103</td>
<td>3,628,418</td>
<td>France</td>
<td>3,701,170</td>
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<td>4,443,685</td>
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<td>3,053,813</td>
<td>3,196,259</td>
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<td>3,206,330</td>
<td>France</td>
<td>3,620,068</td>
<td>Korea</td>
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<td>6</td>
<td>Canada</td>
<td>2,172,662</td>
<td>2,852,389</td>
<td>2,948,888</td>
<td>Canada</td>
<td>3,147,534</td>
<td>Korea</td>
<td>3,377,870</td>
<td>France</td>
</tr>
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<td>7</td>
<td>UK</td>
<td>1,975,637</td>
<td>2,343,114</td>
<td>2,592,742</td>
<td>Spain</td>
<td>2,852,239</td>
<td>Spain</td>
<td>3,029,836</td>
<td>Spain</td>
</tr>
<tr>
<td>8</td>
<td>Korea</td>
<td>1,934,494</td>
<td>1,973,519</td>
<td>2,374,440</td>
<td>Canada</td>
<td>2,629,437</td>
<td>Canada</td>
<td>2,552,862</td>
<td>Brazil</td>
</tr>
<tr>
<td>9</td>
<td>Italy</td>
<td>1,692,737</td>
<td></td>
<td></td>
<td>Mexico</td>
<td>1,817,237</td>
<td>Mexico</td>
<td>1,804,670</td>
<td>Brazil</td>
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<tr>
<td>10</td>
<td>China</td>
<td>1,637,829</td>
<td></td>
<td></td>
<td></td>
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<td></td>
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<td></td>
</tr>
</tbody>
</table>

Source: Organisation Internationale des Constructeurs d’Automobiles (OCIA)

The term of “6+3” is always used to describe the current major automakers in the world, in which GM, Ford, DC, VW, Toyota, and Renault-Nissan as the six largest ones make up the “6”, while PSA, Honda and BMW are the “3”.

2
On the other hand, the Chinese automobile industry is a model case that reflects unique characteristics of economic reform as it evolves in China. As a sector indispensable for multiple heavy industries, the automobile industry was emphasized by national leaders from the very beginning of the planned economy era. In consequence, the automobile industry intensively reflected the institutional essentials of the planned economy system; Automobile enterprises became order-receiving factories, owned and directly managed by central or local governments; Within these enterprises, the party committee as a political organization operated at the helm of administration. Enterprises, in such an economic system, barely enjoyed any autonomy and were merely tools to fulfill production tasks sent from above (Appendix I).

However, during the period of economic reform, the Chinese automobile industry was greatly renovated. With respect to the macro level issue of management mechanisms, the top-down command system was perceived to be completely broken: at the beginning of the reform, the central government tried to establish a large association-like corporation to organize national automakers; next, the automobile industry was handed over to a non-specialized administration, STEC; recently, STEC was replaced by NDRC as a general planning institution for the national economy (Appendix II). At the micro level, modern enterprise institutions have been applied: The
state gradually transferred autonomy away from the central government, which allowed enterprises to carry out management and placed the factory director over the party committee as the head administrator. From the 1990s, the state further shaped these enterprises into corporations similar to those in other market economy countries by refining the ownership and governance structures that regulate these companies. In sum, the Chinese automobile industry has been transformed into a sector resembling the modern market economy.

1.1 The Puzzle of Differing Developmental Models

Due to the uniquely important role of the automobile industry in China’s national economy and the significant impacts of China on world automobile production and consumption, the development of the Chinese automobile industry since the 1980s certainly deserves public attentions. Moreover, the comprehensive industrial advancement, close associations with current globalization, and complicated institutional transformations associated with this industry makes this sector as a particularly valuable mine for social scientists for the exploration of theoretical potentials. Among the myriad, interesting phenomenon appearing during the market transition and globalization of the Chinese car industry, the current project concentrates on interpreting four major developmental models currently employed by the Chinese car assemblers.

In recent years, four development models among the Chinese car makers emerged, which could be delineated via two major dimensions. The first is the nature of ownership of the automaker. In the context of the Chinese market transition, ownership, as a fundamental organization feature, is a good indicator reflecting who actually control the organization. There are three types of ownership, ownership by the central government, ownership by local governments, and private ownership. The second dimension is the technological strategy implemented by the company, which is defined as whether the automaker sets up joint ventures and introduces foreign
models or practices self-reliant R&D to produce indigenous models. This is a fundamental upgrading decision for any Chinese automaker in the context of globalization.

The implementation of this typology reveals some interesting patterns (Figure 2). Enterprises owned by the central government all cluster within the joint venture category, while privately owned corporations all making national cars. With regard to enterprises owned by local governments, the technological strategy implemented may be either the joint venture builder or the national car maker. Thus, four developmental models across the major Chinese car makers emerge: Ownership by the central government coupled with the establishment of joint ventures as the major technological strategy, enterprises owned by local governments and the establishment of joint ventures, enterprises owned by local governments but producing national cars without joint ventures, and privately owned enterprises producing national cars.

![Figure 2: Developmental Models of Major Chinese Car Makers in Recent Years](image)

Note: Densities in the figure show the relative sale scale of these car makers. The highest to the lowest densities respectively indicate the sale range (unit: vehicles) at 500 thousand and above, 200 thousand to 500 thousand, 100 thousand to 200 thousand, and 50 thousand to 100 thousand.
Figure 3 provides a geographic distribution of these automakers in China. As can be seen from this map, these car makers are mainly located in northeast and southeast China.

![Figure 3: Geographic Distribution of the Chinese Major Car Makers](image)

The model classification presented above needs to be qualified. First, this classification excludes the numerous small car makers in China that produce less than 500 thousand vehicles annually. Many of them have the potential to be listed in the near future, but these small enterprises are omitted in order to focus on the major configurations of the largest car makers in China. Second, the ownership classification in the figure is only meant to indicate major ownership features. That is, FAW is not wholly-owned by the central government or Geely Auto completely private, but these represent the majority positions for these companies. The ownership structure of modern corporations is generally complicated, and to simplify ownership classification may bear certain hazards. However, such simplification straightforwardly contrasts the types of ownership structures present among these enterprises. Third, the categories of technological strategy also require further discussion. When attributing a firm to the joint venture, foreign model category, I do not deny the possibility that the firm conducts in-house R&D aimed at production of national models. However, as with technological strategy, the classification
represents the majority of the firm’s business. For instance, although it mainly uses foreign models to compete domestically, FAW manufactures Hongqi, the most famous national brand. As a national car maker, Brilliance Auto also produces a car model introduced by Toyota and operates a joint venture with BMW. Another case is HAG, which has indeed devoted substantial efforts to make national cars. The reason for its apparent contrary classification is twofold: HAG’s production concentrates on the mini-car, which requires relatively less R&D input; but more importantly, HAG signed a joint-venture memo with PSA and will produce via joint venture in the near future.

This study is meant to decode the above puzzle, what contributed to the variations among the four models in the Chinese automobile industry? Specifically, I explore why enterprises owned by the central government pursue technological advancement or upgrading in the form of joint ventures with global companies, why privately owned enterprises all produce national models born out of indigenous research and development efforts, and why enterprises owned by local governments individually pursue either strategy, why are foreign models not produced by privately owned enterprises, or national models by firms owned by the central government, and both produced by enterprises owned by the local governments? This pattern seems to contradict our expectations, where firms owned by the central government have both the resources and the political will to produce national models. Conversely, private enterprises would be expected to jump into the auto sector where their capabilities would make them competitive, first at the level of production, and not research and design, which is more difficult and risky.

The classification presented above is born from careful investigation of a rather simple inquiry about the Chinese automobile industry, who makes cars in China and how? To answer such a question, a straightforward consultation of a sale-ranking table of the Chinese car market provides a starting point. Table 2 lists all domestic car makers with sales over 50,000 units in 2003. At first glance, these car producers could be dichotomized: Shanghai-VW, FAW-VW, and
Shanghai-GM are China’s “Big Three”, together responsible for about 40% of domestic sales; The next eleven car makers responsible for another 40%. However, further observation reveals that each of the big three is a joint venture producing foreign models, as are seven of the next eleven. Thus, as a preliminary response to the “who and how” inquiry, joint ventures are the modal form of production in the Chinese market and foreign models dominant in domestic sales.

Table 2: Car Makers in China with a Sale over 50,000 in 2003

<table>
<thead>
<tr>
<th>Rank</th>
<th>Name</th>
<th>Sale</th>
<th>Market Share (%)</th>
<th>Joint Venture</th>
<th>Product Type</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Shanghai-VW</td>
<td>405,111</td>
<td>19.77</td>
<td>Yes</td>
<td>Foreign models</td>
</tr>
<tr>
<td>2</td>
<td>FAW-VW¹</td>
<td>297,995</td>
<td>14.55</td>
<td>Yes</td>
<td>Foreign models</td>
</tr>
<tr>
<td>3</td>
<td>Shanghai-GM</td>
<td>201,188</td>
<td>9.82</td>
<td>Yes</td>
<td>Foreign models</td>
</tr>
<tr>
<td>4</td>
<td>Tianjin FAW Xiali</td>
<td>117,335</td>
<td>5.73</td>
<td>No</td>
<td>Foreign models</td>
</tr>
<tr>
<td>5</td>
<td>Guangzhou-Honda</td>
<td>117,180</td>
<td>5.72</td>
<td>Yes</td>
<td>Foreign models</td>
</tr>
<tr>
<td>6</td>
<td>Dongfeng Peugeot Citroën</td>
<td>103,126</td>
<td>5.03</td>
<td>Yes</td>
<td>Foreign models</td>
</tr>
<tr>
<td>7</td>
<td>Chana-Suzuki</td>
<td>100,018</td>
<td>4.88</td>
<td>Yes</td>
<td>Foreign models</td>
</tr>
<tr>
<td>8</td>
<td>Chery Auto</td>
<td>90,387</td>
<td>4.41</td>
<td>No</td>
<td>National models</td>
</tr>
<tr>
<td>9</td>
<td>Dongfeng-Nissan</td>
<td>65,126</td>
<td>3.18</td>
<td>Yes</td>
<td>Foreign models</td>
</tr>
<tr>
<td>10</td>
<td>FAW Hainan Mazda</td>
<td>53,128</td>
<td>2.59</td>
<td>No</td>
<td>Foreign models</td>
</tr>
<tr>
<td>11</td>
<td>Beijing-Hyundai</td>
<td>32,128</td>
<td>2.54</td>
<td>Yes</td>
<td>Foreign models</td>
</tr>
<tr>
<td>12</td>
<td>Geely Auto</td>
<td>51,741</td>
<td>2.53</td>
<td>No</td>
<td>National models</td>
</tr>
<tr>
<td>13</td>
<td>FAW Car</td>
<td>51,266</td>
<td>2.50</td>
<td>No</td>
<td>Foreign models</td>
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<tr>
<td>14</td>
<td>Dongfeng Yueda Kia</td>
<td>31,741</td>
<td>2.49</td>
<td>Yes</td>
<td>Foreign models</td>
</tr>
<tr>
<td></td>
<td>Total of above</td>
<td>1,710,937</td>
<td>83.52</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: CATRC and CNAIC 2004

However, if attention is constrained to the domestic automakers, the image becomes much more complicated. In the above sale-ranking list, largest, Shanghai-VW, and the third largest, Shanghai-GM, both belong to a single corporation, SAIC Group, which is now the largest car manufacturer in China. Likewise, FAW-VW, Tianjin FAW Xiali, FAW Hainan Mazda, and FAW Car are either wholly-owned subsidiaries or majority controlled companies of FAW, the oldest Chinese automobile enterprise. To compare these two giants standing behind the listed car-making firms illustrates some interesting results. First of all, both are state-owned corporations, however FAW is directly owned by the central government, which I refer to as a “central
enterprise”, while the SAIC Group is a local government owned corporation belonging to the Shanghai municipal government. Second, as evidenced by Table 2, SAIC Group utilizes the introduction of foreign models via joint ventures as its major technological upgrading strategy. Although three of the four FAW’s affiliates seem not to use joint ventures, the technological upgrading method of FAW indeed has a lot in common with SAIC Group. FAW’s largest car corporation, FAW-VW is a typical joint venture between FAW and Volkswagen. FAW Car and FAW Hainan Mazda, two other affiliates, are actually joint ventures in the making between FAW and Mazda. The last, Tianjin FAW Xiali, formerly Tianjin Xiali, is a special case. As early as the mid-1980s, based on a technological transfer agreement, it started to produce a mini-car model provided by Daihatsu, a Japanese car maker currently affiliated with Toyota. In 2002, this enterprise was incorporated into the comprehensive joint venture project between FAW and Toyota.

SAIC group and FAW are indeed very representative among the other listed corporations, not because they together hold about 60% of total market share, but because their ownership nature and technological strategy are prevalent across other listed corporations. Similar to the relationship between Shanghai-VW, Shanghai-GM, and SAIC Group, the joint venture of Guangzhou-Honda is affiliated with GAIG as a locally state-owned corporation of Guangzhou city; Beijing-Hyundai is a joint venture established by BAIC, which is owned by the Beijing municipal government. On the other hand, FAW also has corporations for which it is representative. DMC is a central enterprise standing behind the joint ventures Dongfeng Peugeot Citroën, Dongfeng-Nissan, and Dongfeng Yueda Kia. Chana-Suzuki is a joint venture established by Chana Auto as a central enterprise. Finally, there remain two critical outliers among the top fourteen auto producers, Chery Auto and Geely Auto. Chery Auto is a newly-emerged Chinese car maker, directly owned by the local government of Anhui Province. The uniqueness of Chery relies on the fact that Chery is not a joint venture and only produces national cars for the market.
The other outlier, Geely, is a national car manufacturer as well, but unlike the state-owned Chery, it is a private-owned corporation.

Is the pattern in 2003 only a temporal phenomenon? The answer is a big no. Throughout the early years of the new century, the market sale hierarchy shown by the year of 2003 was not special, but rather representative. From 2003 to 2007, most of these auto companies consistently remain in the list of producers with annual sales of over 50,000 vehicles annually. A few minor changes are present: a few car makers have formed agreements with new foreign partners, for example, the joint ventures between DMC and Honda, GAIG and Honda, and Chana and Ford; There are a few new incomers joining this group, such as HAG, JCA, Brilliance Auto, BYD Auto and Great Wall. Therefore, a stable list of major corporations exists for this industry, which provides the study with a solid basis for the classification map present above.

1.2 Literature Review

1.2.1 Specific Studies about the Chinese Automobile Industry

This research makes an important contribution to the well-established literature on the Chinese automobile industry. The classics of this field include two comparative studies. In 1995, Eric Harwit published a book discussing several early joint venture projects across China, such as Beijing Jeep, Shanghai-VW, Guangzhou-Peugeot and Panda Motors. Harwit explored the decision-making process present in the Chinese automobile sector and involved government actors. By thoughtfully examining the politics within the ministries of the central government and between the central and local political bodies, Harwit explained the difference in policy outcomes around these joint venture projects. In his interpretation, the roles of perceptions among national or local leaders and the bureaucratic standard operation system were highlighted. A second classic work is the recently-published study by Eric Thun (2006), which systematically examines major Chinese car joint ventures in Shanghai, Beijing, Guangzhou, Changchun and Wuhan. Thun
applied local institutional structures as his main theoretical perspective, namely the relationship between local governments and business groups, to explain variation in performance across different local joint venture projects. Thun clearly emphasizes local government, investigating how these local political agents interacted with the central administration and global actors, which in turn further shaped the development of local automobile corporations.

Although these two studies offer substantial insights into the Chinese automobile industry, the current study expands their scope through incorporation of the newly emergent developmental patterns represented by the non-joint venture projects. The studies of Harwit and Thun are constraint to joint venture projects and do not observe national car makers such as Geely and Chery, which appear recently. By including these new types of automakers, this study actually addresses a wider spectrum of developmental varieties in the Chinese car industry than are analyzed in previous studies. More importantly, these new developmental patterns may reveal new actors, new decision-making processes and new forms of the role of local governments unobserved in previously analyzed forms, which will improve our understanding of the Chinese automobile industry.

1.2.2 The Market Transition Arguments

In the transition economy literature, the coexistence of different forms of ownership is treated as a common phenomenon within the market transition process. However, the transition economy perspective rarely investigates the association between ownership nature and the technological strategies implemented by enterprises.

The ownership issue is a major topic among transition economy research. On the one hand, some scholars consider the market transition to necessarily assume a privatization process. It was proposed that privatization of state-owned enterprises is the only way out for any command economy system troubled by soft-budget problems (Koinai 1986, 1990). According to this view, due to an inevitable trajectory towards a market economy, the observed diversity of
ownership in a transition economy should be temporary (Nee 1989, 1992). On the other hand, great national variance in ownership transformation in transition economies has been well acknowledged, which shows that ownership evolution might be a more complicated issue (Walder 2003; Walder and Nguyen 2008). For example, in China, fiscal decentralization had led the local governments to assume the central government’s former role as “industrial firms” in local economic development (Oi 1992; Walder 1995). This macro-level decentralization actually generates the co-existence of the local centralization and marketilization (Lin 1995). The second scenario indeed fits better the current status of the Chinese car industry; Although there are privately owned car makers rising up during the market transition, the state-owned enterprises still maintain their positions as the major forces in the market.

However, with regards to the impacts of ownership, most of the interest and effort in the transition economy literature is cast on the issue of enterprise economic performance and consequences brought by market transition. For instance, Bilsen and Konings (1998) show the advantages possessed by the newly-established private firms in job-creation in comparison with the state-owned and privatized enterprises. Frydman and colleagues (1999) identify the positive effect of the outsider’s privatization of enterprises measured by sale revenues, employment, labor productivity, and labor and material costs. By contrast, the technological strategy implemented by enterprises possessing different ownership types is barely addressed in this field.

1.2.3 Perspectives of Technological Upgrading

Researchers from different disciplines have developed numerous interpretations for the variance of technological upgrading among enterprises. However, when applying these views into the current subject, these perspectives all have certain limitations. The case of the Chinese car industry seems to bring forward a challenge for theses perspectives.
The Schumpeter Hypothesis

Economists generally support the proposition that large-sized corporations are more advantageously positioned with respect to technological upgrading. However, in the Chinese car industry, it is the smaller firms that appear more aggressive in the production of national cars.

The usage of firm size in any explanation of differences in performance in technological upgrading has a long tradition in economics. The well-known “Schumpeter hypothesis” proposed that large corporations with monopoly powers in the market are more advantageously positioned to make technical innovations because the abundance of resources and economies of scale enjoyed by these largest corporations could better support risky innovations (Schumpeter 1947). The advantage of large-sized corporations is supported in other classical economics literatures as well. In interpreting the emergence of the Fordist-style organizations after the World War II, Alfred Chandler (1990) argued that the large organizations are more efficient because the efficiency from scale and scope economies could increase marginal returns in production. For theorists of international trade, big corporations are able to strategically take advantage of their monopoly positions in overseas markets (Vermon 1971; Hymer 1976).

Economists have had continuous discussions and debates on the Schumpeter hypothesis. Some studies suggest that a positive impact of firm size on innovation might decline when a certain threshold is reached (Scherer 1965), and some found no disproportional innovative performance for the largest firms (Link 1980). Some scholars have had contradictory findings. Cohen and colleagues (1987) reported that the relation between innovation activities and firm size is very weak. Acs and Audretsch (1991) proposed that small firms are more innovative in terms of the output per dollar of R&D than larger ones. Although it should be acknowledged that small or medium-size firms might be more flexible and efficient in certain R&D activities, especially in the current globalization era, large corporations play the prime role in capital-intensive and
structurally-concentrated sectors (Acs and Audretsch 1987; Koeller 1995). The automobile industry is one of these sectors.

Grounded in the above logic, it is reasonable to expect that larger enterprises will outperform smaller ones in terms of technological upgrading in the Chinese car market. However, the reality is just the opposite; the largest enterprises, such as the “big three” of the Chinese automobile industry, namely FAW, SAIC Group, and DMC, are all slow movers with respect to the production of national cars, while the small ones like Chery and Geely are the most aggressive. Though it might be true that the big three may produce higher quality and more technologically sophisticated automobile products, these enterprises indeed lag behind their smaller counterparts in creating new products.

Global Value Chains

Recent globalization literatures suggest that the affiliation between domestic and transnational corporations could facilitate the technological upgrading of enterprises of the host country. However, the four development models reveal the unexpected reality that the national car makers in China rarely establish joint ventures.

In recent globalization studies, there is a great intellectual shift concerning how to understand the global economy. Historically, the negative side of international economic connectedness was once popular among social scientists. Dependency theory once pinned the status of underdeveloped countries on the exploitation by the industrialized countries through foreign trade (dos Santos 1970; Cardoso and Faletto 1979). World system theory (Wallerstein 1974, 1980, 1989) took the international economy as a hierarchical structure consisting of the core, semi-periphery and periphery; the division of labor among and the “unequal exchange” in the international market between these three areas guarantee the exploitation by the core of the periphery as the hierarchy is reproduced and maintained. Nevertheless these views are seriously challenged by empirical developments recently, where the core and periphery have been both
integrated more tightly and where exchanges between these areas have been transformed qualitatively. In another word, the previous “internationalization,” namely the simple extension of economic activities across the world has been transformed to “globalization,” featured by the functional integration of international economic activities (Dicken 2003; McMichael 2003). A critical feature in this new era is the rise of transnational corporations in the global economy and their indirect command of many economic actors through organized producer-driven and buyer-driven commodity chains (Gereffi and Korzeniewicz 1994).

The positive impacts of the affiliation with transnational corporations on technological upgrading in developing countries are highlighted in current globalization studies. In “value chain analysis” (Kogut 1984; Porter 1985), the “global commodity chain” perspective (Gereffi and Korzeniewicz 1994) and the later “global value chain” approach (Kaplinsky 2000; Gereffi and Kaplinsky 2001), transnational corporations are considered to be key players organizing global production networks, providing crucial upgrading opportunities for the enterprises in developing countries. The prototypical upgrading path follows a sequence of OEM–ODM–OBM (Gereffi 1999; Bair and Gereffi 2002); enterprises in developing countries first become involved in global production chains through narrow competitive advantages like cheap labor, but may develop broader advantages as they master needed technologies and skills through participation.

This theoretical perspective leads us to consider the affiliation with foreign corporation as a critical predictor of technological upgrading among the Chinese car makers. That is, the more connections with foreign corporations, the more likely the domestic automaker would acquire advanced technologies, promote R&D capacities, and develop national brands. However, the Chinese car industry presents a contradictory picture: the car makers closely cooperating with foreign corporation in joint ventures mainly manufacture introduced foreign models, while the independent car makers all produce national cars.
The State-centered Approach

State-centered analyses often promote the role of the state in the acceleration of technological upgrading. But again, in the Chinese car industry, the enterprises receiving the most official support are not those actively practicing independent R&D.

According to statistis, support from and direction by the government can substantially assist the technological advancement of domestic enterprises. In general, support for state intervention in a market economy is uncommon. Neoliberalists believe that state involvement generates inefficiency and rigidities that distort the market mechanism, that the state is incompetent in handling the information problem that arises in the administration of the national economy, and unable to monitor the rent-seeking of its own bureaucrats (Evans 1997; Chang 2003). Nevertheless, critics of the neoliberal perspective argue that the unregulated market alone cannot achieve socially optimal levels of economic welfare, which may lead to a serious crisis for capitalism itself (Sassen 1996; Panic 2007), and that the state serves an important role in the mitigation of the business cycle (Yeung 2000). Moreover, since the market itself cannot resolve the problem of coordination, especially in developing countries where the market mechanism is generally weak, state interventions as an alternative mechanism is needed (Aoki et al. 1998). Some evidence suggests that in the current globalization context, state intervention in these manners may also make these economies better positioned with respect to global competition due to the close partnership with the business community (Weiss 1998).

Following this perspective, state intervention could greatly facilitate technological upgrading. Studies interpreting the economic miracles of the East Asian model are exemplary in this aspect. In 1980s serious economic crisis affected Latin American at the same time as the miraculous economic success among the East Asian “tigers,” underscoring the importance of the state in economic growth and technological upgrading. Scholars proposed that the “developmental state” model present in several East Asian countries led domestic enterprises to
realize technological upgrading through well-designed industrial policies, mitigating the inherent technology and capital disadvantages possessed by these countries (Johnson 1982; Amsden 1989; Wade 1990).

This approach, if applied in the Chinese automobile industry, would produce a clear expectation that the enterprises with state support for technological upgrading may naturally be more advanced in the utilization of these new technologies. But in this case, the enterprises receiving substantial support from the state, such as FAW and SAIC Group, are actually not as aggressive as Chery and Geely in terms national car production.

Across the literatures related to technological upgrading above, an interesting dilemma emerges. Predicted by these three approaches, larger enterprises, more closely affiliated with advanced partners and more official support would have better performance with respect to technological upgrading as measured by innovation and production of national cars. However, what really happened in China is that the disadvantaged firms, those that are smaller, not affiliated with foreign automakers, and those receiving less state support are actually more actively technological in their product offerings; They are the makers of national cars and act more aggressively to develop independent intellectual property rights.

1.3 Toward a Theoretical Framework of Social Construction

1.3.1 Two General Propositions

One fundamental problem inherent in the above perspectives is that they fail to incorporate some critical contextual settings of the research site. As presented above, there are two basic factors in the background of the Chinese automobile industry: Internally, this sector like many others experienced drastic institutional transformations in the transition from a command economy system towards a market economy system; Externally, the globalization process impacts this sector as exposure to the global industry increases. In fact, the developmental
models encompassed by the Chinese car makers exactly correspond to these two dimensions. Ownership variance is basically rooted in the institutional changes during market transition, while joint ventures are indeed responses of domestic enterprises to globalization. These specific contextual settings are very important to understand the inability of the theoretical perspectives discussed in the previous section to fully explain this sector. In order to better interpret the variance in developmental models among the Chinese car makers, I submit two theoretical propositions as correctives to address the limitations of the above arguments.

Due to the fact that the Chinese automobile industry is, to this day, embedded in a market transition process, I propose that the enterprises in this study should be analytically treated as “organizations in the making,” rather than autonomous actors. A common assumption shared among some of the above literatures is that the researched enterprises are self-calculating economic organizations within a normal and stable market economy. Under this general research paradigm, organizational actors could be treated as independent actors and certain organizational attributes such as size, affiliations with other organizations, or acquisition of state support could be treated as aspects of organizational strategy, behavior, and performance. However, enterprises in a transition economy should not be automatically taken as autonomous. The market transition itself is a process that generates new enterprises out of the previous command system. Enterprises are often seen as “projects to build” by various actors outside of the organization. Thus, these newly-born organizations are often constructed in an interactive process among different players as a part of market transition. Therefore, to explain the varying developmental models, it is necessary to question the autonomous assumption.

Accordingly, for these automobile enterprises, it should also be mentioned that the current phase of globalization may alter the nature of joint venture initiatives to be more like a domestic political contest rather than an outcome of corporate decision-making discourse based on rational choices. Globalization, as a structural force that breaks the domestic barricades that
mitigate exposure to international capital and commodity flows, has fundamentally changed the environment of the domestic automakers in China. For them, exposure to the international market and incoming foreign automakers presents itself as either a serious challenge or a golden opportunity, depending on whether alliances with advanced foreign partners can be forged or not. Enterprises capable of building joint ventures are definitely advantaged, since they can rely on introduced models without making special efforts in risky and independent R&D activities. As a result, there often emerge political arenas in which different voices may compete for opportunities to set up joint ventures during the decision-making process. Considering the fact that enterprises themselves are constructed during market transition, there is limited room for individual enterprises to play prime roles in this process. In the conduct of this research, then, if the inner mechanisms of enterprises are targeted, the big picture of what is really going on might be lost.

1.3.2 Approach of Social Construction

To interpret the development varieties among Chinese car makers, I advocate an approach centered on the social construction of these auto projects. I propose that under the context of market transition and globalization, across China there have been various local social construction processes that carry impacts on the development of the car industry and I think these processes have shaped the local car projects and determined the ownership and technological strategies of the resultant automobile enterprises.

The conception of social construction was first introduced into social science by Berger and Luckmann (1966). According to them, knowledge of human beings, taken as reflections of objective phenomenon by realists, in fact comes from the habituation and institutionalization based on interactions among actors. Thus, the so-believed universal economic laws are nothing more than shared meanings grounded on a process of social consensus formed through sustained
interaction. This constructionist insight indeed has a deep root in the Weberian tradition of sociology.

“Weber (1978 v.I:4) insisted that all social behavior is indeterminate and social practices can be understood exclusively through interpretation: ‘in no case does [meaning] refer to an objectively ‘correct’ meaning or one which is true in some metaphysical sense.’ Even rationalized social practices, such as those of modern bureaucracies, can only be interpreted subjectively” (Dobbin 1994).

Inheriting the major elements of the constructionist tradition, the social construction approach applied in this study has three building blocks, namely the local developmental ideas, local political structure, and agency.

First of all, development ideas with respect to the car industry held by local actors are highlighted in this study. In the new domestic and global contexts with respect to China, the local car industry, involving a huge amount of investment and advanced technologies, is always on the minds of local actors. These actors may have developed certain development ideas for regional car projects and rationalities behind resultant actions are always based on these cognitive constructs (Powell and DiMaggio 1991). These industrial ideologies could stem from anywhere: Some might be traced back to certain historical legacies, some might be mixed with temporary considerations based on the local economic outlook, and some could even be born from individual entrepreneurship. These developmental ideas often permeate the local decision-making process with means-ends designations that are directly tied to certain instruments (Dobbin 1993) and thus function as a road map for the articulation of the appropriate arrangement of actions in a way that sounds like the best solution for these local actors (Goldstein and Keohane 1993). In fact, previous studies about the Chinese automobile has already acknowledged the importance of cognitive factors, such as the thoughts of the top national leaders and “misperceptions” among political actors at different levels (Harwit 1995). For the current project, I propose that for a local
car making enterprise, the structure of ownership and the method of technological upgrading may just reflect the basic ideas shared by local decision-making actors.

This emphasis on cognitive factors in this project is also heavily influenced by neo-institutionalism insights in organizational studies, which have long focused on the sense-making mechanisms used by actors to understand the constructed rationality of organizational behaviors. In an organizational field, “a community of organizations that partakes of a common meaning system and whose participants interact more frequently and fatefuly with one another than with actors outside of the field” (Scott 1994, 207-8), the “rationalized” organizational structure is indeed copied from the external environment defining the legitimacy of certain organization structures rather than derived from any efficiency-driven economics laws (Meyer and Rowan 1977). These “rational” behaviors could diffuse through coercion, norms, or imitation (DiMaggio and Powell 1983). At the macro level, the formation of national states by structurally similar societies across the world (Meyer et al. 1997) and the formation of similar economic institutions among capitalist states (Hall 1989) could also be interpreted as cognitive consequences. The constructionist perspective is not only able to explain the isomorphic process, but also capable of interpreting variance, especially for national economic policies. For instance, Dobbin (1994) developed a cultural approach to interpret the variance of railway industrial policies among France, Britain and United States; with the neoliberalist policy paradigm diffusing into the global sphere. Fourcade-Guorinchas and Babb (2002) have traced significant cross-national policy variations to the institutionalized state-society ideologies.

Second, although the development models are coined by a sense-making cognitive process, agency should not be dismissed in the analyses (Dimaggio 1988). For some actors, the local car project could be perceived as a very important vehicle to address their developmental ideas, but these ideas could also appear very offensive to other actors insisting on different developmental logics. Thus, cognitive factors surrounding the car project “are always contested...
and ultimately are never settled” and “the content of ideas alters over time or in the course of conflicts and compromises” (Jacobsen 1995:288-89, 300). For certain logics to take the lead in implementation for local car projects, it is agency that interprets their implications, brings the attention of the general public, mobilizes necessary social support, formulates political coalitions and finally accomplishes the implementation. That is, ideas themselves cannot gain political currency without agency. What matters is “how specific actors carried certain ideas into the policy-making fray and used them effectively” (Campbell 2002:29).

Such a tension between ideas and agency could be illustrated through discussion of the relationship of ideas and interests, which “are not phenomenologically separate” (Goldstein and Keohane 1993:26). On the other hand, any interest perception of an actor with respect to a local car project is always subject to cognitive definitions and new ideas have the capacity to “change the perceptions a group had of its own interests” (Hall 1989:369). Through redefinition of the perceptions of interests, ideas convince actors to take new prescriptions to the local car industry (Gao 1997:290). On the one hand, without the underpinning of interests, it is often hard for any development idea to survive. New decisions, designs, strategies and policy paradigms around the car projects are always promoted by “groups that inevitably inflect ideas they adopt--whatever their origin--to serve their own needs” (Jacobsen 1995:288).

Therefore, in order to better understand the development varieties in the Chinese car industry, it is necessary to examine the discourse that unfolds as different actors coordinate or compete with each other to address their own ideas and interests in the local car project. That is, behind the local car making enterprises, there is always “a political project undertaken by powerful actors” (Fligstein 1996:657).

Finally, the local political structure, namely the relationship pattern among the major actors involved with regional economic affairs, is a critical institutional architecture defining most relevant players and distributing political powers as they pertain to the social construction of
local car projects. The market transition in China is a process that produces many formerly-dependent or non-existent actors for the market as a part of the change from the previous command system. Regarding a regional car industry, relevant actors may consist of local governments released as autonomous players during decentralization; privately owned enterprises; new and developing firms emerging after market reform; the central government, which still maintains certain influences on local economic affairs; and the former state-owned enterprises, which gained more autonomy during the reform. However, the above market transition process is not even, but historically path-dependent. Different local political economy arrangements in the planned economy era could bring forward contrasting power-distribution patterns during market transition. The local political structures may take on various forms, which perform differently in the enabling of actors and distribution of powers pertaining to local car projects. These institutional structures are critical intervening mechanisms through which different ideas compete with each other (Steinmo 2001), as has been argued as a part of neo-institutionalist analysis (Fligstein 1990, 1991, 1996). The previous research on the Chinese automobile industry also supports such a perspective: Thun (2006) agrees that local political economy institutions could be a major clue to an understanding of differing performance among Chinese car makers. Thus, I propose with respect to the implementation of an agency-driven social construction process as it pertains to local car projects, the political influences of related actors are always embedded in the local institutionalized relationship which decides their respective powers in the local economic affairs (Thelen 1999; Steinmo et al. 1992).

The perspective that highlights local political structure is mostly indebted to the historical institutionalists; “rather than posit scenarios of freely-contracting individuals, for instance, they

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2 In fact, due to China’s opening to global investment in its automobile sector, the incoming foreign automakers definitely make up another group of actors, joining into the development of local car industries. However, the local car projects, in terms of the organizational ownership structure and technological strategy, are basically controlled by powerful domestic players, and foreign corporations are not a deterministic force. The last chapter will discuss in detail the role of the foreign automakers in the Chinese car industry.
are more likely to assume a world in which institutions give some groups or interests disproportionate access to the decision-making process” (Hall and Taylor 1996:9). Historically-formed institutional structures have proven a capacity to carry crucial impacts for nation-specific models both at the corporation level and the industry level. In the varieties of capitalism approach coined by Hall and Soskice (2001), a grand firm-centered paradigm is developed for comparative capitalism studies in which nation-specific institutional frameworks shaped contrasting corporate strategies between liberal market economies and coordinated market economies. In examining the newly developed East Asian economies, Hamilton and Biggart (1988) attributed the different industrial arrangements of Japan, Korea and Taiwan to the historically-developed structures of domination present in each society, which was conceptualized as the authority structure contained by the state-business relationship. Biggart and Guillén (2002) used a similar approach to explain the varying models across the world of the automobile industry, represented by Korea, Taiwan, Spain and Argentina, and concluded that development paths variation could be grounded on socio-organization legacies.

Figure 4: The Approach of Social Construction
The integration of these three dimensions makes up the framework of social construction used in this project (Figure4). Within such an interpretive framework, the local political structure, namely the related local actors and their power structure, is the basic architecture behind social construction; the development ideas of related actors provide rationales behind their actions in the social construction process, and the unfolding process of social construction results in the developmental models employed by automakers. With the application of this interpretive protocol, here is a brief interpretation of the four developmental models represented by the Chinese car industry.

The model represented by FAW, DMC and others is based on a social construction process led by the central government. Even after market reform, the central government still maintains a dominant role in certain aspects of local economic decision-making. According to its developmental ideas for the national car industry, the central government decides to hold some automakers previously-established by the central government in its own hands in order to directly fulfill these ideas and requires them to establish joint ventures to introduce advanced foreign technologies. Directed under this dominating actor, the related local actors, such as local governments and local enterprises, often appear very cooperative. In this model, the direction from above and coordination from bottom make up the skeleton of local social construction.

The social construction behind the model of SAIC Group, BAIC, and GAIG is shaped by the active role of local governments and support from the central government. Local governments in the market reform process often become the leading actor in the push for local economic development. When the car industry is perceived crucial in a particular local economy, local officials will often demonstrate great interest to initiate their own car enterprise. If local economic development also happens to be a serious concern of the central administration, these local initiatives would be sponsored by the central administration so that joint ventures could locally be
a viable option. The initiatives from the bottom and acknowledgement from above make up the social construction for this developmental model.

By comparison, the social construction behind the development model represented by Chery is mainly grounded on the same active local government level but a different central government. Unlike places enjoying special treatment from the central government, many provinces and cities are always forbidden to develop local car projects by the central administration. According to its national industrial policy, this is necessary for the achievement of industrial concentration and to avoid inefficiencies endemic to superfluous construction and waste. If proposals from the local governments are denied, there would be no possibility for these local governments to establish joint ventures. As a result, local governments, determined to pursue their own car projects, practice self-reliant R&D. Unlike the two models discussed above, the conflict between the local and central levels is a vital characteristic manifested throughout the social construction of this type of developmental model.

Finally, privately owned and technologically independent enterprises, such as Geely and BYD, make up a special group born out of a private-driven social construction process. In the market transition process, the private economy becomes very prosperous in some places where private enterprises become the leading actor. There indeed emerge some local private entrepreneurs who envision car production as a lucrative and promising field and start local privately funded car projects. However, as the Chery-like enterprises, these projects always receive official rejection from the central government. After all, given the fact that even official projects from local government could often be denied, the central government does not rationalize the closing of the door toward the Geelies of China. Conflicts between private enterprises and the regulation performed by the central government are the major elements in the social construction of this developmental model.
1.4 Selection of Cases

Within each developmental model, there commonly exists more than one car maker, which makes it necessary to choose the most representative cases. A simple standard is applied within each category: only the car maker with the largest market share will be chosen. Under this standard, FAW, SAIC Group, Chery Auto and Geely Auto are selected to represent the corresponding models. This standard has several merits. First, the sale criterion is the best marker for market success and the most successful car makers are often the most stable ones.

Second, the chosen automakers are indeed representative in many aspects. For the model featured by a central-government owned enterprise and a joint-venture technological strategy, if HAG or JCA, rather than FAW, was chosen as the representative case, the research would be inadequate in the face of the recent claims of incorporation of HAG and JCA by other automobile enterprises. Similarly, SAIC Group is chosen to represent its group not only because it is the largest car maker in China, but also because it is the first joint-venture builder in the Chinese car industry. In the category represented by Chery, Brilliance Auto would not be a good choice because a minor portion of business is represented by a joint venture. For privately-owned car makers, Geely is certainly more prototypical than BYD and Great Wall; in contrast to the former, Geely was established earlier; In contrast to the latter, Geely’s car production offerings are more similar to other typical car assemblers, as Great Wall mainly focuses on a special type, the SUV.

1.5 Outline of Chapters

The following chapters will be organized as below: The second chapter to the fifth chapter, I respectively discusses FAW, Shanghai Automobile\(^3\), Chery Auto, and Geely Auto. The last chapter will be conclusion and discussions.

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\(^3\) SAIC Group has different names in history. To avoid unnecessary confusions, I uniformly call it Shanghai Automobile.
In each of the empirical chapters, I will operationalize the theoretical argument presented above. I first focus on the local political structure, then discuss the developmental ideas held by different local actors, and finally introduce the social construction processes centered on the ownership and the technological strategy of the particular car enterprise. For every empirical chapter, there is a short summary in conclusion.
FAW, Senior Son of the Chinese Automobile Industry

Located in the northeast China at the city of Changchun in Jilin province, FAW was the first state-built automobile factory of the People’s Republic of China, thus often called as “the senior son of the Chinese automobile industry”. In the planned economy era, FAW was a command-receiving factory directly owned by the central government; during the reform, although the state-enterprise relationship had experienced profound changes, the central government still held this enterprise in its hands to fulfill the national industrial policy in the automobile sector. FAW is a typical case, illustrating how the central government maintained as a deterministic force to shape an automobile enterprise in the market transition and globalization.

This chapter firstly discussed the persistent leading role of the central government in northeast China, the hometown of FAW, throughout the market transition. Next, I introduced the ideas of the central government about import substitution and setting up joint ventures after the economic reform. We also analyzed how FAW managers and the local government positively responded to these ideas in this new era. At last, we analyze how FAW evolved into a corporation directly owned by the central government and set up the joint ventures to be its major upgrading measure. Such a process was led by the central government and at the same time assisted by FAW and the local governments.

2.1 Persistent Dominance of the Central Government

Ever since 1950s when the central government started its heavy-industry pursuit, the northeast part of China, including three provinces of Harbin, Jilin and Liaoning, came to be taken as the ideal place for such a national blue print. Accompanying with continuous investments and constructions in this region, the central government became the dominating force in the local economy. Throughout the reform, though the economic reform demolished the old command
system, the central government still managed to shed critical influence on many enterprises in this region. FAW is just one of them.

**2.1.1 Northeast, The National Heavy-industry Base**

When the central government designed the new China, the northeast was chosen as national heavy-industry base. Institutions of the planned economy system were comprehensively and completely transplanted into this region. In consequence, the northeast became a perfect epitome showing the Chinese planned economy system.

Although heavy-industry projects were distributed all across China, for the central government, the northeast China was always considered as the idealist location. As early as the year of 1945, in the 7th national congress of CPC, Chairman Mao firstly expressed his strong interests upon this region; During the civil war period (1945-1949), CPC had further emphasized that the northeast China should be fully used; In 1950, just one year after the establishment of the People’s Republic of China, Chairman Mao claimed that the northeast China was meant to be the national heavy-industry base (Fu 2004). What made the northeast China so special in the eye of the central policymakers? One major concern was that this region had the nationally best heavy-industry infrastructures built by the Japanese colonists. Since 1930s, Japan gradually controlled the northeast China via the puppet Manchuria government. In order to serve its military need in the Second World War, Japan had poured huge amount of investment in this region to utilize the local resources and manufacture industrial products. By the end of the war, the total investment from Japan had reached over 10.7 billion yen (Zheng 2000). As a result, the northeast China experienced a quick round of industrialization: for instance, the total production of coal increased from 7.09 million tons in 1932 to 25.62 in 1944; the steel output increased from 0.22 million tons to 0.88 million tons (Yi and Lin 2001). As a result, the northeast grew up to be a region with the most advanced heavy industry in the nation: In 1943, this region produced 49.4% of the national
output in coal, 87.7% in raw iron, 93% in steel, 93.3% in electricity, 69% in vitriol, 60% in barilla and 95% in machinery (Yi and Lin 2001).

As the national base for heavy industry, the local economy of the northeast was primarily shaped by the central administration. In 1950, about a half of the national investment and a half of the national college graduates were directed into this region; until 1952, the northeast had used over a half of the national investments in the industrial basic constructions (Fu 2004). During the period of the first FYP (1953-1957), among “156 projects” as major national industrial projects aided by Soviet Union, as many as 50 non-military projects were settled in the northeast (Table 3). Such a centrally-dominant input pattern was persistent in later periods: throughout the planned economy age, the central government investments were always the major mechanism for the local industrial development.

Table 3: Distribution of “156 Projects” (unit: 1 million yuan)

<table>
<thead>
<tr>
<th>Provinces</th>
<th>Number</th>
<th>Planning Investment Amount</th>
<th>Planning Investment Percent</th>
<th>Actual Investment Amount</th>
<th>Actual Investment Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liaoning</td>
<td>20</td>
<td>4.07</td>
<td>25.2</td>
<td>4.59</td>
<td>28.9</td>
</tr>
<tr>
<td>Heilongjiang</td>
<td>20</td>
<td>1.77</td>
<td>11.0</td>
<td>2.05</td>
<td>12.9</td>
</tr>
<tr>
<td>Jilin</td>
<td>10</td>
<td>1.36</td>
<td>8.3</td>
<td>1.46</td>
<td>9.2</td>
</tr>
<tr>
<td>Henan</td>
<td>9</td>
<td>2.54</td>
<td>15.7</td>
<td>1.55</td>
<td>9.8</td>
</tr>
<tr>
<td>Gansu</td>
<td>7</td>
<td>1.30</td>
<td>8.1</td>
<td>1.31</td>
<td>8.3</td>
</tr>
<tr>
<td>Shanxi</td>
<td>7</td>
<td>0.54</td>
<td>3.3</td>
<td>0.57</td>
<td>3.6</td>
</tr>
<tr>
<td>Shaanxi</td>
<td>7</td>
<td>0.40</td>
<td>2.5</td>
<td>0.43</td>
<td>2.7</td>
</tr>
<tr>
<td>Hebei</td>
<td>5</td>
<td>0.28</td>
<td>1.7</td>
<td>0.28</td>
<td>1.8</td>
</tr>
</tbody>
</table>

Source: Based on Dong (2004)
Note: only non-military projects and provinces assigned over 5 projects are listed.

By the end of the second FYP, the northeast had successfully established a comprehensive heavy-industry system and developed many nationally-leading leading enterprises directly owned by the central government such as Daqing Oilfield, Anshan Steel, FAW, China First Heavy Industries and Shenyang Aircraft. These state-owned enterprises had made
significant financial contributions to the nation. In the first FYP period, the financial contribution from Heilongjiang was over three times of the original national investment, while Jilin contributed 60% of the provincial fiscal incomes to the central government; the industrial enterprises in Liaoning, from 1953 to 1988, turned in about four times of the original investment (Yang 2005).

On the other hand, the northeast had been also grown up as a role model in implementing the planning economy institutions. It was “the management school” for the whole country throughout the planned economy era, continuously exporting new management methods and experiences: In the early 1950s, without enough experienced managers, the state-owned enterprises were often run by the factory-level party committees as a political rather than economic institution. It was the northeast which firstly moved these administrative duties to the factory directors and spread such trials to other regions (Yang 2005); In 1960s, Angang, a northeast iron and steel enterprise initiated another round of management innovations, with the famous “Angang Constitution” as a new administrative framework. The key point was to replace the factory director-centered paradigm with a new framework emphasizing the role of the party committee (Dai 1999); In the mid-1960s, Daqing Oilfield as China’s first petroleum enterprise became another national model enterprise. The Daqing model referred to the combination of communist enthusiasms with scientific attitude, the establishment of the role model among workers, and the emphases on the disciplines and responsibility in production (Song 2005).

2.1.2 FAW, A National Automobile Workshop

FAW, the first automobile enterprise in the new China, was a typical state-owned enterprise directly under the central government in the northeast. In the planned economy era, FAW was like a finger of the hand of the central government. According to Gen Shaojie, the FAW director in 1980s and 1990s, FAW is a “specimen” and a “perfect product” of the planned economy system (Wang 1998).
The location of this enterprise was carefully chosen by the central government. In 1950, just one year after the establishment of the new China, MHI of the central government started to search ideal locations for the national first automobile factory. In 1951, Zhou Enlai as the prime minister of the State Council, proposed the location to be around the city of Changchun, with the consideration of the local good industrial foundations, abundant resources and materials, and excellent transportation conditions. MHI later confirmed this choice and the State Council finally approved it in 1951.

The infrastructure construction of FAW was a mobilization of the national resources. In the early 1950s, the central government determined to accomplish its first automobile project as soon as possible. Chairman Mao even made an announcement, specific for FAW:

“Because of the limited experiences and underdeveloped technologies, in order to build such a large project in only three years, we will have to fact great difficulties in labor force organizations, construction technologies, domestic supply of equipment, and production preparation. So the central government takes it necessary for the related institutions to fully support this automobile factory in Changchun.” (Mao 1953)

With such an order from Mao, FAW’s construction became a nationwide matter. All related branches of the central government set the FAW project as priority; Domestic enterprises, manufacturing needed equipments, speed up their production; all Chinese provinces except Tibet and Qinghai had sent their labors and experts. On the other hand, the Northeast Bureau in charge of the three northeast provinces and the city of Changchun as the host city of FAW were required to guarantee the accomplishment of the construction. In consequence, the infrastructure construction of FAW was finished in 1956 as expected.

The governance structure of FAW could not be illustrated more clearly than the announcement from the party committee of Jilin Province in 1956 as below:
“(1) The task of this automobile factory is to comprehensively fulfill the commands from the central committee of CPC in order to warrantee the accomplishment of the planned tasks… (2) The municipal party committee of Changchun should strengthen their lead on the party committee of FAW and organize local resources to assist…; (3) Institutions of the whole province should continue to strengthen their support on FAW. Factories coordinating with FAW and their local municipal, county and district governments should guarantee the production standard, the product quality and the timeliness of fulfilling contracts. Institutions in charge of railway, business, labor, communication, materials, culture and sanitation should try their best to assist FAW.” (FAW 2003a:23)

Regarding to the management, FAW applied the typical management model of the state-owned enterprises, namely the FDRS under the lead of the party committee (Figure 5).

![Figure 5: The Organizational Structure of FAW](source: Based on FAW 1991.)

Throughout the planned economy era, theses governance and management schemes of FAW were often transformed by the central government. In the later half of 1960s, the central policymakers determined to organize large industrial trusts in the automobile industry. Thus, the previous administrative institution was reshaped into CNAIC, of which FAW became a branch.
The management frame of FAW accordingly came through a significant shift. This trial ended with the beginning of Cultural Revolution, when the Revolutionary Committee consisted of the military representatives, heads of the revolutionary factions and some previous managers took over the factory. Not until 1978 was the management of FDRS under the lead of the party committee finally restored.

In a planned economy system, any production of the state-owned enterprises was nothing but assigned tasks; FAW was no exception. Directed to satisfy the automobiles demand of the whole country, from 1953 to 1983, FAW produced over one million trucks, about a half of the national total trucks in use, and turned in 5.1 billion yuan, approximately 8.5 times as the original investment from the central government (Rao 1983; Xu 1983). Directly controlled under the central government, the production of FAW always fluctuated with the domestic political movements (Figure 6): there were two big slumps in FAW’s output. The first one was because of the Great Leap Forward, while the other drop was due to political riots of the Cultural Revolution.

![Figure 6: Automobile Output of FAW, 1956 to 1980 (unit: vehicle)](source: Based on FAW 2003a)

The automobile technology of FAW was acquired through a large-scale and comprehensive technology-introduction from Soviet Union, as was possible only because of the Sino-Soviet political ally.
For the production and management technologies, Stalin Automobile Factory as the largest automobile factory in Soviet Union played a key role. This factory coordinated with many other factories across Soviet Union to implement the technological and technics designs, and manufacture key equipments and tools for FAW. As praised by FAW, Stalin Automobile Factory was the “mother factory”, which “produced the automobile industry” for China (Sino-Soviet Friendship Association 1956). As a result, among the total 8,000 sets of equipments applied in FAW, 80% was from 200 factories in Soviet Union (Zhang et al. 2004); The introduced technological files summed up to 5,469 pieces; work procedure cards and technics materials were 138 copies and 753 volumes; blueprints for the non-standard equipments were 4,085 sets; and blueprints for the technics equipments were 16,942 sets (FAW 2003a). FAW also introduced a management handbook edited by Stalin Automobile Factory, which later became a management encyclopedia for the Chinese automobile industry and many other sectors. Soviet-China technological transfers were also carried out through direct interactions among technicians: From FAW, 8 teams of technicians, totally 518 people, were dispatched to Stalin Automobile Factory to learn needed technologies as internship students; from 1953 to 1957, Soviet Union sent 188 automobile experts to FAW, who offered over 20 thousand suggestions and 1,300 training workshops (FAW 2003a).

In the planned economy system, technological innovations of FAW were always driven by the central state. In order to quickly serve the national industrialization in 1950s, the state specifically set the medium-size trucks as the preferred products. CA10 (also called as Jiefang, meaning liberation in Chinese), as a 4t-truck model, was then introduced from the Soviet Union as the first product of FAW. After mastering CA10 in 1956, FAW upgraded this product to CA10B, which came out in 1960. In 1967, CA140, a 5t-truck model, was developed as a new
generation of CA10. Meanwhile, a series of CA10 variant were developed to meet various demands in the national economic construction, such as CA119 as one-axle trailer, CA40 as dump truck, CA91 and CA92 as trailer, and CA50 as towing truck (FAW 1991). Although the model upgrading was never ceased, CA10 family maintained as the major products in FAW.

In response to the military demand, FAW also manufactured off-road vehicles for the nation. As requested by the government, an off-road vehicle was introduced from Soviet Union to FAW in 1956, later coined as CA30. In 1959, this model was successfully put into production. A series of follow-up models were developed: CA30A was manufactured in 1963, while CA30B and CA30C were later deigned out as well (FAW 1991).

Making cars was fully political-oriented in FAW. Without any private-use market for car consumption at that time, cars were manufactured in China only for a small group of political elites. It was the political consideration that determined whether, what and how cars were manufactured in FAW. As said by Guo Li, an early FAW director remarked, “we are running a restaurant and the leaders choose from the menu” (Fan 1998:54).

The decision of making car could be traced back to Chairman Mao, who expressed the expectation to “seat in our own cars” in 1956. CA71, as the first Chinese car (also called as Dongfeng, meaning winds from east in Chinese, a metaphor for communism forces), was then produced quickly and sent to Chairman Mao for a trial ride in 1958. As a middle-class car, Dongfeng was not prefect for the political ceremonies and events. CA72 (also called Hongqi meaning red flags in Chinese, a symbol of revolutionary spirits), was thus developed and produced in 1959 as a political “gift” for the ten-year anniversary of the People’s Republic of China. As a two-row model, CA72 was also criticized since political leaders favored cars with three rows. So, CA770, an upgraded Hongqi with three-row seats, was then developed in 1965.

1 Asked by the central government, this model was later transferred to SAW built in Hubei in 1960s.
2 The production of Jiefang trucks in the CA10 family lasted until the year of 1986. By then, the total output had reached 1,281,502 vehicles.
This model was applied widely for political activities and later was called as the “nation’s car” (FAW 1998). As a political car, Hongqi never achieved the economy of scale. Hongqi CA72 was only produced for ten years (1956-1966) with a whole output of 202 units; and Hongqi CA770 only had a whole output of 1302 units from 1965 to 1981 (FAW 1998).

In developing these car models, FAW’s upgrading strategies were heavily shaped by the ideas of the central policy makers: because the political requirement of making “our own” cars, the factory had to be self-reliant in R&D and branding; On the other hand, to represent the image of the new China, the technical standards had to be advanced. As a result of both considerations, FAW produced its own car through extensive copies and imitations from foreign models. Using the words from Yao Bin, an early factory director, the principle of car making in FAW was “to extensively imitate and to aptly modify” (FAW 1998: 322). Zhou Enlai, the prime minister of the nation at that time, further clarified such an upgrading rationale: “Imitations could be allowed, but must be in a smart way, that is, the critical part could be copied, while the non-critical ones could be changed” (Shi 1998). Dongfeng as the first model was basically replicated a French auto model of Simca with taking over Benz’s engine; A Chrysler model became the target of CA72, (Lv 1998); For CA770, since most of the design was to upgrade the previous CA72, there were little direct copies or imitations, so CA770 could be deemed as the first independently developed model by FAW.

2.1.3 Enduring State-enterprise Relationship in the Reform

The market transition had profound impacts on the northeast, among which the enduring influence of the central government on some chosen state-owned enterprises was a critical feature of local political structure. The new state-enterprise relationship rebuilt in the reform basically had two faces: on the one hand, the reform released most of enterprises from the planned economy system so that the old state-run factories gradually evolved into autonomous enterprises or even corporations; on the other hand, the central government still managed to maintain
influences on some carefully selected sectors and enterprises so that its previous role over the national economy could persist. Under such a dual-faced market transition, controls of the central government over some enterprises in the northeast was not demolished, but actually lasted, in some different patterns though. FAW just was one of them.

Since the Third Conference of the 11th National Congress, CPC came to acknowledge that the over-centralized governance structure had been a serious disadvantage of the Chinese economy and that it was necessary to endow the enterprises with more autonomy. There then came two waves of reforms, marketilizing the relationship between the government and enterprises.

The first wave, ranging from 1979 to 1992, was featured by the gradually augmented autonomy of the state-owned enterprises. In the first half of 1980s, a series of management rights, previously held by the planning bureaucracy of the central government, was moved downward. Enterprises were permitted to enjoy some freedoms in production, sale, price setting, purchase of raw materials, employment and so on. At the same time, a certain portion of profits was allowed to be kept inside enterprises. Starting from 1986, a responsibility system came to be developed in order to push enterprises to be more independent from the state controls. That is, instead of direct bureaucratic orders, contracts were signed up between the state and enterprises: on the one hand, production assignments were confirmed through these contracts; on the other hand, these enterprises were required by these contracts to be responsible for any losses and gains in the production. In 1988, announcing thirteen management rights owned by the state-owned enterprise, the central government officially confirmed this responsibility system. In the meanwhile, a set of new management principles for the state-owned industrial enterprises were issued by the State Council, permanently overturning the old FDRS under the lead of the party committee. Such a new management framework stressed the leading role of factory director in the ordinary management and the necessity of clarifying obligations and rights inside enterprises.
The second wave, from 1992 to present, centered on the introduction of “modern enterprise institutions”, the major implication of which was to “corporatization” the state-owned enterprises. Four principles proposed by CPC in 1993 became the basic guidance to renovate these state-owned enterprises: Property rights should be clarified; Rights and responsibilities should be explicit; State and enterprise should be separated; And management should be scientific. The issue of property rights was actually the central mission and the application of the corporation system and stock system soon became major protocols: In 1993, in the Third Conference of the 14th National Congress, CPC pinpointed that “the corporation system and the stock system are good experiments in building the modern enterprise institutions”. The first company law was issued in the same year; In 1997, CPC further claimed that the stock system was a legitimate organization form to transform state-owned enterprises in that it could realize the coexistence of multiple ownerships and also kept the dominance of the public ownership in the meanwhile. These policies had resulted in a large-scale wave of “corporatization” and “stockization” among the Chinese state-owned enterprises. These transformations also brought forward new management schemes: the general meeting of shareholders, the board of director, the board of supervisors and the management started to replace the previous FDRS.

Although marketilization upon the state-enterprise relationship was one of the leading logics of the central government during the reform, another competing rationale was also emphasized, namely to maintain the necessary influence of the central government on key sectors and enterprises in the new market economy.

Despite of releasing state-owned enterprises in the reform, the state still preserved the public ownership of these enterprises until early 1990s. The reason of doing this was primarily grounded on political concerns: a bottom line, too sensitive to be dropped in the reform, was to keep the dominance of the public ownership in the national economy. This was considered as a symbolic indicator, signaling the political correctness.
Nevertheless, with the marketilization going on, such an ownership structure encountered big troubles in 1990s. Though gradually getting out of the previous bureaucratic production plans, the huge amount of the state-owned enterprises had decentralized the limited capitals from the state, decreased the production scale and efficiency in the production, generated redundant industrial projects, and finally led to the extensive loss and heavy debts. By the end of 1995, China had as many as 29,100 state-owned enterprises, which only had totally 3,000 billion yuan as mobilizable capitals, namely only 10 million yuan per capita; the asset-liability ratio of these enterprises had reached over 65.9% and a half of them even had a ratio as high as 80%; In 1997, three fourth of state-owned enterprises were in the loss-making (CDRSC 1997). Facing these problems, the Chinese policymakers confessed that the government was not capable to manage well so many state-owned enterprises (Li 1996).

Therefore, from the mid-1990s, the state began to try some new methods, changing the previous ownership structure and meanwhile strategically maintaining the influences in the national economy.

First of all, the government determined to abandon state-owned enterprises considered as less important ones, and concentrate on large state-owned enterprises, as was called “the strategic restructuration of the state-owned enterprises”:

“We should combine the state-owned enterprises reform with restructuration, transformation and management strengthening; we should put our eyes on the whole national economy, develop the large ones and release the small ones, and implement the strategic reorganization of the state-owned economy.” (Jiang 1997)

Under such a policy orientation, non-state capitals were encouraged to invest into the medium or small state-owned enterprises, as transformed most of the state-owned enterprises; one the other hand, the state focused attentions onto some significant enterprises, which were considered crucial to keep influence in the market. Great efforts were made by the central government to
adjust the state-owned economy: in the project of “helping out state-owned enterprise in three years” from 1997 to 2000, 2.4 billion yuan was directly spent by the central government, approximately equivalent to a half of the state-assets held by all of the state-owned enterprises by then.

To guarantee the leading role of the state in the economy, the state also employed many other strategies. It was announced that:

“Under the socialism market economy, the leading role of the state-owned economy in the national economy should be mainly reflected by its controlling powers. (1) The role of the state-owned economy should be enforced both through the state-owned enterprises, and also through the state-holding enterprises and enterprise with state-owned shares; (2) The state-owned economy should hold the dominating position in critical industries and key fields of the national economy, should support, lead, and drive the overall socioeconomic development, should exert important effects in realizing the goal of national macro-control.” (Central Committee of CPC 1999)

The first principle advocated above asked the state-owned capital to be diversified into new organizational forms, which could actually enlarge the influence of the state-owned capitals via a lever effect; the second principle pointed out that the state needed to concentrate on some key sectors in order to control the national economy. And such a sector list included national security related industries, natural-monopoly industries, branches of critical public goods and services, pillar industries, and the significant enterprises in the high-tech industries (Central Committee of CPC 1999). The automobile industry, long deemed as a major pillar industry by the central policymakers, was included as critical sector. Accordingly, FAW, considered as a “significant” enterprise in this pillar industry, was kept in the hands of the central government throughout the market transition.

In spite of the fact that the central government still kept influential in the critical enterprise such as FAW, we should notice at last that the governance mechanisms in the market
transition differed greatly from the previous system. On one hand, in the reform process, the state continuously transformed its old bureaucratic institutions, especially institutions of economic governance. The largest movement was carried out in 1998, when totally forty departments in the State Council was cut into twenty nine and about 200 lower institutions was erased. Specifically for the economic management, nine specialized bureaus, which were respectively in charge of coal industry, machinery industry, petro-chemical industry, textile industry and so on in the planned economy era, were all incorporated into the National Economic and Trade Commission and thus permanently lost their rights of managing enterprise. This reform formally ended the previous direct interventions of the central administration on the enterprises. On the other hand, a committee was organized in 1999, directly in charge of about two hundred large state-owned enterprises including FAW, which were considered crucial and then not to be released to the market. In 2003, another state branch, SASAC was established to be the new head institutions for directing these chosen enterprises, which “performs the responsibility as the investors on behalf of the state; supervises and manages the state-owned assets of enterprises according to law; guides and pushes forward the reform and restructuring of SOEs” (SASAC web). The control of SASAC in these enterprises had a solid ground: SASAC could appoint and remove top managers in these enterprises. Actually for some very special enterprises such as FAW, the top executives should even be discussed and approved by the highest political institution in China, the Political Bureau of the Central Committee of CPC. Currently, the SASAC held 149 the so-called “central enterprises”.

2.2 New Orientations of the National Car Industry

In the market reform, the central government developed some new sights upon the national automobile industry. Particularly in the car production, after experiencing waves of uncontrollable imports, the central policymakers started to practice import substitution and
encourage the establishment of joint ventures in order for promoting domestic productions. These new developmental ideas also penetrated the development of FAW in this new age.

### 2.2.1 Promotion of Domestic Automobile Production

Since late 1970s, the automobile industry as a whole became a hot discussion topic among policymakers in the central government of China. The devastated national economy and weakened public communism confidence after the Cultural Revolution (1966-1976) impelled the government authorities to set economic development as the top priority. In spite of the re-focus on promoting the national economy, the automobile industry was not originally listed in the state plans for economic revigoration. An influential view at that time was that China might not need motor vehicles to facilitate productions as long as the human labors maintained abundant. Influenced by this view, planners of national economy often restrained automobile outputs in order to save resources for other projects. However, officials directly in charge of the automobile industry could not tolerate such a doomed fate. They stressed that although an independent and complete national automobile industry had been established in the planned economy period, the Chinese automotive industry would be too underdeveloped to meet requirements of the fast economic development in the reform. They proposed that the poor transportation situation as the result of neglecting the automobile production had become a “bottleneck” for the economic development (CNAIC 1982): On the one hand, Chinese assemblers, as a copy of automobile factories in Soviet Union, always emphasized output rather than the production efficiency, technological advancement and product quality. A popular slogan among Chinese automobile factories at that time was “the primary issue is to have it or not, and the secondary issue is to be good or bad”; On the other hand, the production capacity of the Chinese automobile industry was extremely biased. The automobile production in the planned economy system mainly focused on
the production of medium trucks, as resulted in a situation of “lacking heavies, few lights, and almost no cars”.3

With these officials strenuously lobbing the government upon the necessity of developing the automobile industry, the top national planners finally paid special attentions to this sector. Two ambitious goals were set up by the central government for the automobile industry since 1980s: First, the automobile sector should be “modern”, namely to catch up with the latest technological standards in the world. More specifically, by the 1990s, the Chinese automobile industry should be capable to “produce a generation of products equivalent to the international level of the 1980s” (Rao 1984: xi-xiii); Second, the automobile industry should become a “pillar industry” for the national economy, serving and stimulating the development of associated industries. Firstly stated in the seventh FYP (1986-1990) and then reconfirmed at the 14th National Congress of CPC in 1992, this goal ensured a special position for the automobile sector in the whole national economy.

As an important part of the automobile industry, the car production was also experiencing such a twist process to win the attentions from above; However, the story of car had its own rhythms. Same as the debates about the value of the automobile production, policymakers kept discussing whether China needed cars or not since the very beginning of the reform. What finally drove the central government to make the decision of developing the car industry was the burgeoning car import since the mid-1980s.

The car production may not be a serious issue in the previous time when the demand was very small; Nevertheless, it indeed became headaches of the central policymakers since 1980s. Since the car production had been long overlooked in the planned economy period, from early 1950s to early 1980s, the output of cars in China was so small that it could almost be neglected.

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3 The heavies and lights respectively refer to the heavy-sized and light-sized trucks.
(Figure 7). Nevertheless, since 1980s, with the demands increased quickly, the car import became unstoppable (Figure 8): China imported about 20,000 cars in 1980 with only importing 667 cars in 1979, while the import amount soon jumped as high as 105,775 in 1985, though the central government had consecutively issued regulations to depress the trend (ECHCAI 1996). There came another wave of car import boom since early 1990s. This time, the wave of import was more significant, as posed an even greater challenge to the central government.

![Figure 7: The Product Structure of the Chinese Automobile Industry, 1955-1981](image1)
Source: China Auto News 2005

![Figure 8: China’s Car Import, 1980s and 1990s](image2)
Source: China Auto News 2005

As a result, the car industry came to gain attentions among the national policymakers since 1980s. For CPC leaders, the flowing-in cars presented not only an economic threat to the
infant domestic car industry, but also a political one that would hurt the national dignity (Li 1998). In August of 1984, the central government organized a discussion in Beidaihe, which was considered as a milestone meeting to tune up the Chinese car industry again. In this meeting, the central government decided that the car production should be encouraged in order to meet the surging domestic demands; In the next year, officials in charge of the Chinese automobile industry successfully persuaded Hu Yaobang as one of the top political leaders, who finally agreed that the development of the car industry should be emphasized in the national seventh FYP; In 1986, the central government issued an policy report to confirm such a decision, which was approved by Zhao Ziyang as the prime minister at that time.

In face of the seemingly unstoppable car import, the import substitution was advocated to be the most necessary policy instrument since 1980s. In the planned economy period, building and maintaining a self-sufficient automobile industry was once taken for granted, thus bureaucrats naturally kept a hostile attitude towards the car import. They had developed very strong justifications in defending such a stance: as claimed by Rao Bin as the top director of the Chinese automobile industry in 1980s, the country’s expenditure for the imports of automobiles from the 1950s had been twelve times more than the cost of building FAW, China’s earliest and biggest automobile factory (Rao 1983). Against such considerations, the import substitution policy was soon adopted with two major measures: high tariffs were applied as weapons to block the imports. In fact, cars became one of the highest-tariff commodities; the promotion of domestic car production turned out to be another important step. In 1987, the state decided to rely on the established automobile enterprises to develop the car production, including FAW, SAW and the Shanghai Automobile.

There then came another problem, namely how these enterprises could possibly get the needed technology for the car production. Under the directions by the central government, to introduce foreign corporations and build up joint ventures became the major solution. The idea of
setting up joint venture was not originally meant to solve the import substitution problem, as would be fully discussed in the next chapter about Shanghai Automobile, which built up the first joint venture with Volkswagen in 1985. The trial in Shanghai was considered as a big success: the advanced car model was introduced and more importantly, the requirement of domestic contents was gradually met, as suggested that the joint venture could effectively serve as a way of encouraging the domestic production in retaliation towards the imported cars. Thus establishment of joint ventures came to a good method for the central administrators in encouraging the domestic car production. To bring these joint ventures in line, the requirement of domestic contents was always accompanying with any approvals of the central government on joint venture projects.

In these national blue prints designed for the Chinese automobile industry, FAW as the largest and oldest automaker in China was taken by the central government as a major protocol to fulfill the national industrial policy. Therefore, all these ideas for the national automobile industry also became the rationale for the central government to direct the development of FAW. Application of these ideas into FAW by the central government had two basic implications: First, in the reform of the state-enterprise relationship, in order to assure the effective control over this important enterprise, it became a necessary solution for the central government to constantly hold FAW in its own hand; Second, for the technological upgrading, according to the designs of the central administrators, FAW ought to follow the official-approved upgrading route, namely setting up joint ventures to introduce the needed technology.

2.2.2 FAW, A Loyal Follower

These new directions proposed by the central government were greatly welcomed by the management board of FAW, which considered these new ideas from the central government to be a good match of its own interests. The reason was twofold:
First of all, the interests of FAW and the central government were closely associated with each other in the market transition. The ownership directly held by the central government made sure that FAW was naturally counted as a privileged enterprise, which was able to enjoy some special policy treatments from above such as the right to set up joint ventures. These treatments could make up some important competitive advantages in the emerging market. In a word, following the steps of the central government guaranteed the market success of FAW. More importantly, when the central government missed certain needs of FAW, the enterprise could often participate in the policymaking process and argue for its own sake. A good illustration would be the 1987 meeting where the car making enterprises were chosen (FAW 2003b): the central administration originally proposed to build a brand new enterprise, excluding the already-established factories. Such a plan obviously disadvantaged the enterprises such as FAW, which had been struggling hard to catch such a profit-making chance via product differentiations. The FAW leaders expressed that the Chinese car industry should be mainly depended on the large enterprises, which were advantageous in terms of capacities and experiences in R&D and production. As a result, the central government dropped the original plan and agreed to make cars at the already-established enterprises.

Secondly, the technological upgrading via the joint ventures indeed offered a quick access for FAW to acquire advanced technologies, which was badly needed by this technologically-outdated enterprise at the beginning of the reform. As the most advanced Chinese automobile factory in 1980s, FAW was seriously criticized as “manufacturing one model for thirty years” without any significant technical renovations. Table 4 was a summary done by engineers of FAW after a visit to the Japanese automobile industry in the 1980s. Their major

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4 The model refers to the CA10 family as the major automobile product of FAW in the planned economy era.
feeling was the comprehensive and complete lag-off of FAW in comparison with the Japanese peers and the urgency to catch up with the international advanced technological standard.

Table 4: Comparisons between Toyota and FAW in 1980s

<table>
<thead>
<tr>
<th>Items</th>
<th>Toyota</th>
<th>FAW</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Development cycle of new products</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Time for developing a new model</td>
<td>3 years</td>
<td>8-10 years</td>
</tr>
<tr>
<td>Time for new products achieving the normal productivity</td>
<td>4 days</td>
<td>1.1-5 years</td>
</tr>
<tr>
<td>Time for new products achieving the normal quality</td>
<td>1.4 months</td>
<td>1.1-5 years</td>
</tr>
<tr>
<td><strong>Sales and production plan</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sale cycle of the new product</td>
<td>3 days</td>
<td>15 days</td>
</tr>
<tr>
<td>Stay time versus production cycle of the parts</td>
<td>300 to 500</td>
<td>3000 to 10000</td>
</tr>
<tr>
<td><strong>Production organization and technology</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Production per person, per year</td>
<td>57.7 units</td>
<td>1-1.5 units</td>
</tr>
<tr>
<td>Time to change a die in the production</td>
<td>3 minutes</td>
<td>2 hours</td>
</tr>
<tr>
<td>Stock reserve time for the products</td>
<td>3 days</td>
<td>0.3-1.5 months</td>
</tr>
<tr>
<td><strong>Labor organization and skill</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Portion of manual work in the mechanical processing</td>
<td>29%</td>
<td>95%</td>
</tr>
<tr>
<td>Labor productivity (ratio)</td>
<td>70</td>
<td>1</td>
</tr>
<tr>
<td><strong>Coordination and material circulation</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Coordination between the assembler and part makers</td>
<td>70-80%</td>
<td>30%</td>
</tr>
<tr>
<td>Cost of the material circulation (ratio)</td>
<td>1</td>
<td>&gt;10</td>
</tr>
<tr>
<td><strong>Quality management</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Overhaul distance (Kilometers)</td>
<td>&gt;300,000</td>
<td>100,000</td>
</tr>
<tr>
<td><strong>Computer and Information</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ratio of the computer application</td>
<td>&gt;90%</td>
<td>30%</td>
</tr>
<tr>
<td><strong>Cost control and financial management</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ratio of profit versus cost</td>
<td>&gt;20%</td>
<td>&lt;15%</td>
</tr>
<tr>
<td>Ratio of capital occupation</td>
<td>1:100</td>
<td>25:100</td>
</tr>
</tbody>
</table>

Source: Based on Chen 1998

2.3 Transforming FAW for National Interests

Equipped with new developmental ideas, the central government became the driving force to transform FAW in the reform, which finally gave birth to a centrally-owned corporation, which used joint ventures as the major upgrading method. Holding interests in such a state-led transformation, FAW and the local governments actively coordinated with the central administration.
2.3.1 From State-managed Factory to State-owned Corporation

When the central government experimenting new measures to reform the state-enterprise relationship, FAW was always chosen as one of the “central enterprises”, which were considered as key ones for the national economy and necessary to be mastered by the central government. Such logic determined the major theme of the social construction around FAW during the reform: FAW was gradually transformed toward a corporation with autonomy in the ordinary management, but the central government still managed to own this enterprise to shed critical influence to fulfill the national industrial policies.

In the first wave of enterprise reform when the central government started to transferred management rights downward, FAW was among the pioneering enterprises to enjoy autonomy. Prior to this movement, the only fund FAW could reserve for itself came from the salary pool. However, in the reform, FAW was able to extract benefit directly from its own production after it certain turn-in. Meanwhile, inside FAW, various responsibility systems were adopted to replace the previous planning scheme (FAW 2003b):

From 1979 to 1981, the government started to permit FAW to classify its profit by two parts, namely the baseline and extra profit. For these two parts, two state-set ratios were respectively adopted to calculate the turn-in amount. After that, FAW could withhold the rest. These profits kept by FAW were generally allowed to be used on its own purposes, either to be reinvested in production, or to improve employee’s welfare and bonus. Echoing this change in profit-turning, FAW began to comprehensively practice the responsibility system. The production and management of the factory were divided into six categories, 24 plans and 240 goals, which were then distributed to workshops, production teams and finally individuals. Totally 250 thousand responsibility goals were then assigned to different production teams and individuals. Each of these sliced responsibilities were further converted into a 100-point score and divided by
months so that a time table was developed for each team or individuals. And bonuses and welfares were decided based on the accomplishment of these tasks.

Started from 1983, another profit-turning method was applied. A baseline turn-in profit (137 million yuan in 1982) and a yearly increase ratio (2.5%) were set by the central government, thus in the following years, FAW could keep all extra profits after handing over the pre-set amounts. This new measure was more like a responsibility system, in which a certain profit was set as responsibility and FAW had the right to keep its share after accomplishing the expectation. In consequence, from 1983 to 1986, the profit accumulated by FAW for itself had reached 406 million yuan, in which 230 million was directly used for production and about 170 million was spent for the welfare of employees. At the same time, the inner management of FAW promoted the responsibility system to a new level under the state directions. Within a state-led movement of “management adjustment of state-owned enterprises” in 1983, seven types of responsibility system was applied including the responsibility system designed for the profit, output, salary, loss, investment, single project and the extra-income. These responsibility systems were later expanded to twenty sorts. Also in this movement, many new management methods were introduced, which summed up to as many as 2,311 kinds across the whole factory in 1985.

Since 1985, FAW was further entitled by the state to enjoy a separately-listed account in the national planning, as had brought more management autonomy to FAW. The straightforward implication was that the production of FAW could be directly responsible for the central government without caring about the previous multi-level bureaucratic procedures. This special

5 In the salary responsibility system, the total salary was fixed, regardless of whether the number of workers increase or decrease in; In the loss responsibility system, the loss was fixed while the loss reduction would be rewarded; For the extra-income responsibility system, the sub-organizations in FAW were allowed to take additional projects from outside if they had already accomplished the production goals, and 20% to 30% of the income from these extra projects could be maintained by these sub-organizations.
treatment offered a privileged position for FAW to negotiate with the central administration face-to-face.

When we looked through the above process of FAW stepping toward a more autonomous status, it should be noticed that the exact state rationale behind these downward autonomies was to activate the momentumless enterprise long managed under the rigid planning system, rather than to deny the role of state in owning and controlling this enterprise. In fact, the state never showed any intentions to let FAW slip off its own hands. In this sense, with the state-owned enterprise being more efficient, the role of state was not weakened, but actually strengthened. A simple proof demonstrating the persistent role of the state was that FAW still had to take bureaucratic orders from above in some critical moments. For instance, in the whole 1980s, always holding the idea to concentrate the industrial structure and drive the automobile production toward being “large-scale” and “specialized”, the central government determined to build large enterprise federations. To fulfill this will of the state, FAW was then required to incorporate many small automobile enterprises across the country. Until the end of 1980s, totally 101 automobile enterprise had been added into a production federation system headed by FAW, including 13 assemblers, 44 manufacturers of buses and retrofitted automobiles, 42 auto-parts producers, and two research institutes across 22 provinces, cities or autonomous regions and 14 state branches (FAW 2003b).

Although the state had primarily played the leading role, forging the state-enterprise relationship was never a game with only one player; On the contrary, with the state releasing more autonomy downward, FAW had also held incentives to protect its own interests. Long managed under bureaucratic commands, FAW indeed did not have a clear interest perception in the planned economy system. Nevertheless, loosening of the state control in the reform made it possible for FAW to enjoy a share of its own business, as cultivated its own interest-calculations. The enterprise, on the one hand, strongly supported the reform plan from above, and on the other
hand, started to express their own concerns, especially when the new policy turned out to be negative for its interests.

The interaction between self-interested FAW and the central government could not be illustrated more clearly without mentioning the debate between the central government and FAW in 1984. In that year, CNAIC6 made an aggressive decision to incorporate a few large automakers including FAW under its direct management: “state plans should go through the corporation as a single gate toward subordinate enterprises”; However, FAW immediately felt threatened by such a plan, which may “turn FAW into a big workshop for this corporation” (FAW 2003b:261). For the sake of protecting the independent status, directors of FAW directly appealed to the central government in 1984. According to FAW, such integration headed by CNAIC would lead FAW back to the planned economy system. The government authorities were finally persuaded to drop such a program and further agreed to offer more autonomy to FAW in R&D, capital raising, product selling, technological introduction and foreign trade. The discussions in 1984 ended up with an official memo, clearly claiming that the future of the Chinese automobile industry should be dependent on “old enterprises” such as FAW, while CNAIC should allow the self development of these enterprises. In the following year, a more formal document was issued by NPC (later NDRC) and a few other institutes, pinpointing that “the central step of reforming the management scheme in the automobile industry is to enlarge the right of the enterprises to be independent and promote their vigorousness”, and CNAIC should be gradually developed as a service-providing organization (China Auto News 2005:23). From then, the role CNAIC kept declining so that it was finally replaced by an association-like organization, CAIF, which was considered as a “bridge and nexus” between the state and the enterprises. CAIF was later renamed as CAAM in 1990.

6 The central government established the CNAIC to take over the duty of the Bureau of Automobile Industry in MMI in 1982, with a major intention to improve the auto sector in a more concentrated structure.
In the second wave of the enterprise reform, the major transformation of FAW was the process of corporationization driven by the central government.

Though the central government held various plans to corporationize state-owned enterprises, for the large and key ones such as FAW, it had cast some special attentions. On the one hand, the state greatly encouraged the corporationalization among large state-owned enterprises through offering these enterprises with independent judicial persons and clarifying their state-owned assets. According to the central officials, these assets belonged to all Chinese people, while the central government was the proper representative holding the ownership; On the other hand, to correct the scattered small-scale production left by the planned economy system, the state started to organized large-scale enterprise groups and encourage the coordination among enterprises, while the large state-owned enterprises became ideal platforms. For the central government, groups and coordination could greatly promote the economy of scale and the organization structure of enterprises.

Under these new directions, FAW was transformed into a state-owned enterprise group consisting of multiple corporations. In 1992, FAW was firstly chosen by the state to make a enterprise group trial. The former FAW was then re-organized into the China FAW Group Corporation as the core corporation for the group. Thus, throughout the whole 1990s, under directions of this core corporation, the FAW group was shaped towards a three-level structure: the core level was the core corporation and some specialized sub-factories, wholly-owned subsidiary companies and directly-affiliated research institutes; the closely-associated level was consisted of the FAW-holding corporations and sharing corporations; and the loosely-associated level was consisted of corporations coordinating with FAW (Gen 1993). In 2001, the FAW group grown up as a large-scale enterprise group equipped with modern corporation institutions: it held one core corporation wholly owned by the central government, 9 directly-affiliated sub-factories,
23 bureaucratic functional departments, 25 wholly-owned subsidiaries, 13 holding companies, 30 sharing companies and 224 coordinating enterprises (FAW 2002).

The entire FAW group was constructed through the efforts of both the FAW and the central government. First of all, under the state direction and self efforts, FAW took over numerous companies in growing up as a group. To do this, the state firstly authorized FAW the rights of managements over the state-owned assets held by the enterprise and thus enabled FAW to make ordinary acquisitions and mergers in the market. As early as 1987, the state had selected FAW as “the experiment model” practicing the authorization of the state-owned capital. In 1993, the state officially authorized FAW to manage all the state-owned assets of the entire group and encouraged the FAW group to apply capital connections to consolidate its affiliates. This led FAW to broadly incorporate other enterprises in the market. It was also worthy to note here that some of these acquisitions and mergers were not directly driven by FAW itself, but actually directed by the central or even local governments. Until 2001, FAW had taken over 38 domestic enterprises, among which, 12 was turned as the sub-companies or wholly-owned subsidiary companies, 11 as holding companies, 9 as sharing companies and 6 as the directly-affiliated sub-factories; FAW also absorbed 145 enterprises as its coordinating enterprises (FAW 2002).

Secondly, leaders of the state and FAW both worked hard to introduce and enforce the corporation institutions into FAW. As early as mid-1990s, the FAW leaders expected the necessity of introducing the corporation governance into FAW such as the board of directors and the responsibility system of general manager (Gen 1993). In 1997, when the state particularly pushed these large enterprise groups to use the company law as a basic guide for the future corporationization, the corporationalization in terms of introducing corporation institution was accelerated in FAW:

On the one hand, FAW adjusted its inner structures through detaching the directly-affiliated sub-factories from its core corporation and simplifying its functional departments. For
FAW directors, keeping the whole manufacturing process in one enterprise was an outmoded legacy of the planned economy system, which had to be changed in order to reach a better specialization structure inside the group. The de-affiliation firstly started from the sectors of auto parts production. Based on 9 auto parts plants of the core corporation, a new part corporation was organized in 1998. This company was so large that it took away 16,491 employees, about 15.6% of total workers in the core corporation (FAW 2003b). Later on, more plants were released from the core as subordinate corporations (FAW 2003a): In 1999, the foundry company, the mould company, the communication company and the energy company were separately organized out of the previous sub-factories; In 2000, another five sub-factories were released from the core corporation, being turned into wholly-owned subsidiaries or holding corporations; With de-affiliating these sub-factories, FAW also simplified the management structure inside. One of most significant changes happened in 2001 when FAW cut its functional departments from as many as 44 to 22. As a result, the management positions were lessened by about 30%.

On the other hand, the FAW group was transformed toward a group with a normalized governance structure. The organization form of the state-wholly-owned corporation is a critical invention of the central government in transforming the old state-owned enterprises into modern corporations. In 2001, the FAW group appealed the government for its core corporation to be changed into a state-wholly-owned corporation and soon received the approval. In consequence, meeting the institutional requirement of the state-wholly-owned corporation, FAW set up the board of director and the management committee, the creation of which finally equipped FAW with a normalized governance scheme: the former was in charge of strategic decisions and the latter was mainly responsible for ordinary management. In the same year, FAW also issued new governance principles regulating the relationship between its core and subordinate enterprises, which stressed the autonomy of these subordinates under the macro-directions from the core.
At last, it should be reminded that the ownership of FAW reflected the dual-face of the Chinese central government in the market reform: though the state had indeed gradually receded from direct interventions into the ordinary management, FAW was always state-owned and always supervised by the state as one of its central enterprises, in order for the central government to control the national economy effectively. Whenever needed, the state would not hesitate to show a “visible hand” on FAW to fulfill its own wills. Such a pattern was guaranteed by some critical institutional mechanisms: The directly head department of FAW is the SASAC, which was meant to monitor the state-owned asset in state-owned enterprises. Another direct and powerful mechanism was that FAW leaders were appointed by the central government as high-ranked government officials. In fact, the appointments of top leader in FAW always should be confirmed by the Political Bureau of the Central Committee of CPC, the highest Chinese political institution.

2.3.2 Upgrading under State Directions

The technological strategy in FAW was also based on the leading role of the central government. Since 1980s, the central government held ambitions to realize technical upgrading in the automobile industry, so did FAW when more autonomy was transferred down. Pushed by the central government, a round of self-reliant innovations had been practiced in FAW upon its truck models. However this method was not applied for manufacturing cars. With the central government agreed to open the gate to foreign capitals and set up joint ventures in the car industry, the car production in FAW was soon following such a path.

Opening eyes to the world automobile industry at the beginning of the reform, the government officials and the FAW managers were both astonished by the serious underdevelopment of the Chinese automobile industry in comparison with the world advanced standards. As a result, incentives to quickly realize technical upgrading turned out to be very strong since the reform: for the central government, the advancement of the automobile industry
was critical for the whole national economy; For FAW, with gradually endowed autonomy, technological upgrading constituted a key advantage of the enterprise in the emerging market. Stimulated by these incentives, they both struggled to search the best ways to realize the technological upgrading as soon as possible.

An upgrading project in FAW was quickly initiated. Centering on remodeling the old models of trucks, this technological upgrading movement in FAW, named as “the remodeling project”, lasted from 1980 to 1986. Its major achievement was marked by a new 5t truck model, CA141, which approached the international standards in the late 1970s and early 1980s. This project was such a large one that no other previous projects could be comparable since the establishment of FAW.

This round of “remodeling” was mainly a self-reliant development process, which was led by the central government and mainly implemented by FAW: Firstly, the central government developed new methods to finance this project so that FAW maintained financially independent during the whole remodeling process. In principle, the state required FAW to rely on its own funds; on the other hand, the central government, no longer providing direct investment as before, created some favorable environments via various policies: as has been discussed above, the state allowed FAW to keep part of its own profits, which was an important protocol helping the enterprise to accumulate necessary funds; the state offered a special treaty on this project as well, which gave FAW additional 0.22 billion yuan in this project; Even when the state indeed directly provided some financial assistance, loans rather than direct investments were used.

Secondly, the denial of the state to completely introduce the foreign technologies led FAW to do the self-reliant R&D in the remodeling. In comparison with the large-scale technological transfer from Soviet Union at the establishment of FAW, the remodeling project was mainly conducted by the engineering team inside FAW. In fact, there were proposals from FAW at the very beginning, advocating the broad introduction of the advanced technology from
foreign countries, but the huge financial input estimated for these introductions made this plan out of the state’s considerations. Required by the central government, FAW ought to accomplish the whole R&D in an independent way. In 1980, the design mission for the new truck model and the corresponded engine was assigned to CARI as the major design department of FAW. With efforts of the FAW technicians, the prototype model was soon made out in 1981 and got approved by the central government in 1983.

This self-reliant remodeling was not a self-closed process; on the contrary, FAW in this project was always trying to absorb advanced technologies from outside. Approved and assisted by the central government, FAW paid a visit in 1978 to Japan to study the Japanese automobile industry (FAW 1998): Joined by twenty top leaders and technicians from FAW, this tour was planed as two parts. First, the team spent one month to visit ten top Japanese automakers including Toyota, Nissan and Honda, etc; Second, the team stayed at Mitsubishi, Suzuki, Nissan, Hino, Toyota respectively for one month in order to have closer observations. For a comprehensive understanding of the advanced Japanese automakers, the team had also been divided into five groups, in charge of product design, technics and quality, assistance of production, and enterprise management. What had been learned from Japan was later summarized into 26 books as instructional materials, containing as many as over 400 thousands Chinese characters. As described by the FAW leaders, the trip to Japan was “a shock to the old ideas and routines historically formed from the past management experience” (Xu 1983). Later on, more study teams were organized and sent out: totally 133 bunches, 1204 people were dispatched to more than 20 countries (FAW 2003b). These activities greatly helped the R&D of the new generation of trucks in FAW.

Just like the state-pushed self-reliant innovations on trucks, the joint ventures built by FAW for producing advanced cars also reflected the wills of the central government and the efforts of FAW itself. The joint venture strategy advocated by the central government since 1980s
marked a critical shift for the Chinese automobile industry, making the joint ventures as a major protocol for the technological upgrading and also for the promotion of domestic production. Thus, from late 1980s to present, FAW had been working hard to form cooperations with proper foreign partners, introduce the needed technologies and increase the output to meet the domestic demand.

To be well prepared to cooperate with the foreign car makers, at the very beginning, FAW associated the technological introductions and joint venture projects during remodeling its old Hongqi model. The first potential partner contacted by FAW was Chrysler from the United States, which sold FAW the whole technologies of a car engine. Nevertheless, this cooperation was later suspended. VW then seized the chance with a good plan for FAW: it proposed to introduce its top-class car, Audi 100, to FAW; promised to realize the domestic production; and more important, agreed to help FAW transform the old Hongqi model through equipping the introduced Chrysler engine into Audi 100. This project finally won the heart of FAW leaders. The good cooperation in transforming Hongqi led to the establishment of FAW-VW as the first joint venture of FAW in 1991. This project was announced to reach the annual output of 150,000 vehicles, which were the models of Jetta and Golf introduced from VW. As the largest joint venture project in the Chinese automobile industry by then, this corporation was strongly supported by the central government: in 1991, the leaders of NPC organized a conference in FAW in order to help with the construction of this new enterprise; in 1992, MMI held two meetings in FAW, organizing 18 enterprises to manufacture facilities needed by this joint venture; in 1994, NPC held another meeting in Beijing to accelerate the facility production for FAW-VW (FAW 2003b).

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7 In 1995, the Audi model, CSV6, was also introduced to this joint venture.
FAW-VW soon realized the domestic production: in 1996, at the end of this project, the domestic ratio of Jetta had reached as high as 84.13%, and the Audi model was approaching 60%. Through FAW-VW, FAW became a top car producer in the Chinese car market: in 2001, Jetta took over 15.3% of the domestic market share and the Audi A6, occupied over 30% market shares of the luxury models (FAW 2005).

In the new century, FAW strategically chose Toyota as another major foreign partner, as pushed the joint venture strategy of FAW to a new stage. Before cooperating with FAW, Toyota had already started local projects in China: It established a joint venture in Sichuan in 1998 and was closely affiliated to the Tianjin Automobile Group. To form the cooperation with Toyota, FAW firstly incorporated these two enterprises into its own group and then started comprehensive cooperation with Toyota since 2002, including building join ventures and many other cooperative projects.

At last, we need to discuss in brief the role of local government in this case. In the process discussed above, the development of FAW seems a story mainly about the central government and FAW. But, did the local government also played a role here? The answer was yes, but absolutely not a deterministic one.

Regards to the local governments in the local political structure, the Jilin Provincial government and the Changchun municipal government, as FAW’s local governments, became more autonomous during a decentralization process like many local governments across the country.8 That is, they were also independent players in this process of shaping FAW.

In terms of the developmental ideas, the development of FAW was closely associated with the interest of these local governments. In spite of being as a central enterprise, FAW created much local employment, consumed local resources and boosted the local economy via

8 Such a decentralization process will be fully discussed in the chapter about Chery Auto.
stimulating the local auto production. From 1953 to 1983, in the Jilin Province, FAW totally generated or helped 5 auto or motor assemblers, 11 retrofitting factories, 38 OEM factories and 88 auto parts factories (Zhao 1983). From 1980s, in the local development plans, the automobile industry was always described as the top advantaged sector of the local economy. For local political leaders, the automobile industry was always a “pillar” for the local economy and FAW was definitely the core enterprise. As Wang Yunkun, the secretary of Jilin province once claimed at the 50 year anniversary ceremony for FAW that the achievement of FAW was not only a success for itself, but also a pride of the Jilin province (FAW 2004).

Even though the local government held its own interest in the development of FAW, due to the fact that this enterprise was firmly held in the hands of the central administration, the only possible position of the local government in this game was to act as a sideman, rather than a compere. Based on such considerations, the local governments, either municipal or provincial, were always to assist with the central government and FAW in the construction. As a result, the major work of the local governments on FAW was supplementary projects such as building necessary infrastructures for water, electricity, and transportation. For instance, in the early 1980s, the remodeling project of FAW needed more lands for new production zones, while the municipal government confiscated a land as large as 535 hectares, from where about 10,000 presents were moved out; In the mid-1980s as the most intensive time for the remodeling project, the leaders of Jilin Province came to FAW for seven times in order to provide necessary helps; In 1991, the joint venture project of FAW and Volkswagen was listed as the number one project of the Jilin Province. In order to successfully build the first joint venture for FAW, the provincial government organized a coordinating office joined by leaders from the provincial government, municipal government and FAW.
2.4 Case Summary

In the developmental models across Chinese car makers, FAW is a typical case for the enterprises owned by the central government and applying the joint venture as a major method of technological upgrading. The local political structure of northeast China, where FAW locates, is characterized by a leading role of the central government. In the planned economy era, the central government had invested extraordinary resources to build the northeast as a national heavy-industry base, while in the reform years the central government still insisted its controls on chosen state-owned enterprises in this region, including FAW. Regarding to the development ideas of local car industry, the central government considered FAW as a critical protocol to serve the national wills: It determined to maintain the state-owned status of this enterprise and led FAW with the newly-designed industrial policy, namely to promote the automobile production for import substitution and to introduce advanced technologies via joint ventures. FAW, as a to-be-transformed enterprise in the reform, actively coordinated with the central government in the above process. For this previous command-receiving organization, there are indeed no other options to best survive the new market but to follow the steps of the central government. Similar concerns also applied to the local governments. Since the car industry was such an important local economic sector, they held strong incentives to assist the central government on any projects around FAW. In sum, the superior power of the central authority and its determined industrial designs made up the basic rhyme of the social construction around FAW in the post-reform era, determining its organizational structure and joint venture strategy.
3. Shanghai Automobile, King of Domestic Market

Located at the city of Shanghai, the economic center of China, Shanghai Automobile established the very first Chinese cars joint venture, Shanghai-VW, in the year of 1985, since when it was quickly developed from a small automaker to the largest car producer in the market. If FAW gave birth to the Chinese automobile industry in the planned economy era, Shanghai Automobile was the one starting the modern automobile industry in China. Nevertheless, unlike the story of FAW, which was primarily driven by the central government, Shanghai Automobile was more of a project pushed by the local government and meanwhile assisted by the central administration. The strong local government and the supporting central administration were keys to understand the development of Shanghai Automobile. In this sense, the case of Shanghai Automobile provides us a chance to explore how a local government in the market transition could act as a leading force in the local car industry with backups from the central government.

This chapter firstly introduced how the central government led the economic construction of Shanghai in the planned economy period and how the market transition witnessed a growth of a centrally-sponsored strong local government in Shanghai. Next, we studied how joint venture became a good upgrading protocol for the Shanghai officials for the local car industry and how this idea was accepted and used by the central government later. Finally, we analyze the local social construction process around Shanghai Automobile, which was featured by the active role played by the local government and the assistance from central government. Such a process generated such a developmental model that Shanghai Automobile was owned the local government and used joint venture as its major technological strategy.
3.1 Growth of a Centrally-sponsored Local Developmental State

Although Shanghai maintained as the national economic center of China before and after the market transition, developmental mechanisms of the local economy in these two stages were totally different. In the first stage, the central government dominated the local development in Shanghai and the local authorities are meekly practitioners of the bureaucratic commands from above; while after the economic reform, a new cooperative relationship was framed so that the local government became the leading force in the economic development of Shanghai and the central government served as a critical collaborator.

3.1.1 An Industrial Base in the Planned Economy System

The historically-formed status of Shanghai as the national economic center was the basic concern for the national planners when positioning it in the national economy system. Prior to the establishment of the People’s Republic of China, the city of Shanghai had a glorious past. In 1920s, “though not as advanced as London in Britain and New York in United States, with regard to the economic importance for the nation, Shanghai is truly comparable.” (Ma 1988:79) In about one hundred years from the first Opium War in the early 1840s to the Sino-Japanese war in late 1930s, Shanghai, as a mid-point city in the Chinese coastline, was developed as the national trade, financial, industrial and commercial center: From 1870s to 1930s, the foreign trade in Shanghai accounted for 45% to 65% of the national total amount; in early 1930s, the members of the Shanghai bank association held 89% of the national bank assets and 58 out of the total 164 banks in China located their headquarters in Shanghai; Shanghai also had the largest market for the foreign exchange, gold and stock in East Asia; In 1930s, the local industry possessed 40% of the national total industrial assets, produced an half of the national total output, and employed 43% of total industrial workers in the country; One third of the national
wholesalers, about 8,300 merchants, were in Shanghai and 60% of the industrial commodities made in Shanghai was sold to other domestic markets (Jin 1984; CSLR 2005).

As a result, after the establishment of the new China, in the minds of the top policymakers, Shanghai should be used well to serve the whole national economy. Ever since the year of 1949 when Shanghai was taken over in the civil war by CPC, this city immediately received special expectations from political leaders in the post-war economic invigoration. Chen Yi, one of the Chinese most-respected generals, was carefully chosen as the first mayor and Shanghai was entitled as a municipality directly under the central government, the first-class administrative level equivalent to a province. However, to tune up this economic engine for the new China had to be postponed temporarily. From 1949 to 1955, due to the impendent war threats, Shanghai as a vulnerable coastal city was excluded from the national development focus. Among the 156 major national projects led by the central government, Shanghai received nothing. In this period, Shanghai even contracted its urban population. When the military issues disappeared, the political leaders soon re-paid interests in this city. Shaping Shanghai to better serve the national economy turned out to be a national mission: In 1956, Chairman Mao proposed “to take good advantages of the industrial foundation in the coastal areas” and particularly mentioned that “Shanghai has a bright future and should be developed” (Tang 2001); In 1956, the first municipal congress of CPC of Shanghai, echoing the top political leader, proposed a formal guideline for the local economic development, which announced a well-known slogan, namely “to fully take advantages of the industrial potentials of Shanghai and properly develop the local industrial production of Shanghai”. Such a slogan kept as the basic principle in the planned economy era, determining the economic destiny of Shanghai in the following aspects:

First of all, the local ownership structure was transformed from the predominant private-ownership to be state-owned or collative-owned. Such a shift of ownership structure in Shanghai was a part of the grand socialist transformation movement launched by the central government in
1956, which was announced as a critical step moving toward the socialist public ownership. Shanghai as the place with the largest “capitalist economy” in China was certainly the major target in this movement. The private-owned industrial enterprises in Shanghai, previously dominant in the local industry, soon disappeared (CSLR 2005): Though producing as high as 72.4% of local industrial output in 1953, in the socialist transformation, the non-state-owned or non-collective-owned enterprises quickly shrink from 22,977 enterprises in 1955 to only 6 in 1956, while the state-owned industrial enterprises rose from only 292 in 1955 to 17,090 in 1956; The private wholesalers, who once contributed 65.5% of the local wholesales in 1950, completely disappeared after 1956, while the sale share of the private retailers also dropped from 91.6% in 1950 to only 1.8% in 1956; At last, with regard to the finance industry, the once prosperous private-run financial institutions were mostly demolished. There were 167 private banks or money shops in 1949 and only three private banks were finally left in 1956.

Second, the economic function and industrial structure of Shanghai were accordingly renovated by the central government’s design. With the establishment of the planned economy system, some economic functions were deprived of Shanghai. The isolation of China from the western world made Shanghai no longer important in the world trade. The state-led socialism transformations further transferred the commodity distribution and financial business to the hands of the central government, as degraded Shanghai from the national trade and financial center. According to the developmental principle mentioned above, the only function left for Shanghai was to serve the national economy as an industrial base.

Third, Shanghai received specific sector-adjusting requirements from the central policymakers. As the industrial center of the old China, Shanghai had previously concentrated on the light industry production. In 1949, the top eight sectors in Shanghai were all light industries such as textile, cigarettes, matches, soap, flour power, leather, and rubber, accounting for 76.0% of the total output value; by comparison, the local heavy industry was rather underdeveloped: the
equipment manufacture only occupied 8.5% of the total output value and the raw material productions such as the steel and chemicals were as little as 3.3% (CSLR 2005). However, since the major economic pursuit of the central government by then was the heavy industry, there emerged great expectations for Shanghai to make a shift toward the heavy-industry sectors. Except for maintaining certain production in the light industry such as the textile production, Shanghai was encouraged in the fields of machinery, electronics and raw material production such as steel and chemicals. And the central government particularly asked Shanghai to make special efforts in the development of advanced industrial technologies and products. Such a policy paradigm could be illustrated the local second FYP (1958-1962):

“We need to transform and develop Shanghai in the following three directions: firstly, to build Shanghai as an industrial city with multiple products, less consumption on raw materials, and light and advanced products; secondly, to build Shanghai as an national industrial base for new technologies and new products; thirdly, to make Shanghai to maintain and develop the coordination with the whole national industry and make the machinery and electronic industry in Shanghai as the national supply base for non-standard equipments and accessories.” (The Planning Committee of Shanghai 1957)

Under these directions from the central government, a significant shift was accomplished in the industrial structure in Shanghai. As can be seen from Figure 9, the tertiary industry, including the trade and finance sectors once prosperous in Shanghai, greatly shrink from 41.7% to 18.6%; in the same time, the secondary industry, especially the industry sector, was expanded from 52.4% to 77.4%. Inside the industry, the heavy industry was only about 1/8 of the light industry in early 1950s; by comparison, the heavy industry grew up to be similar as the light industry in terms of output value throughout 1960s and 1970s. In consequence, Shanghai was developed as a critical industrial base, both in heavy-industry and light-industry: According to the statistics in 1984, the cooper production in Shanghai account for 12.7% of the national total output, steel 13.3%, electricity equipment 26.5%, mining equipment 10.3%, and the metal-cutting
machine tools 13.4%; on the other hand, the overall light industrial products in Shanghai was 12% of the national total, in which bicycles accounted for 20%, sewing machine about one third, watch 30%, television 22.4%, recorder 19.4%, and camera 34.9% (Cao et al. 1987).

Figure 9: The Industry Structure of Shanghai, 1952 to 1978
Source: CSLR 2005
Note: Left pie in each year represents the overall industry structure in terms of output values, in which the construction industry and industry together made up the secondary industry, while right pie describes the inner structure of the industry by light and heavy industry.

In the above process of renovating the Shanghai’s economy to serve the nation, the Shanghai local state kept as a loyal follower of the central commands. Due to the importance of the municipal position in Shanghai, the local leaders were always carefully chosen by the top administration, with a clear mission to serve for the national interest. Accordingly, these local officials generally act as agents loyally practicing the economic directions from above.

Such a central-local relationship could not be better illustrated without discussing the fiscal situation in Shanghai. The fiscal income of Shanghai took a very important position in the national account. As can be see from Table 5, since 1960s, the fiscal income of Shanghai maintained approximately as high as 15% of the national total fiscal income. Nevertheless, the local fiscal expense in Shanghai kept only 1% to 3% of the national total expense. Such an
incompatible structure was due to the fact that Shanghai served as the largest national cash cow throughout the whole planned economy period. There were great fiscal outflows from Shanghai to the central government: from 1950 to 1980, the local fiscal income contribution from Shanghai to the national account approximately reached 200 billion yuan (Yao 1994); over 80% local budgetary income in Shanghai was taken by the central government and in some years, this turn-in ratio was even over 90% (CSFTR 1995). These significant contributions best indicated the subordinate status of the local government and in the meanwhile, the spontaneity and capacity of the local government in stimulating the local economic development had been seriously limited.

Table 5: National and Shanghai Fiscal Income and Expense (unit: 1 billion yuan)

<table>
<thead>
<tr>
<th>Year</th>
<th>National fiscal income</th>
<th>Local fiscal income</th>
<th>Local/National ratio</th>
<th>National fiscal expense</th>
<th>Local fiscal expense</th>
<th>Local/National ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>6.52</td>
<td>0.08</td>
<td>0.01</td>
<td>6.81</td>
<td>0.08</td>
<td>0.01</td>
</tr>
<tr>
<td>1955</td>
<td>27.20</td>
<td>0.21</td>
<td>0.01</td>
<td>26.93</td>
<td>0.19</td>
<td>0.01</td>
</tr>
<tr>
<td>1960</td>
<td>57.22</td>
<td>10.01</td>
<td>0.17</td>
<td>47.21</td>
<td>1.94</td>
<td>0.03</td>
</tr>
<tr>
<td>1965</td>
<td>47.33</td>
<td>6.18</td>
<td>0.13</td>
<td>41.15</td>
<td>0.78</td>
<td>0.02</td>
</tr>
<tr>
<td>1970</td>
<td>68.29</td>
<td>9.84</td>
<td>0.15</td>
<td>58.44</td>
<td>1.29</td>
<td>0.02</td>
</tr>
<tr>
<td>1975</td>
<td>81.56</td>
<td>13.42</td>
<td>0.16</td>
<td>68.14</td>
<td>2.65</td>
<td>0.03</td>
</tr>
<tr>
<td>1978</td>
<td>112.11</td>
<td>16.69</td>
<td>0.15</td>
<td>95.52</td>
<td>2.60</td>
<td>0.02</td>
</tr>
</tbody>
</table>

Source: Zhu and Gan 1999
Note: the local fiscal income is calculated as the budgetary income.

3.1.2 A Shift of Local Political Structure

Shanghai, once developed as a critical industrial center in the planned economy era, was having big troubles in the initial stage of the market transition. With the start of market transition, Shanghai as the previous economic pillar of the national economy moved much slower than the average national paces. From 1980 to 1990, the annual GDP growth rate in Shanghai kept being lower than the national level, except for 1980, 1981 and 1985 (Figure 10). The GDP growth rate dropped from the national top three to the 24th across the country and the growth rate of the income per capital dropped from the national 2nd to the 25th (Shanghai Zhengda Institute 2002). Thus, the whole 1980s seems a lost decade for Shanghai, witnessing a continuous decline of its
economic status in the national economy: in 1978, the local GDP of Shanghai was 7.6% of the national total, the local national income was 8.2%, and the local industrial output was 13.0%, however these values were respectively reduced to 4.2%, 4.3% and 4.9% in 1990 (Yao 1994). Such a fall of Shanghai looked more evident when compared with the other areas. From 1979 to 1990, the averaged annual GDP growth rate of Guangdong, Fujian, Zhejiang, and Jiangsu as the four costal provinces respectively reached as high as 10.5%, 12.6%, 11.8%, and 10.3% while Shanghai was only 7.5% in the same period (Shanghai Zhengda Institute 2002).

![Figure 10: National and Shanghai’s GDP Growth, 1980 to 1990 (unit: percentage)](source: Yao 1994)

The decline of Shanghai in 1980s could be mostly attributed to a basic logic of the central government in steering the market transition: the reform process should be as stable as possible, thus Shanghai, as a key national industry base, should act as a “back guard” to minimize the possible risks rather than as a pioneer taking the lead in these institutional changes. With such an assigned duty, Shanghai had to bear multiple burdens, which greatly held back its economic development:

First of all, as a stabilizer in the reform, Shanghai performed awkwardly in dealing with the newly introduced market mechanisms. In the previous planned economy system, for a city like Shanghai which greatly needed resource inputs from outside for its industrial production, the
production factors such as the raw materials and capitals were always allocated by the central administration. While, with the market replacing the bureaucratic commands, costs of getting these necessities had jumped so high that the local enterprises could hardly afford without increasing their own prices. However, in order to avoid economic risks for the overall country, Shanghai was asked not to reset the prices of its industrial commodities accordingly (Shi et al. 1987).

Secondly, constraint as a late mover in the national reform plan, Shanghai was losing its developmental opportunities to some “periphery” areas. Take the previously-mentioned four costal provinces as instances. Regions such as Guangdong and Fujian, receiving less attention from the central government before, were firstly chosen to attract foreign investments in the reform; on the other hand, in provinces of Jiangsu and Zhejiang which held less state-led industrial projects as “historical burdens”, came to develop active local township and villages enterprises, either driven by the local government or the private entrepreneurs.¹ Apparently, under the special arrangement, Shanghai could not join these newly-rising local economies.

Thirdly, Shanghai was often excluded from the fiscal decentralization launched by the central government. A general process of this decentralization was featured by the re-configuration of the central-local fiscal relationship, in which the local government may retain more of the local tax incomes for itself.² However, in order to lessen the total loss of the central administration in decentralization, Shanghai was often asked to delay its fiscal liberation and play as a buffer for this institutional change: In 1980s, the fiscal burden per capita in Shanghai was once 70 times in comparison with Guangdong (Wang 2003b). And “the huge and stable fiscal turn-in from Shanghai” greatly helped to smooth the national decentralization (Cai 1993:55).

¹ The chapter discussing Geely Auto has a detailed account about Zhejiang’s active private economy.
² This institutional change will be fully discussed in the chapter about Chery Auto.
Due to the declining local economy in the lost ten years, such “back guard” logic came to be challenged since mid-1980s and a power shift was accordingly driven by the governments both at the central level and the local level.

On the one hand, the central constraints in the 1980s were counterattacked by the Shanghai local government, which continuously requested more autonomy to address its own interests. The situation of the local economy was not only the foremost responsibility of the local administration, but also closely related to the political prospect of many local political figures. In 1987, these local requests for more autonomy came to strike the central policymakers:

“At that time, Comrade Zeming, Rongji, Bangguo and Huang Ju all proposed one request repeatedly. That is, Shanghai was to guarantee the fiscal turn-in to the central government in exchange for the local autonomous rights in the reform… The national leaders all acknowledged Shanghai’s supports for the national reform and its current difficult situation… (Finally, the central government decided to) support the claims (from the municipal government) except the fiscal assistance request. Thus, the local autonomy was finally gained.”(Wang 2003b)

Such an arrangement further evolved to a local policy guideline, namely the “Three Promises and Three Reforms”. The former part was basically meant to meet the requirements from above, namely the promise of insisting socialism orientation, following macro-adjustments of the central government, and accomplishing the fiscal turn-in mission with surplus; the latter part emphasized the local autonomy, claiming that the local reform should be self-funded, self-reliant, and ahead of other areas.

On the other hand, to reinvigorate the local autonomy in Shanghai was also gradually acknowledged by the central government to meet its own interests. Enjoying the quick success in the firstly-opened Guangdong and Fujian, central reformers came to have more courages and

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3 These four persons were the major municipal leaders at that time, Jiang Zeming, Zhu Rongji, Wu Bangguo and Huang Ju, all of whom later became the national top political leaders.
experiences to tackle on Shanghai as the next breakthrough for the following reform. Since the early 1990s, the central government started to move Shanghai from the back guard to the front stage in the national reform project. Deng Xiaoping, the major planner of the Chinese reform, repeatedly mentioned the urgency of developing Shanghai as China’s next step in the reform since the late 1980s. Deng had made some well-known directions in this period, which were extremely important for the re-invigoration of Shanghai’s economy in the 1990s, such as “Shanghai is our trump and a shortcut to success”, “looking back, my largest mistake (in the reform) was not adding Shanghai into the four firstly-opened special economic zones”, and “the 1990s is the last chance for the development of Shanghai.” Such re-emphasis on Shanghai’s economic development had critical implications on the local political structure of the local economy: In order to invigorate Shanghai, the legitimate way for the central government was not to keep Shanghai at hands of the central government as the previous time but to free the local government from the position of “back guard” as soon as possible in the new market environment.

As a result of these above efforts, the “back guard” situation was broken in Shanghai and a new type of the central-local relationship gradually evolved out of the previous bureaucratic command system. A basic change was that the local municipal government came to be directly in charge of the local economic affairs. In this sense, Shanghai looked no different from many other released local governments in the decentralization. However, there was indeed an additional feature distinguishing Shanghai from others. Due to the critical economic position of Shanghai for the national economy, there came unusual attentions from the central government to the local development. Thus, the central government held strong incentives to help the local development as a cooperator. As a result, there came a unique local political structure in Shanghai, namely a strong and active local government closely collaborated by the central administration.
Will such an arrangement in the local political structure generate substantial tensions between the local and central level as before? The answer was NO. Firstly, the intervention of the central government on the local economy was no longer through direct bureaucratic commands, but mainly via macro-level policy orientations. Thus, there is a clear functional division, in which the local state performed on the front stage and the central government sat behind. Secondly, the concerns about the unique economic status of Shanghai made the central government very generous in providing special policy treatment, which were definitely welcomed by the local officials.

In such a local political structure, there were commonly two ways for the local and central government worked together in stimulating the re-rise of Shanghai.

First, the cooperation may follow a sequence from the local to the central level. As already claimed by “Three Promises and Three Reforms”, Shanghai could not get any direct financial assistance from the central government, thus a commonly-used strategy to solve developmental bottle-necks was to ask for the special policy treatment from above. These local requests were always positively responded from the central government. For instance, in mid-1980s, in order to collect some starting funds, Shanghai successfully get the authorization from the central government to use foreign loans, as was truly unprecedented across the country; Later, more and more similar privileges were approved such as the permission to set up the local bank, the insurance company, and the market for futures transaction (Wang 2003b).

Second, the cooperative procedure could also go from up to bottom. For the extreme importance of Shanghai in the reform, the central government often proposed developmental plans on its own initiatives for the local government to fulfill. However these proposals were absolutely unlike the previous bureaucratic commands, but more of macro orientations. The local state then became major practitioners of these grand guidelines. Such a cooperative pattern could be clearly observed in the development of Pudong economic zone, the most critical breakthrough
for the economy of Shanghai of 1990s. At the 14th National Congress of CPC in 1992, the central government specifically emphasized Pudong as a national focus:

“To take the development of Pudong in Shanghai as the lead, to develop the cities alongside the Yangtze River, to quickly build Shanghai as one of the international economic, financial and trade centers and drive a new leap for the economy of the Yangtze River delta and the whole drainage area” (Jiang 1992)

Many new special policy instruments were then offered by the central government to help local officials in the Pudong construction. For instance, the central government allowed the state-owned land to be leased out in Pudong, as greatly solved the shortage of construction-used fund at the very beginning; Another critical policy innovation was to open the Chinese currency business for foreign financial institutions in Pudong, which helped to re-built Shanghai as the national financial center. Guided and helped by these central policies, the municipal government made Pudong as the main economic battle field. Until 2000s, Pudong has successfully grown up as the leading region for the Yangtze River economic area and also a main symbol showing the re-rise of Shanghai in the reform era.

3.2 Local Plan and National Breakthrough

In the minds of Shanghai officials, the development of the local car industry was thought as the most important step for the re-rise of Shanghai in the reform era. With the co-efforts from both the local and central government, it became a legitimate plan for the Shanghai local government to run its own car project in the form of a local state-owned enterprise. On the other hand, after carefully searching feasible ways to realize technological upgrading, the local government inclined to introduce foreign automakers and establish joint ventures. It was Deng Xiaoping as the top political leader in China at that time who finally offered legitimacy to this trial in mid-1980s. This brought the Chinese automobile industry into a new age: the previously closed door for the foreign capitals was opened and to set up joint ventures became a universal upgrading strategy for the Chinese automobile industry.
3.2.1 Shanghai’s Initiatives for Cars

For Shanghai officials, bothered greatly by the lost ten years, the car industry came to be considered as a strong candidate to be the most important industrial sector for the local economy and was also a big opportunity to actualize the economic re-rise. From 1981 to 1991, three consecutive leader boards in Shanghai all prioritized the car industry in the local development schedule. Wang Daohan (1981-1985) as the first mayor in the reform era bravely attempted to introduce foreign technologies for the local car production; His follower, Jiang Zemin (1985-1988), officially proposed that the car industry should be “the top pillar industry in Shanghai” in 1987 (CSY 1996); the next mayor, Zhu Rongji (1988-1991) further confirmed that the car industry would be the most important pillar industry in Shanghai.

Behind these decisions to manufacture cars in Shanghai were careful observations on the domestic market situation and local economic advantages of Shanghai. The early 1980s of the Chinese automobile industry witnessed a big wave of import flood of cars, which was almost out of the controls of the central administrators. Import substitution was then advocated to be a necessary countermeasure so that enlarging domestic production became a serious issue for the central policymakers. Trying to get out of the period of the lost ten years, Shanghai officials were very sensitive to any possibilities to advance the local economy and certainly could not tolerate losing such a chance.

On the other hand, the car industry was indeed an advantageous sector in the local economy. Prior to the reform, Shanghai already had set up one of the most advanced car production lines in China. Throughout the whole planned economy period, in the Chinese automobile industry, only three car products were developed from 1957 to 1965 with little output: Hongqi from FAW, Dongfenghong from BAF, and Shanghai from SAF. The Shanghai model manufactured by SAF was not only one of the three, but also became the strongest one in the early 1980s. Although the Hongqi model from FAW long seized the honor as the “nation’s car”,
the production of this model was suspended by the central government in early 1980s with a reason of high oil consumption; The other model, Dongfanghong (meaning sun rising from the east in Chinese, a political metaphor for Chairman Mao) produced by BAF got a even more miserable fate. The production of this car was arbitrarily called off in the political riots of the Cultural Revolution. By comparison, the production of the Shanghai model maintained a rather stable. In 1958, Fenghuang (meaning phoenix in Chinese) as the former model of Shanghai was firstly made out; In 1964, Fenghuang was renamed as Shanghai and reached the output of 50 units in the same year; From mid-1960s to early 1980s, the production of this model gradually and uninterruptedly increased from a few hundreds to over 5,000 units (CSAIH 1991).Although cars were never taken seriously in the Chinese automobile production throughout the prior-reform stage, Shanghai was still counted as one of the most successful car manufacturers in this field, as became a key stake for the local government to be ambitious in this field.

In late 1980s and early 1990s, the local emphasis on the car industry got a more solid ground. The local officials came to combine their ideas about the car production into a more general framework about the local economy transformation: The car industry was considered as an important and integrative part in upgrading the old industrial structure of Shanghai. To get out of the lost ten years, the Shanghai top leaders were desperate not only in acquiring more economic autonomy from above, but also in seeking the potential economic sectors to change the outdated local industrial structure. There were two sectors being pursued by the local officials since late 1980s: the first one was to emphasize the tertiary industry such as financial and trade

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4 One main reason for the success of the Shanghai model in the prior-reform era was the local comparatively excellent industrial conditions, especially the good manufacture capacity in making the automobile components. Before establishment of the new China, Shanghai had already developed the production of automobile components. In early 1950s, there were about 200 component makers in Shanghai, which produced one third of the national output; from 1954 to 1955, 767 automobile technicians were once transferred from Shanghai to Changchun in supporting the FAW construction, which became a significant part for the first generation technicians of FAW (CSAIH 1991). Another secret depended on the fact that unlike Hongqi specifically serving the top-ranked political leaders, the Shanghai model was designed as a common car for ordinary officials. Thus, this model could enjoy a more substantial and stable demand in the planned economy era.
sectors as new developmental platforms. In another word, the local state aimed to change the industrial structure from a pattern of “second-tertiary-first” to “tertiary-secondary-first”; the next plan was to identify the so-called pillar industries inside the secondary industry. Among the six pillar industries proposed by the local government in the early 1990s, the car industry was listed as the first one, ahead of others including the industry of telecommunication equipments, equipments for electric power station, petrochemical and fine chemical industry, steel production, and home appliance.

Such a car-making motivation of Shanghai officials was also closely associated with the central government. In fact, it was the central administrators who actually triggered the first spark of the Shanghai car industry. In 1978 as the beginning year of the Chinese reform, Rao Bin, the major director of the Chinese automobile industry at that time, received an order from NPC, proposing to introduce a production line for cars; Shanghai then became Rao’s first choice, due to the fact that Shanghai had the excellent industrial condition and also was the only place capable of manufacturing cars in relatively large scale (Zhu 2008). It should be noted that such an offer from above was not meant to build a project funded and run by the central administration, but more like a permission for the local government to expand its car production.

Since late 1980s, the central government further confirmed Shanghai as the national car production base. Although introducing a production line to Shanghai might merely be a historical accident, when the central government held new thoughts to promote the domestic car production in late 1980s, Shanghai indeed became a focus for the national policymakers. The reason was simple. When enterprises such as FAW and SAW turned their heads to this promising field, Shanghai Automobile had already proceeded a rather long way. As a result, Shanghai Automobile

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5 Such a chance could be caught by Shanghai was also because in the early years of the reform, Chinese largest automakers such as FAW and SAW were all busy on restoring their truck production to serve the burgeoning demand from the economic revival; Thus, these automakers could not pay enough attentions on this project(Cheng 1995).
received the special cares from then on. In the milestone 1987 Beidaihe conference, Shanghai Automobile was announced to join the FAW and SAW as the officially-approved major car manufacturers. Especially when the two mayors of Shanghai as major advocates of the local car industry, Jiang Zeming and Zhu Rongji became the Chairman and Prime minister of China in 1990s, there were no possibilities for the central government to set any obstacles in front of the development of Shanghai Automobile.

These ideas on the local car industry both from the local and central administrations set up the basic conditions for Shanghai Automobile to be directly owned and managed by the local government itself. The local municipal government had enough motivations to directly set up such an enterprise in order to fulfill its own plans for the local economy, while the central government intended to help with such a local project for its own purposes.

3.2.2 Ideas about China’s First Joint Venture

To decide a car project is an issue, however to figure out how to accomplish is another issue, maybe a more difficult one. As the earliest bird in the Chinese car industry after the reform, Shanghai needed to figure out a way for technological upgrading. Contrary to the birth of the local car project, which was initiated from the central government, the ideas about building a joint venture for technological upgrading was firstly proposed from the Shanghai local administrators.

The birth of the joint venture idea actually followed the failures of some unrealistic plans proposed by the central policymakers for introducing the production line in Shanghai. According to Jiang Tao as the major negotiator in the Shanghai-VW project and Qiu Ke as the first director of Shanghai-VW, this introduction plan had a complicated context (Jiang 2009; Zheng 2006): Originally this project, among a series of plans made by the central government, was meant to develop export in exchange for the foreign currency, which was badly needed by the nation at that time. Thus, the central administrators asked this car project to implement the “compensation trade”. That is, the foreign client supplied necessary technologies, equipment and materials, while
China side mainly took the production part. The central policymakers even made such a detailed production blueprint that this assembly line should yearly produce 100 thousands of cars and 50 thousands of minibuses, among which 20 thousands of the cars and 30 thousands of minibuses would be sold domestically and the rest would be exported. If fulfilled in practice, this idea would make perfect sense: this assembly could serve the domestic demand and thus save money for importing; on the other hand, it could also gain some extra foreign currency. Nevertheless, this plan had a fatal flaw. Its feasibility mostly relies on such an expectation that the foreign clients may be attracted by the cheap labor in China. Such a presumption might be valid for many labor-intensive sectors such as apparels and textiles, but could barely work in the capital and technological-intensive branches such as the automobile production. Basically, the foreign automakers disliked risks in the “composition trade” such as leakage of advanced technologies, incompetence of local production and difficulties of selling the products. Not surprisingly, efforts following this method proved resultless at the end.

The breakthrough for a brand new strategy, namely to establish a joint venture, was born in the negotiations between the leaders of the Shanghai automobile industry and the foreign automakers. Here are some valuable memos from Qiu Ke and Jiang Tao:

“In October of 1978, just one year after my appointment as the general director of the STAIC, I was asked to lead the negotiation team of the car project. My first mission was to go to Beijing for a negotiation with GM from the United States. GM would not like to accept our proposal of compensation trade, but brought forward an idea of setting up a joint venture, in which they would provide technologies, management and capitals. I felt pleased under the table about their suggestion, since I never considered the compensation trade as a promising way to go. In this way, neither could we get the real technologies, nor the needed capitals. But I could not argue with the state council. Now here just comes the suggestion from the United States. I held my excitement inside, told GM to wait for further discussions, and immediately
report to the State Council. In 1978, there was no such thing as a joint venture. So many leaders hesitated to take risks.” (Qiu from Zheng 2007)

“On November 9th, when Gu Ming as the associate director of the NPC asked for directions about whether a joint venture could be applied to the car project, Deng Xiaoping immediately gave a confirmative response, ‘Sure, not only for cars, the heavy trucks could also give a try’. CNAIC then informed Shanghai that later negotiations could concentrate on joint ventures.” (Jiang from Wu 2009)

“The later negotiation did not mention the compensation trade any more, but all about joint ventures….At that time, we had negotiations with GM and Ford from the United States. For GM, there were three rounds of negotiations. In Japan, we talked with Nissan for two times. Toyota did not respond to us and later felt regretted. For French automakers, we had talked with Renault for one time, Citroën for about ten times, Peugeot for two or three times. In Italy, we contacted Fiat. Among all of these automakers, we negotiated most frequently with Volkswagen from Germany, approximately thirty times. Finally, Volkswagen was confirmed as our partner. By that moment, I truly felt the coming of a promising future of the automobile industry in Shanghai.” (Qiu from Zheng 2007)

As can be seen from these detailed descriptions about the birth of the first joint venture in the Chinese automobile industry, the local leaders of Shanghai car industry represented by Qiu Ke and others indeed played a very active role in activating the idea of joint venture. As major negotiators, they were sensitively aware of the drawbacks of the compensation trade model proposed from the central administration and strategically steered the negotiation towards their preferred method, namely to build a joint venture. Obviously, the joint venture proposal fit the local interest much better than the previous compensation trade model: First, a joint venture could provide better chances for the Shanghai automakers to master advanced technologies in the cooperation with the foreign automakers, while the compensation trade may merely result in a CKD pattern, in which the Shanghai automaker simply assemble the imported auto components; Next, setting up a joint venture was a much more realistic solution to attract the foreign automakers into China. Holding certain share in a joint venture was an effective way for the
foreign investors to reduce their worries about the potential risks. Due to the above reasons, leaders of the Shanghai car industry considered the approval of the joint venture as a big success.

The approval of the first joint venture later evolved into a formal national industry guideline for technological upgrading in the car industry.

The support on the joint venture from Deng Xiaoping was not stemmed out of a temporary impulse. In fact, if we checked Deng’s overall performance in the reform, a joint venture project in the car industry indeed suited well with his basic opening rationale. For him, the car industry and many other related sectors had over-emphasized the independence of the national industry, as enclosed China from the world and sacrificed the possibility of technological advancement. Therefore, what Deng cared most was to introduce the advanced technologies and management through opening policies, but not to protect the previous independent status of the Chinese industries. That explained why the joint venture initiative was passed in his hand without hesitations. Given the fact that the inflow of foreign capital in the era of planned economy was once considered as the uppermost threat to national industries, Deng’s decision to open the door for foreign automobile manufacturers marked a new start of the Chinese automobile industry.

Although Deng’s framework accentuated the importance of opening, deeply influenced by the nationalist ideology of the Mao era, bureaucrats in charge of the automotive industry did not necessarily interpret “opening” as simply the surrender to foreign competitors. The ultimate goal was still set towards the technological independence even in an open economic environment. According to these officials, the development of the Chinese automobile industry should follow two stages (He 1994): From 1994 to the end of the twentieth century, the industry should improve its basic conditions; In the next stage from 2000 to 2010, it should catch up with the advanced foreign automakers, develop the capacity of independent R&D, and cultivate a set of competitive domestic enterprises in the international market. Under such a consideration, to cooperate with foreign corporations mainly was taken as a bridge access to such a destiny. Accordingly, an
upgrading schedule for Chinese automakers in the joint ventures was once proposed in mid-1990s: In cooperating with foreign automakers in the joint ventures, domestic automakers were expected to firstly try the R&D of automobile bodies, whole arrangements and components, then move to chassis and system, and finally master the R&D of the engine and whole car (Liu 2006).

As summarized by the policymakers themselves, the joint venture strategy was meant to “exchange the market share for advanced technologies”. This is the essential logic of this upgrading method for the central administrators, which effectively integrate the old national ideal and new thoughts in the reform. There then came two critical components of such a strategy, particularly insisted by the policymakers as assurances for the success of such a method: To avoid the risk of the foreign corporations taking advantages of the joint ventures to control the Chinese car industry, no foreign corporation could hold more than a half of the total share in the joint venture and each foreign corporation could have at most two domestic partners.

Table 6: Major Joint Venture Projects in the Chinese Car Industry, 1983-2004

<table>
<thead>
<tr>
<th>Start Year</th>
<th>Name</th>
<th>Foreign Partner</th>
<th>Investment Proportion</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>Shanghai VW</td>
<td>VW</td>
<td>Shanghai Automobile &amp; others 50%, VW 50%</td>
</tr>
<tr>
<td>1991</td>
<td>FAW VW</td>
<td>VW</td>
<td>FAW 60%, VW 40%</td>
</tr>
<tr>
<td>1992</td>
<td>Dongfeng Citroën</td>
<td>Citroën</td>
<td>DFM 70%, Citroën 30%</td>
</tr>
<tr>
<td>1993</td>
<td>Chana Suzuki</td>
<td>Suzuki</td>
<td>Chana 51%, Suzuki &amp; others 49%</td>
</tr>
<tr>
<td>1995</td>
<td>Nanjing Iveco</td>
<td>Iveco</td>
<td>YAG 50%, Iveco 50%</td>
</tr>
<tr>
<td>1997</td>
<td>Shanghai GM</td>
<td>GM</td>
<td>Shanghai Automobile 30%, GM 50%</td>
</tr>
<tr>
<td>1998</td>
<td>Guangzhou Honda</td>
<td>Honda</td>
<td>GAIG 50%, Honda 30%</td>
</tr>
<tr>
<td>1999</td>
<td>Nanjing Fiat</td>
<td>Fiat</td>
<td>YAG 50%, Fiat 50%</td>
</tr>
<tr>
<td>2001</td>
<td>Chana Ford</td>
<td>Ford</td>
<td>Chana 50%, Ford 50%</td>
</tr>
<tr>
<td>2002</td>
<td>Tianjin FAW Toyota</td>
<td>Toyota</td>
<td>FAW 50%, Toyota 50%</td>
</tr>
<tr>
<td>2002</td>
<td>Beijing Hyundai</td>
<td>Hyundai</td>
<td>BAIC 50%, Hyundai 50%</td>
</tr>
<tr>
<td>2002</td>
<td>Dongfeng Yueda Kia</td>
<td>Kia</td>
<td>DFM &amp; others 50%, Kia 50%</td>
</tr>
<tr>
<td>2003</td>
<td>Dongfeng Motor</td>
<td>Nissan</td>
<td>DFM 50%, Nissan 50%</td>
</tr>
<tr>
<td>2003</td>
<td>Dongfeng Honda</td>
<td>Honda</td>
<td>DFM 50%, Honda 50%</td>
</tr>
<tr>
<td>2004</td>
<td>Guangzhou Toyota</td>
<td>Toyota</td>
<td>GAIG 50%, Toyota 50%</td>
</tr>
<tr>
<td>2004</td>
<td>Beijing Benz-DC</td>
<td>DC</td>
<td>BAIC 50%, DC 50%</td>
</tr>
</tbody>
</table>

Such a strategy became the bible for the Chinese car industry since 1990s. Following the Shanghai-VW as the first joint venture in mid-1980s, all of the significant domestic car makes
were directed by the central government into such a route. As can be seen from Table 6, FAW as the largest automakers at that time, built up its joint venture with VW in 1991; SAW (renamed as DMC in 1992), the secondly largest automaker at that time, chose Citroën as its partner in 1992. As required by the central government, no foreign automakers had more than two Chinese partners and the foreign automakers always took less than 50% shares in the joint ventures.

3.3 Starting a New Age for the Chinese Car Industry

With the direct push of the local leaders and the generous assistance of the central administration, the Shanghai car industry experienced a round of very successful development in the reform period. On the one hand, evolving out of a group of local small automobile factories, a large group corporation owned and directed by the local government, SAIC Group, was finally developed; on the other hand, the successful introduction of the foreign technologies via joint venture helped Shanghai Automobile to quickly catch up with the international standards in car manufacture and became the largest Chinese car maker in the domestic market. Particularly, the success of joint ventures in Shanghai opened a new door for the Chinese automobile industry: In this sense, the Shanghai Automobile since 1980s was comparable to FAW in the early 1950s.

3.3.1 Going toward a Locally-owned Corporation

In the 1980s when the management autonomy was transferred downward, Shanghai Automobile had gone through a very characteristic track: A core enterprise as the platform was gradually born out of the previous association management scheme under the efforts of the local officials and the general direction of the central government.

Such a process was mainly grounded in the historically-formed local governance structure of Shanghai automobile industry. Consider FAW for a comparison. Designed as the base of the national automobile production, FAW was directly built by the central government to be an enterprise leading the other national and local automakers. Thus what FAW faced in the
reform was mostly rounds of transformations on this already-established automaker, echoing new requirements on the state-enterprise relationship. Nevertheless, in the planned economy era, Shanghai did not develop a FAW-like automobile enterprise leading the local automobile production, but held many small local automobile factories instead, most of which came from private-run workshops in the past. In order to coordinate these small automakers, an association-management framework was established as the major governance structure, in which a head institution so-called “the bureaucratic enterprise” was in charge of hundreds of subordinated local automobile factories. In nature, this institution was an office of the government, managing all local automakers to fulfill the economic commands from above.

A brief history of this associational management in the planned economy era could be summarized as below (CSAIH 1991; CSAIR 1999): In 1955, Shanghai Gas-engine Component Manufacture Corporation was built up as the head institution and then incorporated 291 local automobile enterprises as subordinates by 1957; In 1958, Shanghai Power Machinery Manufacture Corporation took over the managerial position, which held 147 subordinates by 1959; from 1960, this administration was renamed as Shanghai Agriculture Machinery Manufacture Corporation and held 68 sub-enterprises by 1966; In 1969, it was renamed again as STAIC with 77 subordinates. The STAIC scheme lasted until the late 1970s.

Due to such a governance structure, when the reform started in the late 1970s, the previous “bureaucratic enterprise” as the head of the local automobile industry naturally became the major platform to practice the enterprise reform. Throughout the whole 1980s, there were four steps through which STAIC was renovated from a bureaucratic enterprises into a real-sense enterprise (CSAIH 1991; CSAIR 1999): First, in late 1970s, among 35 national-wide experimental models, STAIC was approved to be transformed from a bureaucratic institution towards an economic organization directly under the central government; Second, in early 1980s when CNAIC was organized by the central government to integrate the national automobile
industry, STAIC was rebuilt as STAICC and officially confirmed as an local enterprise; Third, in mid-1980s, further detached from the previous bureaucratic management, STAICC was defined as an economic organization with legal person status. In this framework, it was under the macro direction of SEC and also became autonomous in the ordinary management; Fourth, in late 1980s, responsibility systems were applied. In the state-enterprise level, contacts of responsibility were signed between the municipal government and STAICC. In the inter-enterprise level, a series of responsibility contacts was made between STAICC and its affiliates. In the intra-enterprise level, a responsibility system of the general director was applied for the management board.

In reshaping STAIC from a government management branch into an autonomous economic organization, the central government and the local government played different roles. It was the central government who firstly initiated the changes to de-affiliate STAIC out of the bureaucratic system. However, after this first step, the local government in Shanghai performed more actively. In early 1980s, it strategically took advantages the establishment of CNAIC as a critical shift of the national automobile industry to seize the enterprise in its own hands. As can be seen from the establishment document for STAICC issued by the local government, all of the interest-relevant players such as the central administration and CNAIC were carefully addressed, but the major point was also made clear that this new-established enterprise would be belonged and managed at the local level:

“Under the direction of the central government, it (STAICC) is an economic organization practicing independent production, management and accounting activities with a legal person status…It is directly led by SEC and also takes instruction from CNAIC upon automobile business.” (CSAIH 1991)

After this milestone event, further renovations on this enterprise were directly led by the local government.

For Shanghai Automobile, 1980s had indeed witnessed some great advancement in term of the state-enterprises relationship; However these accomplishments were still far from the
requirements of modern corporation institutions. The governance structure, either in the state-enterprise level, the inter- or intra-enterprise level, was still featured by the responsibility system, which was not the final solution in the enterprise reform. For instance, STAICC still had to maintain some management legacies. Shown in the name of STAICC, which got one add-on to the previous title, “coordination”, the major function of STAICC was meant to mobilize its numerous subordinates. In practice, this was still similar to the previous association management. To fulfill certain production missions, STAICC had to rely on “production coordinating bodies” based on its subordinates, rather than mobilized the resources via a clear-defined ownership relationship. Although STAICC sometimes created some leader enterprises to integrate subordinates into one organization, but this was not a well-developed method in 1980s.

These problems came to be addressed by the local government since 1990s, when the national-wide enterprise reform stepped further to emphasize the adoption of the modern corporation institution. STAICC was renamed as SAIC in the year of 1990, which marked a new start of Shanghai Automobile. After that, there came three major stages presented as below.

In the early 1990s, a new management scheme named as “Three-level and Three-center” was applied in SAIC: The headquarters was positioned as a center for investment decisions, the leader enterprises were assigned as centers for management and profits, and the subordinates were considered as centers for production and cost-control (SAIC 1993). Next, to assist the development of SAIC, the municipal government arranged Shanghai Trust and Investment Company to participate into SAIC with a stock share valued 700 million yuan, as increased the registered capital of SAIC from 2.1 billion to 2.8 billion. Due to this event, SAIC introduced the board of directors as the major management mechanism (CSAIR 1999).

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6 These subordinates could be categorized into two groups, the closely-associated ones and loosely-associated ones. For the latter, STAICC generally had no direct financial relationship, while for the former the enterprise finance was divided into two levels, the STAICC level and the subordinate level.
More important changes happened in mid-1990s, when the formal corporation institutions were comprehensively transplanted. Echoing the new direction of the central administrations to corporationalize the previous state-owned enterprise in 1990s, the local government made great efforts to transform SAIC toward a real-sense corporation. In mid-1990s, echoing the central government, the local leaders in Shanghai started to consider the application of modern enterprise institutions in SAIC; in 1994, the SSASAC authorized SAIC to managed the state-owned asset of this enterprise; in August of 1995, the local government proposed to transform SAIC to be a state-owned group corporation with a new name of SAIC Group; in the same month, SSASAC approved the above plan and agreed that SAIC group could use the capital linkage to transform its subordinates into wholly-owned, holding and sharing subsidiaries; on September of 1995, SAIC Group was officially set up (Lin 2008). It should be particularly noted that in the above transformation, the head corporation of SAIC Group maintained to be wholly owned by the SSASAC. That is, the group was basically owned by the local government in Shanghai.

In late 1990s, SAIC Group started to go public to accumulate needed capitals, as reshaped its governance structure and management into a new stage. The stock system was proposed by the central government in 1990s as another way of transforming the state-owned enterprises. Considered this new method as a good direction for SAIC Group, the local government led this group going public. In 1997, SAC was set up as a public corporation, in which SAIC group held 70% of the total share. This move proved to be an effective way of collecting capitals: in ten year, the total share of SAC increased more than six times (Table 7). On the other hand, from 2004, SAIC group gradually moved its major automobile assets into another platform, SAIC Motor. Through a series of capital operations, in 2007, SAIC group has developed a new governance structure: SSASAC held 100% of the asset of the head corporation
of SAIC Group, while SAIC Group held 83.3% of the share of SAIC Motor as the public corporation.

<table>
<thead>
<tr>
<th>Year</th>
<th>The public corporation</th>
<th>Total share (unit. yuan)</th>
<th>Controlling corporation</th>
<th>Share of controlling corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>SAC</td>
<td>1,000,000,000</td>
<td>SAIC Group</td>
<td>70.0%</td>
</tr>
<tr>
<td>1998-2000</td>
<td>SAC</td>
<td>1,400,000,000</td>
<td>SAIC Group</td>
<td>70.0%</td>
</tr>
<tr>
<td>2001-2003</td>
<td>SAC</td>
<td>2,519,999,300</td>
<td>SAIC Group</td>
<td>70.0%</td>
</tr>
<tr>
<td>2004-2005</td>
<td>SAC</td>
<td>3,275,999,090</td>
<td>SAIC Motor</td>
<td>70.0%</td>
</tr>
<tr>
<td>2006</td>
<td>SAC</td>
<td>6,551,029,090</td>
<td>SAIC Motor</td>
<td>79.9%</td>
</tr>
<tr>
<td>2007</td>
<td>SAIC Motor</td>
<td>6,551,029,090</td>
<td>SAIC Group</td>
<td>83.3%</td>
</tr>
</tbody>
</table>

Source: SAIC Motor website

The roles of the central and local governments in the transformation of Shanghai Automobile since 1990s were very much like the previous phase: the local government was the leading agent to push the whole corporationalization process, while the central government provided critical initial conditions.

3.3.2 Establishing Joint Venture and Making Cars

In the car industry of Shanghai, joint ventures were applied by the local officials as the core protocol for technological upgrading. As the first practitioner of this new upgrading method, the local government had to make great efforts to deal with many challenges, while the central administration never grudged supporting this project whenever necessary. Not only did these joint venture projects propelled Shanghai’s car industry to the top position across the nation, but also led the whole Chinese car industry towards such a new track. That is, “one project changes the whole industry” (Cheng 1995).
The successful implementation of the joint venture strategy in Shanghai Automobile could be clearly reflected by the performance of its two major joint ventures, Shanghai-VW and Shanghai-GM.

Regarding to the promotion of the domestic production as one of the major goals of the central government in the car sector, Shanghai-VW and Shanghai-GM had done a good job, greatly increasing the output of cars in China. As can be seen from Figure 11, in mid-1980s, the early production in Shanghai-VW was only about 10,000 vehicles; But, after 2003, the output of the two enterprises reached over 500,000 vehicles. With the significant contributions of these two joint ventures, the total output of SAIC group ranked the first in China, ahead of FAW and DFM (CATRC and CNAIC 2008).

Accompanying with the outstanding production, Shanghai-VW and Shanghai-GM dominated the Chinese market: the former consistently held the largest market share in China for about twenty years from mid-1980s until the latter took the champion position in 2005 with an annual sale of 324,842 vehicles.

In terms of technological upgrading, the two joint ventures indeed introduced advanced technologies in China. From Santana as the first introduced model from Germany in 1985,
Shanghai-VW has developed a large product platform, consisted of six series of models including Santana, Santana Vista, Passat, Polo, Touran, Lavida and Octavia. Although established as late as 1997, Shanghai-GM quickly caught up with the Shanghai-VW in the model introduction. From 1998 to 2004, Shanghai-GM focused on introducing the Buick family: In 1998, Buick Century was firstly manufactured in Shanghai and then from 1999 to 2004, Buick GL8, Buick Sail, Buick Regal, Buick Excelle, and Buick Royuan came in succession. Staring from 2005, GM stepped further to bring its Chevrolet and Cadillac models in the Chinese market. More importantly, cars introduced by these joint ventures gradually came from the popular models in the international market. The implication is that the car production in these joint ventures came to be synchronized with the international market. As can be seen from Table 8, in 1980s, the Santana model was already an outdated one in the foreign market. It upgraded version, Santana 2000, was also not a popular model in the world market. Such a model-introduction pattern actually reflect one fact that, for the new market of the developing countries, foreign automakers often firstly transferred their old models to prolong the life of the outdated technologies. However, the technological advancement in these joint ventures became evident since the late 1990s, when both GM and VW began to bring their popular models to compete in the Chinese market. Particularly, in 2001, the model of Polo was almost appeared in the Chinese market and the German market at the same time, as marked the synchronization of the Chinese car-making technology with the world advanced standard.

Due to these successes in the production, market and technological introduction, the cooperation between SAIC and its foreign partners became more solid. The original contract for Shanghai-VW set the cooperation period as long as 25 years from 1985 to 2010, while in 2002, a new agreement was signed in advance between the two parties, extending the relationship to the year of 2030. Regarding to Shang-GM, the original contract has been as long as 30 years, covering from 1997 to 2027.
Table 8: Introduced Cars in Shanghai Automobile, 1985 to 2001

<table>
<thead>
<tr>
<th>Year</th>
<th>Model</th>
<th>Joint Venture</th>
<th>Technological Level</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>Santana</td>
<td>Shanghai-VW</td>
<td>The technology was in early 1980s standard and the model had been washed out of the foreign market when introduced</td>
</tr>
<tr>
<td>1995</td>
<td>Santana 2000</td>
<td>Shanghai-VW</td>
<td>The technology was in mid-1980s standard and the model was only sold in Brazil when introduced</td>
</tr>
<tr>
<td>1998</td>
<td>Buick</td>
<td>Shanghai-GM</td>
<td>The technology was comparable to the late-1990s standard in North America and the model was still sold in the market</td>
</tr>
<tr>
<td>1999</td>
<td>Passat</td>
<td>Shanghai-VW</td>
<td>The technology was comparable to the late-1990s standard in Europe and the model was still sold in the market</td>
</tr>
<tr>
<td>2001</td>
<td>Polo</td>
<td>Shanghai-VW</td>
<td>The technology was synchronous with the world standard and the Chinese product appeared in the market only five months later than its German counterpart</td>
</tr>
</tbody>
</table>

Source: SAITC 2002

Although these achievements presented above seemed very supportive to the rightness of the joint venture strategy, we should still be conservative in the evaluation. As assumed by the policymakers of the joint venture strategy, the ultimate purpose of setting up joint ventures was to create a bridge for the Chinese automaker to gradually master the key technologies and more importantly to develop independent R&D capacities. In reality, the Chinese automakers cooperating with foreign partners did a good job in absorbing the introduced technology and applying these technologies into production, but moved rather slowly in developing independent R&D capacities. Although some joint R&D activities were indeed practice since the introduction of Santana 2000 (Zhang 2008), there were no serious attempts of the Chinese automakers to develop national models in this period. Such a problem was later incurring a large-scale policy shift of the Chinese automobile industry, as will be fully discussed in the last chapter.

Behind the development of these joint ventures were the great efforts of the local government and generous support from the central administration.

First of all, the cooperation agreement for Shanghai-VW as the initial step of establishing a joint venture was mainly accomplished by the local officials in Shanghai. For these local
officials as the major negotiators, to sign the first joint venture contract was such a hard job, costing them as many as six years from 1978 to 1984. The major difficulty at beginning was the huge gap between the high expectations of the central policymakers and the conservative attitudes of VW. As remembered by Qiu Ke (Ge 2007), even though the joint venture had been approved as a viable way to try, the central administration still insist this project to reach a production scale of 150,000 units and export 80% of the total output. Such an ambitious plan was hardly accepted by VW, which had special cautions to get into the unfamiliar Chinese market. The local officials, though aware of the hopelessness in this direction, struggled to maintain the negotiation so that the relationship may not be broken up. Such a situation lasted until early 1980 when the central government finally agreed to decrease the scale of this project. Another major barrier in the negotiation was the legal issue. In the early years of the reform, there were no laws in China applicable for a joint venture. The German side then proposed to use relevant laws in Germany or the law from Switzerland as a third-country law. In order to solve such a problem, the local officials in Shanghai asked help from the central administration, as finally gave birth to the very first joint-venture law in China (He 1995). The third problem was the concerns of VW about whether the joint venture would have enough foreign currency quotas for importing necessary equipments and whether the joint venture could be fully supported by the central government. Thus, under lobbying of the local officials in Shanghai, China Bank allowed its Shanghai branch to join in this project to take a share of 15%; CNAIC as representative of the central government also took another share of 10% (Jiang and Qiu 1998). Overcoming much more similar

7 The chief Chinese negotiator, Jiang Tao, was a significant local official, later called as “the father of Santana”. As Jiang himself memorized (Ge 2007), in the six years of making the Shanghai-VW contract, he maintained the official position in the local government, though experiencing two shifts, transferring from the Shanghai First Bureau of Machinery and Electronics to the Shanghai Planning Committee and then to the Municipal Congress.

8 These shares were later purchased back by Shanghai Automobile.
difficulties as presented above, the local officials did a good job in the agreement making. In the final version of the agreement, many items were properly designed in favor of the Chinese automakers to master the advanced technologies: The complete technology transfer was confirmed; The technology transfer fee was set reasonable; The domestic content requirement was acknowledged (Mu 1997).

The local government indeed took a leading role in the above agreement-making process, playing between the foreign automakers and the central government to rush the whole procedure. Regarding to the central administration, although it did not directly involved in the specific negotiations, it constantly monitored the whole negotiation process, and provided critical directions, regulations, and assistance whenever necessary.

Secondly, the local government worked very hard to increase the domestic content in its joint ventures, as guaranteed the success of the technology transfer and domestic production as two major purposes of the joint venture strategy advocated by the central administration.

The hardness of meeting the domestic content requirement was unexpected by the local officials when they set up the Shanghai-VW.

“(It) was originally believed that if thousands of component makers across China were mobilized, the domestic production would be realized easily….. However, when we really did it, almost none of these enterprises could fit the requirement without transforming production lines or introducing new technologies! These thousands of auto-part producers were summed up to a zero!” (Cheng 1995)

Due to such underdeveloped component production in China, most components for the introduced Santana had to be imported from Germany at the very beginning. From 1983 when the first Santana was made out to the year of 1987, only a few simple accessories such as the radio and antenna could be manufactured locally. The domestic ratio only reached 2.7% in these five years.
Facing such a problem, in order to push the domestic production of Santana, the municipal government established special administration, launched numerous supporting projects and mobilized huge amount of investment since mid-1980s (Thun 2004, 2006). In 1986, the local officials organized the first administrative institution in charge of the localization of Santana’s production and hundreds of component makers across the country were convoked by the local government to help with this mission; In 1987, another institution was set up for the domestic production of Santana, in which Huang Ju as the associated secretary and mayor at that time took the leading position; In 1988, the domestic production of Santana was listed by the local government as the top project among the fourteen major breaking-through local projects and Zhu Rongji as the mayor of Shanghai at that time launched a coordinating production system for Santana; In 1990, the Santana transmission project as the largest component project for the domestic production of Santana was successfully implemented under the efforts of the local officials (CSAIH 1991).

![Figure 12: The Ratio of Domestic Production of Santana, 1987 to 1996](image)

Source: Based on CSAIH1991; SAIC Annual Reports and China Automotive Industry Yearbooks

The Domestic production of Santana was mainly about the domestic production of Santana’s components. Regarding to the investment, from 1986 to 1990 as the seventh FYP
period, the investment ratio of the assembly versus components for Santana was about 1 to 1, while from 1991 to 1995 as the eighth FYP, this ratio further reached 1: 2 (Lu 1998). In consequence, under the great efforts of the local government, the domestic content ratio of Santana increased quickly from 2.7% in 1987 to 90.5% in 1996 (Figure 12).

On the other hand, the central government also put special cares on Shanghai-VW to quickly meet the domestic content requirement. After all, the import of car components directly consumed the nation’s valuable foreign currency at that time. In the year of 1987, Zhu Rongji as the associate director of NEC at that time said that Shanghai-VW would be abolished if the domestic content could not reach 40% in three years (Lu 1998). In the same year, Yao Yilin as the associate prime minister of the State Council held a conference in Shanghai, clearly demanding the Santana model to realize the domestic ratio of 25% in 1988, 50% in 1989 and full domestic production in 1991 (CSAIH 1991). Besides the direct requests, the central government also designed a tariff structure in order to stimulate the domestic production in SAIC-VW: According to the import regulations in the early 1990s, in the first three years of the technology introduction, the tariff was set as 50%, while in the fourth and fifth year, the tariff would be increased to 80%; However if the ratio of domestic production reached 60%, the tariff would be reduced to 60%; If the ratio reached 60 % to 80%, the tariff would be further cut to 48%; if the ratio increased over 80%, the tariff would be decreased to 32% (Yin 1994).

The implement of the domestic production of Santana not only helped Shanghai-VW to fulfill the will of the central and local officials, but also made special contributions for the overall Chinese car industry. The national-wide component production system established around Santana was fully used by the following joint ventures and their introduced models. Due to this system, Santana 2000 immediately reached a domestic ratio of 65.8% at the very beginning (Automobile Bureau of MMI and CATRC 1995); Buick Century, the first model made by Shanghai-GM was able to realize a domestic ratio as high as 40% of in the very first year of the
production (Lu 1998). More importantly, the success of establishing such a system made the joint venture strategy as a totally feasible method. It proved true that China automakers in introducing foreign models could pass over the primary stage featured by simple CKD, gradually increase the domestic content and finally realize the full domestic production. Thus, the initial trajectory presumed by the joint venture advocates, namely the components production could be localized with the technology introduction, was proved to be a reasonable way to go.

Thirdly, the local government consistently poured large amount of resources and energy to the development of these joint ventures, as served as a fundamental cause for the quick growth of these enterprises in the Chinese market.

In constructing Shanghai-VW, the most striking cases to demonstrate the role of the local government were the three assembly factories built up in succession from 1980s to 1990s. All these three advancements represented the will of the local administrators. For the very first assembly factory to produce Santana in the mid-1980s, the local government determined to sacrifice its SAF as the manufacturer of the old Shanghai model: the production line of Shanghai model was moved out to another place and the previous workshops were vacated so that the infrastructure could be used by Shanghai-VW; For building the second assembly factory in the mid-1990s, the already-expelled Shanghai model devoted even more: The total production of this model was called off so that the infrastructure could be saved for introducing the new model of Santana 2000 (Xu 2008; Jiang 2008). Suspension of the old Shanghai model for the second time really showed a very determined image of the local government. After all, in 1991 just before the decision was made, Shanghai model was still at its peak as a very welcomed car in the market, making a profit as high as 80 million yuan with a total output of 8,000 vehicles (Jiang 2008). The third factory established in 1999 for introducing the Passat model was also driven by the local government insisting to build a world-class automobile plant. With an investment as high as 2.2
billion into the infrastructure of the third factory, the director of VW praised this factory as the most advanced factories of VW around the world (Yan 2003).

As of the project of Shanghai-GM, the local government also acted as the major director. In mid-1990s, when the Santana model was developed well in the Shanghai, local policymakers came to consider new breakthroughs for the future of Shanghai car industry. Thus, to find a new foreign partner in order to develop cars with larger engine-capacity got on the schedule of these local officials. In 1995, Huang Ju, as the municipal secretary and also the director of LTDSCI, officially brought forward these ideas to the central government and immediately got approved, as became the milestone moment for the future Shanghai-GM (Shanghai-GM 1998). In 1997, the Shanghai-GM agreement was signed as the largest joint venture project between China and Unites States at that time; In 1998, the municipal government highlighted Shanghai-GM as the number one local project to accomplish. Under the consistent support from the local government, Shanghai-GM grew up with an unusual speed: In only 23 months after the beginning of the infrastructure construction, the first Buick was made out of the production line by the end of 1998; Only five years after the birth of the first Buick, Shanghai-GM had developed four assembly factories in China; From the year 2005, Shanghai-GM kept as the sale champion in the Chinese car market. In comparison with Shanghai-VW, Shanghai-GM was a later incomer, but a more successful one.

3.4 Case Summary

In the classification of the developmental models, Shanghai Automobile as the current largest Chinese car maker is categorized in a group, which contains enterprise owned by the local government and also dependent on joint ventures as the major technological strategy. The local municipal government actually was the strongest player in the local political structure of Shanghai. In the planned economy era, due to the economic importance, Shanghai long held a
prestigious position in the national economy and its local government often bore more weights among the central administrators; After the reform, the previously-prestigious local officials in Shanghai managed to acquire substantial autonomy and special policy treatments from the central government. In the minds of local policymakers of Shanghai, the car industry was uniquely advocated as the core sector for the city development in the new age of reform and to set up joint ventures for advanced foreign technologies was an ideal solution to realize such a goal. After strenuously lobbying, the local initiatives were finally approved and supported by the central government, as made the local-state-owned car assembly enterprise and the joint venture projects smoothly dominated the local car industry. As a the builder of the very first joint venture in the Chinese car industry, the Shanghai local government made special efforts to organize the supply system for this assembly project, as indeed contributed a solid foundation for the following joint venture projects across China. In fact, when observing the feasibility of the joint ventures, the central government directed most of its major automakers towards such a path. Thus, the story of Shanghai is basically consisted of a local developmental state and a supportive central government.
4. Chery Auto, Champion in Making National Cars

Rising up in Wuhu City of Anhui Province, Chery Auto has grown up as a significant automaker in the Chinese automobile industry. In less than ten years, from a firm without any car making experiences, Chery Auto surprisingly became one of major car makers in the domestic market, especially with the pride of the self-developed brands and models. Gradually enjoying economic autonomy after the reform, Anhui and Wuhu local governments provided major momentum for the Chery project in order to develop the local economy; however such a project was entirely out of the national industrial plan of the central government. As a result, around this car maker, local officials had to play with the regulations from the central government. This chapter provides a good case demonstrating how the local social construction driven by the conflicting local and central governments could generate a developmental model featured by a locally-owned auto enterprises and the self-reliant technological strategy.

The chapter begins with a discussion on the rise of Anhui local governments in the fiscal decentralization, especially the “businessman with red hat” as a special local political phenomenon. After that, motivations and thoughts of the local governments in developing the automobile industry, and the contrasting rationales held by the central government will be discussed. The last session traces, through the waves of conflicts and compromises between the local and central governments, how Chery as a local state-owned enterprise was born and developed, and how the self-reliant upgrading track finally worked out.

4.1 Local States Rising in Decentralization

In the economic transition, Anhui had experienced a great shift in the local political structure. In the planned economy era, the local economy was mainly managed under the central planning system. National planners positioned Anhui as a resource-contributing province, mainly
exporting agricultural products and raw materials to support other areas. Nevertheless, when the
central government decided to retreat from the local economic affairs during the decentralization
in the market reform, the local governments came to be active to push their own economic plans.

4.1.1 Anhui in the Planned Economy Era

In the planned economy era, as many other regions across China, the local development
of Anhui was mainly shaped by the central government. Based on considerations of the central
government, Anhui had been defined as a resource-contributing location for the national
economy. Thus, unlike the northeast of China or Shanghai, the local industrialization received
very little attentions from above.

The unique geographic and historical conditions of Anhui were basic grounds of the
central government when positioning this province in the national economic system: As an inner-
land province located in the southeast China, Anhui was abundant of mineral materials. There are
about 138 kinds of minerals detected in Anhui, among which 76 kinds held significant reserves;
Across all provinces in China, Anhui’s reserves of sulfur-iron, calcite, alunite rank among the
national top three, while minerals such as coal, iron, copper, gesso, bentonite, cement-used
limestone rank among top ten (Anhui DLR Website). On the other hand, Anhui historically was
an agriculture province with an extremely underdeveloped industrial base. The agriculture
production was the major sector in the local economy: In 1949, the output value of agriculture in
Anhui was 1.63 billion, while the industrial output value was only 0.44 billion (Anhui ETC
1999). In comparison with adjacent areas, in the same year, the industrial output value per capita
was as little as 12.20 yuan, one fourth of the value of Jiangsu Province and a half of Zhejiang
Province (Anhui Social Science Institute 1999). Besides these characters, Anhui was also easily
accessible for the nearby manufacture-advanced areas such as Shanghai, in that the Yangtze River
and Huai River running across the whole province. That means, grains and minerals from Anhui
could be easily and cheaply transported outside.
Therefore, in the planned economy era, Anhui province was shaped by the central government as a resource-contributing province: In this period, most of the investments of the central government in Anhui Province were channeled to agriculture or raw-material projects. One representative project was to renovate the Huai River for the local agriculture. From early 1950s to late 1970s, the central government never stopped its investment into this project, which greatly prevented the flood disasters and helped the local agriculture. On the other hand, the local major industrial projects were always designed to exploit the local mineral resources: In the first FYP, a few large mineral-related enterprises were established including Maanshan Iron Factory, Tongguanshan Copper Mine and Huainan Coal Mine; in second FYP, Huaibei Coal Mine, Chaohu Cement Factory, Hefei Chemical Factory and Huainan Fertilizer Factory were built up. These enterprises constituted the basic skeleton of Anhui’s industry in the era of the planned economy. Accordingly, Anhui was clearly asked to serve “primary products” to support the manufacture enterprises of other regions, especially the surrounding areas:

“For every year (in 1980s), Anhui would export more than one billion jins (a half of a kilogram) of grain, about 5 million tons of coals, several hundreds of thousands of tons of pig-iron and steal, several tens of thousands of tons of blister cooper, and large amount of electricity to support the economic development of East China areas and the whole country” (Su and Ou 1987:36-7).

A critical implication to be such a resource-contributing province was that the central government cared less about the local economy to develop any advanced industrial sectors such as manufacture industries. As complaint by the local officials, Anhui was always disadvantaged by the central administration (Su and Ou 1987): Prior to 1970s, the central government stressed the critical industrial projects to be located in the inner-land provinces, while Anhui was classified as a coastal area; in the post-1970 period, the focus of the central government moved back to coastal, but Anhui was then defined as a inner-land province for this time.
With such a status in the national economy, Anhui became one of poorest provinces in China. Without cares from above, the local financial resources were very limited. As the major industrial enterprises were mining-related and also held in hands of the central government, the only profitable field for the local government had to be the agriculture production, which was not able to provide significant local fiscal income.

In such a local political structure, the local government had to be subordinate in face of the central government. No matter what developmental strategies were proposed locally, the central government would deny them whenever they wanted. A typical example could be the failed responsibility system trial in the local agriculture. In early 1960s, in order to restore the agriculture production harmed by the people’s communes, the Anhui provincial government started to experiment a responsibility system for individual households. In 1961, this new method was agreed by Chairman Mao and soon applied to the whole province: By the fall of 1961, 85.4% of the production team in Anhui had adopted this new policy (Liu and Zhou 1983). Welcomed by Anhui peasants, the responsibility system indeed increased the agriculture output: In a survey on 36 production teams, after using this responsibility system, the output per mu increased 38.9% (Liu and Zhou 1983). By the end of 1961, Chairman Mao’s changed his mind. From 1962, the responsibility system was criticized and demolished. Such a shift depressed the local agriculture development: From 1957 to 1978, the grain output per labor force in Anhui increased very slowly, from 1542 jins to 1812 jins, while such a output rate was even lower than the productivity of Han Dynasty as early as two thousand years ago (Wang 1989). However, the local government was so weak in face of the central government and Zeng Xisheng as the top provincial leader, an ardent advocate of the responsibility system, was even removed from his political position.

4.1.2 Decentralization and Local Autonomy

If the central government always had always held Anhui in it own hands, there would be no possibility for Chery Auto to appear; Nevertheless, in the market transition, a process of
decentralization released the local governments so that they could make their own voices in the local economic affairs.

If the decentralization was defined as the transferring economy-management rights from central to local level, this one in the reform was not new, but an old routine in the planned economy era. That is, prior to the reform, the central government had been already adjusting the central-local relationship in this way.

With the establishment of the planned economy, the administration power came to be converged at the central level and any moves of the local governments had to obey the bureaucratic orders from above. Local economic affairs such as planning, management, investment, construction and taxation, were all directed by the central government. As an illustration, in the period of the first five-years, the fiscal income of the central government accounted for 80% of the national total fiscal incomes, while its expense accounted for 75% of the national total (Jing 2008). Nevertheless, this top-to-bottom governance greatly quenched the incentives and weakened the powers of the local governments in economic development. And there arise many complaints from local officials, describing themselves as “marionettes” played by different branches from the central government (An and Ren 2008). Such a governance problem always haunted the Chinese top leaders and often led to the power transferring from central to local level. There were two major decentralizations throughout the planned economy period: In 1956, Chairman Mao proposed that the local governments ought to have more freedom and then a round of decentralization were implemented in the following movement of the Great Leap Forward; In 1966, Mao appealed again that the central government should recede from intervening local affairs and thus another wave of decentralization was attempted throughout the Cultural Revolution.

However, in the planned economy era, the transferring of the right from top to bottom was most like a duty re-division inside the planned economy system and the autonomy gained
from these decentralizations was still subject to directions of the central government. As a result, though some specific management operations might be moved downward, the local governments still had to strictly follow the national orientations on the local economic development. Take Anhui as an example. In the Great Leap Movement, the autonomy gained by local governments were still applied in constructing “Five Smalls”, namely the small-scale steal projects, mining projects, cement projects, machinery projects and fertilizer projects, which was a economic plan proposed by the central government.

Different from the planned economy era, the decentralization after the reform started a new stage of the central-local relationship. The major content of this new decentralization was intensively reflected in the transforming fiscal relationship between the central and local governments. As can be seen from Figure 11, the national fiscal system experienced a two-stage development in the reform: In the 1980s, the fiscal activities divided by two separate domains as central and local level. The turn-in from the local level and allowance from the central level were both fixed. This was called as “eating in different pots”; In 1990s, a new system was further developed, which clarified different taxation channels for the central and local government. A major implication was that the autonomy gained by local states did not have to be strictly constraint within any national economic orders.

One immediate consequence of this decentralization was the rise of local governments as real-sense players in the emerging market. Released out from the central fiscal control, the local governments became responsible for their own gain and loss in the emerging market. For the local officials, to perform well in the local economic development is not only associated with their own welfare, but also important for their political careers. That is, the local governments were stimulated by the fiscal decentralization to act as an active player in the local economic development. In practice, the local governments in the decentralization had been greatly improving the entire national economy (Lin and Liu 2000).
4.1.3 “Businessman with Red Hat”

The local governments in Anhui were among the myriad released local states in the decentralization; However, they indeed developed a unique governance style, which was labeled as “businessman with red hat”. “Red hat” refers to the official positions in the government, therefore, a businessman with red hat implied the co-existence of both the economic and political status in a same person: the local officials in Anhui often directly participated into the market as business managers with keeping their official titles at the same time, while the successful local businessmen were often recruited by the government to become political leaders. As can be seen from Table 9, these dual-role persons were rather common across Anhui Province. Especially, Chery Auto was also managed through this pattern: Zhan Xialai, called as the “father of Chery”, was meanwhile the local political leader of Wuhu city.
Table 9: Major Cases of “Businessman with Red Hat” in Anhui

<table>
<thead>
<tr>
<th>City/County</th>
<th>Name</th>
<th>Government position</th>
<th>Sequence</th>
<th>Corporation position</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wuhu</td>
<td>Zhan Xialai</td>
<td>Secretary of the municipal government</td>
<td></td>
<td>Chief executive of Chery Auto</td>
</tr>
<tr>
<td>Woyang</td>
<td>Liu Junqing</td>
<td>Associate secretary of the party committee of the county</td>
<td></td>
<td>Chief executive of Shuanghui Group</td>
</tr>
<tr>
<td>Woyang</td>
<td>Ma Jinhua</td>
<td>Associate dean of the people’s congress of the county</td>
<td></td>
<td>Secretary of the party committee of Shuanghui</td>
</tr>
<tr>
<td>Jieshou</td>
<td>Zhao Chaobin</td>
<td>Chair of the municipal political consultative conference</td>
<td></td>
<td>Chief executive of Tian’an Group</td>
</tr>
<tr>
<td>Jieshou</td>
<td>Wang Xianyi</td>
<td>Mayor</td>
<td></td>
<td>Director of Shahe Winery</td>
</tr>
<tr>
<td>Jieshou</td>
<td>Pei Jie</td>
<td>Associate mayor in charge of industry</td>
<td></td>
<td>Chief executive of Biquan Group</td>
</tr>
<tr>
<td>Linquan</td>
<td>Liu Sumin</td>
<td>Member of the Standing Committee of the county</td>
<td></td>
<td>Director of Liquan County Fertilizer</td>
</tr>
<tr>
<td>Bozhou</td>
<td>Wang Xiaojin</td>
<td>Member of the Standing Committee of the county</td>
<td></td>
<td>Chief executive of Gujing Group</td>
</tr>
<tr>
<td>Qianshan</td>
<td>Yang Xunxi</td>
<td>Associate director of the county</td>
<td></td>
<td>Chief executive of Qianli group</td>
</tr>
</tbody>
</table>

Source: Based on Fan 2003
Note: The arrow implies that time sequence of these positions. For instance, the arrow of Zhan Xialai demonstrated that he firstly held a governmental job and then a business position.

In fact, as the hometown city for Chery Auto, Wuhu was a typical place rich of “businessman with red hat”, especially for the officials to be transformed as business managers. The businessmen with red in Wuhu hat had been “institutionalized systematized and serialized”, since most local officials joined a state-built corporation, WCIC:

“This red-hat corporation was established in 1998. The total registered capital was 100 million yuan, using the building of the Finance Bureau as an investment of 60 million yuan and investing another 40 million yuan from the local fiscal income. As a state-wholly-owned firm with independent legal person status, the firm is just located inside the building of the Finance Bureau of Wuhu. The previous standing associate mayor is the chief executive (of this corporation)…The general managers and associated managers are assumed by the director and associated director of the municipal fiscal bureau and the associate director of the department of land and resource….After this corporation was set up, the four districts and three counties managed by Wuhu established their own corporations one after another. The
district and county directors then turn to be the chief executives in these firms….To take business positions are completely political actions. The organization department of the Wuhu government considered these businessmen with red hat in WCIC to be through a training program. Every two years, new officials would be sent out and old ones would be called back. Therefore, WCIC, full of businessmen with red hat, is called “the officials school of Wuhu.” (Zhu 2004)

Though these “businessmen with red hat” held dual-roles, it is not proper to arbitrarily judge these persons as corrupted. In fact, such a role featured by official plus businessman was an intentional management arrangement designed by the local government. The officials getting into local corporations were actually assigned with certain missions for the local economy. At the same time, they were always paid through the government channels. In this sense, “businessman with red hat” was often taken as a special developmental strategy in Wuhu.

As a unique type of economic governance of the Chinese local economies in the economic transition, the “businessman with red hat” in Wuhu was not happening without any backgrounds. After the decentralization, most of the local governments in China came to be aware of their own interests and performed actively for the local economic advancement. Thus, in these local economies, it is very common that the economic and political forces were closely intertwined with each other. However, why Anhui had developed such a radical way so that local officials directly involved into the corporation management? And why the political and economic positions became interchangeable in Wuhu?

Part of the answer lies in the fact that, based on the special historical conditions of Anhui, there were no other local players capable of competing with the local states in the emerging market. Firstly, in comparison with the northeast where the central government held central enterprises such as FAW even after the reform, the central government retreated from the local economic affairs in Anhui more completely and comprehensively. This made a large vacancy for the local authorities to fill in. Secondly, as an inner-land province, Anhui was disadvantaged in
introducing foreign capitals and promoting foreign trade: Since the reform, the whole value of export and import in Anhui only accounted for 1% of the national sum, so did the actually-utilized foreign capital; In 2000, the ratio of foreign trade to GDP in Anhui was only 9.1%, while 43.9% was the national average. The foreign trade per capita was only one seventh of the national level, and the actually-utilized foreign capital per capita was only one fifth of the national level (Anhui Statistics Information Net). Such a condition made it impossible for the transnational corporations to take any solid role in the local development. At last, because the resource-driven local economy attached most Anhuines to lands or mines in the past, the labor force outflow from the agriculture sector in Anhui was slow (Bao and Fu 2002). As a result, the private economy was rather weak in Anhui. This was a huge contrast with Zhejiang as a nearby province, where the private-economy was very active and our next cases, Geely, just came out of such an environment. All these factors together contributed to the fact that in Anhui, the local government was the only possible one shedding the leading impacts in the market.

Another part of the answer was that, for the local government, the dual-role arrangement for the local political and economic elites was temporarily an effective and efficient management method for catching up with other economically advanced areas. One remark from a local official was representative:

“In the stage of accumulating the original capitals, the combined role of official-businessman and methods of planned economy could generate huge efficiency and effects. As long as the policy is benefiting the socioeconomic development, adopting measures to meet local conditions, we should accept this special measure in this special period. There is no need to make arbitrarily judgment. However we admit that, sooner or later, this special measure will be cancelled and be corrected by a normalized management scheme.” (Xu 2004:54)

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1 In 1978, 81.4% of Anhui labor force was in the first industry, 10.2% in the second industry and 8.4% in the third industry (Gao 1986).
Specifically for WCIC, Wuhu officials emphasized virtues of this mode to bring better bureaucratic efficiency and economic returns. Considering the establishment of WCIC was originally meant to take advantages of a large loan from the National Development Bank, the local advocates thought they were practicing a superior model in fund management.

“(To establish such a corporation is) to catch the policy opportunity, to increase the state’s capacity of coordinating the construction fund, to prevent the conflicts of different state braches, repeated investment and waste of resources, and to fully take advantages of the loan. ” (Xu 2004:54)

They also believe WCIC could bring the state-led monopoly in the local market, which made good for the local development. As said by Wang Bin, the associate executive of WCIC:

“Assured by the reputation, capital and land from the government, the corporation raises fund from multiple channels and has acquired tremendous socioeconomic returns through the monopoly of the city resources and the insistence on the market orientation and capital operation. WCIC openly raises, manages and accumulates capital for the government and its profits are used for the key areas of the construction of the urban infrastructures. This method fully fits the spirit of the 17th Congress of CPC, completely follows the economic laws, and leads and normalizes the market. The monopoly generates effectiveness! The monopoly generates efficiency! ” (Wang from Yuan 2004:99)

Although the businessmen with red hat indeed made great contributions to the local economy, the dual-role was seriously criticized by the central government. For the central government, the businessmen with red hat may break the free market and bring corruptions. Officials, capable of using their political power in the market to create certain advantages for their own business, would definitely disturb the normal order of the market. It is unfair for others to compete with these government-sponsored enterprises. Further more, the dual role would facilitate rent-seeking officials to extract benefits from the business they participate. In sum, whether or not this measure could be effective in pushing the local economy, it had no credits in the eyes of the central government. In 2004, the central government issued a notice to remove all of the business positions held by government officials. In consequence, Zhan Xialai and other
political leaders in Wuhu had to resign from their business positions, despite no actual corruptions had been ever identified.

However, this ban from the central government only ended this specific local strategy, and did not change the persistent political influence of these officials on the local economy. The local enterprises previously managed by local officials were still seized in the hand of the local government, though not directly handled by the exact same person holding the political authority.

4.2 Local Dreams versus Central Regulations

With the local states in Anhui rising up to master the destiny of the local economy, the automobile industry became a critical choice to for these ambitious local officials. However such a local ideal was directly conflicting with the national industrial policy. These conflicting developmental ideas make up the basic clues to understand the birth and development of Chery Auto in the late 1990s.

4.2.1 Making Cars, New Answer of Anhui Economy

In the reform era, Anhui’s development illustrated a lock-in state of the previous industrial structure. The local economy shaped by the planned economy system was hard to get out of the historically-formed status as “a province of resource”. Throughout the 1980s and 1990s, Anhui repeated the old story (Table 10): the agriculture sector still maintained significant to be among the national top ten; the second and tertiary industries were still mediocre in comparison with other provinces. In fact, the lock-in state reflected not only the legacy of the previous time, but also a choice of the local government. In the minds of the local officials, the resource-related sectors should always be prioritized even in the reform, particularly the development of agriculture. In various local economy plans through 1980s and 1990s, the policymakers tirelessly claimed their determinations on the agriculture development.
Table 10: The Rank of Anhui Economy across China, 1985 to 1999

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<tr>
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<tbody>
<tr>
<td>GDP</td>
<td>13</td>
<td>13</td>
<td>14</td>
<td>13</td>
</tr>
<tr>
<td>GDP per capita</td>
<td>20</td>
<td>23</td>
<td>20</td>
<td>21</td>
</tr>
<tr>
<td>GDP of the First Industry</td>
<td>8</td>
<td>8</td>
<td>9</td>
<td>8</td>
</tr>
<tr>
<td>GDP of the Second Industry</td>
<td>15</td>
<td>13</td>
<td>12</td>
<td>14</td>
</tr>
<tr>
<td>GDP of the Tertiary Industry</td>
<td>14</td>
<td>15</td>
<td>16</td>
<td>15</td>
</tr>
<tr>
<td>GDP of Agriculture</td>
<td>7</td>
<td>8</td>
<td>9</td>
<td>7</td>
</tr>
<tr>
<td>GDP of Industry</td>
<td>15</td>
<td>15</td>
<td>11</td>
<td>12</td>
</tr>
<tr>
<td>Fixed Capital Investment</td>
<td>15</td>
<td>14</td>
<td>15</td>
<td>13</td>
</tr>
</tbody>
</table>

Source: Editorial Committee of Anhui Yearbook 2000
Note: The rank was based on 28 provinces plus Beijing, Shanghai and Tianjin as municipality directly under the central government, not including Hong Kong, Macau and Taiwan.

Nevertheless sticking to such a development pattern, the economy of Anhui had met many problems: First of all, Anhui kept as a mediocre province in terms of economic performance and a poor province in terms of the statistics per capita. As can be seen from Table 10, among the 31 provinces and cities directly charged by the central government, GDP of Anhui maintained around the 13th and GDP per capita around the 20th throughout 1980s and 1990s. Long focusing on the agriculture, Anhui could not step further in the national economy. Secondly, a collateral symptom of Anhui was the weak local fiscal capacity. With such an agriculture-dominant economy, the local government was unable to make its fiscal balance sheet to look any better in the reform: In 1978, the fiscal expense per capita of Anhui was only with 38.6 yuan, the lowest one across China, while Shanghai held the highest one of 236.8 yuan; such a situation maintained until now so that Anhui still has the lowest fiscal expense per capita across China (Wu 2008). Thirdly, the agriculture-dominating economy was susceptible to weather changes, as led Anhui to experience great economic fluctuations in 1980s and 1990s. From 1978 to 1981, the average change index of the national GDP was 6.5, while Anhui was 15.4; from 1982 to 1986, the national index was 6.8, while Anhui was 11.3; from 1987 to 1991, the national index was 7.3 and
Anhui was 6.3; from 1992 to 1999, the national average was 7.0, Anhui was 12.9 (Hu et al. 2001).

These inherent problems had been stimulating the local officials to figure some new ways out, and the industrialization came to be considered as an important direction to go since 1990s. For the Local policymakers, Anhui was an “agriculture-industry” province in 1980s, while for the next step, Anhui should change from an “agriculture-industry” province to an “industry-agriculture” province (Gao 1986; Su and Ou 1987). In the 1990s, the local economic plans highlighted the necessity of pushing industrialization: in the eighth local FYP, the state clearly announced to adjust the industrial structure toward an industry-leading pattern; in the ninth local FYP, the state further claimed to realize the primary industrialization in the new century and reinforce the leading role of industry in the local economy.

Directed under the local officials, the industrial development of Anhui demonstrated some unique characteristics.

Firstly, for the local government, Anhui’s industrialization was not a project from nothing, but considered as a structure-upgrading process. That is, the local industrialization was mainly to adjust the industrial structure biased toward mining and raw material production: In 1992, in the local economic plan, the state listed some new focus fields to correct the old industrial structure, including the electronics industry and machinery industry; In 1993, the state further argued that in the industrialization, the target be industries and products with high added-value, high technology level, and high profit. Such adjustment could be illustrated by two major shifts in the local economy: In the light industry, the agriculture-processing production decline from 80.2% in 1981 to 66.9% in 1998; In the heavy industry, the percentage structure of mining industry, raw-material industry and the manufacture industry changed from 13.3: 47.6: 39.1 in 1981 to 7.4: 37.5: 55.1 in 1998 (Ge and Xia 1999).
Secondly, Industrialization in Anhui was not systematic, but often centered on a few chosen projects, as was praised as a strategy of “releasing the leading birds first” (Bao 1992). With limited fiscal capacity to practice comprehensive industrial construction, concentrating on a few carefully-selected projects was always insisted by the local government. Take the machinery industry, one of the state-selected focus fields, as an example. Holding a weak foundation in machinery manufacturing, the Anhui government had carefully chosen certain projects and then concentrated most of local resources to develop special advantages. In the early and mid 1990s, a series of advantageous products were developed in this field, such as the lift truck, numerical-controlled machine tool, forging machine, electric motor for sewing machine, and odometer for motorcycles (Bao 1992; Zhao 1995).

Within such a local industrialization process, the car industry came to be considered as a critical breakthrough for the local economy since mid-1990s. The ideal for developing the car industry was actually proposed by two levels of governments in the mid-1990s, the Anhui provincial government and the Wuhu municipal government. It is hard to tell which government was exactly the first pursuer for cars, but clearly the decision to explore such a brand new sector should be grounded on the reciprocal stimulations between both of them.

The local historically-established and successfully-developed automobile projects stimulated the local officials in the provincial government to step further. The automobile industry in Anhui was firstly established in Culture Revaluation, when the central government encouraged the local government to build their own complete industry system. In the reform, the local automobile industry came to illustrate a promising future: In the 1980s, the 3t and 8t-trucks were developed as the main local automobile products. In 1983, the local 8t-trucks branded as Jianghuai even ranked the second in terms of output; In early 1990s, with introducing some foreign technologies, the bus production became another growth point for the local automobile
industry. These successful automobile projects had encouraged the local officials to think about more ambitious plans.

At the beginning of the later half of 1990s, the provincial officials began to propose the car production as a new answer, not only for the local automobile industry, but also for the whole Anhui economy. In 1996, when discussing the economic plan for the ninth FYP of Anhui, Wang Yang, the associated provincial leader in Anhui (1993 to 1999), made the first appeal for Anhui’s car industry. This proposal openly expressed the ideas of the provincial leaders to pursue the car industry and became the prelude of Chery. Argued by Wang (1996:6), ‘the car industry as the new developmental focus is a good choice for Anhui’, because 1) the car industry is generally chosen as the pillar industry across developed and developing countries in the world; 2) the car industry has many virtues such as the long production chain, technical intensiveness and the high added-value; 3) in the current industrial upgrading, Anhui needs large and influential projects, while the car industry is an ideal candidate; 4) the development of the car industry could help to change the image of Anhui, so “in the next century, no one would doubt that Anhui is able to be successful in any modern industries” (Wang 1996:8)

In the eyes of the local car advocates, another justification was that manufacturing cars could serve as a reasonable upgrading-extension of the current local industrialization. Wang (1996) specially mentioned:

“In the seventh and eighth FYP (1986 to 1995), we have chosen a bunch of light-industry enterprises as the development focus, such as Meiling (household electrical appliance), Yangtze (household electrical appliance), Royalstar (household electrical appliance), Gujing (liquor) and Fangcao (toothpaste and detergent), as led Anhui toward ‘a province of the light industry’. If we choose and develop the car industry as a pillar industry as soon as possible in the ninth five-year plan, our province will have a new advantageous industry and a new look in the twenty-first century.” (pp. 7-8; the content in brackets is added by the author)
The idea to develop car industry in Anhui had been through some serious debates inside the Anhui government. To set foot in such a field with little experience was a risky move for some local political leaders, especially those who were familiar with the technological hardness of car making. Particularly, to set up a local car project without the approval of the central government was evidently a violation of the national policy. In the debate, most of the objections came from experts in the automobile industry, while most of supporters were “laymen” (Zhang and Chen 2005). Clearly, the final determination on the Chery project was hard to be explained as a result of carefully calculations; On the contrary, it was more like a choice driven by enthusiastic entrepreneurship from certain local officials. Or as commented by media, the birth of Chery was due to a bunch of “knowing nothing, thus fearing nothing” decision-makers. Once the car supporters won the battle, the state had shown great determinations in practice. Depressed for a long time, the ambition of the local official for industrialization burst out whenever a proper outlet was identified: “There were very few successful large projects in Anhui since the reform, so the car project was highly regarded by the Anhui leaders.” (Wang 2003a)

On the other hand, the idea of building the local car industry was also haunting the municipal government of Wuhu in the same period.

Wuhu, a city located in Anhui along the Yangtze River, was one of the typical cities of Anhui: With almost no large industrial projects in the planned economy era, the industrial development of Wuhu was even disadvantaged in comparison with the other Anhui cities along the Yangtze River, such as Maanshan and Tongling, which had already built some recourse-related projects. Without large industrial project, the local economy was thus biased to the light industry. However, since 1990s, Wuhu encountered some new opportunities. In the year of 1990, the central government made an influential decision to set up the Pudong economic development zone in Shanghai and drive the development of the areas along the Yangtze River. Echoing this opportunity, Wuhu was chosen by the Anhui government as a focus area to make a breakthrough
for the Anhui economy. In the 1990s, Wuhu was approved as the national-level “open city along the river” and then allowed to build the first national-level economic and technological development zone in Anhui. Echoing this historical chance, Wuhu started to hold some appetite on the automobile industry. In 1993, the local government invited FAW to joint build a bus-manufacturing firm, FAW-Yangtze, in its economic and technological development zone. With an investment of 430 million yuan, this project had reached the annual production capacity of 2,000 units of buses and 30,000 chasses.

Nevertheless, the local government of Wuhu was not satisfied at all with this bus project and began to put an eye on the car industry. Mentioned by numerous news reports (Zhang 2005, Tao 2004; Li and Niu 2003), two events might be the sparks leading the Wuhu policymakers: in 1992, some businessmen from Henan took advantage of a local military factory to manufacture hand-made minibus branded as Tongbao. The sale easily reached more than 4000 units and created a yearly profit of more than 100 million. Although the production was later suspended, the profitability of this car industry had greatly impressed Wuhu officials; Another turning point was in 1995, when the Wuhu government organized a trip to Europe and learned that Ford was selling out an assembly line for 300 million dollars. A basic idea burst out of the mind of these officials that if introducing this assembly line, Wuhu might be able to build up its own car industry. This finally led to the introduction of an engine assembly, the first step of Chery project.

Pushed by these strong motivations to make cars, setting up an enterprise owned and run by the local government became a necessary move, both for the Anhui and Wuhu local governments. After all, it was impractical to rely on the central government to deploy a FAW-like central enterprise in Anhui. Also the local weak private economy also made it a daydream for the local administrator to expect a local private car maker.
4.2.2 Industrial Concentration: A Conflicting Logic

Contrary to the local car-making enthusiasm, the basic concern of the central government since 1980s was to strictly regulate any new entrance in this sector. As previously mentioned, in 1987, the central government chose several enterprises as the only legitimate automakers for its car industry. Such choices, on the other hand, also shut the door for many others at the same time. This point was made clear in 1988, when the central government officially announced that only “Three Big and Three Small” (“Three Big” referred to FAW, SAW and Shanghai Automobile; “Three Small” were the car projects in Tianjin, Beijing and Guangzhou) was permitted in the car production and no other automakers were allowed to join. In 1989, the national automobile industry administration further developed an institutional mechanism to enforce such an entrance regulation, namely the “directory management”. This directory listed the state-approved automobile products, while any unlisted automobiles were forbidden to be sold in the market. Unfortunately, the car project of Anhui was never mentioned in this directory at that time.

The rationale of the central government behind blocking the unwanted entrance and privileging certain automakers was to concentrate the automobile industry via state interventions.

Figure 14: Total Number of Chinese Automobile Assemblers, 1950s to 1980s
Source: Automobile Bureau of MMI and CATRC 1995; CATRC and CNAIC 2001

The rationale of the central government behind blocking the unwanted entrance and privileging certain automakers was to concentrate the automobile industry via state interventions.
This served as a basic idea of the central administrators in managing the industry structure of the Chinese automobile production in the 1980s and 1990s.

Such an idea had a deep historical root. From 1950s to 1980s, the structure of the Chinese automobile industry had evolved to be very scattered. As can be seen from Figure 14, in terms of total automobile assemblers, there were three waves of increase in prior to 1990s. These surges were mostly based on the periodical decentralizations in the planned economy period. Whenever local governments were allowed to make cars, the number of local assemblers quickly increased: During Great Leap Forward and Cultural Revolution, the central government often encouraged local automobile projects, which gave birth to many new local assemblers. The largest rise happened in early 1980s, when a new round of decentralization was launched and the domestic demand for automobiles increased dramatically. As a result, the Chinese assemblers almost doubled in a short time; by comparison, the independent automakers around the world decreased from about 50 to 30 firms in 1980s (Ronald Burger Strategy Consultants 2001). The majority of the Chinese assemblers made up a group of very small automakers, some of which produced even less than 100 vehicles annually.

After the reform, the over-populated industrial structure with so many small-scale enterprises in the automobile industry kept bothering the Chinese policymakers and the idea of concentrating the limited national resources into a small number of producers became popular. A highly-centralized industrial structure came to be deemed as a symbol of a modern automobile industry (State Council of China 1994a); And an ideal industrial structure of the Chinese automobile industry was considered to be consisted of only two to three large enterprises and six to seven medium-size enterprises (State Council of China 1994b).

So, how the industrial concentration could be achieved? Based on the past experiences, the administrators hardly believed in the market mechanism. Without strong regulations from above, decentralization in early 1980s already enabled so many local governments to build their
own automobile projects: the total number of automobile assemblers in China increased quickly from 56 in 1980 to 114 in 1985 (Figure 14). Thus, Officials in charge of the automobile industry realized that the market mechanism per se could not concentrate this industry, but only more likely generate “repeated construction” and “resource waste”. The conclusion is that a visible hand is needed. Concentrating the industry structure via state interventions, therefore, became one of the major industrial administration tasks. Therefore, any unapproved local automobile projects were strictly monitored and forbidden.

These ideas of the central government resulted in the sharp conflicts between the local and central government. In such a management framework defined by the central administrators, privileged automakers such as FAW and Shanghai Automobile certainly had nothing to worry about, but there left no room for the local initiatives such as the car-making plan of Anhui. This is how great tensions came out between the central government and Anhui: The latter was eager to pursue cars as a protocol for the local economic development, while the former emphasized the industrial concentration to serve the national interest. On the other hand, such an idea confliction also had important implications to the designs of technological upgrading method for the local car project. Due to the “illegal” status of an unapproved car project, application of joint venture strategy was impossible, even though the local government may wish to do so. With all of the foreign investments tightly monitored by the central government at that time, self-reliance R&D might be the only available option for the local government to realized technological upgrading.

4.3 Chery, Unexpected Automaker in China

The birth and development of Chery Auto was characterized by some great tensions between the local and central governments. Steered by the local governments, Chery had to carefully cope with the tight regulations from the central government. That is why Chery had to go through a tough path, especially at the early stage: the local government had to secretly launch
their project, and continuously negotiate with the central authorities to get a legal birth certificate; On the other hand, as an automaker without any acknowledgement from above, it was no possible for Chery to realize the industrial upgrading via building joint ventures, as served as the basic stimuli for its independent technological development.

4.3.1 Hijacking the Central Government

The process of the local governments in Anhui struggling for an acknowledged status for its car project might be best illustrated via the name of Chery. In Chinese, Chery has two characters: The first one, “Qi”, means surprises, which refers that this car maker is an unexpected one in the Chinese automobile industry; the second one, “Rui”, implies good lucks, which was certainly needed by this project in coping with the unfavorable environment at its birth (Zhang 2005).

The ownership of Chery, defined as a corporation belonged to the provincial government of Anhui, was shaped by co-efforts of the Anhui provincial government and the Wuhu municipal government, which worked closely with each other. The fund of Chery was also invested through five local corporations, either Anhui-owned or Wuhu-owned, including Anhui Chuangxin Investment Corporation, Anhui Investment Group Corporation, Anhui Guoyuan Investment Holding Group Corporation, Controlling Corporation of WETDZ and the previously mentioned WCIC. This cooperative relationship could also be illustrated by the political career of Zhan Xialai as the major leader of this project: Zhan was originally an official in the provincial government, while in early 1990s, he was sent by the Anhui government to Wuhu city as the mayor assistant with a special duty to develop the local automobile industry. The establishment of Chery promoted Zhang as the secretary of the municipal committee, the top leader of Wuhu city in the late 1990s. In 2008, he finally returned to a provincial position. In this sense, Zhan was not only a “businessman with red hat” holding dual roles, but also an official transferring between the provincial and municipal levels. Such an arrangement upon Zhan Xialai was indeed an effective
mechanism to make sure the associated interests of the two local governments could be properly addressed in this project.

However, only good cooperation between the local governments was far from enough for Chery to survive. Touching such a highly-sensitive field guarded by the national industrial policy required the local policymakers to be very strategic, otherwise there would come serious political punishment and economic loss. In order to avoid a doomed destiny, a basic strategy was then conceived by the local governments, namely to “hijack” the central government via making the “correcting cost” of the central administration much higher than the “tolerating cost”. That is, the local governments considered that this projection must be carried out underground at the very beginning until it involved large investments and also operating well. Thus, by then, the central government would not dare to risk the cost of revoking such a large project. This trick was actually a common game played by the local governments everywhere across China. Although not all local adventures finally won at the end, for the local officials, it was often worthy to have a try. After all, as long as these local projects turned out to be successful, these regulation-breaking actions was often acknowledged and even rewarded by the central government.

Such a “hijacking” project required the local government to start the car project secretly and accomplish the substantial production quickly, as was exactly what had been done for Chery. The project, choosing Wuhu as the location, was started in 1997, with a secret code of “951” assigned by the local governments (meaning the number one project of Anhui province in the ninth FYP). To hide the real intention for assembling cars, this project started with a puppet corporation, Anhui Automobile Component Industry Corporation, openly announced to focus on auto parts. However, in a very fast manner, all local resources were mobilized and all construction was accomplished toward manufacturing whole cars: A piece of land about 800 thousands of square meters was circled at WETDZ for Chery; A fund of 1.75 billion yuan was
invested from the shareholders mentioned above;\textsuperscript{2} The infrastructure construction was started from March of 1997, while the equipments for the four major car-making technics, stamping, welding, painting and assembly, were fully installed in early 1998; In May of 1999, the first engine was successfully manufactured and at the end of 1999, the first car, model A11 branded as Fulwin, was produced out. Only after 33 months, Chery Auto grew up from nothing.

To make sure Chery keep going, the local governments did not hesitate to do whatever they could do. To maintain the capital supply of this nascent firm, the Anhui government asked the shareholders to re-invest all of their annual dividends into this project to guarantee the supply of capitals in Chery (Wang 2003a). A more challenging job awaiting the local government was to promote the sale of newly-produced cars. Without any trust from consumers on this “illegal” car, marketing Chery models was extremely hard at the very beginning. Not to mention that the quality of these first bunches of cars were very unstable, due to the lack of car-making experiences and also the haste of the whole project. As a solution, the Wuhu government made the first order. The taxi business in this city was required to use Chery’s products. As a result, the earliest Chery buyers, about 400 people, were mostly local taxi drivers, who were then rewarded with a free taxi-business license for eight years; The local state revised the method later: In the taxi license applications, using a Chery car would only cost 7,000 yuan, otherwise the payment increased to 10,000 yuan; Another way of absorbing Chery products was through the local state itself. Zhan Xialai decided that all state-use cars in Wuhu should be Chery models (Wang 2003a).

The efforts of the local governments upon Chery were reflected not only by various supports and favorable policies, but also by the entrepreneurship of Chery’s direct founders and managers, who actually represented the local states in this project. Zhan Xialai as the major builder of Chery had a famous remark: “Choosing to manufacture automobiles is indeed choosing

\textsuperscript{2} Even such a small investment might have been over-exaggerated (Lu 2003): by doing this, the local government attempted to increase its stakes in the future negotiation with the central government.
to taste hardship”. At the very beginning, the construction team was only consisted of as few as eight people. In an interview with Yin Tongyao, who was recruited by Zhan Xialai as one of the eight founders of Chery and later became Zhan’s heritor, Yin traced back their experience in constructing Chery:

“There was nothing here except farm lands when I came here. After the village moved and the lands flattened, it was then left for us. But there were no roads, everywhere was wild. We rented a few apartment behinds the developmental zone, in which we did our jobs in technical layout, blueprints, training, gradually recruit more and more people and even cooked for ourselves. All looks like a joke.” (CCTV 2006)

After the first bunch of cars was sold, the next step of “hijacking” the central government had to be implemented, namely to lobby the central government for a certificate in the national automobile directory. Whatever Chery could produce, without a legal status acknowledged by the central government, the market could only be constraint within Wuhu. However, the local taxi-driver market as the only outlet could not be a permanent solution. According to Jin Gebo, the general sale manager of Chery, the situation became even worsen when the Public Security Department of China publically issued a notice, clearly forbidding Chery’s car to be sold in the national market (Sina.com 2008). Therefore, the local governments had to step further, persuading the central government to accept this local “mistake”. According to Wang (2003), in order for Chery, it was the top provincial leader Xu Zhongling who came to Beijing to implement this mission. To gain the sympathy from above, Xu “admitted the mistakes whenever needed” and strongly appealed the importance to keep this large project in Anhui as a poor province.

Mobilizing various social relationships and political resources, the lobby of Anhui finally succeeded in early 2001, while the offer from the central government was not direct permit, but a more complicated arrangement. According to this plan, in order to be listed in the national directory, Chery had to make a deal with Shanghai Automobile: On the one hand, Chery gave
20% of its stock (about 350 million yuan) to Shanghai Automobile and changed its name to “Shanghai-Chery”. For Chery and Shanghai Automobile, such a stock-for-license deal did not mean any incorporation or cooperation in real sense, but only an expedience to save out Chery. Or as some media described, Chery was “to get eggs from a borrowed hen”. On the one hand, concerning the huge risks of such a local project, Shanghai Automobile would not like to bear such a burden without the substantial interventions from above. On the side of Chery, to be taken over and controlled was also not a preferred destiny for these local founders who had already invested so much into this project. That is why Shanghai Automobile and Chery both agreed on the well-known “Four NOs” as an appendix of the cooperation deal: Shanghai Automobile would not involve into any investment, management, debt-bearing and dividend-sharing in Chery.

As the lat move of “hijacking”, with growing up in the domestic market with an acknowledged status, Chery finally got out of the temporary marriage with Shanghai Automobile. After endowed with a legal status, potentials of Chery were completely released: In 2001, Fulwin reached a sale of 28,000 units, about 2 billion yuan; The sale almost doubled in the next year (50,000 unit, about 4 billion yuan), as made Chery one of the top eight car makers in China; In 2003, Chery put out three new car models, S11 branded as QQ (a minicar model), A15 branded as Cowin (a sedan) as an upgraded version of Fulwin and B11 branded as Easter (a luxury sedan), and the sale reached 90,000 units, about 8.2 billion yuan. The fast development provided Chery with more chips in the game with Shanghai Automobile and the central government. As a result, in 2003, Shanghai Automobile and Chery secretly ended their union and Chery took back its 20% of stock; As a result, the central government officially listed Chery as an independent car maker in 2004. Through its excellent market performance, Chery finally won the chance to stand up independently in the Chinese automobile industry; Experiencing such a long-term depression, the

3 Since 2001, the directory regulation was replaced to a new announcement management. This critical policy change of the Chinese automobile industry is discussed in the last chapter.
local government at last fulfilled their original intentions to establish the local car industry in Anhui.

### 4.3.2 Making Cars Alone

Without timely technological upgrading, there would be no possible for Chery to grow up quickly. Unlike FAW or Shanghai Automobile approved to build joint ventures by the central government, Chery was deprived of these opportunities. In consequence, Chery was institutionally compelled to be technological independent from the very beginning. In this process, to acquire the needed technologies, develop its own models, and train its own R&D team, Chery had applied myriad methods, some of which had even brought legal troubles.

“Interviewer: (Let us image the automobile industry development just like climbing on the peak of Himalaya, the world highest mountain.) we have seen many people climbing through the south slope, which was not a hard way, because they could find the advanced foreign automakers to set up joint venture or cooperation, and use foreign capital, technologies, advanced equipments and even the best car models. While, Yin (chief executive of Chery) seems to choose a relative hard way by going through the north slope namely, to make cars independently). Do you agree with me?

Yin Tongyao (chief executive of Chery): Yes. In fact, we have tries both the south and north slopes. The south slope is not interesting to us, because at the top of the south are the national flags of other countries, not our flag. We would rather climb through the north slope and put on our national flag.”

(CCTV 2005, the content in bracket is added by the author)

Although Yin’s above claim about “north slope” sounds ambitious and stimulating, it is not proper to attribute Chery’s technological independence as a result of personal impulses. Such a choice was actually a result from the tension between the central and local government, which had deleted any other options for Chery expect making cars alone.

On contrary to Yin’s announcement, the incentives of the local government in Anhui and Wuhu to build a joint venture for advanced automobile technologies never faded. In fact, if there
is any possibility to hook up with a foreign partner at the very beginning of Chery, the local officials of Anhui would do without any hesitations. The concerns of the local governments were very straightforward: joint ventures at that time were the most practical shortcut to access to the needed technologies, management experience, and capital input. If a joint venture was doable, just as what happened in Shanghai and Changchun, the local car industry could enlarge domestic market shares and enjoy flooding profits in an easy and quick manner. In reality, to set up joint ventures was constantly experimented by the local governments for Chery throughout the early stage of this new-born firm, though all of these attempts failed in the end.

These failures of Chery’s joint ventures proposals were no surprises at all, given the fact that Anhui or Wuhu was never approved to make cars by the central administration. As discussed before, joint ventures in the Chinese automobile industry were only allowed to be built for certain automakers chosen by the central administration. Apparently, Chery was not one of them, and was even not permitted to produce automobile in the first hand; On the other hand, regulated by such kind of national industrial policy, Chery became a most-likely-doomed project because of its illegitimate status. Therefore, foreign automakers did not take Chery seriously at all.

There was another way for Chery avoiding the fate of walking alone, namely to ally with the largest domestic automakers such as FAW and Shanghai Automobile, but this route was not viable as well at that time. Due to the same concerns as the foreign corporations, the Chinese big three, FAW, DMC and Shanghai Automobile, were not likely to show any enthusiasms toward this new-born firm. That is why there came back indifferent rejections when Chery talked with FAW. Even though Shanghai Automobile was later under the persuaded by the central government to take over Chery, “Four NOs” in the Shanghai-Chery deal indeed denied any chance of Chery to get substantial technology assistance.

In the same interview as above, Yin sketched a more-accurate version of how Chery “chose” to make cars independently:
“Interviewer: Many people wish to do the self-reliant R&D, but it is too hard to proceed. Why do you stick to such a way?

Yin Tongyao: At the beginning, we did not choose, but were forced onto such a way, because there was no other way out. At that time, no one would help us. Later, when we feel this way is doable, we then go ahead without hesitations ……” (CCTV 2005)

On a technological independence path, managers of Chery had to figure out how to acquire the needed technologies. Thus, various strategies were employed accordingly in different stages of Chery’s development.

Chery’s earliest solution was “the integrative imitation”, namely directly purchasing core technologies from foreign countries and comprehensively utilizing domestically-available components to copy an established model in the market. At the initial stage, Chery always held the model of Jetta in its mind, which was a major product of FAW. Considering the fact that the production of Jetta had fostered numerous components suppliers in the Chinese automobile industry, it was a smart way for Chery to copy this well-developed model in order to save the investments and time on its own supply system. As the first step, Chery directly introduced the core auto-parts such as the engine and body from outside, which match Jetta very well. The first introduction, triggered by a business trip to Europe as mentioned before, cost Chery about 25 million US dollars to acquire a second-hand engine production line and the related technologies from Ford. The second introduction helped Chery master the car body technologies. Although there was less confirmed information via official channels, it was quite possible that from Seat as the largest automakers in Spain, Chery acquired the body technologies and then consigned the moulds making to a corporation in Taiwan. Equipped with its own production line for engine and body, Chery proceeded to use the Jetta supply system as much as possible. Only about seven months later, the first model of Fulwin was made out. The integrative imitation was absolutely not a safe measure. Volkswagen, as the introducer of Jetta model, was irritated by the audacious
copy and once forbid all of its suppliers to disconnect with Chery. According to some media, it was Shanghai Automobile who later resolved this confliction through paying 30 million German marks (Sina.com 2003).

After mastering the basics, Chery started its next stage of technological upgrading through “the creative imitation”, namely to develop a whole car via imitating models made by advanced automakers. Chery’s new models in 2003, QQ and Easter, were all extensively absorbed technologies from others. Although these technological imitations were not publicly confirmed by Chery’s managers, it is very likely that QQ and Easter had extensively borrowed designs from Matiz as a minicar model and Magnus as a luxury car model, both of which come from Daewoo Auto in South Korea. Some media guessed that these technologies were even “stolen” when Daewoo went bankrupted in about 2002. Whatever story was behind, Chery’s imitations in these two models were hardly to be categorized as “a complete copy”, because there were indeed many independent designs in QQ and Easter, which also acquired corresponding patents in China. The R&D experiences leaned through these imitations were so meaningful in the growth of Chery: Evolving from a simple integrator of auto-parts, Chery finally came to practice independent R&D. Nevertheless, the troubles came again. Because of these “stolen” technologies, Chery met lawsuits initiated by GM in 2003, which had bought the failing Daewoo and planned to sell a Matiz-based model in the Chinese market. This eye-catching legal battle lasted about three years, ending with a compromise between the two parties. Finally defending itself in front of the top automakers in the world, Chery’s technological strategies of imitations survived the hardest time.

Chery’s third stage of technological advancement was “learning by outsourcing”. That is, based on the achieved independent R&D capacity, Chery began to work with some top R&D corporations in the world specialized in certain technological fields: On one hand, Chery paid for the advanced designs and technologies of these specialized firms in order to quickly improve its
own models; On the other hand, Chery always tried to join in the R&D process of these firms in order to train its own engineer team. Never satisfied with mere imitations which were mostly backward-engineering on the target models, managers of Chery always dreamed of the capacity of forward-engineering R&D. For them, a shortcut gaining these abilities was to cooperate with specialized R&D firms via outsourcing, as may bring many opportunities of learning. In the schedule of Chery, the R&D capacity of engine was considered as most urgent. Since 2002, Chery consigned its engine R&D to AVL Corporation, one of the top engine developers in the world. In the cooperation with AVL, Chery came to send its own engineers to participate into the R&D process. By the end of 2002, Chery totally developed 18 kinds of international-standard engines ranging from 0.8L to 4.0L with whole intellectual property rights, among which 14 kinds were mainly developed by Chery’s own team (Zhan 2008). At the end of 2003, Chery had developed a large R&D team of 200 technicians specialized on engine (Zun 2007). In 2006, the Chery-made engines were exported under a contract with Fiat, a famous Italian automaker.

Proving as a valid way to develop the self-reliant R&D capacity, the same strategy was further applied by Chery in multiple technological fields: In the whole-car design, Chery cooperated with corporations such as Bertone and Pinifarina from Italy, Lotus and MIRA from Britain, and Sivax from Japan; In the field of hybrid power, Chery worked with Ricardo from Britain; In the painting technics, Chery made Dürr from Germany as its partner (Feng, Yin and Wang 2007).

The channels for technological acquisition and upgrading, established via the various strategies mentioned above, might be useless, provided the qualified technicians were not available. In terms of human resource management, Chery had also developed some characteristic solutions.

On the one hand, Chery recruited many technicians from domestic automobile enterprises, especially from the established joint ventures. FAW was a major target of Chery in hunting these human capitals. Approximately two hundred FAW employees were transferred to
Chery, including Yin Tongyao as a major manager in FAW-VW at that time. The large-scale acquisition of qualified technicians was partly base on the networking activities of Chery’s founders. For instance, Yin Tongyao was born in Anhui, as was then used by Zhan Xialai in persuading him to move back for his hometown. Another important application of the hometown tie happened on Gen Shaojie, the top FAW leader at that time and also an Anhuinese. Gen’s sympathy on the Chery project greatly facilitated the movement of human resources from FAW to Chery. For instance, with regards to the employees transferring to other firms, Gen announced in FAW that people leaving for Chery would be counted as resignation, while people leaving for Jinbei Auto, another automaker not affiliated like Chery, would be counted as dismissed (Nan and Chen 2004). Another important outlet of technicians was DMC, from where Chery got a whole R&D team. According to Lu and Feng’s research (2004), in 2000, with the attempt to build a joint venture, DMC dissolved its R&D team. As a result, a group consisting of twenty core technicians in DMC’s R&D department was attracted to Chery, and later implemented most designs for Chery’s QQ, Easter and Cowin (Lu and Feng 2004).

On the other hand, Chery had also attracted many oversea technicians. For instance, Xu Min, director of Chery’s R&D institution, once worked in a world-class automobile R&D corporation in the United States; Yuan Tao, head of the purchasing department in Chery, was an engine expert from France; Gu Yu, manager of one of Chery’s holding corporations in R&D, was preciously employed by Fuji Corporation in Japan (Tao 2005). The oversea technicians also contained foreign technicians, among whom the most famous one might be Terada Shinji a scene-management expert from Mitsubishi Motors in Japan, who joined Chery as the core technician in charge of the quality management (Zun 2008).

These efforts greatly accelerated the R&D advancement of Chery. This could be clearly demonstrated through the number of acquired patents in Chery. As can be seen from Figure 15, as

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4 In fact, the earlier built FAW-Yangtze in Wuhu was also supported by Gen.
a car maker with a short history of less than ten years, Chery’s total patents ranked as high as the 
fifth among all automakers in the China. Surprisingly, it was the number one patent-holder among 
all of the Chinese automakers, exceeding the largest ones such as FAW and DMC. However, 
Chery still illustrated its infantility in this figure: in terms of the type of patents, Chery was very 
weak in the field of invention, which in general represents the most advanced R&D capacity.

![Figure 15: Patent Number of Automakers in China by February of 2006](image)

Source: Based on Zhao (2006)

In the above discussions, a critical question is still answered incompletely, namely how 
Chery could be so successful in the market. Though the active local governments and the great 
upgrading efforts indeed matter, a special advantage of Chery should not be missed here, namely 
the low price. To make market room already occupied by the established joint ventures, the only 
weapon of Chery was to keep the price as low as possible. For instance, its very first model, 
Fulwin, was sold with a very low price, only 88,000 yuan (about 10,000 dollars), which was 
cheaper than all major models by about 30% to 40% at that time.

Such a low-price advantage was closely associated with Chery’s unique developmental 
model. First of all, with very limited financial input from the local governments, to save money as 
much as possible became a routine in the Chery project. Most of infrastructure designs were done 
by Chery itself, which greatly reduced the costs to only one million yuan; A “rolling
"development" principle was also applied to save funds. That is, the infrastructures and equipments were not established once for all, but gradually accomplished with the increasing production requirement. According to an normal estimation, the infrastructure construction of Chery would at least cost 2.0 to 2.5 billion yuan, but the actual cost was only 0.8 billion (Chen 2008b). In comparison with the huge investment of joint venture project such as FAW-VW (14.0 billion) and Dongfeng-Citroën (13.1 billion), the total investment in Chery was as small as less than 2.0 billion (Li and Niu 2003).

Secondly, “Chery was standing at the shoulders of giants, but not held in the hands of giants” (Yang 2008). The low-price advantage of Chery was also due to the fact that it fully took advantages of the supply system already established by the joint ventures. Further more, as an independent player, Chery could choose the best price in the market, as greatly drove the price down.

Thirdly, the road of technological independence helped Chery to avoid “rent-seeking”, prevalent among foreign corporations in the joint ventures. In the Chinese automobile industry, the established joint ventures actually held a big burden in pricing, for a significant part of profits had to be transferred to the foreign partners through the “rent-seeking” process. Besides the shared profit according to the joint venture contract, there are many other channels for foreign car makers to exploit extra profits from their joint ventures (Fu and Zhang 2006): For instance, the foreign corporations could charge higher prices in model introductions, technical supports, and equipment introductions. As a result, it commonly costs 2.5 to 4.0 million to purchase a new car design in the market, while join ventures often paid as high as ten to twenty times to their foreign partners for the similar models (Fu and Zhang 2006). However, practicing the self-reliant R&D, Chery never had such a problem.
4.4 Case Summary

The developmental model instantiated by Chery Auto as the champion of national car
makers in China draws attentions on those enterprises which belong to the local government but
manufacture national cars without any joint ventures affiliations with foreign automakers. The
local political structure of Anhui, the home province for Chery Auto, is a typical one among
many local economies in the decentralization of the economic reform, during which the central
government released its hand off the local fiscal activities and empowered the local governments
to be autonomous in pursing its own interests in the local economic development. The only
exception is that the local bureaucrats in Anhui directly played as directors and managers of
corporations in the local economic development, as has been called as “businessman with red
hat”. With the considerations that Anhui had long been a resource-contributing province in the
planned economy era, for the local officials, the car industry appeared to be a critical
breakthrough of the local economy in the new market environment. Nevertheless, the central
government could not agree on such a local initiative, which was out of the national industrial
plan at that time. For these policymakers, projects like Chery would harm the industrial
concentration as a major goal of the national industrial policy. As a result, there came waves of
conflictions and compromises between the local and central governments, as finally generated a
local-state-owned car enterprises producing national cars without any foreign partners.
5. Geely Auto, First Grass-roots Automaker

Among very few private-owned car makers in the China, Geely Auto was the earliest one. It grew up very quickly from Taizhou City of Zhejiang Province since the late 1990s. Li Shufu, the major founder of Geely, was often called as “the automobile maniac” by Chinese media. Considering the fact that Li independently started Geely with almost no car-making experience and very little fund, such a seemingly-sarcastic nickname might also be a great compliment. The case of Geely Auto seems to represent a classical market-transition scenario, in which market forces came to dominate the local economy, the private entrepreneurs rose up and the old command economy system receded. However, the state still matters here: like Chery, the central government greatly troubled local private businessmen in car making, as drove Geely toward technological independence; unlike Chery, Geely had no support from the local states, thus, with a same challenge but less resources, Geely had experienced a much harder time.

This chapter has three parts. Firstly how the local political structure of Zhejiang was shifting to be a private-entrepreneur predominant pattern is discussed. The next session is about how car-making stimulated the local private entrepreneurs in Taizhou and how a special local industrial culture stressing machinery-manufacturing sectors contributed to this process. At last, the chapter analyzed how Geely struggled for its business success in dealing with the discriminating central administration and the indifferent local governments, as finally led to a model featured by the private ownership and self-reliant technological strategy.

5.1 Market Transition, Zhejiang Type: Rise of Private Economy

The story of Geely seems more like a personal legend of its director, Li Shufu, an impulsive and idealist entrepreneur, however it is not proper to say that the birth and growth of this private firm was wholly an individual matter. In fact, the opposite was very much true: Geely
had its own social origins. Among hundreds of thousands of private businessmen delivered by the
great institutional changes in Zhejiang, Li Shufu was no exception at all.

5.1.1 “Zhejiang Phenomenon”

The marvelous economic advancement of Zhejiang after the reform has recently been a
well-known topic in the Chinese media. There came out different titles highlighting the
uniqueness and successfulness of Zhejiang in the economic reform, such as “Zhejaing Model”,
“Zhejiang Phenomenon” and “Zhejaing Experience”. Here is a representative comment upon
Zhejiang:

“Ever since the reform, among provinces competing with each other, there come out very few of
them accomplishing the ‘leap-forward development’, while Zhejiang was indeed one exception, called as
‘Zhejaing Phenomenon’.” (Yu 2006)

In a recent issue of Business Week, after comparing Zhejiang to other regions of China such as
Jiangsu and Shanghai, Huang (2008) praised Zhejiang as “a free-market success story, and
reminded the Chinese policymakers to “look no further than its own star province” when figuring
out the future of China.

Comparing Zhejiang in the pre-reform and post-reform era could offer some important
clues about what had been going on in this region: First of all, the GDP related statistics in
Zhejiang are very impressive. From 1953 to 1978, the annual GDP growth rate in Zhejiang was
only 5.7%, lagging behind the national average about 6%; In contrast, from 1978 to 2005, the rate
of Zhejiang increased to 13.2%, much higher than the national average, around 8% (Zhejiang
Statistics Bureau 2006; Lv 2008). In terms of GDP per capita, from 1979 to 2001, the growth rate
in Zhejiang reached 12.1%, the fastest one ahead of all the other provinces across China (Wang
2002). In 2005, Zhejiang became the first province in China with the GDP per capita overcoming
the threshold of 3,000 US dollars. Secondly, growing in such a speed, Zhejiang’s economy has
reached an unprecedented position across China in the market transition. As can be seen from
Table 11, Zhejiang was rising up so quickly in the national economy ranking: In about twenty years, Zhejiang’s economy had jumped up to be one of the top 5 in China.

<table>
<thead>
<tr>
<th></th>
<th>Rank in 1980</th>
<th>Rank in 2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>12¹</td>
<td>4</td>
</tr>
<tr>
<td>GDP per capita</td>
<td>14¹</td>
<td>4</td>
</tr>
<tr>
<td>Fiscal income</td>
<td>12</td>
<td>5</td>
</tr>
<tr>
<td>Export value</td>
<td>13</td>
<td>4</td>
</tr>
</tbody>
</table>

Source: Wang 2002  
Note: according to the statistics of 1978.

However, the growth of Zhejiang could not be fully illustrated only through these general economic numbers. Comparing Zhejiang with other fast-growing provinces could further demonstrate the uniqueness of this province. From the start of the new century, Zhejiang’s GDP rank in China maintained as stable as the national fourth, following provinces of Guangdong, Shandong and Jiangsu. However, the development pattern of Zhejiang is totally different from any of them. As can be seen from Table 12, compared with these top three provinces, Zhejiang is smaller in the population size and geographic area, which partly explains the gap of GDP size between Zhejiang and the other three. However, if the value per capita is checked, the muscle of Zhejiang is shown to be much stronger. In comparison with Jiangsu holding the second highest GDP per capita among the four, Zhejiang is 10.5% higher. GDP per capita was not implying a number on paper, but may reflect the real welfares for the local residents: Compared with the richest Guangdong, the urban residents of Zhejiang have more disposable income by 14%, while the rural residents have more net income by 44.4%; Compared with Shandong, this advantages of Zhejiang are more significant, 49.8% in urban and 67.9% in rural areas. In fact, the high personal income is one of the most important features of the Zhejiang economy: From 1984 to 2006, the net income of Zhejiang rural residents had kept as the national highest for 22 years; For seven
consecutive years from 1999 to 2006, the personal disposable income of the urban residents in Zhejiang maintained as the number one across China (ETC of Zhejiang Province 2007).

**Table 12: Comparing Zhejiang, Guangdong, Jiangsu and Shandong in 2006**

<table>
<thead>
<tr>
<th></th>
<th>Guangdong</th>
<th>Jiangsu</th>
<th>Shandong</th>
<th>Zhejiang</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resident Population (1 million)</td>
<td>93.0</td>
<td>75.5</td>
<td>93.1</td>
<td>49.8</td>
</tr>
<tr>
<td>Area (1,000 square kilometer)</td>
<td>180</td>
<td>100</td>
<td>160</td>
<td>100</td>
</tr>
<tr>
<td>GDP (1 billion yuan)</td>
<td>2598.9</td>
<td>2154.8</td>
<td>2184.7</td>
<td>1564.9</td>
</tr>
<tr>
<td>GDP per capita (yuan)</td>
<td>28072</td>
<td>28685</td>
<td>23546</td>
<td>31684</td>
</tr>
<tr>
<td>Personal disposable income per capita in urban (yuan)</td>
<td>16016</td>
<td>14084</td>
<td>12192</td>
<td>18265</td>
</tr>
<tr>
<td>Net income per capita in rural (yuan)</td>
<td>5080</td>
<td>5813</td>
<td>4368</td>
<td>7335</td>
</tr>
<tr>
<td>Total import and export (1 billion US dollar)</td>
<td>327.2</td>
<td>160.4</td>
<td>93.3</td>
<td>139.1</td>
</tr>
<tr>
<td>Actual-utilized foreign investment (1 billion US dollar)</td>
<td>14.3</td>
<td>17.4</td>
<td>10.0</td>
<td>8.9</td>
</tr>
<tr>
<td>Foreign trade dependency index (national average: 100)</td>
<td>161.8</td>
<td>104.6</td>
<td>34.7</td>
<td>70.9</td>
</tr>
<tr>
<td>Foreign trade by the foreign enterprises (%)</td>
<td>65</td>
<td>81</td>
<td>54</td>
<td>41</td>
</tr>
<tr>
<td>Sale of large-scale commodity market (1 billion yuan)</td>
<td>255.8</td>
<td>582.2</td>
<td>333.8</td>
<td>732.0</td>
</tr>
<tr>
<td>Economic Value added of private economy in GDP (%)</td>
<td>40.0</td>
<td>33.0</td>
<td>40.2</td>
<td>54.9</td>
</tr>
</tbody>
</table>

Source: Based on Ding (2007) and Zhejiang Statistics Bureau (2007)

Why the personal income matters so much here? This indicator actually gets its significance based on an inherent dilemma of the Chinese economic development, namely a poor society with a growing economy. In general economic development path of China after the economic reform was to participate in globalization via promoting large-scale of import and export, introducing the foreign investment and thus joining in the international labor division. The richest province, Guangdong, as China’s first opened place to the foreign capital and market, is very representative of this type of development. As can be seen from Table 12, the total import and export of Guangdong were far more than the sum of the other three provinces. Though not comparable to Guangdong in foreign trade, Jiangsu, a later follower of this model, was leading in the foreign investment. With attracting more foreign capitals than Guangdong, 81% export of Jiangsu was done by the foreign enterprises (Table 12). The model practiced by Guangdong and Jiangsu was based on such a mechanism: Foreign capitals are closely combined with the local cheap labors. In such comparative-advantages-pursuing arrangement, the price of labors should be fundamental in sustaining the competitiveness. Therefore, it is always not easy for wages to be
elevated, even when local GDP have been greatly enhanced. By comparison, Zhejiang was obviously on another track. The local economy was less driven by the foreign trade and investment: According to Table 12, the actual-used foreign investment in Zhejiang was only about a half of the amount of Jiangsu; In comparison with that fact that four fifth of export was done via foreign corporations in Jiangsu, the ratio in Zhejiang was only about 40%, though the total import and export of Zhejiang was similar to Jiangsu. Therefore, not following the common development methods, Zhejiang may represents an endogenous growth model, which turned out to bring more welfare to the local society.

Then there comes another question, how Zhejiang could develop so quickly without using foreign market and investment? The secret was the local private economy, the most active one across the country since the reform.

The activeness of Zhejiang private economy could be shown by the macro-economic data. From 1978 to 2006, the private economy of Zhejiang increased by an amazing annual rate of 28.9%, more than twice of the local GDP growth rate; as a result, the weight of the private economy jumped from only 5.7% of the local GDP in 1978, 15.0% in 1990, 33.5% in 1997, 40.9% in 2000, to 53.8% in 2003 (Zhejiang Statistics Bureau 2007). In Table 12, the economic value added from the private economy in Zhejiang accounted for 54.9% of the GDP, much higher than Guangdong, Jiangsu and Shandong.

At the organization level, in terms of the registered capital, realized industrial output, sale, total retail sale of consumer goods, foreign currency from export and the number of public corporations, the private-owned enterprises of Zhejiang had been ranked the number one across China for eight consecutive years from 1998 to 2006 (Zhang and Yang 2006). In the investigations on the private-owned enterprises by the All-China Federation of Industry and Commerce from 1997 to 2006, Zhejiang enterprises always made up the strongest group: In 2006,
for example, among the top 500 Chinese private enterprises, 203 came from Zhejiang (Zhejiang Statistics Bureau 2007).

At last, the prosperity of Zhejiang’s private economy could also be reflected by the local private entrepreneurs. According to the annual reports of the Hurun Research Institute, private entrepreneurs from Zhejiang have build up the strongest group among the richest Chinese: In 2006, among the top 500 list for Chinese richest, Zhejiang ranked the first by owning as many as 106 entrepreneurs, while the second one, Jiangsu, only had 60 entrepreneurs (Hurun.net 2006).

5.1.2 Private Economy, Rising Up in Transition

If the private economy is a key factor to understand Zhejiang’s economic development, why other places could not follow the same path? In another word, why Zhejiang uniquely develops such an active private economy?

A comparison between Anhui and Zhejiang could be helpful to resolve the above inquiry. These two provinces were comparable in that both are located near Shanghai, the economic center of China; Both shared the similar national economic ranks at the beginning of the reform (Zhejiang, about twelfth; Anhui, about thirteenth), however in 2005, GDP of Zhejiang rose to be the national 4th and Anhui degraded to the 15th (Yu 2006). In such a comparison, some unrelated factors could be easily distinguished. Obviously, the natural endowment was not responsible at all, since Anhui was definitely much more resource-abundant than Zhejiang; Anhui’s advanced human capital in comparison with Zhejiang, represented by the local nationally outstanding colleges, also did not matter here; If the local culture was considered, Anhui’s business tradition instantiated by the historical famous Hui business gang also seemed less relevant here. These analyses falsify such an argument that the favorable business environment would necessarily facilitate the growth of private economy in the market transition.

The above discussions have a major implication: The development of the private economy, which is supposed to be one of the major goals of the market transition, may rely on
not only the replacement of the market rules with the precious command system, but also the
growth of the private entrepreneurs as the real agents operating the new system. However, these
agents themselves were neither given, nor automatically born out of the institutional changes in
the market reform, but a kind of precious human resources, which could only be cultivated under
specific conditions and efforts.

In Zhejaing, there indeed existed certain institutional logics rooted in the economic
transition, which were highly responsible for the local extraordinarily active private economy. As
proposed by Zheng Yumin, a head official in charge of Zhejiang economy, the secret of Zhejiang
development is “Three No”, namely no natural endowment, no investment and no special policy
treatment from the central government (Zheng 2008). This seemingly irrational reasoning, that
the miracle of Zhejiang just came from “nothing”, in fact offered some critical leads to
understand the origin of the local private economy.

In the planned economy era, Zhejiang was “institutionally” neglected and even forgotten
by the central government. From 1952 to 1978, the national investment in Zhejiang was only 7.7
billion yuan so that each Zhejiangnese only had 410 yuan, a half of the national average; Zhejiang
only ahead of Tibet among all Chinese provinces in terms of national investment (Lv 2008; Pan
and Sha 2003). In a planned economy system, where the destiny of a local economy was
commonly determined by the central government, Zhejiang was certainly doomed. Such a poor
position of Zhejaing was well grounded for the national policymakers. First, Zhejiang was
disadvantaged in resources so that it may not be efficient for the government to spend its limited
capitals here. According to an estimation on basic resources per capita, Zhejiang was ranked as
the last but two among 28 provinces, autonomous regions and municipality directly under the

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1 In fact, the ignorance of the central government on Zhejiang did not change at all after the reform: from
1978 to 1993, the investment per capita from the state-owned units in Zhejiang was only three fourth of the
national average, ranking 22th across the country (Fang et al. 2000).
central government in China. With the national average set as 100.0, the score of Zhejiang was as small as 11.5, only ahead of Shanghai and Tianjin as two provincial-level cities (RDRC of State Council 1987). Another concern of the central government was that Zhejiang was geographically at the front line of war toward Taiwan. Due to the military preparation, it was almost impossible for any critical industrial projects to be located there.

In the planned economy era, with little investment from above, Zhejiang’s economy often had troubles in sustaining itself and sometime, even the basic survival became a serious problem. According to a local saying, the basic geo-economic situation of Zhejiang was depicted as “seven mountains, one water, and two arable lands”. Unfortunately, at the same time, Zhejiang was also a populous province: by the end of 1981, in Zhejiang, the population density reached as high as 380 people per square kilometer, which was the fourth highest in China (National Statistics Bureau 1982). As a result, the arable land in Zhejiang was so small that the area per capita was less than a half of the national average. Thus, without any significant supports by the central government, the local economy was often fragile to support local people, who always faced pressures to make a living under the planned economy system.

In consequence, there emerged survival-driven private business in Zhejiang during, which often had to go underground. Take Yiwu, a small county in Zhejiang as an example. Even in Cultural Revolution, when the communism ideology was most prevalent to depress the private economy, Yiwu people still managed to practice the so-called “feather for sugar” in order to

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2 Tibet was not included in this statistics.
3 Yiwu was indeed a very representative case to illustrate the growth of private economy in Zhejiang. With the very active private economy, it grew up to a world-class market for small commodities in the thirty years after the reform.
4 “Feather for sugar” was a local characteristic business in Yiwu, which could be traced as early as Ming dynasty. In the agriculture spare time, Yiwu peasants carried the brown sugar, a local characteristic product, to other regions in exchange for feather of fowls. When they returned home, these feathers could be used as fertilizer.
make a living. In this small county of Zhejiang, agents for the later emerging market had already been cultivated inside the planned economy system:

“In my village, there were about fifty ‘shoulder poles’, doing the feather for sugar business. According to their agreement (with the production team), they should turn in 100 jins of feathers per month, or 1 yuan per day to the production team. If the condition was met, the team would give them the full load of working points. (If not going out to do private business), even though the all working points were gained, we could only be compensated at the end by 90 yuan, 400 jins of paddy and 100 jins of wheat. With these foodstuffs, we could hardly survive. Not even mention any left-over. But, these people who went out for business could gain all working points, and also have extra profits after turn-in. Needless to say, the income of people going out was much better than staying at the production team.” (Pan 1997)

The unfavorable condition rooted in the institutional arrangement prior to the reform ironically had already cultivated the seeds of the private economy, which served as a major way out for local people to survive the ignorance from the centrally-designed system and the miserable environment. In sum, on the one hand, the vigor of the local private economy in Zhejiang was actually stimulated by the institutional discriminations in the planned economy era; On the other hand, “the weakness of planned economy in terms of penetration and control made it relatively easy for the private economy to grow ‘out of the system’” (Zhejiang Statistics Bureau 2002). In consequence, in 1978, the beginning of the economic reform, state-owned industrial enterprises only accounted for 61.3% of the local total industrial output, lower than the national average of 80.8%, while the weight of non-state-owned industrial enterprises had been already two times of the national average (Fang et al. 2000).

5.2 The Dream for Cars: Personal Impulse or Local Culture?

The seemingly-insane decision of Li Shufu to establish Geely was not entirely a personal impulse, but stemmed out of a special machinery-manufacturing culture of his hometown city, Taizhou, a small city in Zhejiang. However, such local enthusiasms on cars were not welcomed
by the national industrial policy at all. This idea confrontation prelude the hard path ahead of this local car project.

5.2.1 “Taizhou Manufacture”: A Special Local Industrial Culture

In Zhejiang, the dominating role of the private economy had shaped some general features of the local industry upgrading. Due to the active private economy, the small and medium-sized enterprises made up the majority of Zhejiang enterprises. Accordingly, the light industry, requiring relatively less investment and technologies and thus becoming the major choice of private enterprises, became popular branches in Zhejiang such as the sectors of textile, apparel, and food processing. Particularly, “small commodities” became the major advantaged local products: The lighter, fastener and eyeglasses produced in Wenzhou, the ties produced in Shengzhou, the stockings produced in Zhuji, etc. all occupied a significant portion in the domestic and even the international market. Corresponding to prevalent small commodity production, myriad specialized markets across Zhejiang became a critical mechanism, facilitating the production, sale, information exchange and technological upgrading of these commodities.

However, Taizhou stands different. Taizhou was often paralleled with Wenzhou in the often-used conception of “Wen-Tai model”, referring that both of them were the birthplaces of Zhejiang’s private economy after the reform. So, Taizhou was certainly representative of the Zhejiang model in the general sense: The private economy in Taizhou was also very active (see Zhang et al. 2008). However, Taizhou was special in certain ways: Taizhou’s private entrepreneurs illustrated a very strong preference on the manufacture sectors, especially on the machinery-making. This phenomenon was called as “Taizhou Manufacture”.

Checking the economic development of Taizhou, the first impression might be that the second industry in Taizhou was growing up as the leading force in the market transition. As can be seen from Figure 16, starting from the mid 1990s, the second industry rose up as the local dominant sector. Driven by the strong push from this sector, the GDP growth rate of Taizhou was
always higher than Zhejiang average: In the eighth FYP period (1990-1995), Taizhou’s GDP annually increased by as high as 24.8%; By comparison, the Zhejiang average was 18.8% and the national average was 12.1% (Chen and Dai 1996).

**Figure 16: The Industry Structure of Taizhou, 1978 to 2004 (unit: 1 billion)**
Source: Zhang et al. 2005

Inside the quick growth of the second industry since mid-1990s, the manufacture industry, especially the machinery manufacture industry, was indeed the major force. Prior to the mid-1990s, the food industry, and the apparel and leather industry respectively became the local top sector, as seemed nothing special among the other regions in Zhejiang: At the very beginning of the market reform, given the extremely underdeveloped industrial base, Taizhouese had to rely on the local agriculture products as the first step. Producing and processing fruits and aquatic products became the major local economic activities. While, same as other Zhejiang places, the labor-intensive textile-related industries later became another developmental focus for the local economy. However, since mid-1990s, these “traditional” sectors were gradually replaced by a bunch of newly-developed sectors, among which the machinery manufacture industry was the most significant (RTTPE 2005): For instance, the motorcycle industry in Taizhou turned to be one of the largest across China. The motorcycle components of Taizhou occupied about a quarter
of the national total output; The local sewing-machine industry had developed as the national largest production and export base. Taizhou’s industrial zigzag stitching machines even occupied 70% of the world market; Taizhou also became the national largest production base for valves and water pumps. A few major products occupied more than a half of the domestic market; At last, Taizhou’s home appliance and refrigeration fittings production was rising up as well. The market share of freezers made in Taizhou reached about one fourth in the national market.5

Due to the outstanding performance of the machinery-manufacturing sector, in the comparison with other areas in Zhejiang, the economy of Taizhou demonstrated some local features. First of all, Taizhou had witnessed the growth of some large corporations. From 1985 to 1995, the net asset of 140 most important enterprises in Taizhou increased from 14.97 million yuan to 256.34 million yuan and by 1994 these enterprises had contributed 21% of the total local tax and profit (Chen and Dai 1996); Since the mid-1990s, a bunch of national-leading enterprises had been successfully developed locally such as Qianjiang Motor (motorcycle), Feiyue Group (sewing machine), Star Group (home appliance) etc. Although the small and medium enterprises were still popular in Taizhou, the emerging large manufacture corporations often played an important role in the local economy, integrating these small enterprises into local industrial clusters. Secondly, Taizhou had developed the specialized markets for machineries. Just like other places in Zhejiang, various specialized markets were pivotal for the prosperity of the local private economy. In fact, Luqiao, a district of Taizhou was one of the top three specialized-markets-concentrating regions inside Zhejiang (Cai and Wang 2005).6 Due to the local preference

5 Besides these machinery sectors, Taizhou had also developed other competitive industries. Since the mid-1990s, Taizhou became the national largest production base of the chemical raw material for medicine. And the local production of plastic products was also an advantaged sector, consuming one eighth of the plastic resin in China. The traditional light industries such as food industry and leather industry in fact still held a position in the local economy, though not dominant as before: the output of tangerine cans was one third of the world total and the simulated leather shoes ranked number one in China in terms of output and export.

6 The other two areas was Yiwu and Keqiao (a district of Shaoxing), which were the host places for the Yiwu small commodity market and the Shaoxing light industrial textile market.
on machinery manufacturing, Taizhou’s specialized markets were machinery product oriented, such as the Zhejiang Material Recycling Market, Luqiao Machine-Electronics Hardware Market, Auto-Motor Component Market, and Taizhou Electronics Market etc.

The perspective of comparative advantages could not offer a good interpretation for the local culture of “Taizhou manufacture”. Taizhou was a typical zone of Zhejiang, being short of various resources; Regarding to the transportation condition, Taizhou was one of the most difficult places to be accessed inside Zhejiang; About the arable land resources, the area per capita of Taizhou was only one sixth of Zhejiang average (Chen 2008a). Perhaps, the only “advantage” of Taizhou prior to the reform was human labors, too redundant when calculated from the limited arable land. However, that did not necessarily link to any development of the machinery manufacturing. Further more, the specific historical condition during the planned economy era brought more misfortunes to the local economy. Prior to the reform, Taizhou was often depicted as “three lines” (Zhang et al. 2005): It was located directly at the “war frontline” between the mainland China and Taiwan and the sporadic military conflicts were never stooped in the 1950s and 1960s; It was also called as the “fire line” where the local armed conflicts in Cultural Revolution was one of the most severe riots in China; At last, it was called as the “short line”. That is, from 1950 to 1978, the national investment in Taizhou was only 0.46 billion, the lowest one among all the cities or areas in Zhejiang. As a result, until 1978, Taizhou’s economy ranked the second to the last across Zhejiang (Shi et al. 2004).

Then, how was such an industrial culture born in Taizhou? A few socio-historical mechanisms matter here.

First of all, the large-scale outgoing labors from Taizhou at the very beginning of the reform stimulated the local demand for machinery products. In the early 1980s, floating Taizhounese reached as large as over 500 thousand, while the total local employees in the same period was only about 2, 500 thousand (Chen and Dai 1996; Taizhou Statistics Bureau 2005). As
one of the popular businesses for these outgoing Taizhounese, shoe-repairing firstly triggered the local machinery manufacture: Shoe-repairing commonly required some simple equipment, as inspired some Taizhounese to make shoe-repairing machines locally. This soon led Taizhou to be the largest production base for shoe-repairing machines in China (Chen and Dai 1996). This sector further evolved to the manufacture of sewing machines, a pillar sector in Taizhou.

Secondly, Taizhou’s unique recycling business prosperous after the reform created a favorable environment for the local machinery manufacture. Ever since the reform, Taizhounese zealously recycled the waste materials and scrap equipments from outside, which later became a local characteristic business. According to Wei Xiajiu, the secretary of Taizhou from 1983 to 1987:

“At that time, we got a big business here. People from Luqiao and other places of Taizhou started to collect wasted metals. The business was continuously expanded. The abandoned machine tools, television, automobiles, tractors, even aircrafts, components from Tanks were all collected from everywhere of China.” (Wei 2008)

Memorized by Xiang Bingyan, the next secretary of Taizhou from 1987 to 1990, this business indeed provided the local machinery manufacture with renewed machines and unavailable industrial material:

“When firstly seeing this business in Luqiao, I was truly surprised. Inside and outside the town, on the streets and roads, near the agricultural lands, scrap machines were everywhere. Some stuff may weigh tens of tons. Where did they get these wastes? And how were they capable of shipping these things? After all, the mountain roads to Taizhou were too difficult to go through. These scraps were obsolete and oily. The waste plastics and rubbers were piled like a mountain. Luqiao people worked very hard on these wastes. After disassembly, repairing, cleaning and painting, these machines were just like newly-made and directly sold to the small factories in the villages. For non-repairble ones, people knocked them down and got the steels and other mineral materials, which were scarce materials and precious commodity in terms of
the national economic plan. This business was not only lucrative, but also in favor of the industrial
development of Taizhou.” (Xiang 2008)

Most importantly, knocking down the obsolete equipments made the seemingly-advanced
industrial production no more mysterious to the local people and gradually encouraged local
entrepreneurs to make machinery-manufacturing trials. In fact, activities in recycling business
gave birth to a routine for the local entrepreneurs in machinery manufacturing: To firstly acquire
the product, to dissemble and study it thoroughly, and finally figure out how to make it out.

Thirdly, some local institutional innovations, closely associated with the well-mobilized
local social network, resolved the financing problems encountered by private entrepreneurs in the
machinery manufacture. Machinery production was often capita-intensive, while the financing
issue was often a major barrier for local entrepreneurs who were not only short of capital in hand,
but also discriminated by the local bank system. Nevertheless, Taizhounese had invented some
methods, successfully raising the needed capital.

The first innovation was the stock-cooperation system. The stock-cooperation, firstly
invented in Taizhou in early 1980s, was a special enterprise organization form, in which several
individuals or households cooperated together to establish and manage an enterprise via
agreements. This kind of organization was indeed based on the local social networks. Through the
family and social ties, father and son, brothers and sisters, relatives and friends were convened
together when they found out business opportunities. At that time, such a system was not
belonging to any of the official definitions of enterprise, such as the state-owned, collective-
owned or individual-owned enterprises: The cooperation among a few individuals or households
could not be defined as “collective” because of its relatively small scope, nor could it be defined
as “individual” because of the existence of multiple investors. Although this new enterprise form
brought many troubles, it was soon admitted by the local officials as a local institutional
advantage:
“Taizhou was impossible to copy Ningbo and the south of Jiangsu (These two areas were famous for the township and village enterprises directly sponsored by local governments). We did not have their conditions and opportunities. Regarding to Wenzhou, it mainly relied on individual merchants, different from the manufacturing-orientated Taizhounese. Since neither model is applicable for us, the only way left was to…walk out our own path…namely, to greatly develop the stock cooperation system.” (Xiang 2008; bracket content is added by the author)

What on earth was the advantage of the stock cooperation system? Obviously, this organization form provided a good solution for fund-raising problems faced by the Taizhounese in the machinery manufacture. On the one hand, cooperation between individuals or families could overcome the financial limitations of individual entrepreneurs; On the other hand, it also represented a governance structure acceptable to the local private entrepreneurs. Through some decision-making mechanisms based on local social networks, the stock cooperation system effectively avoided the ownership ambiguity.

Another innovation was the local civil finance. The underground debit-and-credit activities were popular among Taizhounese with a common form of “Hui” (namely, a union). Developed out of family and friend ties, a Hui was commonly consisted of one “head” as the convener, who was the one in need of the loans, and several “feet” as the participants, who joined to offer financial assistance. A dice was rolled to decide the order of feet so that a detailed payment and withdraw scheme was made for each participants (Chen and Dai 1996). Hui had developed many advanced forms, some of which were profit-driven and involved large funds.

Different from these unofficial and even illegal Hui, another mechanism channeling needed capitals for the local private economy was private-run finance institutions, which emerged from the late 1980s. Due to the ignorance of state-owned banks on the local private enterprises, especially on the small and medium ones, local private finance institutions took this market room and grew up very quickly. Taizhou is currently the only prefecture city in China to have as many
as three private banks. The private finance institutions and private enterprises in Taizhou were highly “complementary”: Private enterprises found market opportunities, while private banks offered high-efficient financing assistance (Zhang 2007).

5.2.2 The Automobile Maniac and His Opponents

Growing out of a machinery-manufacture environment, Li Shufu, father of Geely, could be considered as a perfect specimen of the private entrepreneurs in Taizhou: Li’s business consistently centered on making various machineries. However, his choice to make cars still seemed too wild even in the eyes of local people. After all, a car project generally involved personally-unaffordable investment and extraordinarily advanced technologies in production and management. Without consulting automobile experts, in common sense, people would be aware of the imprudence of such an idea: How could a single private entrepreneur afford such a huge project? Nevertheless, Li Shufu seemed unstoppable. There might be nothing better to depict his “craziness” except his well-spread sayings in media:

“How could it be so difficult to make a car? Isn’t a car just a motorcycle plus two additional wheels? Isn’t a car just two sofas with four wheels?” (Author: this might be the most frequently quoted words when media named Li as the automobile maniac.)

“Give me a chance to suicide!” (This is a well-known reply from Li when some people considered his car-making ideas just like a suicide.)

“What is innovation? Innovation should be the thing you insist on even though all others disagree. If your decision is same as others, how could it be innovative?” (This one is Li’s definition on innovation.)

Li’s “craziness” did not rise up unexpected, if his previous business career was carefully examined. His business career prior to the Geely project had three phases:

The whole 1980s witnessed a marvelous rise of Li Shufu as a young entrepreneur. In the early 1980s, Li was one among the hundreds of thousands of Taizhounese, starting their own business and struggling in the new market economy. At the age of 19, just graduating from the
local high school, Li launched his first business, the photography. After a while, he moved his attentions to extract silver from developer (a photo-processing liquid) and soon accumulated some money. In the mid-1980s, he started to make refrigerator components. After gaining some component-manufacturing experiences, Li soon decided to make the whole refrigerator. In less than one year, Li developed the evaporator as the key refrigeration part and made out the first bunch of refrigerators. By the May of 1989, his sale had reached 40 million yuan (Li 2008).

Frustrations came as quick as successes. In the late 1980s, the central government started to control refrigerator manufacturers, disallowing unapproved incomers (This is exactly same as regulations on the automobile industry). Being afraid of the state punishment, Li ended his refrigerator business without any resistance, donating production facilities to the local state. His bad luck continued. Trying to make some “easy” money from the real estate market in Hainan Province, Li had a big loss of his previous earnings in making refrigerators.

These temporary failures were just small episodes in Li’s legendary career. His second rise started from early 1990s, when he focused on producing magnaliu bending boards, a type of construction decoration material. As the earliest manufacturer of this material in China, Li quickly became successful: In 1991, the sale reached as high as 8 million yuan; In 1993, 150 million; In 2001, 340 million (Zheng 2007). Accumulating funds from decoration materials, Li became restless again to play with machineries. This time, his choice was to make motorcycles. In 1992, Li’s motorcycles came out with a brand of “Geely”; in 1998, the output reached 350 thousand vehicles, exporting to 22 countries in the world (Li 2008).

Based on this chronicle of Li Shufu’s early business career, we could get some critical clues to understand how his ideas upon the cars could be possibly generated. First of all, like many Taizhounese, Li Shufu held a strong preference on the machinery manufacture. As we can see from above, from the photography business to the refrigerator, from the decoration material to the motorcycle, Li’s interest always cruised around the same field, namely machinery
manufacturing. Throughout his early business career, the only deviation was the real-estate speculation, while the failure in this field reinforced his choice back to the familiar track.

Second, Li’s entrepreneurship was unique among others. The “craziness” illustrated in his car project was born long before the car project itself. Either in making refrigerators or motorcycles, Li all faced great social pressures: When these ideas were firstly proposed, surrounding people such as his family members always expressed strong disagreement and sharp criticisms. The extraordinary courage shown by Li in face of these decries was actually the harbinger of his insistence in making cars.

However, Li’s ideas on car making were not welcomed at all by the central government. As has been discussed in the previous chapter, the central government had firmly closed the door of the car industry, with the belief that any new incomers would worsen the already over-crowded industrial structure. In front of these regulations, Li Shufu was even more disadvantaged than the disobeying local governments in Anhui and Wuhu. This private initiative, with no official backgrounds, had no credits at all in the eyes of the central administrators. On the other hand, the mobilization of political resources to gain the acknowledgement of the central authority, which proved extremely critical for the final success of Chery, was also unavailable for Li. Because of denials of the national regulations, just like Chery, Li Shufu was not to allow setting up a joint venture and had to implement the self-reliant technological upgrading.

5.3 Geely Auto, Developing without Official Backgrounds

Without any official acknowledgement like FAW and Shanghai Automobile, and also without any official background such as Chery, Geely was the most disadvantaged one across the four cases presented in this study. Accordingly, Geely had indeed experienced the hardest development process: On the one hand, Li and his colleagues struggled very hard to lead Chery as
a private car maker surviving the discriminated policy environment; On the other hand, Geely managers had to experiment various upgrading methods to make cars independently.

5.3.1 Survival in Discriminations

Facing the government regulations, Geely had at least three major barriers for its survival: First, a production-permit from the central government in order to sell its products in the market; Second, enough funds to start and sustain the production; Third, a market space for its final products. These issues seemed closely intertwined with each other: Without a legal status certified by a production limit, it would be hard to attract other investments or apply loan from the banks; The shortage of capital would definitely be a bottle neck for any meaningful car-making activities and thus would harm attempts to get a production permit; If cars made by Geely were not accepted by consumers, the permit and investments would both be meaningless. None of them was an easy job for Li Shufu as a private entrepreneur.

To accomplish the very first goal, namely gaining an official birth certificate for the Geely cars, Li Shufu totally spent four years (1997-2001). During this torturing process, Li Shufu managed to employ various tactics, playing hard with the bans from the state in order to push his "illegal" car-making plans.

Li’s first strategy was the “shell-borrowing” approach, namely to affiliate his enterprise with already certified enterprises for using their production permit. In fact, such a strategy was not new in Li’s business career, but a well-learned and well-used trick. For an entrepreneur frequently entering the state-monitored fields such as the refrigerator and motorcycle, Li Shufu had indeed accumulated some experiences in playing this game. In his early career, the retreat from the promising production of refrigerators was later proved to be a mistake, given that many similar enterprises actually survived this round of regulations via various strategies such as allying with certified enterprises. This bitter lesson soon helped Li in his motorcycle business. Same as refrigerators, the production of motorcycle was strictly regulated as well by the central
administration and there was no hope for a private entrepreneur to get a production permit in this field via direct applications. However, this time, Li finally figured the way out: He firstly persuaded a state-owned motorcycle enterprise to be his “shell”, in which Li paid for each motorcycle manufactured under the borrowed production license; Later, he spent 60 million yuan to directly purchase a bankrupting motorcycle enterprise in order to get an official license (Meng 2003).

With the successful experience in motorcycle manufacturing, the “shell-borrowing” strategy was then applied by Li Shufu as an important key to knock the door of the car industry. Like a drama, a jail factory was chosen as his first shell (Meng 2003; Zheng 2007): In 1997, a jail-affiliated automobile factory located in Sichuan province was discovered by Li Shufu. Designed as a training program for prisoners, this factory was certainly not a normal enterprise and also not an ideal cooperator in common sense. Moreover, the permit owned by this factory was specifically issued under the bus category, not applicable to cars. Nevertheless, the state regulations had deprived Li of the right to be more selective. Since there was nothing to care except a production permit, Li made great sacrifice in this deal. To persuade the factory to borrow the permit, Li offered 30% stock to the factory in a joint project. This became the first step of Li’s car-making march, though it was far from a satisfactory one:

“Except the merit of cheap labor (prisoners as workers), there were so many problems in a jail factory. First thing first, it was not easy to get in and get out in a jail. More seriously, it was so hard to match institutions between a private enterprise and a jail. They (the jail managers) did not contribute a penny and they run such an organization that every tiny issue had to be reported (to the superior administrations) for instructions.” (Meng 2003: 96-97; bracket content is added by author).

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7 In order to meet the requirement of this bus-specific permit, Li had to later transform his products into bus-like vehicles.
8 Li Shufu later managed to take back the 30% stock and completely held the permit.
The “shell-borrowing” method had other applications: Li took advantage of his own motorcycle business as a “shell” to acquire the needed land for the car project. Due to policy sensitivity, there was no way for the local government to authorize any land for Li’s car project. To resolve this problem, Li made the land requests under the title of his well-developed motorcycle business. Under such a legitimate “shell”, the first piece of land, about 850 mu, located in Linhai as a county-level city under the administration of Taizhou, was successfully acquired in 1997.

With the permit and land, Geely’s production expanded in a very fast manner. Linhai became a production base of Geely Auto and the first car, Haoqing (meaning ambition in Chinese), was soon produced out in 1998. In the next year, Li Shufu built another base in Ningbo, a city in Zhejiang province, where Merrie (meaning happy days in Chinese) came out in the year of 2000 as the second model of Geely. Nevertheless, a serious problem arose: According to the national policy, a production permit should only be used in the originally-issued location, thus both bases in Linhai and Ningbo held great hazards to be revoked. Again, getting a new permit became a issue.

To resolve the possible crisis, Li Shufu invented another trick of “crying for support”, namely to draw the government attentions and social sympathy through publicizing the discrimination Geely received as a private enterprise and the rightness of his self-reliant automobile project. In various public occasions, Li started to reiterate the same complaints:

“Please allow private enterprises to bravely experiment, allow us to have car dreams. For these investment as high as several billions, we will not ask a penny from the government, and loan a penny from the government. All outcomes will be on us and no risk on government. Please give us a change to fail!”

Although it was not for sure that Li’s homework on the public relationship directly changed the mind of the central government, at least, his emerging influences on the public opinions had exerted great pressures on national policymakers: They began to treat this “activist”
seriously and feel interested in this private-run project. In an incomplete list (2003), from July to September in the year of 2000, as many as four investigation teams from the central government had visited Geely. These visitors even included the director of NPC, Zeng Peiyan. In 2001, Geely was finally approved as a legitimate car maker by the national administration.  

The second problem Li encountered was to raise enough funds. Despite being a successful businessman, in comparison with one and a half billions of yuan as the minimum investment set by the government for a car project, Li’s personal account was far from being enough. To make it even worse, private corporations in China were relatively hard to get any financial assistance from banks, which were mostly run by the state. Moreover, considering the “illegal” status and the consequent great risks of this project, no banks would like to cooperate with Li. Even the local private local financial institutions were rarely persuaded by Li: the total loan made by Geely in its early stage, about several tens of million yuan, was only from one local private-run credit cooperative (Tian and Li 2001).

Rejected by official financing channels, Li had to seek other mechanisms. First of all, the active local civil financing provided him opportunities. Although the detailed investment structure in Geely was not open, it was for sure that Li Shufu was backed up by a group of local private investors. In mobilizing these investors, Li invented a critical strategy, called as the “boss” project: Li, as “head” of Geely, invited the local interested investors, as “bosses”, namely to establish or join to establish component enterprises assisting Geely; These boss-built enterprises were inherently a part of Geely as sub-factories without an independent legal status so that the ownership relationship between Geely and these investors were often based on informal negotiations (Yuan and Xie 2003). The consequent coordination framework was very intriguing:

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9 In fact, Li’s “cries” were closely embedded within an emerging shift of the major policy paradigm in the Chinese automobile industry since late 1990s, which will be detailed in the last chapter.
The relationship between Geely and its sub-factories was not in a strictly hierarchical structure, while it was also not a contract-based cooperation among independent firms in that these sub-factories were all dependent on Geely. This governance structure was a typical illustration about how business behaviors were embedded in the local social networks. As a matter of fact, neither ownership nor contract connected these enterprises, but the local social ties.

After getting the production permit in 2001, Geely had more the financial pressures because of the production expansion. This led to Li’s application of another fund-raising strategy, namely to raise money in the stock market. Considering that a brand new company may not attract enough interests for investors in the stock market, Li chose to transplant the well-used “shell-borrowing” method again: Through a series of complicated interaction with PG as a public company in Hong Kong, from 2003 to 2005, Li Shufu successfully realize his plan (Figure 17).

![Figure 17: Geely Auto Going Public, 2003 to 2005](image)

Source: Based on Li 2007 and Liu 2006

Note: Shanghai Maple was once an independent automaker, but was incorporated into Geely Auto to be the third production base in 2002.

At last, the market space was a fatal issue for the survival of the new-born Geely. Recall the situation of Chery: Without the production permit in the early stage, the local states in Anhui could exert political powers to create a market out of the local taxi business. But, this method was not applicable to Geely as a private car maker. Holding the permit from the jail factory, the early
products of Geely dare not appear in the market as cars. That is, the state regulation indeed squeezed Geely out of the formal market. On the other hand, though Geely later acquired a car-making permit, its market prospect was no promising at all. The Chinese car market in the late 1990s had been already occupied by introduced car models from a few joint ventures. For a new and underdeveloped incomer such as Geely, the only possible room was low-end products with very cheap prices, namely the “economic cars”. Thus, Li determined to make the cheapest car in China. Prior to the year of 2001, Geely’s first model, Haoqing, maintained as the cheapest one in the market with a price about 50,000 yuan (about 5,000 dollars); In 2001, when the central government released price controls on cars, Geely soon initiated a price war with its market competitors, fighting for the honor as the cheapest car in China. Such price wars of Geely competing for the cheapest car title repeatedly broke out after then. Greatly disturbing and destroying the established pricing scheme of the domestic car market, Li Shufu received another nickname from media, “catfish in the Chinese automobile market”.

Regarding to the secrets in maintaining these low prices, Geely was not much different in comparison with Chery: Strategies of Chery discussed in the previous chapter, such as “rolling development” in the infrastructure construction and the independent R&D, were all applied in Geely as well. However, Geely’s supply system indeed had some unique features:

“Many component suppliers for Geely Auto were the previous suppliers for Geely motorcycles. They had been transformed in order to fit the strategy of Geely. By now, these suppliers, about 200 enterprises, mainly concentrated in Taizhou, Ningbo and Wenzhou. Geely Auto controlled over 50% of them, as is a main reason for Geely to well control the production cost.” (Li Shufu from Zhang 2004)

Besides the internal control of production cost, Geely had also developed some unique coordination with some of its suppliers: Based on the mutual trust and expectation of long-term cooperation, a bunch of firms always supplied exclusively-low-price products to Geely even without any ownership connections. This interesting relationship often replied upon social ties,
which had supported the local civil financing as discussed before: For example, Shanghai Velle Corporation, an excellent automobile condition producer, was such a supplier. The boss of this corporation was in fact an old friend of Li Shufu. At the very beginning of Geely Auto, it was Li who offered the boss an opportunity to supply the air condition to Geely. As a result, Shanghai Velle Corporation became a subsidiary-like supplier of Chery and the boss even titled Li Shufu as the top director of his company even though Li had no investment (Zhu 2006). Of course, such relationship is not uni-directional: These suppliers often expected to have the long-term business cooperation with Geely to grow up together.

At last, the low price of Geely cars was also benefited from the advanced auto-part supply system in Zhejiang. The private-run auto-components makers were already developed very well in Zhejiang since the reform. In order to make their own room in the domestic market, these private suppliers were also good at maintain low price. As a result, it was relatively easy for Geely to acquire components in a cheap price and then decrease the cost of making the whole car.

After years of struggles, Li Shufu and his Geely Auto finally held a firm position in the Chinese car industry. Geely Auto stepped onto a fast development track after the acquisition of the production permit in 2001. The sale of Geely reached 24,000 units in 2001, 47,800 in 2002, 150,000 in 2005 and 204,000 in 2006; Since 2005, Geely maintained as one of the top ten car makers in the Chinese market (Zhejiang News 2008). By the end of 2004, Li Shufu had set up the four production bases in Linhai, Ningbo, Shanghai and Luqiao. Since 2005, Geely started another round of expansion, in which six new production bases across China were in design or construction including Xiangtan, Lanzhou, Cixi, Jinan, Chengdu and Guilin. According to the long-term plan, in 2015, the production capacity of Geely would reach 2 million vehicles, occupying 10% market share in China (Geely Auto 2008).
5.3.2 Geely’s Upgrading Road: Challenges and Passions

“We should make efforts to export Chinese cars to the world, rather than let cars from all over the world to run in China.”

“Setting up Joint-venture is just like the addiction of opium. The one who holds the brand and core technologies controls the game.”

These two well-known quotations from Li Shufu were representative in expressing his ambitions for technological independence. Not only did Li dream of making the national cars to sell in the international market, he also directly attacked the joint-venture strategy advocated by the national policymakers. Li’s claims could easily lead us to recall the similar words coming from Zhan Xialai, the leader of Chery Auto. Is this a coincidence that the two entrepreneurs held the same nationalistic ideals? Apparently no. For either Zhan Xialai in the state-owned Chery or Li Shufu in the private-run Geely, the choice toward the technological self-reliance was born from the same institutional logic: They were both excluded by the central government in the national plan for the car production and thus there were no possibilities for them to set up any joint ventures. They had to do it alone, if they were determined to make cars.

On the same technological path as Chery, the first upgrading method of Geely Auto was also the integrative imitation, namely to copy an established model in the market and utilizing available components as much as possible. Inside Geely, this strategy was called as “Miao Hong” (meaning a calligraphy training method in Chinese through which trainees could follow the model character to practice). However, Geely was more aggressive: unlike Chery who carefully took Jetta as an ordinary and well-sold model, Geely’s first “model character” was Benz, one of the most luxury and advanced models in the world. This project was initiated as early as 1997, when Geely was still struggling for a production permit of cars. Although to copy Benz required an extremely high technological standard, Li’s preparation was very cursory: His engineer team was only consisted of only three persons, who actually came from his motorcycle factory; There
were no blueprints, model data, and manufacture equipments except drawing boards and hammers. The actual imitative integration was thus a very rough process (Mei and Feng 2005): Li knocked down one Benz and one Hongqi (the luxury model of FAW) and combined their components into a new car. The body of this car was actually hand-hammered with the glass reinforced plastic. In the next year, another model was made out following the similar way. This time, Li’s team made some progresses by constructing a whole component list. Although the braveness was laudable, Li’s Chinese version Benz could not be taken as successful.

After these two experiments, Li transferred to more feasible ways of upgrading. The targeted model was degraded to a cheap but very popular model, Xiali, made by Tianjin Auto. In the 1980s and 1990s, Xiali was a major mini-car model in the Chinese car market. Just like Chery imitating Jetta, Geely started to comprehensively copy Xiali since 1998. This third experiment finally produced Haoqing as the first car of Geely, which extensively borrowed Xiali technologies such as the chassis, engine, and most components. From then on, the second Geely model, Merrie, and the third one, Ulion, were also developed from the Xiali platform. Particularly, these models were all equipped with a same engine as Xiali, Toyota 8A.

Just like the lawsuits Chery had encountered in its imitation on Jetta, Geely was also involved in similar troubles when copying Xiali. Tianjin Auto, as the major “victim”, was irritated by Geely’s growth. For the leaders in Tianjin Auto, it was ridiculous that Geely fully took advantage of the whole production system of Xiali and in the meanwhile competed with Xiali in the market. In 2000, Tianjin Auto increased the price of Toyota 8A engine used by Geely from 17,500 yuan to 22,000 yuan; In 2001, as a more vehement response, Tianjin Auto disallowed its engine factory and the components suppliers to do any business with Geely (Zhu 10

10 Merrie was produced out in 2000 and Youliou came out in 2002. Because Geely did not get any production permit until 2001, Merrie and its former model Haoqing had to be designed as hatchback vehicles so that they could be not acknowledged as “cars”. However, with the permit issued, Youliou was designed as a sedan.
2006). Unlike Chery who had Shanghai Automobile to “pay” for its mistake, Geely had to rely on itself in such a crisis. As a countermeasure, Geely started to search alternative suppliers for the non-core components and accelerate its own engine R&D. Another attack came on Geely very soon. At the end of 2002, Geely was sued by Toyota, one of the top car makers in the world. The major complaint was that Geely’s Merrie model used a logo very similar to the Toyota’s one, misleading consumers to associate the two enterprises. Facing Toyota’s compensation request as high as 14 million yuan, Geely never compromised throughout the whole litigation. This legal confliction last for almost one year and ended with the victory of Geely.

Geely’s early technological development and the similar experience of Chery discussed before have shown the value of imitation, which was a common choice among the out-of-plan car makers in China as their first upgrading step. Imitations evidently was a short-cut for these inexperienced automakers to quickly start the production and get into the market; On the other hand, although imitations were always associated with potential infringement of the intellectual property rights, under the specific environment of China at that time, there were indeed some spaces for these imitators to protect themselves. The ambiguity of the related laws and policies, the cost for the victim in pursuing a law suits, and the attitude of the central government may all help these “illegal” automakers to safely get on board at the end.

The acquisition of the official production permit in 2001 totally released Geely from the status trouble and then derived a new round of the technological upgrading, in which Geely started to get out of the imitation stage:

Firstly, the whole car R&D process was formalized in Geely. Since 2001, engineers in Geely started to follow the modern standards in the whole car R&D (Mei and Feng 2003): In the previous imitations on Xiali, Geely’s R&D was usually a backward-engineering process with very simple hand-drawing tools; However, in the new stage, Geely came to practice forward-engineering and also started to construct digital models. Mybo, the first national sports-car
developed by Geely in 2002, was the first attempt in this direction, while Free Cruise, a sedan developed by Geely in 2005 was a milestone model indicating the accomplishment of this transformation.

Secondly, Geely’s products evolved from the low-end to high-end in the market, transferring from low-price and low-technology to high-price and high-technology cars. The major models of Geely in the early stage including Haoqing, Merrie and Ulion as mini-cars were all were typical low-end products. However, from producing Free Cruise as a middle-sized car in 2005, Geely stepped into a more advanced market. Soon after Free Cruise, Geely consecutively developed Kingkong in 2006 and Vision in 2007, both of which were medium cars with more advanced technologies and higher price tags. These two models plus Free Cruise were called as “New-three” of Geely (Haoqing, Merrie and Ulion were “Old-three”). In 2007, the New-three had replaced Old-three as the major products of Geely in the market, occupying 63% of Geely’s total sale (Figure 18). In the same year, Geely announced that it had accomplished a strategic transformation, in which the company transferred from relying on the price advantage to emphasizing the technology advantages (Geely Auto 2007).

![Figure 18: Sale of Geely Models in 2007 (total: 18,1517 vehicles)](source: Geely Auto 2008)
Thirdly, Geely had made some critical progress in developing core automobile parts. In fact, the attack from Tianjin Auto in 2001 by suspending the engine trade served as a trigger, driving Geely to develop its own core parts such as the engine and transmission. These achievements indeed helped Geely grow up as an independent automaker.

From 1998 to 2006, Geely experienced two stages of engine development. The first one was instantiated by MR479Q (1.3L) and MR481QA (1.6L), which were developed out of Toyota engines previously used in the Old-three; The next generation of engine was represented by the independently-developed JL4G18 (1.8L), which was a world-class engine with the advanced VVT technology.11 This engine was also the first VVT engine in China. Until 2006, Geely had developed a series of engines ranging from 1.0L to 1.8L. According to an engine evaluation in 2007, MR479Q (1.3L), MR481QA (1.6L) and JL4G18 (1.8L) were all listed as one of the top ten Chinese engines in their respective groups, while JL4G18 even ranked the second in the 1.8L group (Tom.com 2007). Another breakthrough was the automatic transmission. Making automatic transmissions was once a forbidden zone for the Chinese car makers since 1980s and all automatic transmissions used in China had to rely on import or foreign partners of the domestic joint ventures. In 2002, Geely Auto invested 80 million yuan to initiate a project for developing the automatic transmission technologies. In 2005, this project successfully gave birth to the first automatic transmission in China. As a 3-speed product, this transmission was soon equipped in the model of Free Cruiser; In 2006, a 4-speed product was further developed and equipped into Geely’s new models.

The above technological upgrading was accomplished via various strategies employed by Geely Auto.

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11 VVT is the abbreviation for variable valve timing, which is a newly developed technology of the automobile engine R&D in the world automobile industry.
First of all, like Chery, Geely outsourced incapable R&D to international specialized firms as technology partners in order to quickly realize the technological advancement and also acquire opportunities to learn in the cooperation. As early as 2002, Geely started to seek technology assistance from Italian Automobile Solutions and Daewoo International. From then on, more corporations specialized in the needed field by Geely, either domestic or international, were invited to join Geely’s automobile R&D. This was such a well-applied strategy that the New-three of Geely all extensively applied technologies from outside (Shi 2007). In these outsourcing activities, Geely had always been developing its own R&D capacity. In cooperation with Daewoo International for the milestone model of Free Cruiser, Geely always practiced a “1 to 2” principle, namely one Korean technician should be working with two Chinese technicians from Geely (Information Weekly 2005). Another example was the R&D of the VVT engine. To quickly master the core technology, Geely chose to cooperate with FEV as a famous engine R&D company from Germany. However, Geely Auto insisted that all of R&D of FEV must follow the requirements and receive the acknowledgement from Geely, and in these communications, Geely engineers could raise technological questions whenever needed (Zhu 2006). Holding such a strong intention of developing its own R&D capacity, Geely Auto grew up quickly in cooperation with these specialized corporations.

Secondly, Geely recruited excellent “human capitals” from everywhere. Regarding to management experts, under Li Shufu, all of the four associate directors of Geely Auto were invited from outside, including Xu Gang, the former general accountant of Zhejiang Local Taxation Bureau; Nan Yang, the former general manager of Shanghai-VW; Zhang Zhe, the former general accountant of Macro Group; and Zhan Wanjin, the former general manage of business in FAW-VW (Su 2007). Some of associate directors in Geely were actually from the dominating joint ventures in China. This was just like Chery where Yin Tongyao as the director was dug out from FAW-VW. In terms of introducing technicians, Geely was also doing a good
job. In fact, Geely’s early imitation on Xiali was just done by an engineer team “invited” from Tianjin Auto. Here is a list of some major technicians from outside in Geely: 1) Pan Yanlong, the former general engineer of Nanjing Fiat. Joining Geely to be in charge of the R&D Institute, he became the major builder of Geely’s R&D system; 2) Xu Binkuan, previously the general engineer of Tianjin Gear Factory and the director of a national research team for automatic transmission technologies. He was the major technician for Geely’s transmission R&D; 3) Cui Xiaoli, the former director in the technology department of Tianjin Toyota Motor Corporation. He led a research team, successfully developing the first national VVT engine in Geely; 4) Hua Fulin, the former chassis expert in FAW. He was the major technician developing the chassis for Geely’s Vision model. 5) Guo Konghui, the only academician representing the whole automobile industry in the China Academy of Engineering. He joined Geely as a senior technology consultant.

Although the developmental process discussed above was full of Geely’s various strategies as responses to the discriminative environment created by the central government, it is unfair to attribute the local government as a totally irrelevant player here.

In the market transition, when the private entrepreneurs replaced the central government as the dominating force in Zhejiang, the local governments generally responded with a very supportive attitude. This made the local governments in Zhejiang as a critical sponsor of the rising private economy. From the early 1980s to the late 1990s, Zhejiang governments continuously issued policies permitting and encouraging the development of the private economy. Although the whole process was not smooth,12 the political atmosphere toward the private

12 At the very beginning of the reform when the political ideology supporting the market transition was not fully acknowledged, the private economy was often depressed by the local governments. Take Wenzhou as an example. In the early 1980s, when the local private economy just started to grow up, “eight kings”, namely eight most outstanding local private entrepreneurs, were put into jail by the local government because of “speculation and profiteering”. Their “crime” was purely political: “making such a big fortune means developing capitalism” (Gao 2008).
economy in Zhejiang consistently illustrated a market-favoring trend throughout the 1980s and 1990s. For instance, the famous local slogan proposed in the 1980s, “to emphasize development regardless of character, to care results regardless of proportion”, exactly expressed the minds of the local governments to get rid of the previous ideological constraints, which criticized the private economy for its non-socialist “character” and strictly regulated its “proportion” in the local economy. After 1992, the local government released even stronger signals, such as the famous “Four Deregulations”, namely no limitations on the proportion of the private economy, on the developmental speed, on the business pattern and on the business scale.

In spite of the positive attitude of the local governments toward the emerging private economy, the local officials left the market operations to private entrepreneurs and mainly work on the macro-level to help with the well-functioning of the local market. In this sense, the local governments in Zhejiang were certainly different from those in Anhui.

In the case of Geely, such a role of the local governments got a chance to illustrate: The local states never stopped Li’s car-making business, but was also reluctant to directly involve. Due to highly risks, the local officials kept very conservative on Li’s car project. There were no financial assistance and even the land for Geely’s infrastructure was only approved in the name of Li’s already successful motorcycle business. After Geely acquired the production permit and started to grow up in a healthy way, the local government started to change the attitudes. Since 2002, the top political leaders in Zhejiang started to praise the importance of Geely Auto and demonstrate intentions to assist this corporation. However, the local states still kept their hands off the operations of Geely. With such a role played by the local state, the assistance Geely had acquired from official channels was often personal rather than institutional. In Geely’s record,

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13 However, this does not mean all Zhejiang governments are exactly the traditional “liberal state” as a gatekeeper of the free market. In fact, some local governments always actively pushed the local economy through improving the market macro-environment. The growth of Yiwu as the world supermarket was a good instance to illustrate this type of local governments in Zhejiang.
there were indeed a few officials who had ever made contributions in Geely. Huang Xingguo, the secretary of Taizhou, was one of them. When his position moved to Ningbo in 1999, Li Shufu was offered a chance to acquire a local land as Geely’s second production base; Xu Guang, once mentioned as the current associate director of Geely, helped Geely in an interesting way: He resigned from his official position in the Local Taxation Bureau, moved to Geely, and then used previous social capitals in the government to raise fund for Geely. The list could certainly be made longer, however these personal helps could not deny the fact that the local state did not shed deterministic influence on the growth of Geely Auto.

5.4 Case Summary

Geely Auto is representative of the very last developmental model, which refers to a group of private-owned car makers implementing self-reliant R&D as their technological pathway. The dominance of the private-owned enterprises was a major feature of the local political structure in Zhejiang as the hometown province of Geely Auto. As a resource-scarce and war-preparing region, Zhejiang had been long overlooked by the national planned economy system before the reform. With a shallow foundation of planned economy, in the market transition, the private-owned enterprises rose up as the major momentum of the local economy, while the influence of the central government often retreated to the background. Moreover, the local governments of Zhejiang in general kept positive to these local private businesses. As a result, Zhejiang became a province with the most active private economy throughout China. Taizhou, a city of Zhejiang, was the place where Li Shufu as Geely’s founder grew up as a success entrepreneur. “Taizhou Phenomenon”, a unique local culture favoring the development of machinery manufacturing, served as a hotbed for entrepreneurs such as Li to generate ideas to make cars locally. However, the central regulations disallowed this type of spontaneous car production from grass-roots and became the major barrier for Geely Auto to overcome; the local
government was reluctant to be involved into the specific operations of private-owned enterprises. As a result, Geely Auto had to go through a very tough process to grow up as a private-owned enterprise and to make cars independently.
6. Conclusion and Discussion

Sociologists do not often focus on detailed stories of specific economic organizations, perhaps because company-level analyses may not offer substantial theoretical implications. Nevertheless, the present project presents a comparison of four representative car manufacturing enterprises across China in an exploration of the hidden mechanisms behind differences in the application of developmental models in the Chinese car industry since the 1980s. Such a project makes theoretical sense because it illustrates the complications of the market transition, globalization, and how these issues are intertwined at both the national and organizational levels.

In this final chapter, I first summarize this comparative study and discuss its major theoretical implications based on the empirical findings. Next, I discuss the role of the foreign car makers, which has not been fully discussed in the previous chapters. Finally, a recent trend in the Chinese automobile industry is introduced. I argue that another round of nationwide social construction is going on in the Chinese automobile industry, one that may greatly change the future of the developmental models discussed through the cases in this project.

6.1 Four Developmental Models under Social Construction

The original intention of the project was to inquire about the Chinese car industry, who produces cars, and how. By examining various car makers in China, we identify four development delineated by ownership and technological strategy. The interpretation of the differing models then becomes the major research mission in this study.

Commonly-used theoretical tools have limitations to the explanation of this research question. Transition economy literatures in general focus on ownership and consequent economic performance without much attention to how technological strategies could possibly be related to ownership. On the other hand, there are indeed numerous perspectives offering insights into
variation in technological upgrading performance among economic organizations. The size of an enterprise is stressed by economists as a critical indicator for R&D capacities. Foreign corporation affiliation is a well-acknowledged factor in current globalization studies, and the role of developmental states is emphasized to explain successful upgrading in East Asia by state-centered analyses. These factors suggest that a large, foreign-affiliated and state-supported car maker would be more likely to successfully conduct technological upgrading in comparison with small companies that are not state supported or affiliated with foreign companies. However, the Chinese car industry tells the opposite story.

The theoretical perspective used in this study is based on a social construction approach, which attaches importance to the roles of ideas, local political structure, and agency to the emergent shape of ownership and technological strategy implemented by different car enterprises across China. Such an approach argues that due to the historical path dependency of the previous planned economy era, the market transition in China has generated various types of sub-national political structures. These institutionalized architectures have created different local actors with disproportionate powers in the regional economic development. This view also highlights the ideas of the involved actors concerning the local car industry as a critical cognitive mechanism through which rationalities and interest perceptions lead the involved actors in the local car projects. These ideas, in competition or coordination, are fundamental clues to an understanding of the strategies and interactions of the local actors. This perspective finally introduces agency into the analysis. In local car projects, development ideas need to be mobilized and implemented by local political structures and actors. At the same time, agency is always bounded by constraining political structures and shaped by the cognitive factors. The process of idea generation and implementation as they pertain to local car projects intensively reflects the roles of ideas and political structures and makes up the basic social construction process.
The different developmental models among the Chinese car makers are interpreted through four representative cases. The empirical findings for these four cases are summarized in Figure 19. As can be seen from this illustration, the four Chinese car makers experienced the economic reform and opening to globalization differently which resulted in unique patterns of organization ownership and technological strategy. Such an empirical comparison validates the importance of social construction in the interpretation of the varying developmental models present in the Chinese car industry.

The sub-national political structure takes various forms in different regions, making the investigation of local institutional architecture a basic variable for the study as they define relevant actors and distribute political powers. The central government maintained authority in Jilin (Changchun) after the economic reform but lost most of its influence in Zhejiang, where the private economy became central to local development. In both cases, the roles of local governments were not significant, in contrast to the overwhelming roles played in both Shanghai and Anhui (Wuhu). Nonetheless, the former enjoyed a prestigious relationship with the central government while the latter did not.

These political structures, which emerged during market transition, are indebted to historical legacies traced back to planned economy era. Jilin’s historical role as the nation’s heavy industry base provided a major justification for the persistent role of the central government in the management of FAW. The uniquely important economic position of Shanghai planned era made local officials prestigious enough to lead the development of its own car project and creation of the first joint venture. As a place long forgotten by the central administration, Zhejiang’s active private economy emerged in part from the weak penetration of the planned economy. Finally, Anhui’s traditional role as a resource-contributing region that receives little investment from above provided local officials with the opportunity to play a central role in decision making.
<table>
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<tr>
<th>Case</th>
<th>Local Political Structure</th>
<th>Developmental Ideas</th>
<th>Process of Social Construction</th>
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<tbody>
<tr>
<td><strong>FAW</strong></td>
<td><strong>The central government</strong>: The leading and controlling power in the local economy</td>
<td><strong>The central government</strong>: FAW was a main protocol for import substitution and joint venture strategy.</td>
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<td></td>
<td><strong>FAW</strong>: Follower and coordinator with the central administration</td>
<td><strong>FAW</strong>: Technological upgrading should be realized as soon as possible.</td>
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<td><strong>The local governments</strong>: Assistant for the central government</td>
<td><strong>The local governments</strong>: The car industry was crucial to the local economy.</td>
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<tr>
<td><strong>SAIC Group</strong></td>
<td><strong>The municipal government</strong>: The most active builder of the local economy with a nationally-prestigious status</td>
<td><strong>The municipal government</strong>: The car industry was a key for Shanghai to re-rise in the national economy in the new age.</td>
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<td></td>
<td><strong>The central government</strong>: Generous supporter of the local municipal government with special policy treatments</td>
<td><strong>The central government</strong>: To develop the car production in this city was a worthy way to try and thus needed to be encouraged.</td>
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<td></td>
<td><strong>The local governments</strong>: The dominant of the local economic development with its officials being “businessmen with red hat”</td>
<td><strong>The local governments</strong>: making cars is a major way-out for saving the underdeveloped local economy.</td>
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<td><strong>The central government</strong>: Autonomy provider transferring rights downward during the fiscal decentralization</td>
<td><strong>The central government</strong>: Unapproved local car projects would break the national overall industrial concentration.</td>
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<td><strong>Chery Auto</strong></td>
<td><strong>The local private-owned enterprises</strong>: The major propellant in the local economy</td>
<td><strong>The local private-owned enterprises</strong>: The machinery manufacturing was an ideal field to pursue, so was the car-making.</td>
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<td><strong>The central government</strong>: Supervisor of the local private economy in general sense</td>
<td><strong>The central government</strong>: Grass-roots car projects may disturb the whole auto industry.</td>
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<td></td>
<td><strong>The local governments</strong>: Supporter of the local private economy in the macro-level</td>
<td><strong>The local governments</strong>: States should stay away from specific enterprise operations.</td>
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<tr>
<td><strong>Geely Auto</strong></td>
<td><strong>The local private-owned enterprises</strong>: The major propellant in the local economy</td>
<td><strong>The local private-owned enterprises</strong>: The machinery manufacturing was an ideal field to pursue, so was the car-making.</td>
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<td><strong>The private-owned enterprise, Geely Auto</strong>, had to struggle for a legal status from the central administration and had to make cars independently since there is no chance to set up a joint venture. In this process, the local states provided limited assistance.</td>
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The developmental idea as another critical variable in this approach serves as a critical cognition mechanism, as it represents the rationality behind the different actors legitimately involved in local car projects. The ideology of the central government in the car industry set a basic tone for any car project in China. Separately discussed in several chapters, the ideas of domestic production promotion by import substitution, introduction of technologies via joint venture, and concentration of industry structure through directory management composed the major rationales of the central government. However, the central government’s template was not universally adopted at the local level.

Of the four cases, FAW may be the only one to take ideas from above while making complaints. FAW’s consideration was straightforward: As an out-dated enterprise created before market transition, there was no better option than to closely work with the central government to facilitate its own technological upgrading. For Shanghai Automobile, it was the local municipal government that invented the joint venture method and then got approval from the central government through political lobbying. In these two cases, the ideas held by the central government were locally welcomed because FAW and Shanghai automobile were both among a few enterprises chosen by the central government to make cars. However there were “outsiders” holding strong incentives to make cars either for local economic development in the case of Anhui’s Chery Auto or for business concerns in the case of Li Shufu’s Geely Auto. In these two cases, local ideas seriously conflicted with national industrial policy.

How political structures and developmental ideas led to different ownership patterns and technological strategies was intensively demonstrated through the local social construction processes driven by agency on the part of various actors. In the case of FAW, the story is mainly about how directions came from the central government and were then implemented by FAW and the local governments. By comparison, for the case of Geely Auto, the scenario was opposite; the private enterprise hid its car-making intentions to avoid punishment from above and meanwhile
searched for means to get legitimate status. Consequentially, the local car project had to be self-reliant because a joint venture project required the nod of the central officials. On the other hand, strategies and actions of local states were the major content for the social construction processes of Shanghai Automobile and Chery Auto. For the former, the process was basically harmonious. The local government got special acknowledgement and support from the central administration to gain approval for what was otherwise a rule-breaking joint venture. However, for the latter, the local government had to develop a series of strategies to deal with a hostile environment in which the local car project was considered in violation of the national industrial policy. Similar to Geely Auto, making cars without joint ventures became the only solution for Chery Auto.

This study has multiple theoretical implications. First of all, the existence of local social construction processes sheds light on the market transition literatures because it shows that a transition economy may be far more complicated than commonly assumed. The role of the state in the market transition should be treated more carefully. In this study, a general marketilization trend was apparent at the macro-level. However, as illustrated in the four cases, such a process was absolutely not a simple replacement of states with the rising market. Both the central state and the local states carried strong influences on local economies. More importantly, in light of the findings in the Chinese car industry, this study suggests that a transitional economy may experience multiple transformations at the sub-national level. Depending on the specific historical institutional legacies inherited from the planned economy era, the central government, local governments, the previously-established state-owned enterprises, and newly-rising private-owned enterprises may combine into varying power structures. Holding separate ideas and interests, these actors could generate varying developmental models applicable to enterprises at the local level.

In exploring how the Chinese car enterprises developed their technological strategies in the face of the introduction of foreign automakers, this study also contributes to the current
globalization literature, especially with regards to how globalization is intertwined with transitional economies. At least in the Chinese car industry, globalization became embedded in a domestic political process. That is, although foreign car makers were a necessary actor in any proposed joint venture project, these transnational corporations themselves held limited influence on whether and how the car project would work. It was the domestic players who steered the whole process. Particularly, the role of ideas was critical here. In the Chinese car industry, the central government developed a clear logic of exchanging market share in the Chinese market for advanced technologies and implemented this strategy via industrial policies. Such a cognitive framework constrained all foreign corporations in some fundamental aspects. Only joint ventures, where foreign capital would hold a minority stake, granted legitimate entry into domestic production for foreign companies. Therefore, the present study suggests that the domestic institutional environment should be an indispensable dimension to fully understand how globalization influences the economy of a certain nation, especially for the transition economies where the market institutions generally cannot be assumed as given.

The approach applied in this study is an attempt to integrate two major types of institutionalism prevalent in the current social science literature, namely organizational and historical institutionalism, and to demonstrate the complementarities of these two major institutionalism perspectives. Organizational institutionalism takes the cognitive-related mechanisms as the major tool for understanding the structures and behaviors of organizations, while major attention for historical institutionalism is the historically-formed political structures. This study proposes that developmental ideas and political structures are both important in decoding the varying developmental models employed among these Chinese car enterprises. Without developmental ideas, the local political structures themselves may not generate the forms of any of the car industries observed. In fact, the local political structures discussed in these cases also broadly existed in other regions of China. Thus, if the independent role of ideas is not
acknowledged, researchers would have great difficulty explaining why Jilin (Changchun), Shanghai, Anhui (Wuhu) and Zhejiang (Taizhou) could develop their car enterprises when other regions possessed the same local political structures. On the other hand, ideas alone cannot interpret the research question. Without local political structures to set the stage and assign the actors with different roles, ideas would only be useless imaginations.

This study may be illuminating to sector-specific or region-comparative studies in China. Across the different branches of the Chinese economy, the multi-model phenomenon was not unique in car manufacturing, but also broadly existed in sectors such as electronics, textiles and apparel, raw materials, and even agriculture. Thus, the social construction approach adopted in this study could serve as a basic tool for researchers in exploring varying developmental paths inside these sectors. In addition, this study has closely associated the varying car-making models with the local political structures and developmental ideas. Because of this, it serves as a powerful model for comparative regional work, which has recently become a popular research topic in China studies.

Finally, this comparative study may inspire further research into the Chinese car industry, especially studies linking the Chinese models to the other well-acknowledged developmental models present in the world automobile industry. For instance, a study focused on Asian industries could utilize the Japanese and Korea car industries as classical cases for a developmental model, one where the government strategically led the domestic automobile enterprises as they developed into successful national cars makers and promoted learning from foreign automakers. However other Asian countries, such as Thailand, obviously followed another track, one in which the foreign corporations are encouraged to set up automobile enterprises and then are encouraged to export. India might represent another model, one where the central government closed the door to foreign investors in the car sector and actively encouraged the emergence of national car makers. How different are the developmental models
identified in this study from these Asian models and what institutional mechanisms could be possibly shared among these cases, though at the national rather than the local level? These questions might be interesting for future studies.

6.2 Transnational Corporations in the Chinese Car Industry

Although in this study foreign automakers were not taken as a deterministic force in the social construction processes, it should not be overlooked that these incoming transnational corporations also hold their own interests and employ various strategies in China. This section is meant to discuss this group of actors.

When first coming to China, the transnational corporations perceived their opportunities as the result of the price-distorting environment created by policy paradigm of the central government. Between the early 1980s and the mid-1990s, the Chinese automobile market remained underdeveloped. The output of passenger cars accounted for 2.4% of China’s total automobile production in 1980 and only increased to 22.4% in 1995 (China Auto News 2005). Private demand for cars was very limited and most consumption came from institutional users such as government agencies and enterprises. Also, car prices were not determined by supply and demand in the market because the central government tightly controlled the pricing procedure through a series of bureaucratic measures. As a result, what was more attractive in such a market to these incoming foreign automakers was not the size of the potential consumer base, but the high profit margins that resulted from the lack of competition (Huang 2002). Under the policy of import substitution, trade barriers had indirectly raised the prices of domestically produced automobiles to an extraordinarily high level in comparison with international standards; The state policy of industrial concentration helped to create and maintain a few oligopolies which are enjoyed by incoming foreign automakers. Additionally, investments from the state in the form of joint ventures actually decreased the risks for foreign corporations.
Since the late 1990s, the Chinese automobile market has grown quickly, leading to “a mature stage for FDI” in the Chinese automobile industry (McKinsey 2005). The late 1990s witnessed a significant increase in automobile demand from private individuals, which mostly consisted of passenger cars. Price regulations were loosened as well, and automobile manufacturers gained more autonomy in determining the prices of their products. A more crucial change was China’s entry to the WTO in 2001 (Harwit 2001; Noble et al. 2005). According to China’s WTO concessions in the automobile industry, all import quotas and licenses were scheduled to end in 2005 and tariffs would be reduced to 25 percent by July 2006. Responding to this new environment, most of the international automakers came to believe that the optimal time for doing business in China had finally come (Table 14). Not only did the first incoming companies, such as VW, PSA, and DC increase their stakes in China, investments from Japanese and Korean automakers also poured in, represented by Hyundai, Kia, Nissan, Honda, and Toyota.

Table 14: Assembler Projects of the Incoming Transnational Corporations in China

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Source: China Auto News 2005.

Although it was always the central government that held the approval rights for any joint venture proposals, foreign corporations could still decide when to get in and with whom to cooperate. Three representative cases, Volkswagen, General Motors and Toyota, illustrate the different strategies of these transnational corporations in setting up joint ventures in China (Table 15).
Table 15: VW, GM and Toyota in China

<table>
<thead>
<tr>
<th>Corporation name</th>
<th>Affiliated corporation</th>
<th>Chinese partner</th>
<th>Joint ventures (Shares percent)</th>
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</thead>
<tbody>
<tr>
<td>VW</td>
<td>SAIC</td>
<td>Shanghai-VW (50%)</td>
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<td></td>
<td>FAW</td>
<td>FAW-VW (40%)</td>
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<tr>
<td>GM</td>
<td>SAIC</td>
<td>Shanghai-GM (50%)</td>
<td>Shanghai GM (Shenyang) Norsem Motors (25%)</td>
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<td>SAIC-GM-Wuling Automobile (34%)</td>
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<td>Shanghai GM Dong Yue Motors (25%)</td>
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<td>Toyota</td>
<td>FAW</td>
<td>Tianjin FAW Toyota (50%)</td>
<td>Sichuan Toyota Motor (50%)</td>
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<td>GAIG</td>
<td>Guangzhou Toyota Motor (50%)</td>
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<tr>
<td>Daihatsu</td>
<td>Hino Motors</td>
<td>FAW Huali (Tianjin) Automobile (25%)</td>
<td>Sheng Fei Hino Auto (24%)</td>
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</table>

Among the three cases, VW entered earliest, signing its first joint venture agreement in 1983. Volkswagen used up its quota from the central government, which required that one transnational corporation could have no more than two Chinese partners, to partner with Shanghai-VW, often called “South Volkswagen,” and FAW-VW, “North Volkswagen.” In terms of performance in the Chinese market, Volkswagen is definitely a champion. Because of its status as the earliest incomer, its two joint ventures occupied over half of the domestic market until 2002.

GM came to China in 1992. In contrast with VW, GM only has one domestic partner, Shanghai Automobile. When GM became interested in other partners, it incorporated the target enterprises within the Shanghai-GM framework, called the “Chinese-Chinese-Foreign” model. In this manner, GM built effective cooperation with several other Chinese partners. Although not the first adventurer in the Chinese market, GM is indeed the fastest growing, and it is also the automobile transnational corporation most aggressive in the transfer of R&D activities to China. For instance, GM has built a very large joint R&D institution in Shanghai with Shanghai Automobile, the Pan Asia Technical Automotive Center.
Across these three cases, Toyota was the most conservative initially. In the 1980s, Toyota mainly exported cars to China and did not consider joint venture projects. However when the Chinese market became more lucrative in late 1990s, it soon adjusted by setting up its own footholds in the Chinese market. At first glance, Toyota acted like GM. When starting “a wide scope of joint activities” with FAW (FAW website 2006), it asked FAW to integrate its previous partners in China, Tianjin Auto and Sichuan Toyota Automobile Corporation. On the other hand, Toyota was also similar to VW in that it later chose GAIG as a second Chinese partner for joint venture. Beyond this, Toyota also took advantage of Daihatsu and Hino, affiliated corporations, to establish additional joint ventures in China.

6.3 New Trends in the Chinese Automobile Industry

Since the late 1990s, there has emerged a shift in policy paradigms held by the central government with respect to the Chinese automobile industry. Unlike the regional social construction processes, this development carries national scope and could profoundly influence the developmental models we have discussed before. This last section discusses this new trend in the Chinese car industry. The recent shift of the policy paradigms in the Chinese automobile industry could be summarized in three dimensions.

First, the Chinese government adjusted its policy with regard to technological acquisition, from one that obtained production technology through joint-ventures to one that promotes self-reliant research and development (R&D) and national brands, beginning in the late 1990s. In the Industrial Policy of the Chinese Automobile Industry announced in 2004 (State Council of China 2004), the state urged domestic automakers “to strengthen the capacities of R&D and technological innovation,” “to actively develop products with independent intellectual property rights,” and “to implement the strategies to promote national brands.” Second, state strategy with respect to foreign trade also changed significantly, from import substitution to export promotion.
Since the late 1990s, the state enthusiastically promoted auto exports. Its support for domestic automobile exporters was unprecedented. For instance, Chery Auto, one of the most outstanding car exporters in China, was awarded a large loan of five billion yuan from the Export-Import Bank of China in 2005. The government soon expanded its list of supported entities through official recognitions of the so-called “export bases” and “export enterprises;” 8 cities, 44 assemblers, and 116 auto-part producers were entitled. Third, management of industrial structure moved from strict regulation of new entrants toward reliance on market mechanisms. The usual policy instruments implemented in the 1980s and 1990s, such as directory management, the monitoring and approval procedure, and production permits gradually came to an end in the late 1990s. The product directory and the strict regulations on investment were both relaxed. Rather than officially sanctioning certain automakers, the state claims reliance on market competition to decide winners (State Council of China 2004).

Behind these three transformations is a nation-wide social construction process. Foreign corporations, previously not deterministic in the local car projects, served as a major structural trigger in the development of this change. With the Chinese car market growing rapidly since the late 1990s, the global automakers came to dominate the domestic market via established joint ventures. According to Table 2 in the introduction chapter, among car makers with sales of over 50,000 units in China, ten out of fourteen were joint ventures.

This dominance of foreign automakers was definitely unexpected by the central policymakers, thus the previous policy paradigm received serious challenges. Some officials began to admit that the Chinese automobile industry was “large,” but “far from being strong” (Zhang 2003). That is, it was too weak in terms of self-reliant R&D capacity and national brand, despite the fact that outputs of automobiles was high. Public opinion also started to blame the industrial policies in part for domination by transnational corporations. It was even claimed that this situation may threaten the national security of the economy (Zhang et al. 2001).
The strategy of technology acquisition through joint venture was the first policy instrument to be broadly questioned. One particular problem had consistently touched the public’s nerves toward joint ventures. According to the government’s expectations, the Chinese big three automakers were supposed to be the major players in the development of independent R&D capacity and national brands, and this was a prime rationale for government support of joint ventures. Nevertheless, most of the automakers that had engaged in the development of national cars were small automakers, such as Chery and Geely. It appeared ridiculous that these companies had been the targets of discrimination by the central government for a long time. This contradiction between the policy goal and reality drew much public sympathy toward small automakers such as Chery and Geely and created strong political pressures directed against the joint venture builders. The public voices criticized current policy on the basis that joint ventures would not contribute to the mission of developing national brands because the introduction of foreign technologies apparently did not automatically turn into independent R&D capacity among Chinese automakers (Lu and Feng 2004). To fix the problem, opponents of the current policy paradigm stressed that the state should emphasize the implementation of self-reliant development among these large joint venture automakers and also relocate state support to the small but innovative automakers.

With respect to import substitution, foreign trade regulations were blamed for the foreign corporation to conduct rent-seeking behavior due to the distorted domestic prices that resulted from import restriction. On the other hand, China’s new membership in the WTO essentially nullified existing import regulations. In the post-WTO period, import substitution was considered outdated and problematic, whereas the promotion of automobile exports became highly valued. A very influential “third way strategy” was then proposed (Chen and Lu 2002a, 2002b), which stated that China should promote exports of automobiles via domestic production of foreign models. Advocates of this direction believe that, as a large country with abundant cheap labor,
China could gradually turn these comparative advantages into technical competitiveness because in the long term, after global automakers move assembly lines to China, they could gradually move R&D functions as well. This “third way strategy” was meant to be distinguished from both the Korean model and Brazilian model. In the former, the state supported national automakers by limiting the entry of foreign automakers, while in the latter, foreign automakers overwhelmed the domestic automobile industry due to the absence of regulation of foreign entry.

The old practice of industry structure management was also criticized as improper. A major complaint was that state regulations limiting market entry had not effectively prevented active investments from either local governments or private capital. More importantly, it was argued that the practice of providing a few giant automakers with strong government support had depressed normal competition in the market (Zhang 2002). Hence the pursuit of industrial concentration was accused of creating oligopoly positions for joint ventures and discriminating against innovative domestic automakers. In the new post-WTO environment, the previous worries of policymakers about “repeated” investments in car production largely vanished and the market mechanism was highly revered (Qin 2001).

This round of social construction was driven by many actors, such as scholars, public media, state bureaucrats and even the top national leaders. Former state bureaucrats in charge of China’s automobile industry were one of the most influential and determined groups to advocate the policy shift. With an ingrained ideal to pursue a national industry that was imprinted during the era of planned economy, retired bureaucrats and managers in the automobile industry were very upset about the predominant foreign automakers in the Chinese market. To these people, the industry had lost its track toward self-reliant development and the government should adjust industry policy as soon as possible. As the previously significant figures in the automobile industry, their voices often reached the top policymakers and were well-received (e.g. Li 2001; Gen 2004; Jiang 2006).
Some scholars specialized in studies of industrial development also contributed greatly to the policy shift. Lu and Feng’s well-known research on Chinese national automakers in 2004 was a momentous empirical study of the issue of innovation capacity in the Chinese automobile industry. They painted an impressive picture in which some small automakers in China worked hard to develop independent brands while weathering discrimination from state policy. In contrast, the big three automakers in China enjoyed profits through their oligopoly positions, but made no efforts to develop national brands. Their report generated strong public criticism against the large domestic automakers, and this outrage created great political pressure on the state to change the existing automobile policy at the time.

The social construction also reflected a mixture of various bureaucratic positions and the political forces they represented. The Ministry of Science and Technology was well known as an active sponsor of the promotion of self-reliant development in the Chinese automobile industry. It actually funded Lu and Feng’s study mentioned above. It also encouraged many other policy researchers to investigate this issue in many other industries. On the other hand, The Ministry of Commerce was less keen on self-reliant development, but it showed a strong interest in promoting export-oriented policies. Its ambitious goal was to increase automotive exports to $70 billion by 2010, about thirty times the value in 2000. DRCSC, an important think tank of the central government, made the famous third-way proposal (Chen and Lu 2002a, 2002b), and it also participated in the appeals directed toward ending state intervention in industry structure management (Qin 2001).

On the other side, large domestic automakers, as the major target of criticism, experienced a hard time in this social construction process. In the early stage of the debate, these automakers that represented the joint ventures tried to defend themselves. They claimed that the state and the general public should have more patience because the current small scale of production in China did not justify any meaningful self-reliant R&D initiatives, and any effort to
pursue this goal would turn out to be a great waste of capital (Lu and Feng 2004). Under surging political pressure, however, they soon gave in. After all, either at central or local level, these major domestic makers were all state-owned. When the state was determined to go toward this new direction, these domestic automakers quickly shifted away from the introduction of foreign models and toward the development of national brands. For instance, SAIC recently announced that its production of national brand cars would reach 200,000 units in 2010, while FAW promised to reach 800,000 units by the mid-2010s (Tong 2006).

Such a policy shift is still unfolding in China and new studies are needed to explore the implications of this nation-wide policy adjustment, especially upon the developmental models we have discussed in this study.
Appendix I: Chinese Enterprises in the Planned Economy Era

In the planned economy ear, enterprises in China barely shared any autonomy out of the national planning system. For the workers and leaders in these enterprises, neither did they have the ownership of the organization they worked for, nor did they hold any substantial decision right in management. The state built the infrastructure, introduced the technologies and equipment, trained the labor, appointed the leader, made the production plans, supplied the raw materials, and took the output and profit, while there were nothing more left for these enterprises themselves except following the bureaucratic commands from above and accomplishing the production assignments. These state-owned enterprises generally held a common internal governance structure, FDRS under the lead of the party committee. In this scheme, the top bureaucracy was the party committee. The factory director under the party committee was in charge of the specific management. Below these directors were the section leaders and associated directors in charge of various functions. The production was carried out in workshops, which were often consisted of multiple production teams.

![Diagram of Chinese Enterprises in Planned Economy Era](image)

**Figure 19: Chinese Enterprises in Planned Economy Era**

Source: Based on Ma and Liu 2000
Appendix II: The Current Management of Chinese Automobile Industry

Figure 20: The Current Management System in the Chinese Automotive Industry

Source: Based on Shi 2004
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Organisation Internationale des Constructeurs d'Automobiles (OCIA) www.ocia.net


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Biography

Qiushi Feng was born in July 27, 1975. He got his bachelor degree in the major of social work from Jilin University in China (1994-1998). In August of 2002, he was admitted by the Sociology Department of Duke University. In August of 2004, he got a master degree of sociology at Duke. In April 2009, he got his PhD degree in the major of sociology at Duke.

Qiushi Feng’s major publications include an coauthored paper, “Social Network Types, Intimacy and Healthy Longevity among the Chinese Elderly” in Social Sciences in Health Care and Medicine edited by Frank Colobum and published in Nova Publisher; two co-authored books in Chinese, Entrepreneurship in the 21st Century published by Jilin People’s Press and Introduction of Social Statistics published by Jilin University Press. He recently translated the Sociology of the Economy edited by Frank Dobbin into Chinese, which has been published by Shanghai People’s Publishing House.

Qiushi Feng has won numerous fellowships and awards. The major ones include the Julian Price Endowed Dissertation Research Fellowship offered by the Graduate School of Duke University, the Summer Fieldwork Research Fellowship offered by the Asian/Pacific Studies Institute of Duke University, the PhD Student Fellowship offered by the Sociology Department of Duke University, Shide Academic Fellowship offered by the Shide Foundation in China, the Excellent Undergraduates Fellowship offered by Jilin University and the Outstanding Undergraduate Honor awarded by Jilin University.