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Chinese foreign economic policy-making: Studies of the foreign-invested automotive sector

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Chinese Foreign Economic Policy Making: Studies of the Foreign-Invested Automotive Sector

By

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Abstract

This study employs a decision-making framework for analyzing the modern automotive bureaucracy in the People's Republic of China. It traces the history of China's vehicle industrial development, and examines four cases of foreign-invested passenger car projects. Based on this empirical data, the study makes predictions of future automotive progress in China.

Decision-making in China tended to be hierarchical and centralized in the national government from 1949 until the death of Mao Zedong in 1976. Reforms begun under Deng Xiaoping diffused political power, enhancing the role of local governments in the policy process. China's opening to the West allowed foreign entrepreneurs to further affect policy, and economic reforms made domestic economic factors more pertinent. The study's theoretical framework takes into account all of these elements in the policy process.

The case study data indicate Chinese actions in developing an automotive strategy show some tentative progress toward rationality. Introduction of American Motors (Chrysler), Volkswagen, Peugeot, and the short-lived Panda Motors projects essentially cut China's dependence on Japanese imported vehicles. Though China benefited from technology transfer, however, by early 1992 the country remained incapable of exporting vehicles. The founding of additional ventures in the early 1990s threatened to leave a glut of domestic supply, and indicated the diffusion of central control over the nation's automotive industrial development could lead to future inefficient production.

Policy-making in the automotive sector, then, remained fragmented, as central, local, and foreign actors moved to advance their own agendas. Were policy over other industrial areas to develop in such a way, China's economic modernization drive would be adversely affected in the coming decade.

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My interviews depended on many Chinese and foreign sources related to the automotive industry in China. Though most preferred to remain anonymous, I am obviously very grateful for their help. Special thanks to Mr. Don St. Pierre of Beijing Jeep, for his early help and encouragement of my work, and to Dr. Christiane Finckenstein of Volkswagen, for her advice during my fieldwork year in Beijing.

Finally, I thank my parents for their support during my time in Berkeley. Their concern helped me persevere over my years of thesis writing, and made the process easier and more enjoyable.

Chapter 1:

Bureaucratic Politics Theory and the Chinese Passenger Car Industry

With the dawning of the reform era in China in the late 1970s, political leaders and industrial planners focused their strategy for redressing decades of isolation in pursuing a paramount goal of "modernization" in nearly all areas of industrial development. One prominently visible measure of the nation's economic status, however, projected a clear image of backwardness: China's urban streets and country roads were largely populated by inefficient, unattractive and often unreliable passenger cars, automobiles designed in the early 1960s or even decades earlier. A subsequent flood of vehicle imports in the early post-Mao Zedong years enhanced the country's transport capabilities, but proved a major drain on hard currency reserves.

Reform of the domestic automotive sector, then, became an important part of the nation's industrial modernization drive. At a minimum, the Chinese hoped to develop a successful program of car and truck import substitution; with persistence and some luck, they might even emulate their more prosperous neighbors, Japan and South Korea, in fostering a remunerative export-oriented industry. To achieve such goals, however, the Chinese would have to depend on help from more technologically advanced nations. Given a tradition of self-reliance, both in domestic and international interaction, the bureaucratic task of successfully coordinating the absorption and utilization of the complex and expensive foreign technology would be formidable for both national and local political leaders.

This thesis uses experiences of foreign passenger car companies in China to assess the forces acting on the automotive bureaucracies over the past decade, and the outcome for the newly established ventures. In particular, it asks: What institutions and political leaders have helped shape the policy process, and what are their motivations? What role have local governments played in the industry's

development? How have the goals of the foreign automobile companies themselves helped shape the automotive landscape? Finally, has there been any tangible bureaucratic learning in successive interaction with these foreign investors?

In order to answer these questions, this study will employ a framework based on theories of bureaucratic politics, of crisis management-type bargaining, and of international perception and misperception. These tools should shed light on what will most likely be a key industrial sector of the Chinese economy in the coming decades. The results will also help paint a broader picture of Chinese foreign economic policy making in general, a further goal of this project.

The theoretical framework I have chosen stands in contrast to many prior approaches, which assume dominance of the decision-making process by the very top of the political leadership. Below, I give a brief introduction to past China studies research, before introducing the study's own theoretical structure.

Why Study the Bureaucracy?

Few past researchers have devoted their attention to in-depth case studies of specific issue areas and their associated bureaucracies, and even fewer have employed theoretical models in such endeavors. Instead, scholars often look primarily to the top leadership in Beijing for clues to the direction of China's development. Why, then, is it in fact important to study the lower-level Chinese administrative institutions?

Several authors have pointed out increasing decentralization of the foreign trade apparatus has in fact made the lower levels of the bureaucracy more important. Harry Harding presented evidence showing the expanding power of such institutions as the Ministry of Foreign Economic Relations and Trade (MOFERT).[1] Barry Naughton pointed out a significant rise of decentralization in the decision-making

[1] Harry Harding, *China's Second Revolution*, Washington, D.C., Brookings, 1987

apparatus for assigning capital construction investment throughout China.[2] Still others, discussed below, directed attention to the developing bureaucratic entities responsible for foreign economic policy-making. Few of these authors, however, attempted a detailed analysis of the increasingly important institutions, or used case studies to bolster their arguments.

Why have scholars avoided looking closely at the Chinese bureaucracy? First, the Chinese system has been, until recently, quite difficult to penetrate. Chinese were to avoid divulging "state secrets" to foreigners; even general communication with such outsiders was discouraged. Much of the relevant information, then, was found in statements of the top leaders, published in newspapers or journals or broadcast over the radio. Foreign researchers in the 1960s and 1970s found exiles and migrants from southern China to Hong Kong were also good sources; but the scarcity of central government bureaucrats among their numbers made many types of focused, in-depth interview research nearly impossible.

Though China remains a relatively secretive society, the amount of personal contact allowed with foreigners has vastly increased. The requirement for efficient functioning of economic transactions forces the Chinese to be more open in publicizing their bureaucratic procedures. In other words, even in the face of the June, 1989 crackdown on dissent in China, it is now easier to gain access to the lower levels of power than in the years preceding the economic opening to the outside world.

Previous work also tended to focus on top leaders because, in the past, the top leadership did retain a tight grip on power. As I hope to show in my historical chapter (Chapter Two), and in the following case studies, however, the demands of a complex international economy have given certain bureaucratic experts a more

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[2] Barry Naughton, "Central Control Over Investment," in David M. Lampton, ed., *Policy Implementation in Post-Mao China*, Berkeley, University of California Press, 1987, pp.51-80

exalted position, with the result that top leaders are more limited in their choice of action. To focus solely on the highest leaders today, I will argue, is to miss much of the important process that goes on at more removed levels of power.

Of course, one cannot ignore the actions at the top level of decision making, particularly among those who make political and ideological decisions. One part of this study (Chapter Three) also focuses on some of the highest political and bureaucratic leaders. This section, however, will try to take into account the bureaucratic and other constraints imposed on even the top political figures. It will also look for evidence of misperception among these decision makers. For example, are leaders constrained by distortion in the information available to them? Are they further detrimentally affected by past experiences? In asking these questions, the study begins to reveal some of the theoretical approach lacking in previous, mostly atheoretical, work, some of which is outlined below.

Empirical Studies of Chinese Foreign Economic Policy-making Institutions

Some Sinologists have ventured overview studies of bureaucratic sectors, without choosing case-study formats. Most of these studies tend to be descriptive and lack a theoretical framework. One finds work ranging from political economy analyses to the popular "how to do business in China" type of book.

Micheal Yahuda discussed the early stages of China's post-Mao foreign economic relations in a context of international security competition, and analyzed the role of domestic economic reform in foreign policy making.[3] James H.T. Tsao provided a wealth of statistics and empirical analyses of Chinese foreign trade dating back to 1950, but, again, did little more than describe technical problems and make economic predictions.[4] Nicholas Lardy combined some of Yahuda's ideas

[3] Michael Yahuda, "China's Foreign Relations and the Modernization Programme," in Jack Gray and Gordon White, ed., *China's New Development Strategy*, London, Academic Press, 1982, pp.37-54

[4] James H.T. Tsao, *China's Development Strategies and Foreign Trade*, Lexington, MA, Lexington Books, 1987

with the description of Tsao. He described the role of China in the world economy, and suggested implications for American strategy.[5]

Doak Barnett took a somewhat different viewpoint. He looked specifically at foreign policy making by examining various organizations within the Chinese government. He described the top-level leaders, the politburo, the party secretariat, the state council, the foreign ministry, and other actors. This study, however, was mainly descriptive; it lacked analysis linking the various policy-making bodies. Furthermore, Barnett's discussion of the foreign economic policy-making institutions was limited, as he devoted only a small portion of his attention to such organizations.[6]

One of the best analyses of the Chinese foreign trade bureaucracy was Rosalie Tung's 1982 study.[7] She traced some of the significant reforms enacted between 1978 and 1982, and related them to the relevant bureaucratic organizations. She had relatively detailed descriptions of such entities as the Ministry of Foreign Trade (now MOFERT), the China International Trust and Investment Corporation (CITIC), the Bank of China, and others. Like Barnett, however, she did not discuss the interaction of these various parts of the bureaucracy.

A few researchers have introduced foreign economic case studies to the scene. Ryosei Kokubun looked at China's policy vacillations over the import of Japanese factory equipment during the late 1970s and early 1980s, but his work was largely empirical.[8] Earlier work by Michel Oksenberg investigated the bureaucratic institutions associated with agriculture; this study, however, focused primarily on domestic economic developments.[9]

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[5] Nicholas Lardy, *China's Entry Into the World Economy*, Lanham, MD, University Press of America, 1987

[6] A. Doak Barnett, *The Making of Foreign Policy in China*, Boulder, Westview Press, 1985

[7] Rosalie Tung, *China's Industrial Society After Mao*, Lexington, MA, Lexington Books, 1982

[8] Ryosei Kokubun, "The Politics of Foreign Economic Policy-making in China: The Case of plant Cancellations with Japan," in *China Quarterly*, No.105, March, 1986, pp.19-44

[9] Michel Oksenberg, "Economic Policy-Making in China: Summer, 1981," in *China Quarterly*, No.90, June, 1982, pp.165-194

Students of business also analyzed Chinese foreign economic relations, often trying to discern the optimum approach for foreigners to take in interacting with the relevant Chinese bureaucrats. For example, Lin Jianhai studied American motivations for creating joint ventures with China.[10] He investigated the forces that drew American investors to China, and analyzed these factors using statistical methods, and theories of joint-venture dynamics.

Lin's conclusions included lists of the positive and negative factors Americans faced in choosing to invest in China. He also made some comparison of Chinese and American attitudes toward the joint ventures, but did not, however, focus specifically on the misperceptions brought on by the long term goals of the two sides.

Victor A. T. Koh analyzed cultural expectations in conducting business in China.[11] He investigated Chinese feelings towards various nationalities, and used these results to predict the future success of some 18 different nations and regions in trade relations with China. Though this work was useful for examining the Chinese attitudes toward the outside world, no comparison was made of foreign perceptions of and approaches to the Chinese side.

Business journals present a further source of empirical data. Publications such as *The China Business Review* and business school magazines feature articles tailored to potential future investors. Availability of space, and the general scope of these journals, however, tends to prohibit a fully developed theoretical analysis of Chinese industrial development.

Finally, there are many "how to" type books that offer advice for the businessperson about to be sent to China. Philip Wik, among others, offered such a study.[12] His book included some history of China, lists of technical requirements for

[10] Lin Jianhai, *Foreign Investment in China*, Ph.D. dissertation, Georgetown University, 1986

[11] Victor A.T. Koh, *Cultural Expectations for International Marketing and Business in the People's Republic of China*, Ph.D. dissertation, Ohio State University, 1986

[12] Philip Wik, *How to Do Business With the People's Republic of China*, Reston, VA, Reston Publishing Com-

operating in the socialist country, and a discussion of social life in China. His more valuable chapters, however, offered advice on overcoming cultural differences, and on "navigating the bureaucracy." (He suggested the following: "Preparation. Persistence. Patience."). This type of work may be useful for understanding the attitudes some foreigners bring along when they first interact with Chinese bureaucrats.

Few of the above-mentioned writers move much beyond empirical description in their analysis of the foreign economic institutions. Because of this omission, they lack the ability to pinpoint some of the most pertinent forces shaping bureaucratic outcomes, and to formulate predictions for future policies. The following section introduces theoretical tools that may help ameliorate these shortcomings.

Theory Drawn from International Relations Work

1) Bureaucratic Processes

Studies of bureaucratic decision making achieved prominence in the United States in the mid-1970s. Many of these works still hold sway. Below, I outline the ideas from some of this research.

One of the most widely read and discussed works was done by Graham Allison.[13] He proposed three models for analyzing political decision making: 1) a rational actor model; 2) an organizational processes model, and 3) a bureaucratic politics model.

The rational actor model (Model I) focused on top leadership, assuming decision-makers to be rational, and allowing leaders to put through courses of action with little resistance. Lower levels of the government are essentially "black-boxed." Allison, however, rejected this model because of its failure to take into account the lower levels of political machinery.

pany, 1984

[13] Graham T. Allison, *Essence of Decision*, Boston, Little, Brown, 1971

Allison's "Model II" painted a picture of a governmental conglomeration of organizations. Each part of the bureaucracy could produce only limited types of outcomes; change in these results was curtailed by rigid "standard operating procedures" (SOPs). Thus, a top leader might say "do not do A, do B," with the result that, even though those listening *wanted* to do "B," they were only *capable* of doing "A" (without a period of retraining, anyway).

The "Model III" in Allison's scheme proposed the heads of bureaucratic organizations had their own interests to defend when it came time to make a decision. During discussion, bureaucratic representatives biased their opinions in favor of their own organization ("where you stand depends on where you sit."). The resulting decision was a medley of various organizational preferences.[14]

Researchers later in the decade sought to apply psychological factors to the decision-making process. John Steinbruner suggested bureaucracies are not capable of processing all of the incoming data to which they are exposed.[15] The resulting overload leads to the same type of behavior Allison predicted: standard operating procedures become automatic responses when stimulated by appropriate incoming information and requests for solutions. Steinbruner went one step further than Allison, however, in suggesting that standard operating procedures could be recombined, under novel circumstances, into a process called "instrumental learning."[16]

A later section of this essay introduces my methods for applying the above bureaucratic theories to study of the relevant automotive bureaucracies in China. Now, however, I move on to discuss some further theories that will be employed in my analysis.

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[14] Allison's work was later the topic of criticism: international relations theorists claimed Model I's parsimony was more valuable than the added description obtained in the other two models (see, for example, Kenneth Waltz, *Theory of International Politics*, Reading, MA, Addison-Wesley Publishing Company, 1979). Others claimed bureaucratic models gave excuses to leaders for their shortcomings and errors (See Stephen Krasner, "Are Bureaucracies Important?" in *Foreign Policy*, no.7, summer 1972, pp.159-179)

[15] John Steinbruner, *The Cybernetic Theory of Decision*, Princeton, NJ, Princeton University Press, 1974

[16] *Ibid.*, p.79

2) Perception Problems and Crisis Management

Robert Jervis was a leader in formulating the problems of perception encountered by national leaders.[17] He proposed, for example, that decision makers react to incoming stimuli by turning to memories of similar past occurrences. Decisions are distorted for several reasons: new events are often slightly different from the reference drawn from the past; the past example may be incorrectly chosen; or *one* past example is selected, rather than a combination of several experiences.

Actors also may suffer from cognitive dissonance: once a decision is reached, the actor experiences a surge of confidence in the correctness of his action. Decision makers then close their minds, even in the face of new incoming information. "Wishful thinking," misperception brought on by excessive optimism, can also cloud the decision-making process. As for possible solutions to the perception problem, Jervis suggested a "devil's advocate" may be able to point out cases of flagrant misperception of a current problem.

The ideas of Jervis, and of some of the bureaucratic politics writers, were synthesized in the work of Glenn Snyder and Paul Diesing.[18] They proposed a linkage of domestic policy-making processes with inter-governmental bargaining during crisis situations to predict outcomes of potential international conflict.

One must note that Snyder and Diesing limited the use of their model to crisis scenarios involving the distinct possibility of international war. None of my work will involve China in such a position. I therefore take some liberty with Snyder and Diesing's efforts in applying their ideas of bargaining to international economic relations.

The model described by Snyder and Diesing proposes international bargaining

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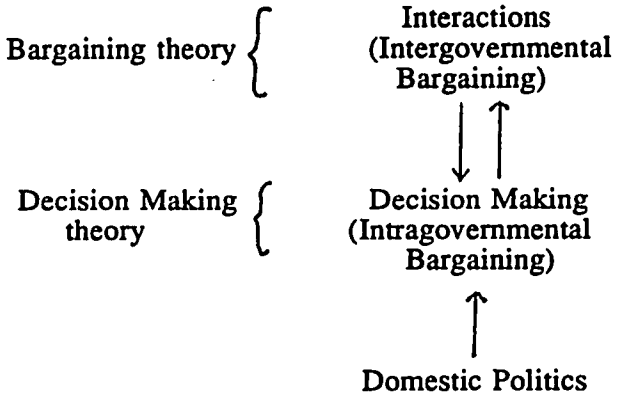
[17] Robert Jervis, *Perception and Misperception in International Politics*, Princeton, NJ, Princeton University Press, 1974

[18] Paul Diesing and Glenn Snyder, *Conflict Among Nations*, Princeton, NJ, Princeton University Press, 1977

has its roots in domestic politics and in decision-making theory. Part of their work is summarized in the following diagram:



Snyder and Diesing adopted the work of Jervis on perception and Allison on bureaucratic politics to formulate their decision-making theory. In their study, they applied these ideas to more than 16 historical cases. They found general validity of the ideas in several instances.

Past China scholars have in fact employed some of the above theories in their work. Below, I briefly review some of this work, before introducing my own scheme for analyzing the institutions under investigation.

Decision-making Approaches to Chinese Political Studies

One of the earliest suggestions to employ bureaucratic political theory came in the work of Roger Dial.[19] Dial discussed the possibility of applying general characteristics of bureaucracies to the Foreign Affairs ministry. Though Allison was not

[19] Roger Dial, *Advancing and Contending Approaches to the Study of Chinese Foreign Policy*, Halifax, Canada, Dalhousie University, 1974

mentioned, Dial referred to set decision-making processes that may exist in the ministry (Dial called them "issue fixes").[20] He questioned the assumption that leadership is concentrated at the top of a bureaucratic organization, and called for study of the lower levels of the foreign affairs bureaucracy.[21] Dial asserted bureaucratic limitations may be better guides to outcomes than ideology.[22] Finally, Dial also suggested using an interest group approach to the study of foreign policy. Dial, however, provided relatively little empirical evidence to support his assertions.

Robert Boardman proposed the application of perception theories to the study of Chinese foreign policy.[23] He pointed out the absence of such analysis in the China field, and gave a summary of various psychological studies on perception done to the present day. (This work, however, preceded Jervis's writing).

Boardman discussed the type of information available to Chinese decision makers, and the possibility their decisions would be affected by various incoming stimuli. He suggested, for example, that studies of Chinese publications might indicate the type of information absorbed, which in turn would help researchers understand the tools Chinese decision makers have for formulating solutions to problems. Boardman, however, like Dial, provided little empirical data on China.

Kenneth Lieberthal and Michel Oksenberg were some of the first to employ policy making theory in a coherent and comprehensive fashion.[24] They somewhat indirectly adopted the work of Allison, finding the "rational actor" model unsatisfying,[25] and sought to apply decision-making and problem-solving theories to a study of the Chinese energy sector.[26]

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[20] Roger Dial, "An Organization Decision-making Approach to Chinese Foreign Policy: Towards and Explanation of Revisionism," in *Ibid.*, p.292

[21] *Ibid.*, p.294

[22] *Ibid.*, p.301

[23] Robert Boardman, "Perception Theory and the Study of Chinese Foreign Policy," in Dial, *op. cit.*, pp. 321-352

[24] Kenneth Lieberthal and Michel Oksenberg, *Policy Making In China: Leaders, Structures, and Processes*, Princeton, NJ, Princeton University Press, 1988

[25] *Ibid.*, p.14

[26] *Ibid.*, p.16

These two authors did a very thorough job in finding detailed information on the institutions they sought to study. They concluded that authority in decision making is in fact "fragmented" across various bureaucratic levels.[27] Policy making is diffuse, and can depend on bargaining between top central leaders, ministerial officials, and/or influential local politicians, they wrote.[28] Furthermore, they found foreign investors also helped shape the development of those energy sector projects that were oriented to foreign trade.[29] Finally, they discovered a significant degree of progressive learning and flexibility among policy makers in the petroleum industry; there was, however, less such adaption in other energy-related issue areas.[30]

My own approach seeks to build on the theoretical framework of Lieberthal and Oksenberg, while adding new empirical data in a different issue area, that of the passenger car industry. Little of the above-mentioned research, for example, attempted to isolate the influence of foreign forces on the Chinese domestic decision-making process; my case study chapters highlight the goals of foreign automotive executives and their bids to influence Chinese foreign-economic policy. Margaret Pearson's recent work,[31] however, did include many elements of Chinese-foreign interaction common to my presentation; my concluding chapter provides some comparison with her findings. In general, though, her study chose to touch on the whole spectrum of Sino-foreign cooperation, and thereby lost some of the analytical power obtained in focusing on one issue area.

Earlier studies also failed to employ the misperception ideas of Jervis. Considering the great differences in culture and past practices of the Chinese and foreign automotive representatives, it would be surprising if misunderstandings did not

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[27] *Ibid.*, p.22

[28] *Ibid.*, p.3

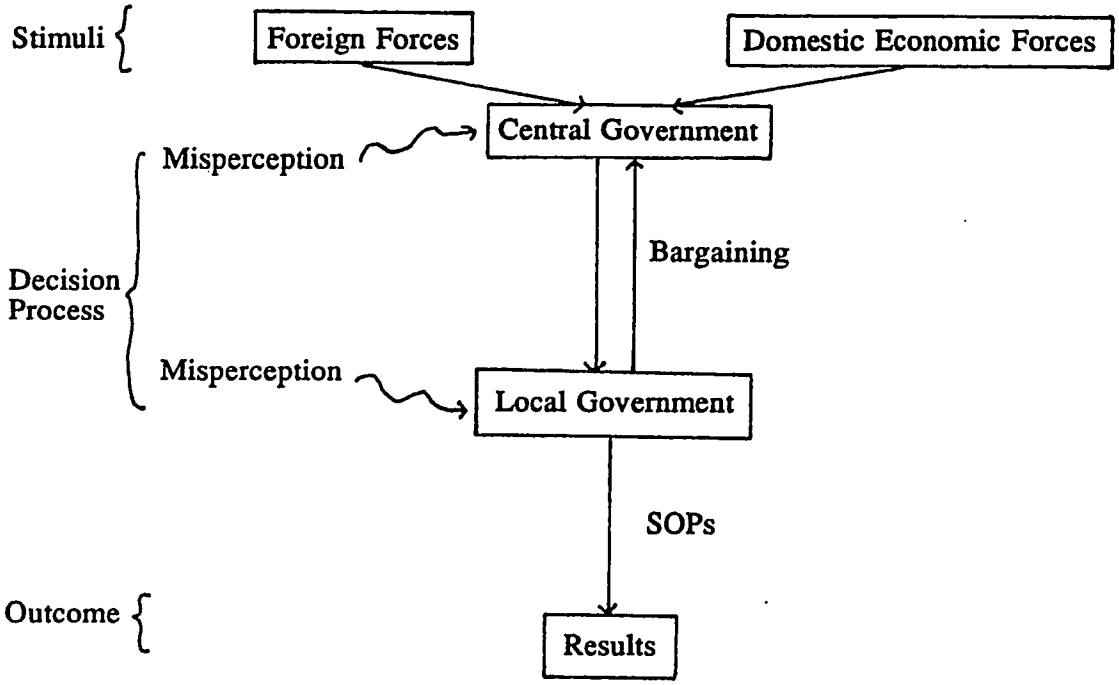
[29] *Ibid.*, p.31

[30] *Ibid.*, pp.248-249

[31] Margaret Pearson, *Joint Ventures in the People's Republic of China*, Princeton, NJ, Princeton University Press, 1991

cloud the stimuli foreigners exerted on the Chinese policy makers. To further utilize Jervis's work, one should also consider the influence of misperception between higher and lower levels of the Chinese political system. Finally, the motivational elements of "wishful thinking" may also serve to distort the policy process at many levels of the Chinese bureaucracy.

The following chart and discussion summarize the framework and theoretical elements of my study:



"Domestic economic forces" are defined here as economic factors fostered within China that shape the objective needs of the country as a whole, rather than meeting the narrow desires of some specific constituency. For the automotive sector, domestic economic forces include, for example, the legitimate requirement of work units and individuals for the use of passenger cars; this represents the macro-

economic demand side of the industry. The subsequent need to satisfy such demand pushes the issue of automotive development onto the political agenda. Other domestic conditions, such as recession, that may make foreign automotive investment attractive, are also elements here. Finally, domestic economic forces also include the latent wish among many policy makers and ordinary citizens that China might somehow emulate Japan and South Korea in exporting automobiles, thus potentially elevating China's economic status above that of a nation struggling to rise out of its early developmental stage. This factor is linked to the process of fostering a sense of pride and improved self-image throughout the whole of the country.

The "foreign forces" in this study are limited to foreign auto companies and their representatives that directly or indirectly persuade the Chinese to put automotive development on the national agenda. European and American companies have proposed and developed cooperative projects with China; in contrast, Japanese manufacturers have tempted the local market with imports, forcing the Chinese to implement import-substitution measures to avoid foreign exchange deficits. In the more intimate cooperation with the non-Japanese companies, moreover, elements of misperception have affected the decision-making process within the Chinese government, as my case study chapters will reveal.

The actual decision-making process analyzed here highlights bargaining that must take place within the government before a decision is made. For the central government in Beijing, this study includes the interaction between various pertinent ministries and their chiefs, and the top national leaders who traditionally receive much analytical attention. The study also focuses on the conflicts between local and national level political bodies in the development of the automotive sector. These bargaining elements are made manifest in the case study chapters.

My decision-making analysis extends to a discussion of misperception among the most important national and local decision makers. Chronicles of these leaders'

backgrounds help indicate latent qualities that may shape policy decisions in significant ways.

Finally, as Allison suggests, implementation of policy decisions may be slowed by bureaucratic standard operating procedures. The case study sections will try to show how the Chinese automotive bureaucracy was able to cope with the new problems and prospects that arose in the cooperative ventures with foreign manufacturers.

The thesis, then, begins in Chapter Two with an overview of China's automotive history. This chapter's goal is to trace the objectives of China's "domestic economic forces," and explain the emergence of and need for "foreign forces" in the post-Mao reform era. (The goals of the "foreign forces" appear more explicitly in the later case-study chapters).

Chapter Three outlines the structure and function of the pertinent sections of the Chinese government that form the substrate for the stimuli of these elements. It also introduces brief personal histories of the key officials involved in the auto industry's development, tracing the careers of current Vice Premiers Zhu Rongji and Zou Jiahua, and former automotive czar Chen Zutao. Each of these men influenced the development of the cases under study to varying degrees.

The following chapters focus on four case studies. Chapter Four introduces the first automotive joint venture in China, Beijing Jeep. This case is rather unique among those analyzed, as it presents a crisis situation between the Chinese government and American investors; it is therefore particularly suited to a theoretical framework based on the work of Snyder and Diesing.

Chapters Five and Six analyze the joint venture companies of Shanghai Volkswagen and Guangzhou Peugeot. These ventures are noteworthy for their distance from Beijing, and for the subsequent need for coordination and cooperation

between the national and local political bodies.

Chapter Seven is devoted to the wholly foreign owned enterprise, Panda Motors, the latest South Korean/American-invested automotive project in China. This venture, which has received great scrutiny from foreign media sources, presents a wealth of information for study of local and national political conflict and cooperation, as well as bargaining within the central government, and between the central government and foreign investors.

Finally, Chapter Eight gives an overview of the automotive bureaucracy's development over the past decade, and tries to probe for political progress. In particular, it looks for the type of bureaucratic "learning" Steinbruner suggested may develop as political bodies gradually adapt to new stimuli.

Chapter 2:

An Overview of the History and Policy Development of the Automotive Industry, 1949-1991

From the early days of the People's Republic, the Chinese realized the enormous strategic and economic necessity of a well-developed vehicle industry. This chapter traces the development of what Chapter One defined as the "domestic economic forces" that foreign firms faced in the late 1970s and 1980s. It further examines, from an historical perspective, the early government guidance necessary for constructing an automotive industry in a centrally-planned system, one which varied considerably with the oscillation of political and economic trends. The chapter outlines these sometimes dramatic policy swings over the decades after the 1949 communist victory. It thereby provides the necessary empirical base for later applications of the theoretical model introduced in Chapter One.

Early Production and Policies: 1949-1965

Prior to 1949, China's automotive sector consisted mainly of vehicle repair stations in the big cities, along with a hand full of small-scale bus and cargo truck chassis production plants built in the 1930s and 1940s.[1] Many of the passenger cars in use then were purchased from Western nations; the Canton Bus Company, for example, had specialized in importing British and American cars and busses.[2]

In the face of the prior reliance on imported vehicles, the construction of an indigenous vehicle manufacturing capability emerged as a key to successful economic development of post-war communist China. Efficient transport of rural

[1] *Zhongguo qiche gongye nianjian*, (Chinese Automotive Industry Yearbook), Jixie gongye chubanshe, Beijing, 1984, p.131

[2] *Far Eastern Economic Review*, May 6, 1954, p. 567; cited in Jim Mann, *Beijing Jeep*, New York, Simon and Schuster, 1989, p.31

produce, preferably in mechanized trucks, would be vital for spurring agricultural development. Furthermore, with the beginning of the Cold War and threats to China from several fronts, an automotive industry was needed to enhance military mobility.

Only one year after the founding of the People's Republic, therefore, the Chinese were eager to create their own large-scale vehicle industry. In 1950, they approached the USSR for help in planning an auto factory, and the Ministry of Heavy Industry commissioned a "preparatory office" to guide the motor industry's development.[3] Soviet experts arrived in Beijing to offer advice.

By 1951, the Chinese had chosen Changchun in northeast China as the site of their "First Automotive Works" (FAW). In the aftermath of Japanese occupation since the early 1930s, the area possessed a high concentration of railway lines and other industrial development conducive to vehicle manufacture.

To develop their nascent freight transport capabilities, the Chinese decided to exclusively manufacture trucks at their new plant. The first product would be a 4-ton Soviet model "ZIS 150" (later re-named the *"Jiefang,"* or "Liberation" model), and the target was 30,000 vehicles per year.[4] Such initial decisions were approved by the early Finance and Economic Commission of the Government Administration Council *(Zhengwuyuan caijing weiyuanhui).*

In 1953, the government acknowledged the importance of the auto industry by formally establishing the "Automotive Industry Administration Bureau" under the First Ministry of Machine Building. Construction of FAW began, with China's leader Mao Zedong contributing an inscription for the factory's founding. The FAW officially opened in 1956, and was soon followed by automotive ventures in

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[3] Much of the following historical information is from *Zhongguo de qiche gongye (The Motor Industry of China)*, pp.14-23, published by the China Automotive Technology and Research Center, 1986

[4] The ZIS 150 itself was based on American World War II vintage Ford trucks. See Maria and Bohdan Szuprowicz, *Doing Business with the People's Republic of China*, New York, Wiley, 1978, p.319

industrialized Nanjing, Shanghai, and other cities, factories also focusing on trucks and utility vehicles.

By the mid-1950s, the Chinese recognized the need for a small number of passenger cars to, at a minimum, service top-ranking leaders. In 1958, the FAW produced its first *Hongqi* (Red Flag) model limousine, a luxury vehicle modeled on Daimler Benz's model 220 sedan. That same year, the Shanghai Automobile Assembly Plant began manufacture of its Phoenix model passenger car. Actual production, however, was negligible; in 1960, the whole nation produced only 98 of its own cars; in 1961, only 5. (See Figure 2.1). To compensate for the small number of domestically produced vehicles, China imported an average of some 1000 passenger cars per year from 1954 to 1965 (See Figure 2.2), mostly from Eastern Europe. The pre-1949 cars imported from the West gradually became extinct, as they suffered from a lack of compatible spare parts.[5]

Chinese automotive production policy fluctuated over the course of the communist nation's first decade. The early 1950s were marked by emphasis on worker innovation at the manufacturing level. With the arrival of Soviet experts in the mid-1950s, however, the Chinese stressed adoption of foreign methods and experiences. FAW's use of the Soviet model truck plans exemplifies such technology absorption. During the mid-1950s, worker input was in fact discouraged, as it was thought to interfere with successful utilization of Soviet technique.[6]

The "Great Leap Forward" years (1958-1960) again reversed the attitude toward automotive innovation. The Chinese shifted toward reliance on their own working styles, and campaigned against dominance of foreign technologies and equipment. Such a shift was characteristic of Great Leap policies; one historian has noted that "Mao's program, simply put, envisioned the development and application of modern

[5] *Far Eastern Economic Review*, May 6, 1954, p.567, cited in *op. cit.*

[6] See "The Automotive Industry," by Jack Baranson, in William Whitson, editor, *Doing Business with China*, New York, Praeger, 1974, p.173

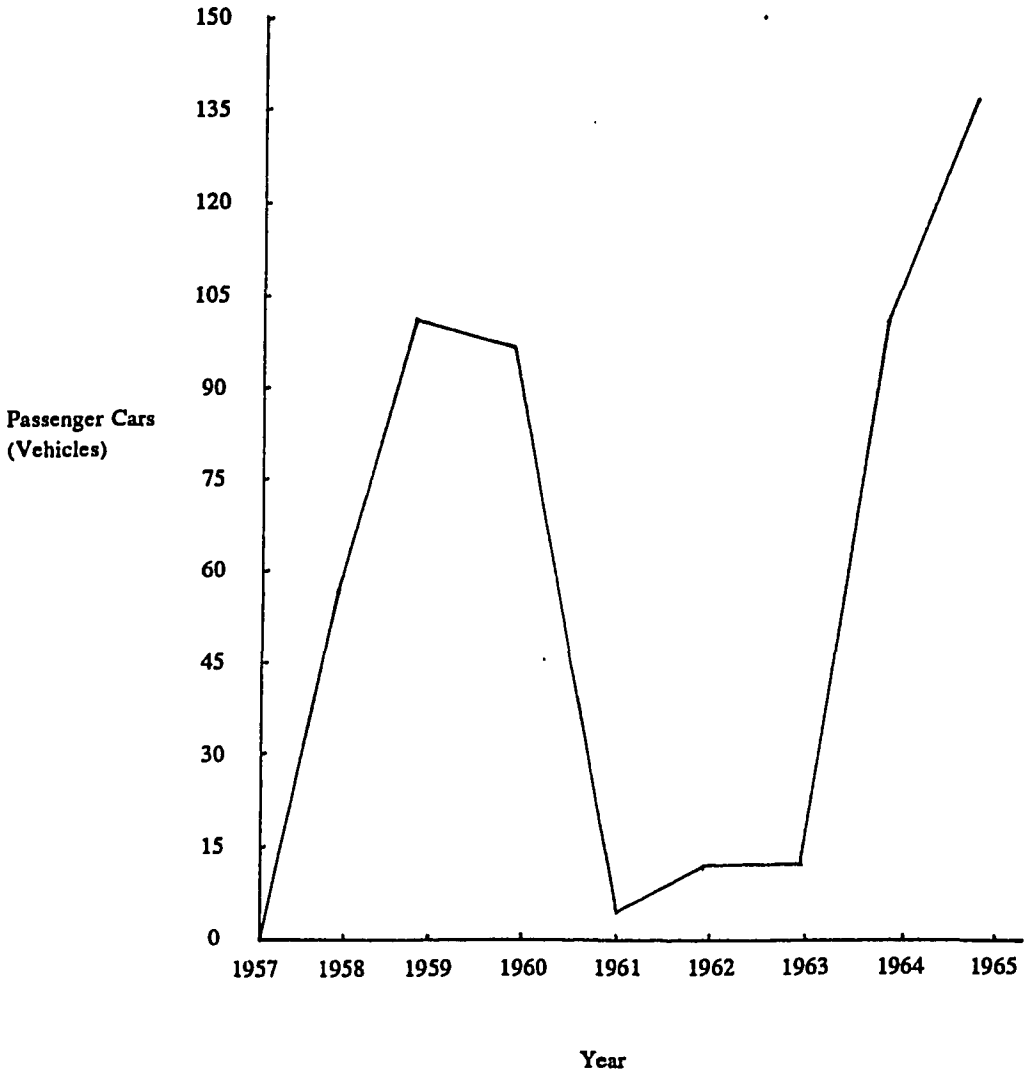

Figure 2.1: Annual Passenger Car Production, 1957-1965

Source: *Zhongguo qiche gongye nianjian* (China Automotive Industry Yearbook), Beijing, 1988, p.127

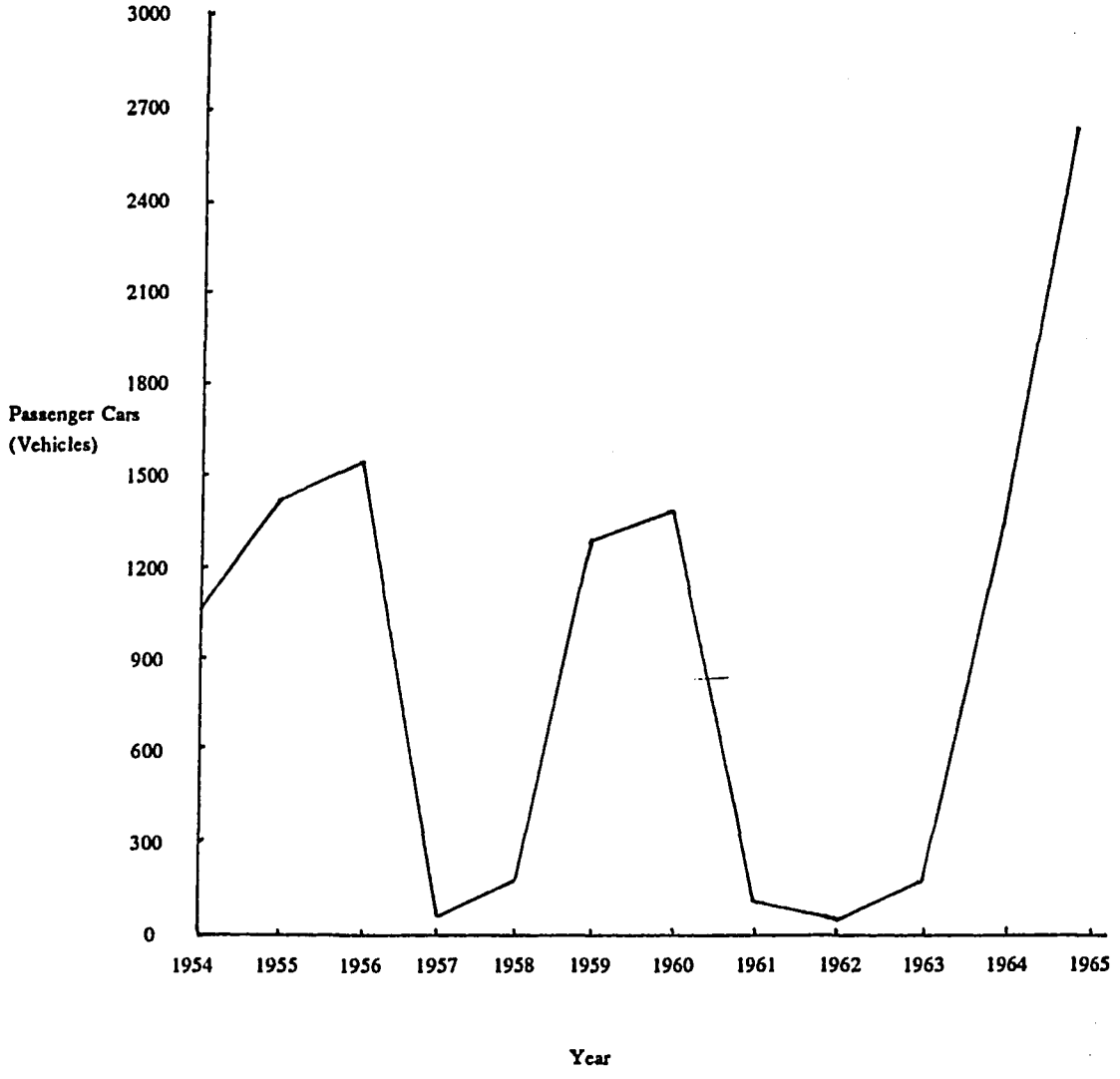

Figure 2.2: Annual Passenger Car Imports, 1954-1965

Source: *Zhongguo qiche gongye nianjian* (China Automotive Industry Yearbook), Beijing, 1988, p.529

science and technology without professional scientists and technocrats."[7]

In the aftermath of the failed "Leap," the Chinese returned to emphasis on raising technical standards, with less stress on the sometimes ill-informed ideas of production-level workers.[8] The flight of Soviet technicians with the Sino-Soviet split, however, weakened China's ability to adopt foreign technology, though in 1965 China did hold talks with France's Berliet company on construction of a truck factory.[9] The focus on domestic bureaucracy-led technical advance, however, ended in 1964, as reliance on the masses again came to the fore, parallel to the beginning of the Cultural Revolution and the renewed dominance of Maoist policies.

The policy swings guiding automotive development roughly parallel the political clashes among China's top leadership over the country's first 15 years. Early post-revolution development relied on practical measures to rebuild the war-torn nation, and on Soviet technical advice; Mao Zedong's influence was somewhat eclipsed in these years. With the reassertion of Mao's policies during the Great Leap era, however, the automotive industry emulated policies of self-reliance. The failure of the Great Leap was reflected in the automotive industry's swing back to technological reliance in the early 1960s. However, this brief pragmatic and technocratic period, like the one experienced by the whole nation in the early 1950s, ended with Mao's reassertion of power, and the launching of the Cultural Revolution in the mid-1960s.

1966-1976: The Auto Industry Under Revolutionary Policies

As relations with the Soviet Union deteriorated in the 1960s, Chinese leaders became worried about the susceptibility of the country's largest vehicle plant in Changchun to foreign attack. In 1965, the newly formed China National Automotive Industrial Corporation (CNAIC) approved the creation of a Second Automotive

[7] Maurice Meisner, *Mao's China and After*, The Free Press, New York, 1986, p.224

[8] "The Automotive Industry," by Jack Baranson, in William Whitson, editor, op. cit., p.173

[9] *Ibid.*, p.186

Works (SAW), and the next year the Chinese decided to build the new truck factory in the relatively isolated mountainous region of Shiyan in Hubei province.[10]

The SAW factory was to put into practise the ideals of self-reliance, and would depend on technology and experiences of other domestic Chinese manufacturers. Though ground-breaking in Shiyan began in 1967, however, the factory was not fully operational until 1975, though some actual production began as early as 1970.[11] Delays were probably the result of Cultural Revolution-related turmoil, which also lowered total production of cars and trucks in the whole nation from 34,501 in 1966 to 12,255 in 1968.[12]

Passenger car production received scant attention during the early years of radical Maoist leadership. Such vehicles were still primarily intended for high-level cadres, as private car ownership and operation were essentially prohibited.[13] In 1966, the FAW introduced a more spacious model of its *Hongqi* luxury vehicle, and the First Ministry of Machine Building approved a plan to enlarge the Shanghai factory's "Shanghai Brand" cars in 1972.[14] Still, passenger car production dropped from 302 in 1966 to 196 in 1970[15] (see Figure 2.3), and car imports virtually vanished (Figure 2.4).

Though overall production growth was slow, the revolutionary years emphasized the spirit of geographical self sufficiency, mentioned above, and led to a spiraling growth in the number of automotive manufacturers spread around the nation. In 1964, China had 417 factories producing trucks, cars, motorcycles and fundamental automotive parts; by 1976, the number had more than quadrupled to 1950[16] (See

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[10] *Zhongguo de qiche gongye (The Motor Industry of China), op. cit.*, p.16

[11] Maria and Bohdan Szuprowicz, *op. cit.*, p.319

[12] *Zhongguo qiche gongye nianjian, (China Automotive Industry Yearbook)*, Jixie gongye chubanshe, Beijing, 1988, p.127

[13] Maria and Bohdan Szuprowicz, *op. cit.*, p.318

[14] By then, the Shanghai plant was also capable of producing the "Sea Swallow" car, a very small vehicle with a 0.3 liter engine.

[15] *Zhongguo qiche gongye nianjian, (China Automotive Industry Yearbook)*, 1988, *op. cit.*, p.127

[16] *Ibid.*, p.119

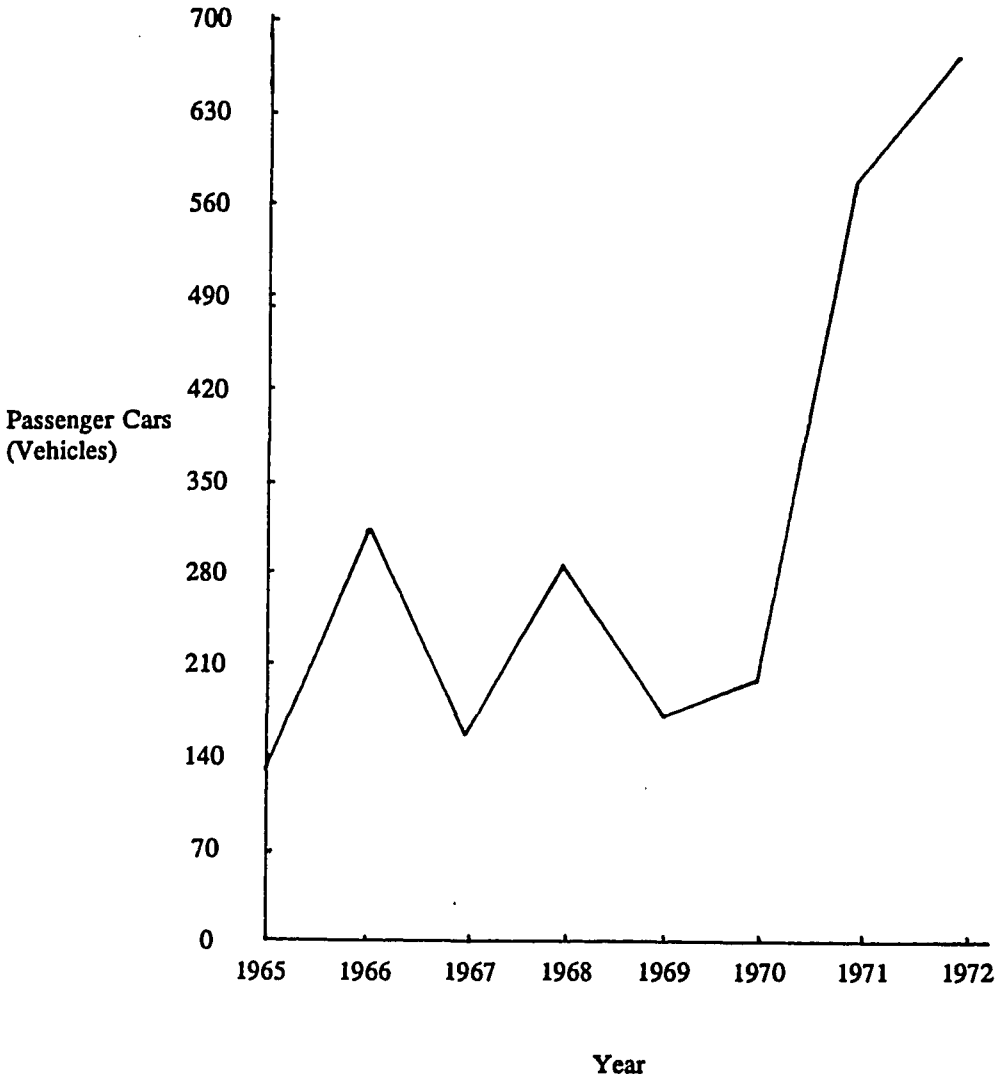

Figure 2.3: Annual Passenger Car Production, 1965-1972

Source: *Zhongguo qiche gongye nianjian* (China Automotive Industry Yearbook), Beijing, 1988, p.127

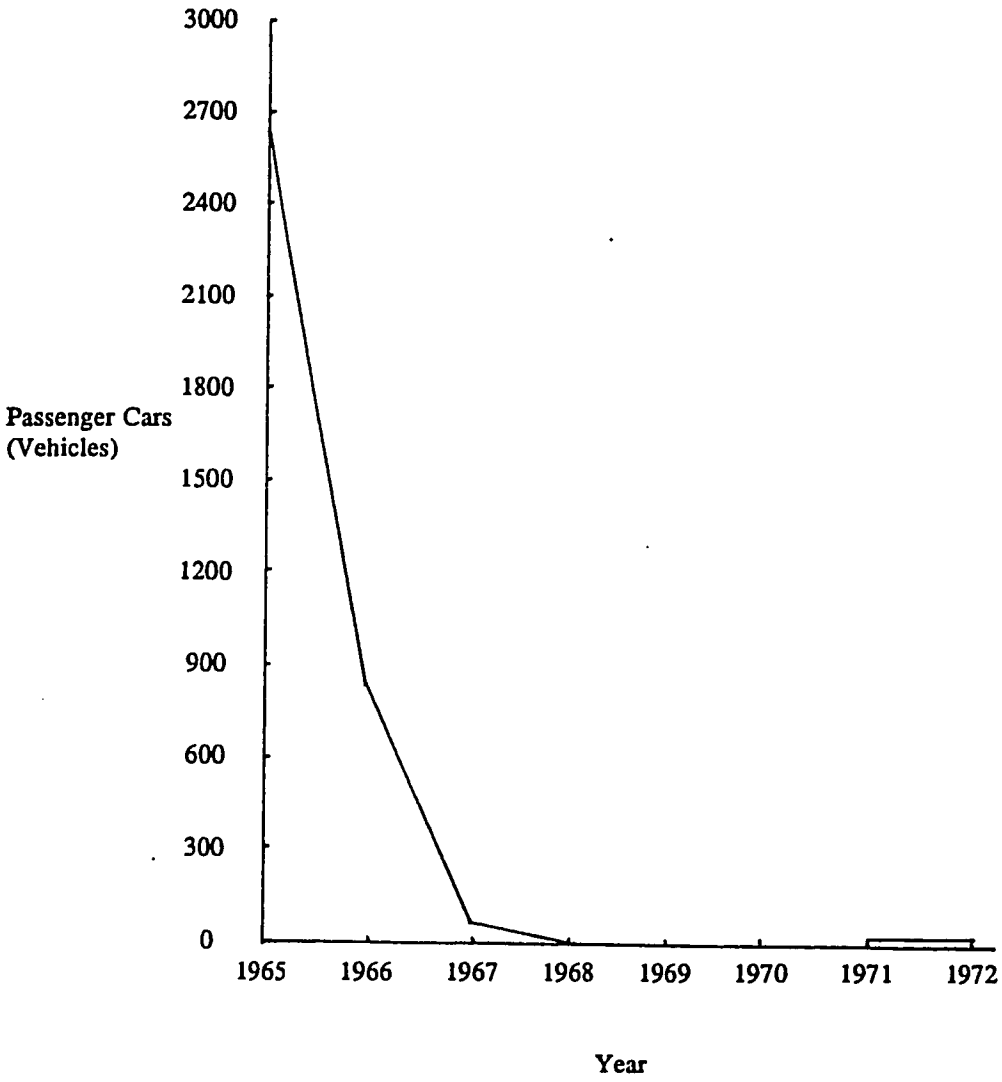

Figure 2.4: Annual Passenger Car Imports, 1965-1972

Note: Data is unavailable for the years 1969 and 1970

Source: *Zhongguo qiche gongye nianjian* (China Automotive Industry Yearbook), Beijing, 1988, p.529

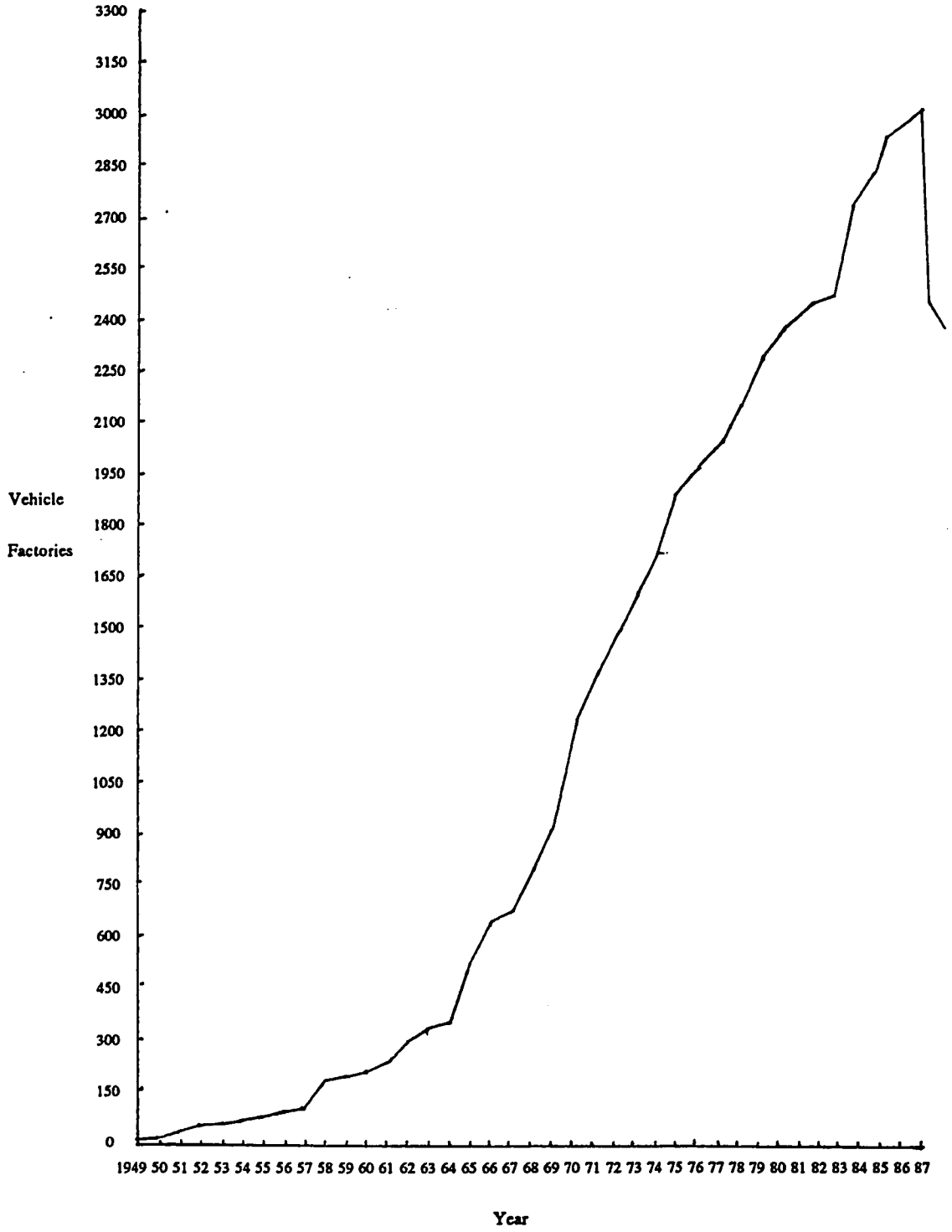

Figure 2.5: Growth in Number of Truck, Car, and Motorcycle Factories, 1949-1987

Source: *Zhongguo qiche gongye nianjian* (China Automotive Industry Yearbook), Beijing, 1988, p.119

Figure 2.5). Nearly every province (including remote Qinghai) came to boast an automotive plant. Of some 50 factories capable of serial production of trucks or other vehicles, however, only four were reported able to manufacture more than 10,000 units per year. Some plants produced only a few thousand or a few hundred vehicles annually,[17] resulting in significant, though generally ignored, diseconomies of scale in many geographical areas.[18]

Automotive policy development in the late 1960s was primarily inspired by Maoist principles. The inherent experiences of the masses, rather than foreign expertise, were termed the best sources for improving production capability. The industry's general aims in the revolutionary times included the development of domestic grass-roots production bases in each province to avoid dependence on foreign technology and production systems, while designing Chinese model vehicles better suited to local conditions.[19] To achieve these goals, the government precluded any meaningful foreign investment in the automotive sector, and tightly controlled exchanges of technicians. The Chinese eschewed importing completed vehicles, and even rejected the idea of licensing technology to update local products.[20] One observer noted in the early 1970s that "industrial backwardness is viewed as an advantageous force to be harnessed, rather than as an inhibiting factor in the development process."[21]

Though China suffered no lack of "industrial backwardness," it gradually came to realize, as domestic vehicle production volume and quality fell, the value of import-

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[17] Maria and Bohdan Szuprowicz, *op. cit.*, p.318

[18] For a rough comparison, American auto manufacturers in the 1960s targeted equipment for production of some 60 cars per *hour* per assembly line, for an annual plant capacity of 200,000 to 400,000 units, then considered an economy of scale. (See Charles E. Edwards, *Dynamics of the United States Automobile Industry*, Columbia, S.C., University of South Carolina Press, 1966, pp.155, 161).

One should also note that in the year 1916, Buick was already able to produce 73,827 units of one popular model in its product line. (See Jerry Heasley, *The Production Figure Book for U.S. Cars*, Osceola, WI, Motorbooks International, 1977, p.89).

[19] "The Automotive Industry," by Jack Baranson, in William Whitson, editor, *op. cit.*, p.172

[20] *Ibid.*, p.172

[21] *Ibid.*, p.174

ing some vehicles developed using foreign, mainly capitalist, technology. Such automotive contact with foreign firms, however, developed slowly. Following the Sino-Soviet split of the early 1960s, total car and truck imports fell from 24,865 in 1958 to a post-revolutionary low of 1123 in 1961.[22] In 1971, China imported some 10,157 trucks, mostly from Italy, Rumania, Japan and France. Still, the percentage of domestically-produced trucks in service rose from some 50 percent in 1970 to about 65 percent in 1975; most of the rest of the vehicles on the road were Soviet and Eastern European imports, and a fraction were from Japan and Western Europe.[23] China also exported a small number of trucks to Tanzania, Albania, and North Vietnam as part of the country's foreign aid program.[24]

Japanese automotive commerce with China was inhibited during the 1960s and 1970s by Chinese restrictions on companies that had ties to Taiwan and South Korea. In 1971, however, Japan's largest manufacturer, Toyota, promised to limit its contacts with those regions, and it subsequently was allowed to participate in China's trade fair in the spring of that year.[25] The Chinese reportedly had a predilection for Toyota, as that company's trucks, captured in the wake of the Japanese surrender after World War II, were a prime resource for the Communist forces fighting the nationalists in northern China.

Toyota began to explore technological cooperation with the Chinese, ranging from exchanges of technicians to joint production of new vehicle models and importation of a complete integrated automotive plant. An early proposal called for a factory to make up to 150,000 cars and 30,000 trucks per year.[26] Other Japanese firms followed Toyota's lead in the early 1970s, and exchanges of technical experts between the two countries grew quickly during the mid-1970s.[27] Japan supplied

[22] *Zhongguo qiche gongye nianjian, (China Automotive Industry Yearbook), op. cit.*, 1988, p.529

[23] Maria and Bohdan Szuprowicz, *op. cit.*, p.323

[24] "The Automotive Industry," by Jack Baranson, in William Whitson, editor, *op. cit.*, p.184

[25] *Ibid.*, p.184

[26] *Ibid.*, p.184

[27] *Ibid.*, p.186

some 45 percent of China's truck imports in 1974, and sold nearly $300 million worth of vehicles and parts to China from 1970 to 1975, accounting for about 30 percent of China's import market.[28]

European nations played a smaller part in China's developing auto industry. Their affiliation with the Chinese was limited to exports, mainly of trucks, with France contributing about 17 percent of China's imports. Italy, West Germany, and Sweden provided a limited number of vehicles, and, in 1975, Fiat's president visited Beijing for talks on technical cooperation.[29] The Chinese refused to buy American products, however, until normalization progress came in the mid-1970s.

The period of renewed interest in foreign technology in the early 1970s again paralleled a realignment of China's top leadership as some of the country's pragmatic officials, purged in the opening years of the Cultural Revolution, were rehabilitated. In 1973, Deng Xiaoping resumed his political place as vice premier, future premier Zhao Ziyang became party secretary of Guangdong province, and, in 1975, the reformer Wan Li became minister of railroads. At lower levels, automotive experts like future top leader Chen Zutao (discussed in more detail in Chapter Three) returned from exile in the countryside to manage the major vehicle factories. The general trend among nearly all leaders, furthermore, was toward greater, though qualified, contact with the West, as exemplified by Chairman Mao's 1972 meeting with US President Richard Nixon.

By the early 1970s, then, the Chinese had reinstated many technical experts to positions of authority, and again saw a need to rely on foreign cooperation to advance their automotive industry. Though the Cultural Revolution only officially ended with Mao's death in 1976, Chinese adoption of Maoist policies in the automotive sector had become somewhat diluted with the introduction of limited

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[28] Maria and Bohdan Szuprowicz, *op. cit.*, p.324

[29] *Ibid*, p.322

cooperation with foreign manufacturers. The period after Mao has shown an accelerated degree of interaction with foreign automotive firms, as the case study chapters of this thesis will show. The next section traces the general bureaucratic political climate surrounding the post-Mao reform period's automotive opening to the West.

Post-Mao Political Attitudes and Developments in the Auto Sector

In the wake of political emphasis placed on industrial development following the death of Mao in 1976, and a resultant desire to tap the opinions of rehabilitated automotive experts, a discussion of the proper direction for general automotive policy gradually emerged in the Chinese press in the late 1970s and early 1980s. Automotive planners felt it necessary, first, to stem the mushroom-like proliferation of vehicle factories (see Figure 2.5), a legacy of the self-reliant Mao years. These factories, mentioned above, were "small, but complete" *(xiao er quan)*, in the earlier spirit of Maoist policies, but the new Chinese leaders now stressed the need for specialization and coordination among factories.[30] The Chinese eventually succeeded, by the late 1980s, in limiting the total number of the industry's factories (See Figure 2.5).

In addition to rationalizing the number of vehicle plants, the automotive agenda in the early pragmatic years also listed modernization of factory equipment as a high priority.[31] As vehicles on the road aged, furthermore, they were to be replaced more quickly with newer automobiles.[32]

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[30] See Zhao Hong and Xiong Zhaoxiang, "Dui tiaozheng woguo qiche gongye de kanfa," (Opinions on Adjusting Our Automotive Industry), in *Caizheng yanjiu ziliao* (Finance Research Data), 1981, No.90, pp.26-30

[31] Sun Xi, "Dui woguo qiche gongye chanpin gaizao wenti de fenxi," (An Analysis of the Problems of Transforming Our Automotive Industrial Products), in *Jingji lilun yu jingji guanli* (Economic Theory and Economic Practise), 1982, No.1, p.26

[32] Luo Maoxuan and Liao Guojun, "Woguo qiche gongye chanxiao qingkuang diaocha," (An Investigation of Our Automotive Industry's Production and Marketing), in *Guangdong jinrong yanjiu* (Guangdong Finance Research), 1982, No.2, p.27

The early 1980s were days when the automotive sector in general was beginning to grow at a rapid clip, even compared to other Chinese industries. The total production value of vehicle and parts production doubled from RMB 8.84 billion in 1980 to RMB 16.45 billion in 1984, and doubled again to RMB 37.3 billion in 1988 (figured in 1980 constant prices).[33] Over the same period, automotive production value grew from 1.76 percent of China's gross national industrial production to 2.39 percent in 1984, and to 2.53 percent in 1988.[34] Highway transport took an increasing percentage of the country's passenger travel, rising from 72 percent of total traffic in 1983 to 79 percent in 1986; the share of freight transport on the road, however, remained relatively constant.[35]

The Chinese moves to rationalize and modernize factories producing mostly trucks, however, had little initial impact on the still nascent passenger car industry. Production hovered around 2600 vehicles per year, a slight increase over the 1819 cars produced in 1975[36] (See Figure 2.6). This small number of cars emanated principally from only two manufacturers, located in the above-mentioned Shanghai vehicle factory, and at Changchun's FAW works.

While the domestic industry languished, the opening to the outside world, and the resulting tourist trade, created a huge demand for cars to serve as taxis. Guangzhou city, for example, began building its taxi fleet with an initial order for 270 vehicles from Hong Kong in September, 1979, and other cities soon followed Guangzhou's example. Furthermore, work units granted permission to retain foreign exchange from export earnings were quick to purchase Japanese cars, busses, minibusses and vans for their own use.[37]

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[33] *Zhongguo de qiche gongye (Automotive Industry of China)*, by the China Automotive Technology and Research Center, Jilin Science and Technology Press, 1989, p.4

[34] *Ibid.*, p.5

[35] *Ibid.*, p.29

[36] *Zhongguo qiche gongye nianjian, (China Automotive Industry Yearbook)*, 1988 *op. cit.*, p.127

[37] Todd Thurwachter, "Development of the Chinese Auto Industry: Foreign Participation and Opportunities," US and Foreign Commercial Service document, Guangzhou, China, 1989, p.4

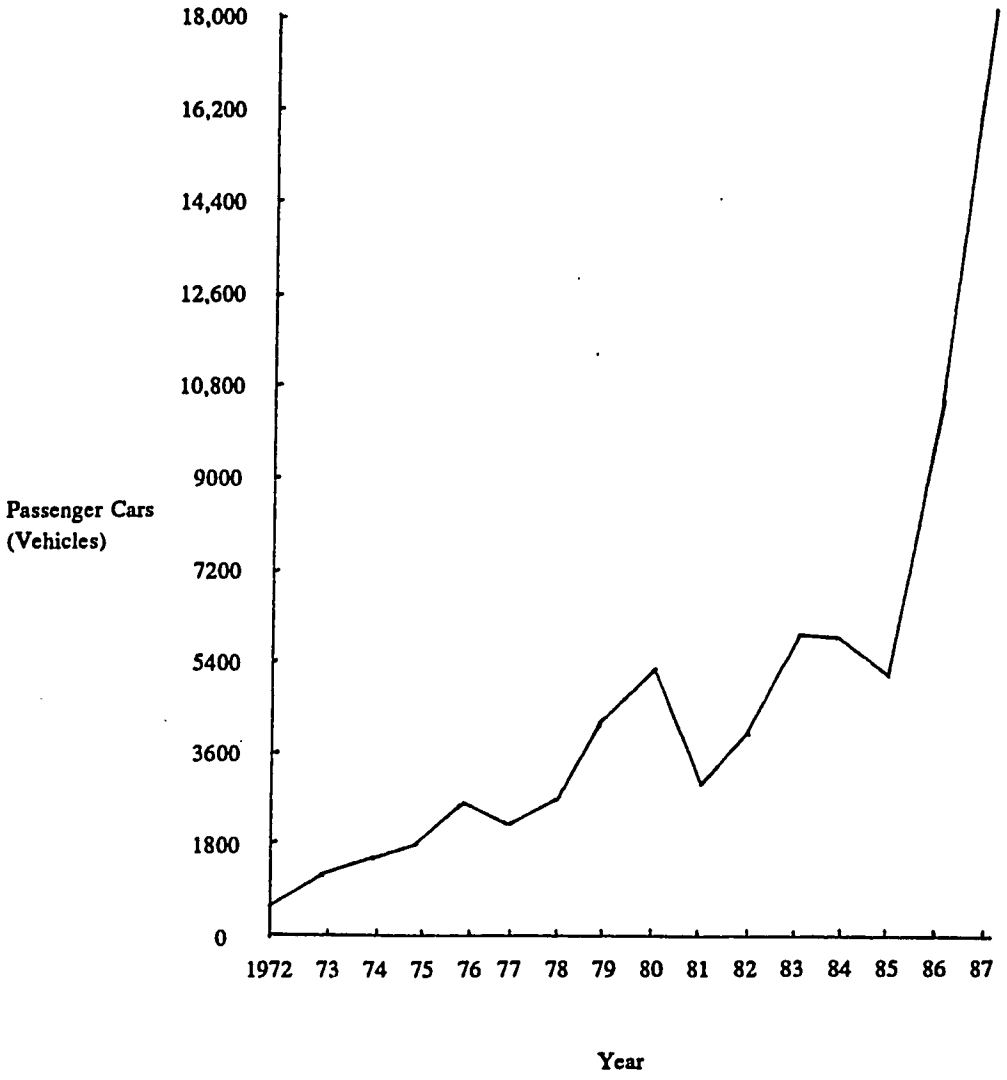

Figure 2.6: Annual Passenger Car Production, 1972-1987

Source: *Zhongguo qiche gongye nianjian* (China Automotive Industry Yearbook), Beijing, 1988, p.127

In contrast to the rather rudimentary modernization priorities of foreign automotive policies in the early and mid-1970s, then, the policy problems of the new decade were suddenly rooted in the need to impose some limits on the number of foreign passenger cars and other vehicles imported into China. Car imports alone leaped from 52 vehicles in 1977 to 667 in 1979, and to 19,570 in 1980[38] (See Figure 2.7). The government responded with tighter import restrictions, and total car and truck imports temporarily fell, to 8831 in 1982.[39]

Despite the short reprieve, however, relaxed restrictions in the mid-1980s brought a renewed shock to Chinese auto planners, as imports of cars and trucks again sky-rocketed (See Figures 2.7 and 2.8). The sharp rise from 1984 to 1986 was partly the result of favorable regulations that brought the infamous Hainan Island vehicle binge of 1984. The island was exempted from a 260 percent import duty imposed on the rest of the country, a benefit meant to spur development. Unfortunately, Hainan officials took advantage of the lenient rule to import tens of thousands of cars and other vehicles, mostly from Japan, and re-sell the automobiles at premiums of 3 to 5 times the purchase cost to other mainland provinces.[40] The island's import flood ended in November, 1984, as the Bank of China suspended issuance of letters of credit for cars sold to Hainan, but not before 89,000 vehicles had entered China via the island.[41]

The quashing of the Hainan scandal did not, however, signal the end to China's automotive import binge. After a taste of Japanese and other Western vehicle quality, Chinese farmers continued to clamor for the reliable trucks; taxi companies still thirsted for Toyota Crowns and Nissan Bluebirds. In 1985, China spent a record $3 billion to import some 350,000 vehicles, a figure including 105,775 passenger

[38] *Zhongguo qiche gongye nianjian, (China Automotive Industry Yearbook)*, 1988 p.529

[39] *Ibid.*, p.529

[40] Thurwachter, *op. cit.*, p.4; according to this report, China spent more money on Hainan car imports than on the island's eight major projects.

[41] *Ibid.*, p.5

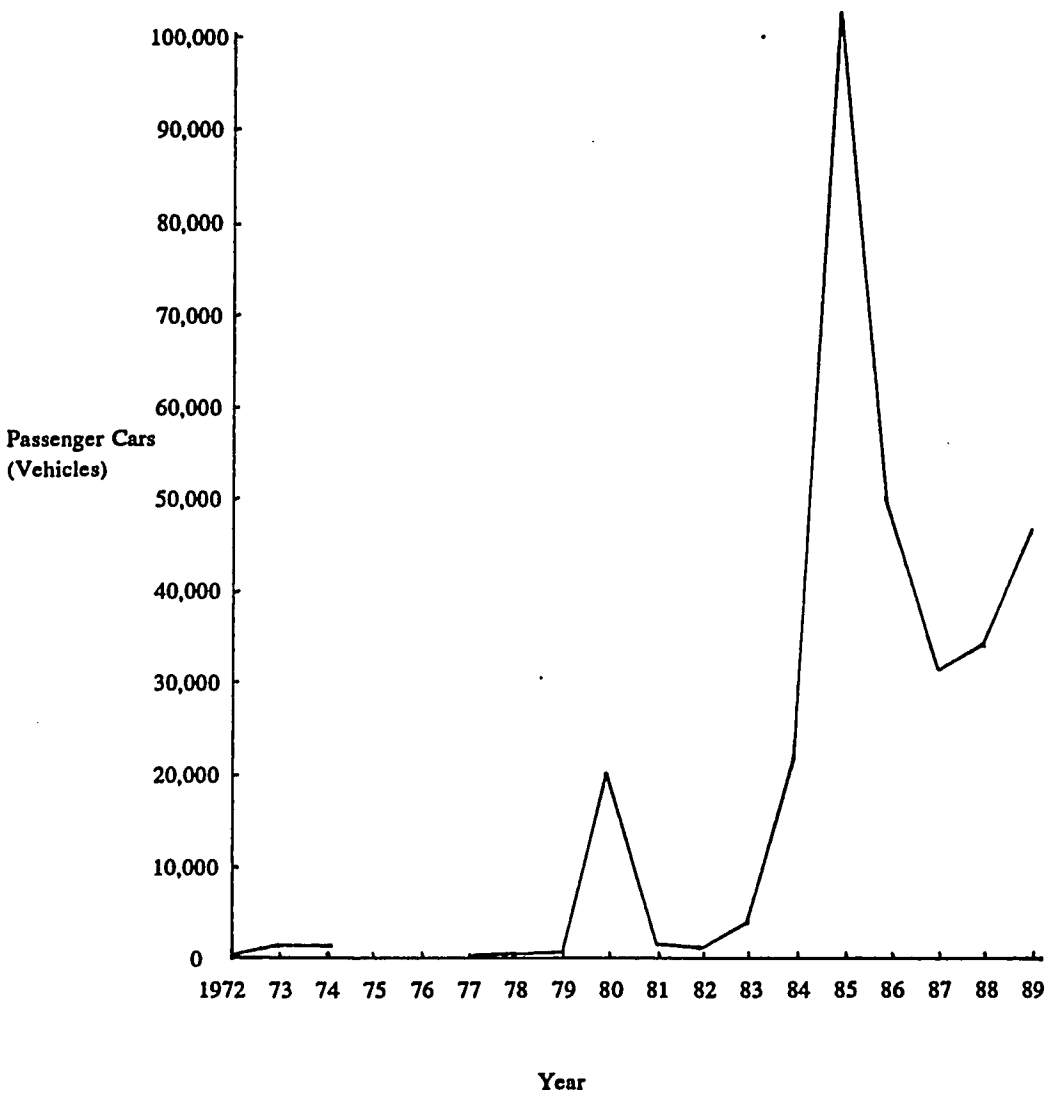

Figure 2.7: Annual Passenger Car Imports, 1972-1989

Note: Data is unavailable for the years 1975 and 1976

Sources: *Zhongguo qiche gongye nianjian* (China Automotive Industry Yearbook), Beijing, 1988, p.529, for 1972-1987
Zhongguo tongji nianjian (Chinese Statistical Yearbook), Beijing, Zhongguo tongji chubanshe, 1990, p.651, for 1988-1989

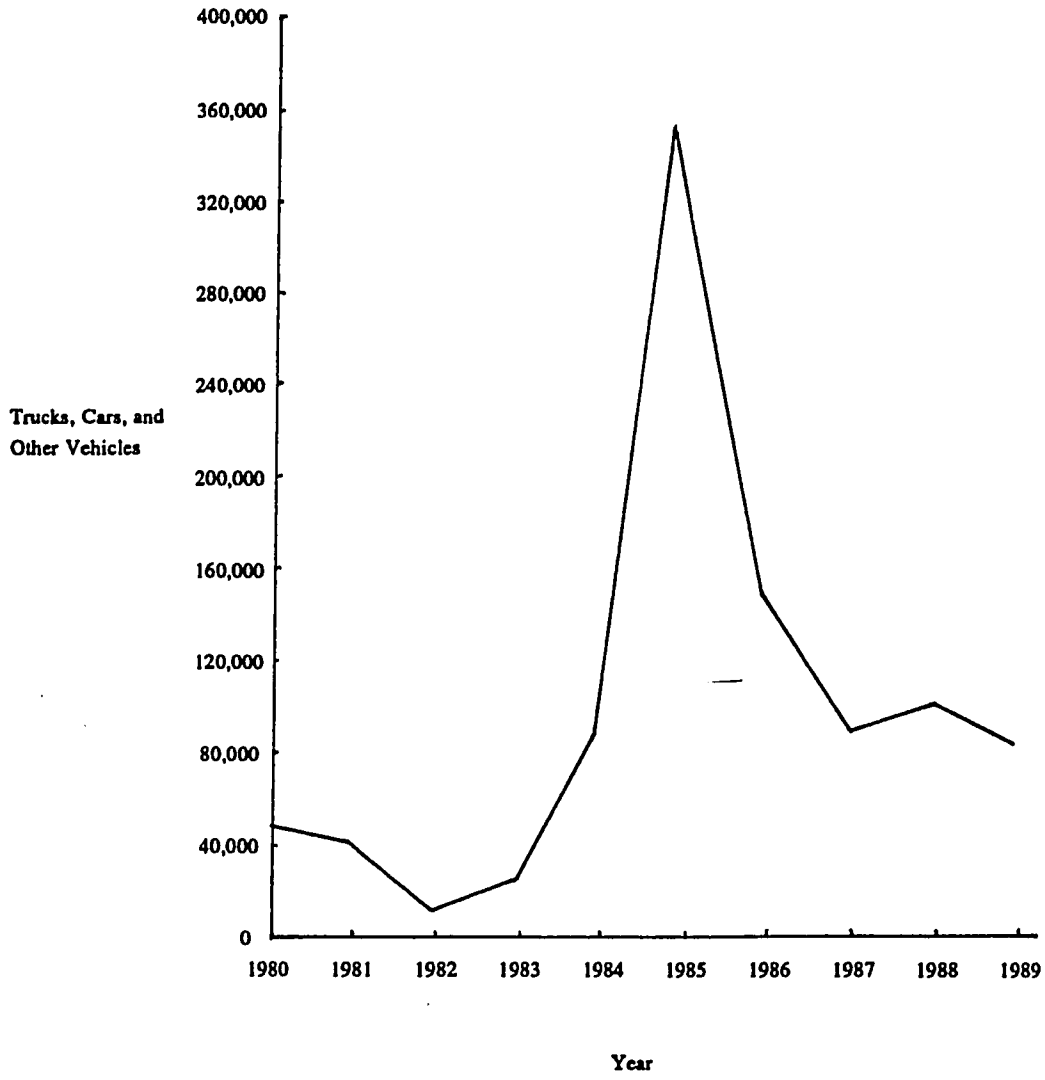

Figure 2.8: Annual Total Vehicle Imports, 1980-1989

Sources: *Zhongguo qiche gongye nianjian* (China Automotive Industry Yearbook), Beijing, 1988, p.529, for 1980-1986
Zhongguo tongji nianjian (Chinese Statistical Yearbook), Beijing, Zhongguo tongji chubanshe, 1988, p.731, for 1987
Zhongguo tongji nianjian (Chinese Statistical Yearbook), Beijing, Zhongguo Tongji Chubanshe, 1990, p.651, for 1988-1989

cars.[42] A November 4, 1985 edict, however, significantly curtailed imports by requiring the approval of both the revitalized China National Automotive Industrial Corporation (CNAIC) and the State Planning Commission's[43] Office for Import Investigation before the purchaser could receive an import license.[44]

By the mid-1980s, the Chinese finally began to turn their attention to solving their import troubles by shifting production from heavy trucks, which was sufficient to meet demand, to lighter trucks and domestically produced passenger cars. As the case study chapters of this thesis indicate, the Chinese quickly realized cooperation with foreign manufacturers in the form of joint ventures would be the key to a rapid increase in production capability. These later chapters will focus in detail on specifics of the foreign ventures that did appear in China, and the various political conflicts that ensued with the births of the new companies. Some of the general concerns of the automotive bureaucracy over the approach to foreign investors, however, are included below in this chapter.

The high import numbers inspired, for example, some radical suggestions to remedy the automotive dilemma. The new leader of the CNAIC, Chen Zutao,[45] proposed in 1985 that a new large-scale, specialized vehicle plant should be built in China every 5 years.[46] Chen also called for an increase in the number of automotive joint ventures and foreign loans to the industry,[47] and an increase in automotive exports, which had advanced at an uneven pace[48] (See Figure 2.9). Other voices made somewhat irrational or contradictory suggestions. One called for limiting new vehicle technology to that of Japan only, in order to capitalize on the apparently

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[42] *Zhongguo qiche gongye nianjian, (China Automotive Industry Yearbook)*, 1988 p.529

[43] Both these organizations are described in greater detail in Chapter Three.

[44] Thurwachter, *op. cit.*, p.5

[45] See Chapter Three for further discussion of Chen's policies.

[46] Chen Zutao, "Woguo qiche gongye da fazhan de ji xiang juece," (Policies of the General Development of Our Automotive Industry), in *Juece yu xinxi (Policy and Information)*, 1985, No.2, p.14

[47] *Ibid.*, p.14

[48] Ji Zhuoru, "Fenfa tuqiang zhenxing woguo qiche gongye" (Go All Out to Make the Country Work, and Promote Our Automotive Industry), in *Juece yu xinxi*, 1986, No.3, p.6

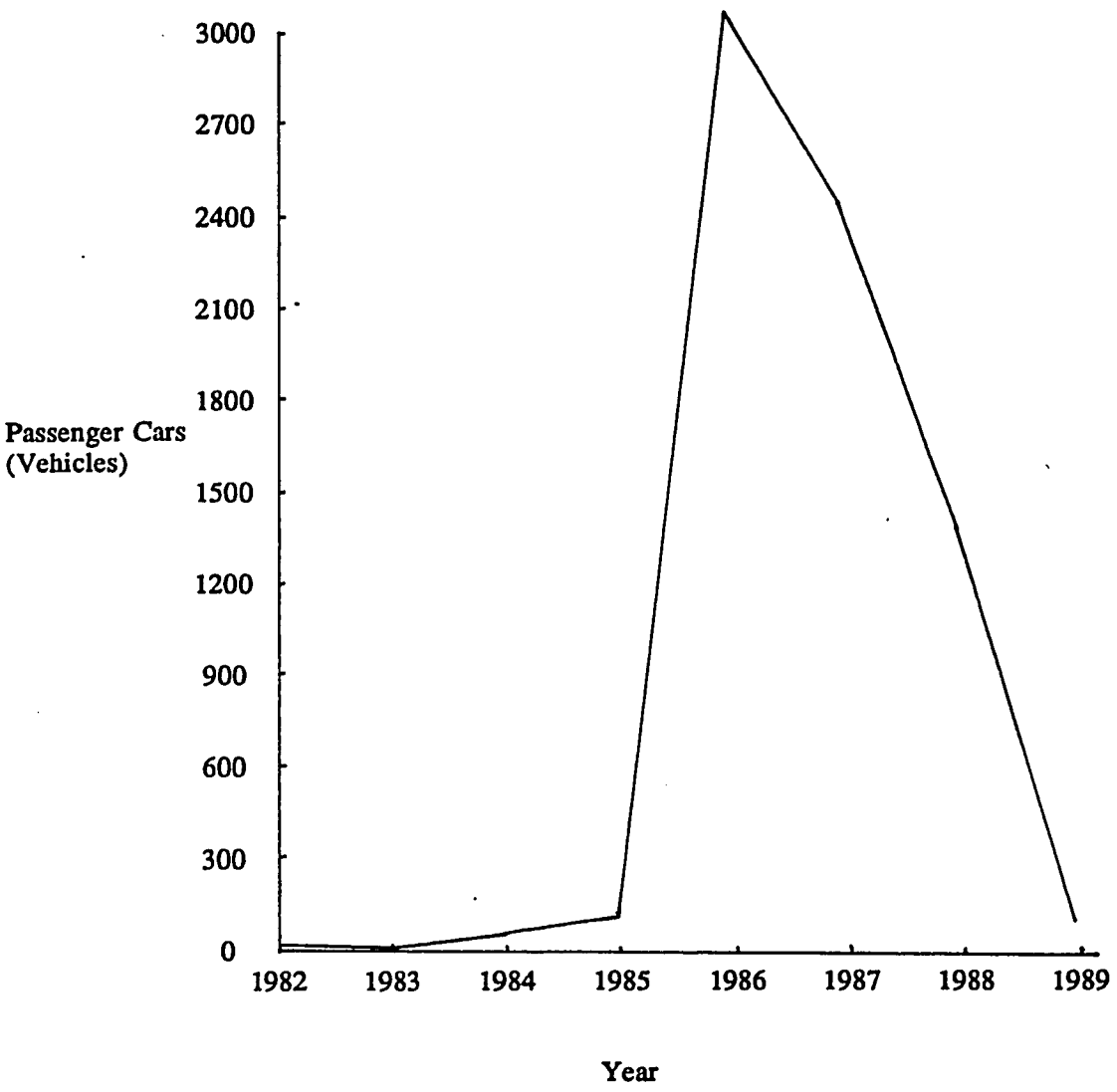

Figure 2.9: Annual Total Passenger Car Exports, 1982-1989

Source: *Almanac of China's Foreign Economic Relations and Trade*, Hong Kong, China Resources Advertising Company, Ltd.; for 1982 and 1983: p.1065 in 1984 edition; for 1984: p.925 in 1985 edition; for 1985: p.1075 in 1986 edition; for 1986: p.481 in 1987 edition; for 1987: p.534 in 1988 edition; for 1988: p.447 in 1989 edition; for 1989: p.433 in 1990 edition

boundless export potential of Japanese car models, and for completely excluding further European and American technology import.[49] Others sought the reduction or suspension of using scarce foreign currency reserves to import the disassembled vehicle kits[50] (commonly known as "Completely Knocked-Down," or "CKD" sets, discussed in more detail in later chapters) that were processed at Chinese factories.

A consensus in the late 1980s, however, recognized the need for acquiring advanced technology and rationalizing and concentrating far-flung production facilities, many of which, though not passenger car producers, were vital parts suppliers to the new foreign cooperative plants. The Chinese also saw value in reforming factory management procedures. To develop a long-term strategy, China formed a study group with Japanese specialists in early 1986,[51] and the policy bureau of the central State Science and Technology Commission carried out a major study of the passenger car industry in 1987.

It is important to note here the general devolution of automotive policy-making authority to technical experts. In day-to-day affairs, top leaders played little role, even allowing policy debate to flow into the public press.[52]

The latter years of the 1980s, then, saw several published articles calling for accelerated small car production. Many noted such vehicles would not only stem imports, they might also develop into an export industry;[53] these writers

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[49] Ji Jie, "Yinjin xianjin jishu jiakuai woguo qiche gongye de fazhan" (Introduce Advanced Technology, Speed Our Automotive Industry's Development), in *Gongye jingji guanli congkan (Industrial Economic Management Collection)*, 1985, No.3, p.7

[50] Lei Liulong and Li Huidong, "Guanyu zhongguo qiche gongye fazhan zhanlue wenti" (On Questions of China's Automotive Industrial Development Strategy), in *Qiye yanjiu (Industrial Research)*, 1986, No.5, p.7; and Zhao Ying, "Shilun woguo qiche gongye baohu zhengce" (Policies on Protecting Our Automotive Industry), in *Jingji yanjiu cankao ziliao (Economic Research Reference Data)*, 1987, No.37, p.41

[51] *Far Eastern Economic Review*, March 13, 1986, p.9; this study later recommended, among other steps, production of passenger cars at FAW and SAW, and tighter restrictions on imports of cars and auto parts. See also *Jingji cankao* (Economic Reference), August 3, 1987, p.4

[52] The case study chapters of this thesis chronicle in more detail the relations between top and lower-level officials.

[53] See, for example, Yang Lincun, "Dui fazhan woguo jiaoche gongye de ji dian kanfa" (A Few Opinions on Developing Our Passenger Car Industry), in *Zhongguo keji jitan* (China Technical Compendium), 1987, No.5, p.26; and Hu Zixiang, *et. al.*, "Jiasu fazhan woguo xiao jiaoche gongye de tantao" (An Inquiry Into Speeding Our Small Passenger Car Industry's Development), in *Gongye jingji guanli congkan* (Industrial Economic Management Collection), 1987, No.9, pp.20-23.

undoubtedly hoped China could emulate the examples of Japan and of the rapidly developing automotive export industry in China's other East Asian neighbor, South Korea. In what was perhaps a display of national pride, other automotive researchers argued bicycles and subways could never truly substitute in urban areas for passenger cars, and that, furthermore, no other truly modern country in the world lacked a developed passenger car mode of transport.[54] Some also analyzed the need for steel, fuel, and roads to support the industry, and found the raw materials and infrastructure, though then inadequate, would develop with proper technical aid.[55] One writer summarized these arguments by stating "Without passenger car production, there can be no modernization of the automotive industry."[56]

Despite the outpouring of enthusiasm, no long-term passenger car development plan emerged until 1988, when the top leadership became temporarily involved in the decision-making process. Central officials considered the so-called "Big Three, Little Three" *(San Da, San Xiao)* scheme proposed at their annual autumn Beidaihe leadership conference. According to this plan, China's main vehicle manufacturers would be the First Auto Works in Changchun, the Second Auto Works in Hubei, and the Shanghai vehicle factory, which by then had formed the joint venture with Volkswagen discussed in Chapter Five. The three minor players would be the joint venture companies of Beijing Jeep (see Chapter Four), Guangzhou Peugeot (see Chapter Six), and the Tianjin Automotive Corporation, which had a licensing agreement with Japan's Daihatsu.[57] The plan also called for increasing passenger car output to 40 percent of vehicle production by the year 2000.[58] To further stimulate

[54] Jiang Xianfen, "Fazhan jiaoche, shi zai bi xing" (It is Imperative to Develop Passenger Cars), in *Qiye yanjiu* (Industrial Research), 1987, No.7, pp.15-16

[55] *Zhongguo keji jitan*, 1987 *op. cit.*, p.27

[56] Su Lian, "Lun qiche gongye de diwei he zuoyong" (On the Automotive Industry's Status and Effect), in *Gongye jingji guanli congkan* (Industrial Economic Management Collection), 1987, No.9, p.15 (my translation).

[57] Wu Facheng, "Qiche gongye wu nian lai de xin fazhan ji qi jin hou de fazhan zhanlue" (The Automotive Industry's Progress Over the Past Five Years and Future Development Strategy), in *Jingji yanjiu cankao ziliao (Economic Research Reference Data)*, 1988, No.180, pp.30-31

[58] Thurwachter, *op. cit.*, p.9

domestic production, in late 1989 the Chinese again tightly restricted vehicle imports from Western countries, limiting incoming vehicles mainly to Soviet and Eastern European models.

With the enunciation of the *San Da, San Xiao* plan, some Chinese analysts further stipulated that the industry should refrain from blindly building any other new passenger car factories.[59] The desire to somehow emulate America's concentrated auto industry in the Michigan and Ohio region, or Japan's centralized Nagoya-Tokyo area factories, manifested itself in various Chinese references to several of their main factories as "China's Detroit," or of their localities as "Motor City."[60] By fostering rational parts supply industries and manufacturing efficiency, focused automotive factory sites would promote production.

With diffuse manufacturing facilities already spread around the nation, however, a result of the policies of the 1950s and 1960s, China was reluctant to simply concentrate production in one or two regions. The six major facilities, therefore, stretched from Changchun to Guangzhou, and included nearly every major region in between (see map, Figure 2.10). The proposed Panda automotive venture (see Chapter Seven) threatened to further dilute passenger car production, as did two new planned passenger car facilities, joint ventures between Hubei's SAW and France's Citroen, and Changchun's FAW and Volkswagen, both of which signed contracts in late 1990.

Finally, as China entered the 1990s, automotive analysts again began a reassessment of the industry's direction. One official renewed the call for an end to imports of CKD kits in any future automotive ventures, citing high costs and China's

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[59] *Jingji yanjiu cankao ziliao (Economic Research Reference Data)*, 1988, No.180, p.31

[60] See, for example, He Ling, "Ruce xiaqu jianbucheng zhongguo de 'Detelu'" (If Things Go On Like This, There Will Never Be a Chinese "Detroit") in *Shijie jingji daobao* (World Economic Herald), March 3, 1986, p.14 (on Shanghai Volkswagen); Li Hongqi, "Cong shan shenchu qiche cheng" (An Automotive City in the Depths of the Mountains), in *Ban yue tan* (Semi-Monthly Chatter), 1982, No.23, p.44 (on SAW); and "'Auto Town' is Underway" (no author cited), in *China Daily*, September 20, 1989 (on Panda Motors).

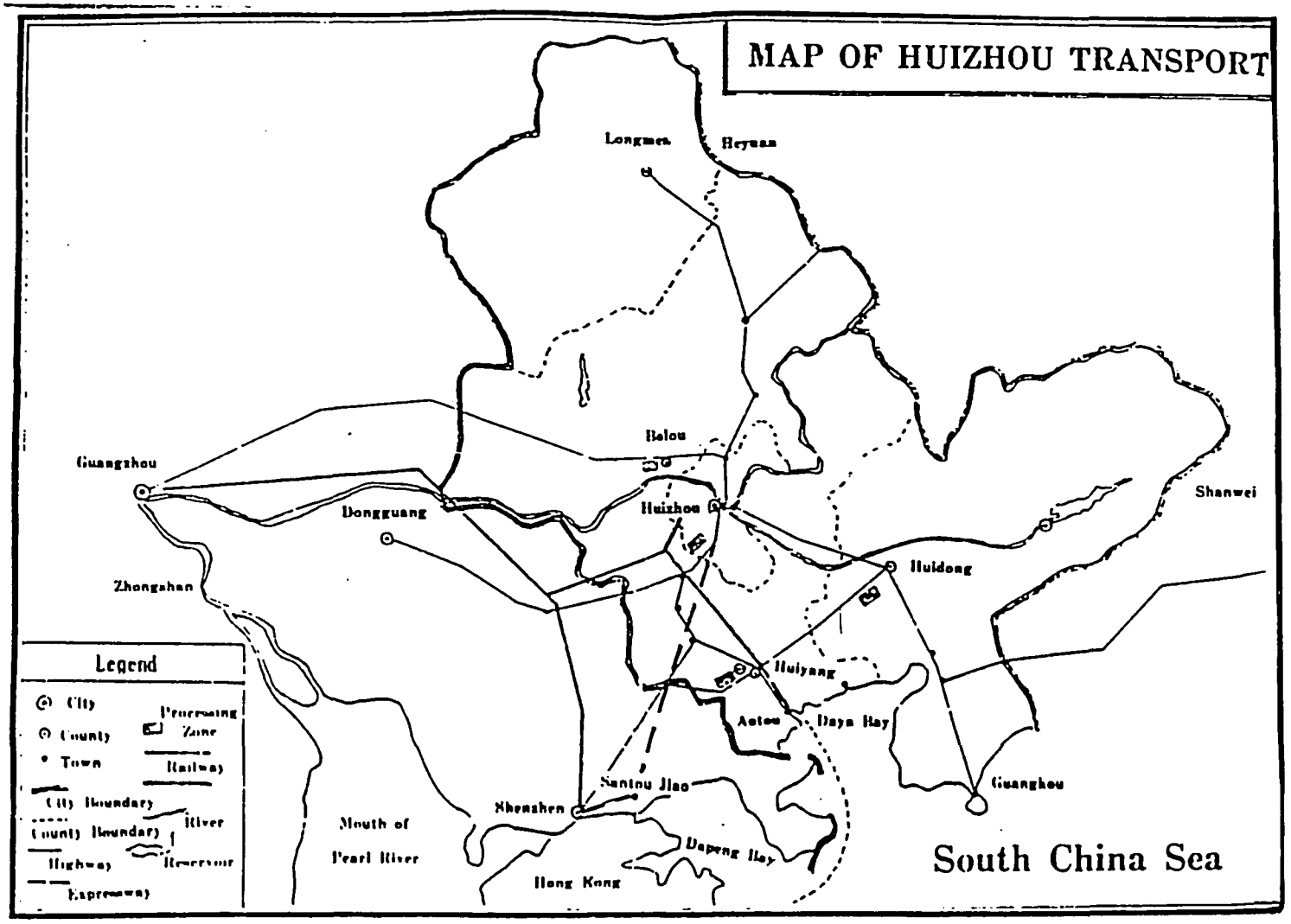

Figure 7.1: Map of Huizhou Region

Source: *Investment Guide '90 Huizhou*, Edited by Huizhou Investment Centre for Taiwan Compatriots, Huizhou, 1990

difficulty in absorbing advanced technology.[61] (Such a move, however, would have stifled the extant passenger car producers, all of which were joint-venture factories importing CKDs). A scholar at one of China's most prestigious research institutes wrote in mid-1989 a strongly-worded criticism of the assumed need for passenger car development in China. He pointed out the serious traffic problems, tremendous requirement of funds to build highways, and general transport inefficiencies accompanying a large-scale auto industry.[62]

In 1991, the influential *Jingji Ribao* (Economic Daily) published a series of articles designed to chart a new path for car production.[63] The newspaper proposed targeting private purchasers for sales of small cars, noting that many cities in China had standards of living high enough to comprise such a market.[64] It further pointed out that the existing purchasers of small cars, namely government officials, represented a drain on national funds, as well as potentially corrupt abusers of their privilege to buy such vehicles. The inability of the joint ventures to meet world-level quality standards prohibited exports. Therefore, to maintain and increase passenger car production, the government was encouraged to promote sales to the domestic private market. As of this writing, it was not clear whether the newspaper's call would significantly affect policy makers, though, as the rest of this thesis will show, nearly all of the joint venture producers had dreams of tapping just such a market.

As mentioned above, this dissertation focuses primarily on the experiences of the passenger car joint ventures that have operated in China for several years. Though

[61] *Zhongguo qiche bao (China Automotive News)*, January 4, 1990, p.3

[62] Zhou Jiayi, "China's Passenger Car Industry," unpublished manuscript, Graduate School of the Academia Sinica, May, 1989, pp.22-24

[63] Cited in *China Daily*, June 29, 1991, p.4

[64] One Chinese estimate in 1989 forecast that in the year 2000, there would be between 3 and 14 million passenger cars on China's roads. The same source suggested that in 1989, some 400,000 to 600,000 families in China already had sufficient income and the desire to purchase a passenger car. (Zhou Jiayi, "China's Passenger Car Industry," *op. cit.*, pp.6, 12)

the Japanese have had extensive contact with the Chinese automotive industry, they have refrained from signing a major joint venture contract, and are therefore excluded from close analysis here. The final section of this chapter, however, briefly discusses some of the salient points of the Japanese participation in Chinese passenger car development.

The Japanese Role

In spite of the cooperative efforts offered by Japanese companies in the 1970s, discussed above, the Japanese initial preference in China was to sell finished vehicles. Thus, the early 1980s saw Japan snatching the lion's share of China's import market, with Toyota alone selling some 40,000 vehicles to China in 1984, mostly in Hainan.[65] Japanese passenger car exports peaked in the mid-1980s, however, and gradually declined for the rest of the decade as the Chinese relied more on joint venture products, barter imports from the USSR and Eastern Europe, and the Japanese vehicles already on the road.[66]

In addition to exports, however, the Japanese have at times considered some more lasting automotive cooperation with the Chinese. Representatives from Japan explored prospects in the early 1980s for joint ventures in Beijing and Shanghai; these cities, however, later turned to the Americans and West Germans, respectively, to sign contracts. The Japanese thereafter failed to form any joint venture for car manufacture.[67]

Chinese automotive officials interviewed for this thesis almost universally criti-

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[65] Thurwachter, *op. cit.*, p.4

[66] China's Ministry of Foreign Economic Relations and Trade (MOFERT) statistics indicate passenger car imports from Japan fell from 17,454 in 1985 to 844 in 1986, and to only 145 in 1989. These figures, somewhat incompatible with those from the *China Automotive Industry Yearbook* cited above, are most likely too low. See *Almanac of China's Foreign Economic Relations and Trade*, Hong Kong, China Resources Trade Consultancy Co., Ltd., 1987 to 1990 editions

[67] Isuzu, however, has had a successful joint venture producing light trucks in Beijing. See Thurwachter, *op. cit.*, p.11

cized Japan for its unwillingness to part with the advanced technology needed to found such a large-scale joint project, noting the Japanese may have feared competition from China for export markets, and, in any case, much preferred to reap the greater profits of assembled vehicle sales to China.[68] One Toyota assembly operation in Guangdong to build Dina light pickup trucks, for example, stopped after 2000 vehicles had been manufactured, reportedly because Toyota refused to cooperate beyond simple kit assembly.[69] A Shanghai official who had been rebuffed by Toyota in 1983 commented "I told Toyota that after several years have passed, you will not see any Toyotas in Shanghai - only VWs."[70]

The only significant Japanese passenger car cooperative venture has been between Daihatsu and Tianjin Automotive Industrial Corporation. The venture was a technology licensing agreement, signed in November, 1986, for a 7-year term. The Chinese soon began producing the small Charade Diesel model car, and by 1991 annual production had reached 10,000 vehicles, with some 40 percent of the parts made in China.[71] In 1988, the factory was named one of China's "Little Three" manufacturers. Tianjin workers also received training in Japan, as part of the initial contract.

In spite of the Tianjin factory, however, the Japanese remain minor players in the Chinese effort to foster an indigenous passenger car production ability, a result of their reluctance to share technology on any significant scale. The most recent 1990 joint venture car project agreements to produce vehicles in Hubei and Changchun were both signed with European investors, indicating the Japanese still lack an interest in playing any major role in China's small car industrial development.

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[68] Based on several discussions in China, 1989-1990

[69] Thurwachter, *op. cit.*, p.11

[70] *Far Eastern Economic Review*, May 23, 1985, p.75

[71] *Beijing Review*, August 19-28, 1991, p.18

Conclusion

This chapter has outlined the early pendulum-like policy swings of the 1950s and 1960s, illustrating the contradiction between Maoist policies of grass-roots innovation and self reliance, and the pragmatic forces preferring rational industrial development and use of foreign technology. Both sides, however, seemed to recognize the importance of a viable vehicle industry, and the continuous construction of production facilities, and resultant general increases in automotive output over the decades, testifies to this assertion.

With Mao's death, those favoring foreign technology and investment, a rationalized production system, and meaningful passenger car manufacture, seem to have won the day. The precipitous advent of domestic vehicle demand reinforced the pragmtists' calls for such steps. There followed, then, basic agreement on the ultimate goals for the automotive sector.

As the first chapter of this thesis has indicated, however, concurrence on general goals does not necessarily form the basis for coherent bureaucratic action. This chapter has shown that the post-Mao era fostered public debate and a divergence of opinion on the precise path China should take on the way to a healthy passenger car industry. It has also indicated that by allowing foreigners a chance to participate in the country's automotive development, the Chinese had introduced a new element to the equation, one less subject to the central leadership's control.

The case study chapters of this thesis will later focus on the foreign interaction with the more free-thinking bureaucratic structures of the 1980s. Before introducing the cases, however, Chapter Three assesses the substrates on which the foreigners could act, by examining in some detail the most relevant political institutions and actors participating in the automotive industry's reform-era development.

Chapter 3:

Automotive Political Structures and Individual Leaders

This chapter outlines the political actors and institutions that helped determine the foreign-invested automotive climate in the 1980s. It is divided into three sections. First, it looks at the central government structure for regulating the industry, taking a snapshot view of the highest levels (elder leaders, the State Council, and central government commissions) and a more in-depth examination of lower levels (the various machine-building ministries and automotive corporations). This section seeks to gauge central control over the automotive sector, and pinpoint bureaucratic rivalries in regulation of the industry.

The following section focuses on local automotive governmental bodies. What responsibilities are these levels assigned, and how is policy-making power allocated within the municipal unit? Later case study chapters provide further detail, and examine the interaction of the cities with the Beijing leadership. This chapter gives an overview of the four locations (Beijing, Shanghai, Guangzhou and Huizhou) of the ventures under study.

The final part of the chapter provides brief biographies of three leaders closely associated with one or more of the ventures under study. In looking at Chen Zutao, Zhu Rongji, and Zou Jiahua, we ask: how have their personal backgrounds shaped their outlook on automotive policy? Do personal rivalries, institutional loyalties and connections, or private goals color their policy-making efforts? Do what may be thought of as "typical" cadre backgrounds yield the expected political actions? This section, and the later case study chapters, seek to address these questions.

The Automotive Industry and Central Government Structure

Elder Leaders

Over the first fifteen years of China's economic reform era, the top political leadership was dominated by elderly CCP revolutionary leaders. Though generaly lacking formal titles, these officials often functioned as invisible hands to approve broad policy propositions decided at lower bureaucratic levels. The powers and responsibilities of this elite group have been described elsewhere;[1] this section therefore briefly focuses on three elderly leaders closely identified with the automotive sector.[2]

Bo Yibo, born in 1908 and a member of the CCP beginning in 1925, was one of China's top elderly leaders throughout the 1980s and early 1990s. Following stints as Finance Minister and Chairman of the State Construction Commission, Bo was the first director of the new State Economic Commission (SEC), serving from 1956 to 1966; he thereby established a firm base in implementation of economic and industrial policy. After the Cultural Revolution, Bo was Chairman of the State Machine Building Industrial Commission from 1980 to 1982. Though he relinquished many of his posts in the mid-1980s, Bo remained a force in the conservative policy-making camp. As vice chairman of the CCP's Central Advisory Commission, Bo joined other elderly leaders who advocated restraint in economic transformation.

Bo took an active interest in the automotive sector, participating in planning and giving several speeches on the progress of the industry. He expressed some caution in the early 1980s on cooperating with foreign firms, putting self-reliance before full collaboration.[3] A later speech, however, acknowledged trends in reform and

[1] See Kenneth Lieberthal and Michel Oksenberg, *Policy Making in China*, Princeton University Press, Princeton, NJ, 1988, pp.35-41

[2] The following three biographical sketches are based primarily on information found in *Zhongguo dang zheng jun renwu zhi*, (Annals of China's Party, Governmental, and Military Personalities), Wide Angle Press Ltd., Hong Kong, 1989; and in *Who's Who in China*, Foreign Language Press, Beijing, 1989.

[3] See *"Guowu weiyuan Bo Yibo tongzhi zai zhongguo qiche gonye gongsi dongshihui di yici huiyi shang de jiang hua,"* (State Council Member Bo Yibo's Speech at the First China National Automotive Industrial Corporation

decentralization of the automotive industrial structure.[4] Perhaps in part to help him keep a check on automotive policy development beyond his retirement, Bo's son Bo Xiyong took a position as vice president of the China National Automotive Industrial Corporation (CNAIC) in the late 1980s.[5]

A second senior leader, Gu Mu, also reportedly had considerable interest in the automotive sector.[6] Born in 1914 and a CCP member since 1932, Gu was an SEC vice minister under his close ally, Bo Yibo, from 1955 to 1965. Gu was nominal chairman of the State Construction Commission from 1965 to 1970, though he had in fact been purged in 1967. As director of both the State Import and Export Administration and State Foreign Investment Administration in the first post-Mao years, Gu had the opportunity to shape China's "open" policy in the early 1980s. By the end of the decade, though, Gu's highest official post was that of vice chairman of the Chinese People's Political Consultative Conference.

Gu was generally looked on as a conservative leader, one favoring central control and planning, and demonstrating ambivalence about the West.[7] He helped shape the metallurgy and petroleum industries in the early 1980s, and was subsequently embarrassed by the troubles of the expensive Japanese-imported Baoshan steel plant.[8] According to one foreign source, Gu also maintained a particular interest in automotive development, taking a position as manager of the State Council Automobile Leading Small Group (discussed below) in the late 1980s, and thereby had some significant influence in formulating automotive policy.[9]

(CNAIC) Board Meeting) (summarized), in *Zhongguo qiche gongye nianjian*, (Chinese Automotive Industry Yearbook), Jixie gongye chubanshe, Beijing, 1984, pp.3-7

[4] *"Bo Yibo tongzhi zai zhongguo qiche gongye gongsi shou jie wuci ji er jie yici dongshihui shang de jiang hua,"* (Comrade Bo Yibo's Speech at the First Session-Fifth Meeting and Second Session-First Meeting of the CNAIC Board), (summarized), in *Zhongguo qiche gongye nianjian*, (Chinese Automotive Industry Yearbook), Jixie gongye chubanshe, Beijing, 1986, pp.9-10

[5] The CNAIC and Bo Xiyong are discussed in more detail in this chapter and in the following case studies.

[6] For more detail on Gu, see David Lampton, *Paths to Power: Elite Mobility in Contemporary China*, Ann Arbor, University of Michigan, 1986, Chapter Four (on the career of Gu Mu).

[7] See Lampton, *op. cit.*, pp.119, 145

[8] *Ibid.*, p.142

[9] Based on July, 1990 interview in Beijing.

Finally, Ma Hong, though not quite in the top echelons of elderly leaders, also took a notable role in shaping the course of automotive development. Born in 1920, Ma joined the CCP in 1937. He served as secretary general of the State Planning Commission from 1952 to 1954, and was leader of the Policy Research Office of the SEC from 1956 to 1965. During the reform era, Ma took a position as vice chairman of the State Machine-Building Industry Commission, serving under Bo Yibo. In 1988, he was named vice chairman of the National People's Congress's Financial Economic Committee, though his true power base lay in his leadership of the State Council Economic and Technological Development Research Center, a post he acquired in 1985.

Though Ma's political bent was unclear, sources report he took a great technocratic interest in automotive policy making. He apparently held a post in the State Council's Automobile group, working under Gu Mu, and his own research center was a further source of automotive policy making.[10] In a 1987 speech at an automotive strategy conference, Ma demonstrated some detailed knowledge of China's vehicle requirements, calling for an increase in small car production and quality to reduce automotive imports, and advances toward a planned market economy.[11] He praised the reformist leader Zhao Ziyang's policies several times in this address, indicating a more liberal stance toward industrial reform.

Though actions of the above-mentioned leaders are difficult to document, their influence was probably manifested in efforts to curb rapid moves for cooperation with foreign automotive investors. Their age kept them from playing detailed decision-making roles, but their status, power bases built during tenures at industrial-related institutions, and interest in automotive policy made these leaders

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[10] Based on 1990 interview with a foreign source in Beijing.

[11] See Ma Hong, *"Tantao juyou zhongguo tese de qiche gongye fazhan zhanlue,"* (A Discourse on a Development Strategy for China's Distinct Automotive Industry), in *Zhongguo qiche gongye nianjian*, (Chinese Automotive Industry Yearbook), Beijing, Jixie gongye chubanshe, 1988, pp.12-15

part of the anonymous group of top officials whose informal approval was apparently required for major policy initiatives.

The State Council and Commissions

At the top of the central government in the early 1990s lay the State Council, headed by the Premier. The State Council played little day-to-day role in managing the automotive industry, but it did approve large joint venture or WFOE projects, ones in excess of a RMB 200 million investment;[12] automobile ventures typically surpassed this level. The State Council also certified import quotas for motor vehicles, and for disassembled vehicle kits. This duty was assigned the Machinery and Electronics Import Inspection Office, led in 1990 by former Machine Building Industry minister Zhou Jiannan.

Under the State Council came the State Planning Commission (SPC). The SPC was responsible for formulating and carrying out the national economic plan. For the foreign-invested auto industry, this power was of vital importance, as it gave the Commission virtual control over the numbers and types of vehicles factories could produce. The SPC also had to approve joint ventures, and, in most cases, wholly foreign-owned enterprises, or WFOE's (though, as we will see, Panda Motors was able to bypass the need for an SPC chop). Automobile ventures were greatly dependent on the Planning Commission for insuring approval of a constant, reliable supply of raw materials and energy resources.

The SPC had its own set of experts to help formulate its policies toward auto industry development. Under the top ministers lay the Second Comprehensive Industrial Branch; this group's deputy director in 1990, Xu Bingjin, was directly accessible to the foreign auto manufacturers. The automobile department under this branch had approximately 15 staff members.

[12] This figure is valid as of 1989.

The State Economic Commission (SEC) existed throughout most of the 1980s; its task was to implement the plans formulated by the SPC. It was concerned in the middle of the decade with technological improvement, management reform, and rational distribution of raw materials and energy.[13]

Several SEC officials had ties to development of the automobile industry, including Ma Hong (mentioned above), and Rao Bin and Zhu Rongji (described below). In 1988, the SEC was dissolved, with many of its functions going to the SPC and a new Ministry of Materials. In early 1992, however, Zhu Rongji led a movement to reconstitute the SEC; this maneuver is discussed later in the chapter.

Finally, a State Council Automobile Leading Small Group was created in July, 1987, to coordinate national automotive policy. It included representatives of the Planning, Economic, Machinery, and other committees, and the CNAIC.[14] This group, however, apparently ceased to function by 1989 , and it is not clear how much influence it actually held during its brief tenure, though foreign business sources indicate it may have held veto power over major automotive projects.[15]

The Ministerial Level

The next level of bureaucracy (coordinated, but not directly governed, by the SPC) brings us to the ministerial ranks. The most import of these for the automotive industry was the machine-building ministry, which receives in-depth examination below. The discussion is followed by analysis of the China National Automotive Industrial Corporation (CNAIC), subordinate to the machine-building ministry. Finally, we discuss other ministries more peripherally related to the automotive sector.

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[13] See Lieberthal and Oksenberg, *op. cit.*, p.72

[14] *Zhongguo qiche gongye nianjian* (Chinese Automotive Industry Yearbook), *op. cit.*, (1988), p.6.

[15] Based on July, 1990 interview in Beijing.

Machine Building Ministerial Bodies[16]

After the founding of the PRC in 1949, the Ministry of Heavy Industry was the first ministry-level organization supervising machine building; under it came a Bureau of Machinery Industry.[17] In 1952, however, with the cessation of the Korean conflict, the First Ministry of Machine Building (FMMB), which would exist for the next 30 years, took charge of developing civilian machinery production.[18] With Huang Jing as minister (until 1956), the FMMB had bureaus devoted to automobiles, machine tools, ship building, electrical machinery, and other products.

As the new nation turned its attention toward automotive production (detailed in Chapter Two), the ministry formed various automotive production bureaus and offices, outlined in the following section. The FMMB itself, moreover, underwent several transformations over its first decades. In February, 1958, for example, the First Ministry absorbed the Ministry of Electrical Equipment and part of the Second Machine-Building Ministry.[19] By 1966, there were eight machine-building ministries; most of the second through eighth ministries, though, were military-related, and provided little competition with the FMMB.

Control over automotive planning and construction seems to have been tightly controlled at the ministry level until the early 1960s, when experiments in lower level devolution of authority (namely, to the China National Automotive Industrial Corporation, or CNAIC, discussed below) pulled some of the planning powers away from the First Ministry. In 1960, furthermore, the Ministry of Transport took over

[16] Much of the information in this and the following section is based on information found in *Zhongguo de Qiche Gongye* (The Automotive Industry of China; also translated as "The Motor Industry of China"), China Automotive Technology and Research Center, Changchun Wenyi Printing House (for 1986 edition) and Jilin Science and Technology Press (for 1989 edition), pp.14-23 (in 1986 edition) and pp.25-27 (in 1989 edition); and *Dangdai zhongguo de jixie gongye* (China's Current Machinery Industry), Zhongguo shehui kexue chubanshe, Beijing, 1990, part one

[17] See Chu-Yuan Cheng, *The Machine Building Industry in Communist China*, Aldine-Atherton, Chicago, 1971, pp.8-9

[18] The Second Ministry of Machine Building specialized in defense-related production.

[19] Cheng, *op. cit.*, p.11; by the 1960s, however, the Fourth Ministry had taken over the electronics industry. See *Ibid.*, p.120

the functions of production, supply, and sales of auto parts from the FMMB.[20] In 1963, however, the FMMB was granted control over China's motorcycle production. That same year, the ministry regained its authority over parts production from the Transport ministry, indicating the FMMB may have won a small inter-ministerial power struggle.

The chaos of the Cultural Revolution ended such decentralization and realigning trends, as purges at the ministerial level tended to freeze bureaucratic responsibilities. Furthermore, as Chapter Two indicated, planning and development of the automotive industry generally suffered on a broad scale.

As the Cultural Revolution's chaos subsided, the FMMB took up the reigns of automotive planning as best it could. In 1972, for example, it approved a plan for increasing production of Shanghai-brand sedans. The following year, it helped chart the expansion of Jinan's auto factory.[21]

In the post-Mao era of industrial reorganization, China's machine-building ministries were revamped on several occasions. Bo Yibo became chairman of a new State Machine Building Industry Commission in February, 1980; this commission oversaw the various machine-building ministries. In May, 1982, the FMMB merged with the Agricultural Machinery Ministry, the State Instrument and Meter Bureau, and the State Electrical Equipment Bureau to form the Ministry of Machine Building Industry (MMBI).[22] The first minister was Zhou Jiannan; the former FMMB minister, Rao Bin, became board chairman of the CNAIC (this posting is discussed below). The CNAIC itself assumed quasi-ministry level status, though it officially remained under the MMBI.

The MMBI's authority began to diminish with a 1984 State Council proclamation calling for separation of China's political and industrial sectors. Rather than

[20] The Ministry of Commerce also lost some rights in this field.

[21] *Zhongguo de qiche gongye, op. cit.*, p.17

[22] The MBI Commission thereby disbanded.

existing as simple extensions of the bureaucracy, enterprises gained some rights to decide on personnel, product, and profit-sharing policy. The ministry (and the CNAIC, as the following section indicates) thereby lost some powers it had previously enjoyed.

In the wake of this process, MBI minister Zhou Jiannan left his job in November, 1985, and moved to become an advisor to the party's Financial and Economic Leading Small Group.[23] The position of MBI minister then remained vacant for more than a year, a delay probably the result of indecision over further plans to re-organize the machine-building sector.[24] Finally, in December, 1986, the MMBI merged with the Ordinance Ministry, then led by Zou Jiahua, to form a new Commission of Machine Building Industry, which Zou took over as chair.

The decision to create the new commission was engineered by Premier Zhao Ziyang. Zhao wanted to put machine building and military production under one roof, thereby transferring civilian management expertise and orientation to the military's industrial sector.[25]

Changes in the machine-building structure were still unfinished. Little more than a year after the commission was inaugurated, it merged with the Electronics Ministry (in April, 1988) to become the Ministry of Machine-building and Electronics Industry (MMEI). Again, Zou Jiahua took the minister's post, which he held until his promotion to the State Planning Commission chairmanship one year later. Zou's long-time deputy and reported ally, He Guangyuan, took over the top spot at the MMEI.

By 1990, the MMEI had regained a fairly strong grip on the CNAIC. The ministry had the power to approve the appointment of the CNAIC leadership, as the

[23] See 1987 *China Directory*. Tokyo, Radiopress, 1986, p.28. By 1990, as noted above, Zhou was head of the State Council's Machinery and Electronics Import Inspection Office.

[24] Two new vice ministers, however, arrived in December, 1985, to aid leading MBI vice minister He Guangyuan.

[25] *China Aktuell* (Topical China), December, 1986, p.763

corporation's chairman merely held vice-ministerial ranking. Furthermore, the CNAIC approached the State Council and SPC only through its superior ministry. The MMEI also had control over allocation of raw materials among industries (including that of automobiles) under its jurisdiction, and over investment in these industries.

In the early years of China's machine-building ministerial development, then, the automotive industry was subject to some rivalry between ministries, as the challenge from the Transport Ministry in the 1960s shows. The creation of the CNAIC in 1964 represented a power play from below (though it was instigated from Liu Shaoqi and other top leaders above). As the following section indicates, the Cultural Revolution delayed the development of the semi-independent automotive entity, and a reconstituted CNAIC saw a steady decline of its authority in the 1980s. Over the same decade, however, the machine-building ministerial entities gathered increasing powers, eventually virtually reabsorbing the CNAIC, and thereby reasserting their claim to guiding automotive industrial advances.

The CNAIC

The first embodiment of an automotive-specific government entity appeared in 1950 as a "preparatory office for motor industry" under the Ministry of Heavy Industry. Its earliest guidance came from Soviet experts. In 1953, the office became the "Automotive Industry Administration Bureau," also known as the Sixth Bureau under the FMMB.

By 1958, the Bureau was responsible for regulation of such items as automobile model number coding; the superior ministry, however, retained powers including the choice of actual models that factories would produce. In 1964, however, at the suggestion of China's president Liu Shaoqi, an experimental automotive trust emerged, taking the title of China National Automotive Industrial Corporation

(CNAIC). The new entity was to be superior to the main auto producing factories, including those in Changchun, Beijing, Nanjing, Chongqing, and Wuhan. In all, the CNAIC governed some 75 industrial plants.

The CNAIC gained further momentum as the State Economic Commission, apparently with the blessing of the FMMB, ratified the plan for an experimental automotive trust.[26] In 1965, then, the CNAIC took a leadership role in planning the Second Auto Works factory in Hubei.

The CNAIC experiment coincided with (though did not necessarily inspire) great automotive industrial advances. From 1964 to 1965, automotive total output value rose 69 percent, personal productivity 61 percent, and automotive output 64 percent.[27]

With the purge of technical experts during the Cultural Revolution, the CNAIC was accused of being a "revisionist roader organization," and was eliminated.[28] Its functions were apparently re-absorbed (in name, anyway) by the FMMB. As Chapter Two indicated, however, automotive planning evaporated, leaving each small industrial sector isolated and uncoordinated.

Following Mao's death in 1976, pragmatic reformers moved to revive the earlier goal of coordinated automotive production. In 1980, then, the State Machinery Industry Commission promulgated a scheme for reorganizing the automotive industry; two years later, the State Council re-established the CNAIC in Beijing.

As noted above, the first post-Mao CNAIC director was Rao Bin. Rao, known as the "Father of China's Auto Industry," had been an important figure in the PRC's early years, serving as mayor of Harbin in 1949, secretary of Songjiang province from 1950 to 1954, and a vice chairman of the State Economic Commission in the early 1960s. He was also one of the founding managers of Changchun's First Auto

[26] The CNAIC thereby took over the functions of the Sixth Bureau, which was then abolished.

[27] *Dangdai zhongguo de jixie gongye, op. cit.*, p.46

[28] *Ibid.*, p.432

Works.

Rao, unlike other early machine-building leaders, apparently received no formal education in the Soviet Union. His work in building both the First and Second Auto Works, however, gave him a stature among auto leaders others found difficult to match.

Rao's attitude toward post-reform automotive development was generally conservative. In a 1985 speech, for example, he put little emphasis on the role of foreign cooperation in improving product quality and reliability, even though three major joint ventures (described in Chapters 4-6) had already been established. A later talk emphasized the need for substituting Chinese-made auto parts for imported parts, though Rao did mention the need for technical cooperation with foreign manufacturers through joint production.[29] One source noted Rao and Zhao Ziyang feuded over decentralization policies, with Rao fearing loss of central control over the industry's development[30] (a fear realized in the late 1980s, as discussed below).

CNAIC's reincarnation, however, seemingly brought it some significant potential tools to mold the industry. The corporation's charter gave it the responsibility of planning output according to national goals, and modernizing management and production processes.[31] The CNAIC also became the leader of several "associated companies," including the FAW in Changchun, SAW in Hubei, and factories in Beijing, Tianjin, Shanghai, Jinan, Chongqing, and other cities.[32] As indicated in Chapter Two, however, these companies were accustomed to self-reliance, and resisted

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[28] *"Rao Bin tongzhi zai zhongguo qiche gongye gongsi shou jie wuci ji er jie yici dongshihui shang de jiang hua,"* (Comrade Rao Bin's Speech at the First Session-Fifth Meeting and Second Session-First Meeting of the CNAIC Board), (summarized), in *Zhongguo qiche gongye nianjian,* (Chinese Automotive Industry Yearbook), *op. cit.,* 1986, pp.13-15

[29] *"Rao Bin tongzhi zai zhongguo qiche gongye fazhan zhanlue taolunhui shang de jianghua,"* (Comrade Rao Bin's Speech at the Chinese Automotive Industry Development Strategy Conference), in *Zhongguo qiche gongye nianjian, (Chinese Automotive Industry Yearbook),* op. cit., 1988, pp.16-20

[30] Based on 1991 interview in Beijing

[31] See *"Zhongguo qiche gongye gongsi zhangcheng"* ("The CNAIC Constitution") in *Zhongguo qiche gongye nianjian, (Chinese Automotive Industry Yearbook),* op. cit., 1984, pp.55-57

[32] For more detail on some of these factories, see Martin Weil, "Overhauling the Automotive Industry," in *The China Business Review,* July-August, 1986, pp.28-33

attempts at CNAIC coordination.

At its founding, in fact, the CNAIC had difficulty in establishing its authority. The corporation's budget was small, and the central government generally favored large infrastructural projects over machine building. Furthermore, the CNAIC received little profit from vehicle sales, as local governments reaped most of the factory incomes.[33] As a partner in the 1985 Shanghai Volkswagen venture, however, the CNAIC sought a steady, and perhaps increasing, supply of foreign exchange.

CNAIC's planning powers were further challenged in the mid-1980s. Though it could veto projects, CNAIC depended on local governments and factories to push through the corporation's own plans.[34] CNAIC also fought battles with the Machine Building ministry over the right to control automotive foreign trade.[35] Eventually, much of this power went to the Ministry of Foreign Economic Relations and Trade's (MOFERT's) machinery import-export branch, MACHIMPEX.[36] (The CNAIC, however, maintained its own import-export entity, the China National Automotive Industry Import Export Corporation (CAIEC). The division of labor with MOFERT became unclear, though MACHIMPEX reportedly was the dominant force).[37]

As the automotive industry received growing attention in the middle and latter 1980s (see Chapter Two), the powers of the CNAIC paradoxically declined. This development was the result of several factors: First, as noted above, the central government instituted a program of general de-centralization. Those enterprises taking part in joint ventures, in particular, felt a greater degree of independence from

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[33] *Ibid.*, p.32

[34] *Ibid.*, p.32

[35] Christopher Clarke, "Decentralization," in *The China Business Review*, March-April, 1984, p.9

[36] Based on 1990 interview in Beijing.

[37] Kenneth Lieberthal, *et. al.*, *US-China Automotive Industry Cooperation Project*, The University of Michigan, 1989, Volume 1, Section 3, p.34.

Beijing, as they had foreign partners providing a source of hard currency and planning expertise. By 1986, the CNAIC could regulate only the FAW, SAW, factories in Nanjing and Jinan, and auto parts manufacturers.[38]

A further reason for CNAIC's decline was the fall in leadership quality. As noted, Rao Bin had brought immediate prestige to the CNAIC in its early years of reincarnation. Rao stepped down as board chairman in July, 1985,[39] and was replaced by Li Gang, who had been CNAIC general manager. Li gave up his general manager's position, however, in September, 1985, to CNAIC chief engineer Chen Zutao, who assumed the actual leadership of the CNAIC.

Chen, described in more detail in the following biographical section, lacked the revolutionary credentials and administrative skills of Rao. He tried to instill his ideas of large-scale production and Soviet-style central control at the height of the decentralization movement. The tide of reform ran against Chen, and he apparently lacked the power to resist.

In 1987, then, the CNAIC reached the nadir of its influence: it lost its power as a "corporation," *(zonggongsi)* and became simply a much looser "association" *(lianhehui)* of the nation's automotive manufacturers.[40] As an association, the CNAIC became a body that merely gave advice; it lacked the authority to make final policy decisions, such as those related to technology import, quality control, and domestic sales.

The resulting power vacuum led to some chaos among the automotive factories. As mentioned in Chapter Two, for example, many small companies scattered around China produced limited numbers of vehicles, in quantities representing diseconomies of scale. All of these companies hoped to survive and continue to make profits, of course, and therefore many spent scarce hard currency on foreign technology license

[38] Based on 1991 interview in Beijing.

[39] Rao subsequently died in August, 1987.

[40] The company retained, however, its English acronym "CNAIC."

agreements, contracts the CNAIC could no longer veto. The result was a spate of inefficient factories, purchasing exactly the same technology, with little benefit for the expenditure.

To rectify such problems, the State Council attempted in early 1990 to restore the preeminence of the CNAIC. In February, it was again made a corporation, and, on paper, it had the power to prevent technology duplication, decide on the types of vehicles to produce, and other functions. In fact, however, it found the current of decentralization too strong to resist, and, as of early 1991, had actually regained few of the powers it enjoyed in the early 1980s.[41]

At this critical juncture, the organization's leadership did little to enhance the CNAIC's position. When Chen Zutao retired in 1988, his successor, Cai Shiqing, was reportedly hand picked by the SPC chairman and concurrent Machinery and Electronics Industry minister, Zou Jiahua. Cai was characterized as a very passive figure, one with little backbone.[42] Even with central attempts to reign in automotive production, then, the CNAIC leadership seemed incapable of response.

Perhaps the CNAIC's major problem over its early history was the reluctance of the top leadership to pursue the automotive industry's development. Not until 1964 did an automotive corporation emerge, and it was quickly snuffed out. Following its rebirth in 1982, the organization seemed to have a good chance to assert itself, with a clear mandate and influential leader.

The retirement of Rao Bin, national decentralization, and the general absence of an automotive advocate in the top leadership levels, however, made the CNAIC's development prospects dim. During the first decade of reform politics, then, the CNAIC saw its authority gradually erode, as it surrendered its powers to local-level factories, and, as the case study chapters will show, played a diminishing role in

[41] Based on 1991 interview.

[42] From 1991 interview.

regulating the joint venture companies.

Though strong leadership at the helm of the CNAIC would probably not have greatly affected the course of events, the downward-sloping quality of Rao Bin's successors may have accelerated the corporation's decline. Finally, though it had struggled for many years to establish some independence from the various superior machine-building ministries, the appointment of Zou Jiahua's ally as CNAIC chief indicated the corporation would closely follow ministerial policy (and that of Zou, reportedly a proponent of rail transport) for at least the first years of the 1990s.

Other Ministries

Though the machine-building ministry and CNAIC took the lead in shaping automotive development and policy, many other ministries naturally had peripheral functions. The following two played prominent roles in shaping the joint venture automotive corporations discussed in the case study chapters:

MOFERT was responsible for considering and approving all joint venture contracts involving the use of foreign capital. After a contract was certified, MOFERT generally did not take part in regulating a joint venture. The ministry did, however, take an interest in insuring that foreign exchange would be balanced by the companies it approved. As later case study chapters will show, MOFERT felt some responsibility for such a balance.

The Ministry of Aeronautics and Astronautics (MAAS) was interested in the passenger car industry mainly as a market for its civilian industrial parts producing factories. The MAAS became determined to make sales to the auto industry particularly during the late 1980s, as cuts in military manufacturing hurt the ministry's ability to fill its coffers. MAAS played a significant part in the progress of Panda Motors (Chapter Seven).

The following case study chapters will provide empirical evidence of the role the above institutions took in developing the foreign-invested automotive sector. Before moving on to that discussion, however, we briefly examine local political industrial bodies.

The Automotive Industry and Local Government Structure[43]

At the top of the municipal structure, the mayor had potentially the most power in directing the course of such a capital intensive industry as auto manufacturing.[44] Mayoral participation in this sector, however, varied. In the early 1990s, Beijing mayor Chen Xitong (who was also a State Councillor at the national level) simply had too much on his political plate to take time to direct the industry's development in his city, but mayors of Shanghai, Guangzhou, and Huizhou took an active interest in automotive development within their jurisdictions. Of course, with their many other duties, the amount of time they could devote was limited. They concentrated on major decisions, such as the creation of new ventures, significant restructuring of existing projects, and mediation of serious problems the enterprises encountered.

In addition to the role played by city mayors, each city had delegated one or more vice mayors to put the auto industry into their portfolios. By the late 1980s, Beijing vice mayors Zhang Jianmin and Wu Yi had absorbed municipal authority over their city's automotive development. Guangzhou's vice mayor in charge of the sector, Xie Shihua, was the board chairman of Guangzhou Peugeot from 1985 to 1987, and Shanghai and Huizhou vice mayors also took special interest in their

[43] As noted above, the following descriptions are pertinent mainly to the large cities capable of supporting joint venture vehicle manufacturers. The information in this section, therefore, is not necessarily applicable to smaller municipalities that also had automotive output.

[44] Of course, each municipality under study here also had a local Communist Party hierarchy; information gathered during interviews, however, indicated that day-to-day management and planning in the automotive arena generally was reserved for the political and bureaucratic structures. In the case of Shanghai, the mayor (Zhu Rongji) was simultaneously party secretary.

cities' auto industries. These vice mayors seemed to have significant power when the mayor was preoccupied with other matters. Zhang Jianmin, for example, helped negotiate the settlement of the Beijing Jeep crisis in 1985. Shanghai's vice mayors fell somewhat in the shadow of that city's more active mayor, Zhu Rongji, though at this writing it was not clear whether the city's new mayor, Huang Ju, or Communist Party leader Wu Bangguo, both of whom served under Zhu for several years, would take such a dominant role.[45] Huizhou's vice mayor Li Hongzhong held extensive authority over his city's Panda project.

Beijing and Shanghai both had automotive leading small groups in 1990, and Guangzhou had plans to establish one. (Huizhou's industry was not extensive enough to warrant such a body). The small groups included one or more vice mayors (and, in Shanghai, the mayor was the symbolic head) and representatives from the cities' economic, planning, and international trade committees, and from their automotive industrial corporations. Beijing's group had 15 people in the fall of 1990, and Shanghai's had about 20. These small groups tried to chart a general course for the local industry, and provide a forum for coordination among the disparate government bodies.

Other municipal committees had various planning and management roles, taken in coordination with the municipal automotive industrial corporations. In general, a planning commission formulated long-term development schemes, and an economic commission carried out these plans. Implementation in the automotive sector consisted of regulating energy allocation, seeing that industrial laws were followed, and other functions. The foreign economic relations commission considered joint venture and other foreign investment projects, but, like MOFERT, played a minor role in implementing the approved project.

The importance of the auto industry was evident by the composition of some of

[45] Huang Ju, however, had been a member of the city's automotive leading small group, discussed below.

these committees. In Shanghai, a vice chairman of the city's economic commission until 1989, Lu Ji'an, was head of the city's automotive corporation in early 1991; Lu's power in the economic commission remained strong, though. In Guangzhou, the board chairman of Guangzhou Peugeot, Xie Gancheng, was concurrently the vice chairman of the machinery and electronics department under the economic committee; he was, by a special mayoral order, the only high-ranking city official allowed from the commercial sector.

In Huizhou, much of the municipal power for regulating the auto industry was vested in a committee-level Economic Construction Leading Group. The group consisted of 40-50 people in late 1990, and was responsible for macro-management of municipal programs related to the Panda company and other projects. A vice manager of the group was devoting almost all of his time to the new auto project.

The powers of automotive industrial groups varied in each city. Their main function was to coordinate the suppliers to the main auto manufacturers in their jurisdiction.[46] The Beijing Automotive Industrial Corporation (BAIC) had relatively loose control over the city's factories, partly because of the fairly large number of producers in the capital. In Shanghai, however, the SAIC had powers to regulate the finances of the city's companies; they depended to a great extent on SAIC for loans, and SAIC decided how much money each factory would receive. The Guangzhou Automotive and Agro-machinery Industrial Corporation (GAAIC) controlled many of Guangzhou's auto parts production and vehicle plants, but it competed with factories under the control of the city's military and transportation committees. Indirectly, GAAIC also competed with parts suppliers in other areas of Guangdong Province.

Finally, Guangdong Province had a special Panda Motor Company Work Group,

[46] One must note, however, that joint ventures had a considerably greater degree of financial and political independence, based on special joint venture laws, than did state-owned companies, in their relations with the automotive industrial groups.

set up directly under the governor's office, to help Panda coordinate itself with the rest of Guangdong Province. In early 1991, this group consisted of 11 people, representing the provincial economic commission, machinery and electronics bureau, and the automotive office. It is noteworthy that there was no such provincial-level group for the Peugeot venture; we discuss the relationship between the Guangzhou venture and Guangdong Province in Chapters Six and Seven.

By the end of the 1980s, Chinese localities had developed extensive regulatory institutions for guiding automotive development. Later case studies will examine their interaction with the foreign-invested corporation under their jurisdiction, and their ability to work with the central government to solve problems. The following section, however, briefly returns to the central level to spotlight three leaders who helped shape automotive policy development.

Automotive Industry Decision-makers: Three Personal Profiles[47]

The following biographical sketches focus on three men closely associated with the automotive industry or related government offices. As Chapter One noted, personal backgrounds and experiences of individual decision-makers can affect the perception of administrative choices, and the rationality of the eventual decision. Furthermore, institutional loyalties and obligations, based in past occupational experiences, can also play a major role in shaping policy selection.

Following are brief biographies of Chen Zutao (already mentioned briefly in Chapter Two and above), Zhu Rongji, and Zou Jiahua. Each played a major role in

[47] The discussions below are based in part on biographies found in several sources, including: *Zhongguo dang zheng jun renwu zhi*, (Annals of China's Party, Governmental, and Military Personalities), *op. cit.; Zhonggong-dangshi Renwu Lu* (Records of CCP Era Personnel), Chongqing, Chongqing Chubanshe, 1986; Wolfgang Bartke, *Who's Who in the People's Republic of China*, second edition, K.G. Sauer, 1987; and *Who's Who in China*, Beijing, Foreign Language Press, 1989. For Zhu Rongji, see also *Tan Suo* magazine (also titled *The Quest*), August, 1991, pp.77-79; on Zou Jiahua, see *Tansuo*, December, 1989, pp. 69-70. Most of the information on Chen Zutao is based on interviews.

the development of one or more of the joint venture case studies discussed in Chapters Four through Seven; these latter chapters give further detail on their policy-making roles.

Chen Zutao

Chen Zutao was born January 20, 1928, in Hubei province. He was the son of Chen Changhao (1906-1967), a high-ranking military-revolutionary figure during the 1930s.[48] Chen's early years were significantly affected by his father's career. The elder Chen left for study in the Soviet Union in December, 1927, one month before his son's birth. One of the Soviet-trained "Twenty-eight" Bolsheviks who later clashed with Mao Zedong, Chen Changhao studied at Moscow's Sun Yatsen University for more than two years. His son most likely remained in China during this period.

Chen Changhao returned to his home nation in 1931, and took up a military post as political commissar in the communist New Fourth Army, serving under Xu Xiangqian and Ye Jianying. Chen Changhao took part in the 1934 to 1935 Long March, though it is unlikely his son was present.[49] Following the elder Chen's alliance with the rebel communist Zhang Guotao, Chen Changhao, in some disgrace, left for the Soviet Union in August, 1939 (officially going for medical treatment), where he remained until returning to China in 1952.

Chen Zutao reportedly spent part of his childhood in Yan'an, thereby acquiring the moniker *"hongxiaogui,"* (young revolutionary).[50] With his father's departure,

[48] The identity of Chen Zutao's mother is unclear. Harrison Salisbury reported Chen Changhao was married to former textile vice minister Zhang Qinqiu (1904-1968) in the mid-1930s; she died, however, during the Cultural Revolution, and sources interviewed in 1990 indicated Chen Zutao's biological mother was still alive. She was most likely, then, an earlier wife of Chen Changhao. (For Salisbury's account, see his *The Long March*, New York, Harper and Row, 1985, p.151).

[49] As Chen Changhao's apparent second wife, Zhang Qinqiu, took part in the Long March, Chen Zutao's mother may have been left in central China to raise the young boy.

[50] One source reports Chen, like Li Peng, was personally raised by Zhou Enlai and his wife Deng Yingchao (see Jim Mann, *Beijing Jeep*, New York, Simon and Schuster, 1989, p.284). Chen's later problems during the Cultural Revolution, however, cast some doubt on the assertion of such close ties to Zhou.

however, Chen left China, spending his high school years in the USSR.

It is unclear whether Chen Zutao returned to China at or before the communist victory in 1949, but, in any case, by 1950 he had begun advanced study at Moscow's Bauman Engineering Institute, where he remained until about 1953. He acquired part of his practical training at the Stalin Automobile Factory.[51] During these years abroad, Chen had a chance to interact with Li Peng, then the leader of the Chinese student association in the USSR.

On his return to China, Chen took a post at Changchun's First Auto Works, becoming a vice chief engineer in the early 1960s. He stayed in Changchun until 1967, when he was sent to the countryside at the beginning of the Cultural Revolution. By 1969, however, he had resumed work as a senior official at the Second Auto Works in Hubei. In May, 1982, Chen was picked to be chief engineer at the newly reconstituted China National Automotive Industrial Corporation, and in September, 1985, he became CNAIC general manager, a post he held for three years.

As Chapters Four, Five, and Seven point out, Chen played a significant role in shaping the development of foreign-funded automotive projects. Chapter Two already noted his interest in expanding the number of foreign-invested factories and foreign loans, and in increased automotive exports. Later chapters chronicle his actual intervention in the resultant ventures.

During his tenure at CNAIC, Chen further became known for his deep admiration of General Motors. One source noted Chen favored the company because of its size and management abilities; another source said that, to Chen, GM was like a "beautiful American girl," one which the Chinese automotive industry should court. Other sources report GM shared some personal interest in Chen, sponsoring one of his sons to study in the United States. For all of the "romance" with General Motors, however, the company failed to establish a joint venture car manufacturing

[51] This was the same place future CCP general secretary Jiang Zemin received instruction in 1955.

plant in China during Chen's tenure.[52]

Chen's exit from the CNAIC paralleled the rise to prominence of Zou Jiahua, discussed below. In 1988, Chen, at age 60, retired from his CNAIC positions, though it is unclear whether he left willingly. Many sources note a personal enmity between Chen and Zou, who became the head of the SPC virtually simultaneously with Chen's removal.

Though he left the CNAIC, Chen's affiliation with the auto industry was by no means finished. He was, first, given the somewhat symbolic post as a Standing Commissioner of the State Science and Technology Commission.[53] Soon, however, Chen took an assignment as advisor to Guangdong Province on matters related to Panda Motors (a position described in more detail in Chapter Seven). Meanwhile, Chen's son also solidified ties to the automotive industry in the early 1990s, holding a managerial job at the Second Auto Works.

Chen generally fit the description of a conservative, Soviet-educated cadre, suspicious of ties to the West. He was, however, eager to enhance his own status, and advance the career of his offspring.

As later chapters will show, Chen's personal ties to Li Peng, and animosity toward Zou Jiahua, played significant roles in shaping at least one of the cases under study. The blemishes on the career of his father, Chen Changhao, however, seem to have had little ill effect on Chen Zutao's rise to prominence in the 1980s, perhaps indicating that such negative stigmas are not necessarily inherited.

Zhu Rongji

Zhu Rongji, a native of Hunan's provincial capital, Changsha, was born in 1929.

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[52] GM did, however, sign an agreement in 1988 with a Beijing engine plant to produce two-liter gasoline engines.

[53] The Commission, led by State Councillor Song Jian, may have gained added importance in late 1991 when Deng Nan, one of Deng Xiaoping's daughters, joined it as a vice minister.

Zhu's parents were poor, and they died when he was still young. Zhu raised himself, however, and funded his own high school education through scholarships.

In 1947, Zhu entered Qinghua University, and immediately took an active role in student politics. He became head of the university's student union, and joined the Chinese Communist Party in October, 1949, as PLA troops marched into Beijing.

In 1951, Zhu graduated from Qinghua with a degree in electrical motor engineering, and was named deputy chief of the Product Planning Section in the Planning office of the Industrial Department under the Northeast China People's government. The following year, he assumed the post of deputy division chief of the newly-established State Planning Commission.

In spite of his early success, a brief speech critical of some elements of the communist system caught Zhu in China's anti-rightest campaign of 1957. He was expelled from the CCP and demoted. During the Cultural Revolution, he was sent to the countryside for five years of labor.

Zhu began his rehabilitation in 1975, when he was made a deputy chief engineer in a company regulated by the Petroleum Ministry. After the third plenum of the 11th CCP Congress in 1978, Zhu was completely exonerated, with the support of his former superior at the State Economic Commission, Ma Hong, and assigned in 1979 to be a deputy bureau director at the SEC. In 1982, he was named director of the Technical Transformation Bureau under the State Economic Commission, and the following year was promoted to be an SEC vice minister. That year, Zhu edited a book advocating modernization of China's economic managerial practices based on Western theories.[54]

In March of 1984, Zhu led an economic delegation to Hungary, Czechoslovakia, and other East European socialist states. Later that year, he became vice president of

[54] See Zhu Rongji, ed., *Guanli xiandaihua*, (Management Modernization), Beijing, Kexue puji chubanshe, 1983; one section of the text analyzes General Motors, pointing out features of its large corporate management structure (see pp. 61-68).

China's Industrial Economics Society. In January of 1986, Zhu led another delegation abroad, this time to France and West Germany; he evolved into one of China's top officials charged with attracting Western investment.

Chapter Four of this thesis discusses in some detail Zhu's work in helping the Beijing Jeep venture resolve its crisis of early 1986. By early 1987, however, Zhu was headed to Shanghai, where he became deputy party secretary, serving under Jiang Zemin. In November, 1987, Zhu was promoted to alternative CCP Central Committee membership.

Zhu became mayor of Shanghai in April, 1988 (even though he could not speak the Shanghai dialect).[55] He succeeded Jiang Zemin, who retained his post as the city's party secretary. When Jiang left to become general secretary of the national CCP, Zhu became simultaneously party chief and mayor of Shanghai, imitating Jiang, who briefly held both posts from November, 1987 to April, 1988.

Zhu soon developed an enthusiastic following in Shanghai among foreign business people, and particularly among Volkswagen investors, as Chapter Five demonstrates. He formed a municipal commission empowered to quickly approve foreign investments of up to US$30 million; foreigners, pleased with the opportunity to avoid the need for many signatures, dubbed the commission the "one-chop stop."[56] Zhu also created a committee of foreign businessmen to offer the city special counsel.[57]

During Shanghai's protests in the wake of the June, 1989 Tiananmen massacre, Zhu avoided polemics in appealing for calm in his city. He refrained from calling in the military, instead using civil servants to end demonstrations. Zhu also promoted economic modernization as a solution for China's social problems; his program to

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[55] "I can't speak the Shanghai dialect, but I can understand what Shanghai people are saying," he told the local press on assuming the office. See *The Wall Street Journal*, November 22, 1988, p.A10

[56] *The Wall Street Journal*, November 22, 1988, p.A10

[57] *New York Times*, November 5, 1989, p.21

develop East Shanghai (the Pudong area) using foreign investment was key to his local strategy.

In July, 1990, Zhu led a mayors delegation to the United States; his trip represented one of the first high-level delegations to visit the US after the 1989 Tiananmen events. By this time, foreign press reports had begun to call him "China's Gorbachev," comparing him to the Soviet Union's reformist leader.[58] Zhu was later promoted to vice premier, along with Zou Jiahua, in April, 1991, apparently at the insistence of paramount leader Deng Xiaoping.

In late 1991, Zhu made a further bid for power, as he used his position as chief of the State Council Production Office to promulgate further reforms. In this capacity, Zhu wanted to see, for example, conglomeration of state enterprises, implementation of bankruptcy laws, reduced stockpiles of un-marketable goods, and higher quality standards in the passenger airline industry.

The Production Office, introduced in early 1991, assumed many of the powers of Zhu's former State Economic Commission. As noted above, the SEC was partly absorbed into the SPC in April, 1988; as of late 1991, the Production Office was struggling to regain the powers previously held by the SEC. One report predicted it would soon assume status as a commission-level agency.[59]

Zhu represented a rare political breed in the top post-Mao echelons of the government, as the only victim of the 1957 anti-rightest movement to be elevated to the vice premier level. He was also expelled from the Communist Party in 1957; purge victims of the Cultural Revolution (including such top figures as Deng Xiaoping and others) typically retained their party membership. This made Zhu's later rise to power even more striking. Furthermore, unlike other top leaders of his age, Zhu received no education in Eastern Europe.[60] Finally, Zhu's lack of familial or pre-

[58] Zhu shunned the term, commenting that "if I were the Gorbachev of China I'd be in a lot of trouble now." See *Asiaweek*, April 26, 1991, p.36

[59] *South China Morning Post*, November 5, 1991, Business p.3

[60] Premier Li Peng, one year older than Zhu, spent seven years in the USSR, as did vice premier Zou Jiahua;

1949 revolutionary connections makes his rapid ascension in the 1980s almost unbelievable.

In general, Zhu's basic orientation was Western-looking. He spoke fluent English, and one of his sons was a university student in Wisconsin.[61] (Many other top leaders, of course, also had children studying in the U.S.).

Zhu's rather unique background, then, placed him in the forefront of the liberal economic reformers. Chapters Four and Five focus more closely on his activities in the middle and late 1980s.

In conclusion, however, one should note Zhu's activism in the early 1990s was generally confined to the economic arena. Perhaps sensing the problems inherent in the type of political reform promoted by former CCP chief Hu Yaobang, and that applied by Soviet President Mikhail Gorbachev, Zhu's efforts focused on continuing and expanding economic liberalization. His power base, moreover, lay more in the government and in connections to elder leaders, rather than in the party or military. With the incipient leadership changes of the 1990s, however, Zhu stood as a possible heir to the highest levers of control, ones that could have potentially presented him the ability to significantly reorganize China's political apparatus.

Finally, as the case study chapters will indicate, Zhu favored foreign-funded automotive development in the few chances he had to influence the industry's progress. Earlier discussion noted the industry had few powerful advocates devoted to foreign cooperation among the top leadership in the late 1980s and early 1990s; with his record of supporting Beijing Jeep and Shanghai Volkswagen, and western ventures in general, Zhu stood to be a useful ally for the rapidly growing foreign-invested automotive ventures.

Jiang Zemin studied one year as a trainee in Moscow, and Politburo member Li Tieying spent six years in Czechoslovakia in the 1950s.

[61] *New York Times*, November 5, 1989, p.21

Zou Jiahua

Zou Jiahua was born in October, 1926, in Shanghai, the son of revolutionary journalist and publisher Zou Taofen (1895-1944). He was one of three children born to Zou Taofen's second wife, Shen Cuizhen.[62]

There is little history of Zou's childhood years, though his father spent most of the pre-World War Two years in Shanghai, criticizing the KMT government for failing to counter Japanese expansionism. With the outbreak of war, Zou Taofen traveled to various parts of China (including a brief residence in Hong Kong) before settling in Communist-controlled northern Jiangsu in November, 1942, where he was welcomed by the New Fourth Army.[63] Though the elder Zou soon left for surreptitious medical care in Japanese-controlled Shanghai (where he died in 1944), Zou Jiahua remained in the CCP guerrilla area.

The younger Zou launched his own career in 1944, studying in the Finance and Economic department at the New Fourth Army's Huadong Construction University in the Huainan base area. He joined the CCP in 1945, and took a post in the construction section of the industry and commerce office under the Shandong provincial people's government.

Zou spent the rest of the civil war years in Northeast China, taking various party posts in Songjiang Province. In 1948, he attended Russian classes at Harbin's industrial university, and moved on to Moscow (in a group that included future premier Li Peng) to study mechanical engineering at the Bauman Engineering Institute.[64]

On returning from the Soviet Union in 1955, Zou held a variety of factory posts, including the directorship of Shenyang's Number Two Machine Tool Factory, and

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[62] Zou's younger brother, Zou Jingmeng, later became a director of China's Meteorological Bureau, and an alternate CCP Central Committee member. Nothing is known of Zou's (probably younger) sister.

[63] See *Biographical Dictionary of Republican China*, Howard Boorman, editor, New York, Columbia University Press, 1970, pp.319-321 for further detail on Zou Taofen.

[64] Chen Zutao also studied at the Bauman Institute, and most likely knew Zou at this time.

delegation chief engineer of the Northeast Electric Power Administration. From 1964 to 1966, he was head of the Number One Ministry of Machinery's research institute. With the start of the Cultural Revolution, however, Zou was sent to the countryside to labor.

In 1972, Zou was rehabilitated, taking the job of deputy director of the Machinery research institute's revolutionary committee. The following year, he was named deputy director of the State Council's Defense Industrial Office. In 1974, he took a further military-related role as a cadre of the PLA Science and Technology Commission for National Defense.

Zou's status rose quickly with the post-Mao rehabilitation of pragmatic leaders, as he was elected an alternate member of the CCP Central Committee in August, 1977. From 1982 to 1985, he served as vice minister of the Commission of Science, Technology, and Industry for National Defense. Zou was Minister of Ordinance Industry from mid-1985 to December, 1986, when that ministry merged with the Ministry of Machine Building to form the Commission of Machine Building Industry; Zou became commission chairman. In April, 1988, Zou was appointed head of the new Ministry of Machine Building and Electronics Industry (MMEI); that year he also was named a State Councillor.

The latter years of the 1980s saw further leaps for Zou's career. He became a CCP Central Committee member in 1985, his top party post as of late 1991. In December, 1989, Zou took the chairmanship of the State Planning Commission from a frail Yao Yilin, and in the spring of 1991, he was elevated with Zhu Rongji to a vice-premiership. Unlike Zhu, who lost his position of power in Shanghai, Zou was allowed to keep his top job at the SPC.

In late 1991, the Chinese leadership felt Zou, like Zhu Rongji, presented a friendly face to foreign nations, and he was sent to Germany in October of that year as China's highest-level envoy to visit since June of 1989. Led by Volkswagen's

automotive ventures, Germany's foreign investment in China topped that of all other European nations.

Zou's career presents many close parallels to that of Premier Li Peng. Like Li, two years his junior, Zou was the son of a famous revolutionary, and spent part of his youth in the CCP guerrilla base areas.[65] Both studied engineering in Moscow over the years 1948 to 1955, when they undoubtedly became well acquainted. During the Cultural Revolution, however, Li's close personal ties to Premier Zhou Enlai saved him from persecution; Zou was not so lucky, even though his wife, Ye Chumei, was the daughter of the late marshal Ye Jianying (one of the few top leaders not purged during the turmoil of the late 1960s).

Considering Zou's background, one might assume he would hold political views similar to those of Li or Chen Zutao (discussed above). In the aftermath of the 1989 Tiananmen massacre, however, Zou apparently said little to support the prevailing hard-line policy.[66] Chapter Seven of this dissertation, moreover, shows Zou's clear split with Li and Chen over the approval of Panda Motors, and reveals further insight into his attitude toward cooperation with foreign investors.

In general, Zou supported development of the foreign-funded automotive sector in the 1980s and early 1990s, making publicized visits to Shanghai Volkswagen, Beijing Jeep, and Guangzhou Peugeot. Some sources, however, reported Zou had doubts about the feasibility of Chinese automotive development, favoring instead the railway system for freight and passenger transport.[67]

Zou's elevation in 1991 to the vice premiership simultaneously with Zhu Rongji prompted some comparisons. Zou's generally centrist policies, and his more extensive connections to the military, the CCP, and the powerful SPC, together with his

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[65] Li Peng's father, Li Suoxin, was killed by the Chinese Nationalists in 1931; Zhou Enlai adopted Li Peng and helped raise him at the Yan'an base camp.

[66] *Asiaweek*, April 26, 1991, p.34

[67] Based on 1990 interviews in China.

notable family ties (his wife and late father) gave him a much broader power base than that of Zhu. Zou, however, seemed to lack the type of reformist vision found in Zhu's economic policies; were Zhu to succeed in strengthening China's economic system, his resultant prestige might make him a formidable rival even for the well-positioned Zou.

Conclusion

This chapter has analyzed the bureaucratic institutions that constitute China's automotive policy-making framework. By understanding the history and hierarchy of the most important offices and leaders, we can now look to the case study chapters for evidence of policy-process problems predicted in the introductory chapter's model.

Based on the information in this chapter, then, one might expect to see, for example, conflict among top leaders or commissions and the subordinate ministries; competition between the machine-building ministry and its subordinate CNAIC; or disagreement among central policy-makers and local automotive structures. Several personality clashes, based on backgrounds described here, may influence policy formulation and implementation; personal backgrounds could also indicate the tenor of relations with foreign automotive investors.

The following chapters offer empirical evidence to test the policy-process model, based on this chapter's institutional descriptions. Chapter Four, on Beijing Jeep, describes China's first automotive joint venture.

Chapter 4:

Beijing Jeep's Bumpy Road

As the first Sino-foreign automotive joint venture, the Beijing Jeep Corporation stood to be a prototype for future cooperative projects. The company would be a test case, one which would reveal the kinds of problems, both political and economic, that would appear for other investors the Chinese hoped to attract.

Beijing Jeep, however, did not always shine as a model for other foreign firms eying the Chinese automotive sector. The company was plagued by early problems, some of which threatened to extinguish the nascent venture. After a significant crisis and confrontation in 1986, though, BJC skillfully capitalized on conditions in the Chinese political and investment environment to help assure the venture's continued progress for the next several years.

This chapter, like the following case studies, is framed in the theoretical context outlined in Chapter One. It begins with the early history of the automotive company.

Jeep Talks

The spark for the Jeep venture came on a day in 1978, when the Chinese-American businessman C.B. Sung was lecturing to officials of the First Ministry of Machine Building.[1] Representatives of the Beijing Automotive Works (BAW)

[1] For more detail on the early history of the venture, see the comprehensive study *Beijing Jeep*, by Jim Mann, New York, Simon and Schuster, 1989.

Mann, a reporter for the *Los Angeles Times*, bases his book primarily on lengthy discussions with the Americans involved in the Beijing Jeep venture (primarily the company's former president, Don St. Pierre, and other American Motors executives). The book is thorough in chronicling the history of the Jeep venture, and I use much of his empirical work to supplement my own interview and documentary findings.

Though his research is sound, Mann's narrative is interspersed with comparisons to other foreign investment projects in China, some of which (such as the nuclear power industry) are quite peripheral to the automotive case. Other anecdotes about expatriate life in China are often distracting.

Mann's conclusion is apparently influenced greatly by the 1989 Tiananmen massacre, which occurred just before the book was published. Perhaps this makes him more pessimistic about Beijing Jeep's long-term prospects than the company's success over the past three years (noted later in this chapter) would warrant.

approached Sung about finding a joint venture partner for their rough terrain vehicle factory. Sung contacted the American Motors Corporation (AMC) in Detroit, which manufactured Jeep-model vehicles. He then became an intermediary for the earliest talks between the Americans and Chinese. After contacting other car manufacturers in Japan, Great Britain, France and the United States, and comparing bids, BAW chose to focus on AMC as a potential partner.[2]

BAW had its own roots in pre-liberation China as an assembly factory. In the PRC's first five-year plan, the factory was assigned the task of providing fuel pumps and other parts to Changchun's First Auto Works. In 1958 the company began producing its own vehicles, and, after expansion, in 1966 made its first model 212 rough-terrain automobile,[3] a Jeep-like car based on a design supplied by the Soviet Union.

In early 1979, AMC officials arrived in Beijing to begin discussions on forming the new company. The Americans met with a team of Chinese negotiators, including Rao Bin, then a vice-minister at the First Ministry of Machine Building, and later the first director of the China National Automotive Industrial Corporation (CNAIC). The two sides agreed at these early meetings that a venture had promise. An early memo at the time projected cooperation on improvement of the jeep already manufactured at BAW, production of a new family of vehicles, and manufacture of parts in China for export.[4]

Subsequent talks made little progress over the following two years, as the Chinese reportedly considered, then rejected, an alternative venture with Japan's Toyota.[5] Furthermore, the Chinese government was slow to approve the AMC

In general, Mann saw a "short, unhappy romance" of American business in China. My findings in this and following chapters, however, indicate that, though the "romance" of foreigners looking for an unlimited market among the vast Chinese population may have been over, opportunities for foreign venture success in China remained.

[2] *Beijing Review*, November 4, 1989, p.21

[3] *Zhongguo qiche gongye nianjian* (China Automotive Industry Yearbook), Beijing, 1986, p.507

[4] *Beijing Jeep, op. cit.*, pp. 47-48

[5] *Ibid.*, p.61. The talks foundered on Japanese unwillingness to part with the technology the Chinese desired. (See Chapter Two for more discussion of Japanese investment attitudes).

feasibility study. One Chinese source noted that "no one [among those studying the report] would take the responsibility of approving the plan until more than a year after the report was submitted"[6] in 1979. Each department apparently feared taking responsibility for any resulting problems with the new joint venture.

At the same time, however, the top levels of the automotive bureaucracy itself were also undergoing rapid post-Mao structural reorganization, as outlined in Chapter Three, and this is also cited as a factor delaying the talks.[7] BAW had "more than ten government sections overseeing its operation and interfering with its work."[8] Over four years of negotiations, the factory "reported to its leaders on the situation of their talks with AMC more than 300 times, averaging one every five days, but heard little in response."[9] Such hesitancy may have been rooted in official wariness of the motivations of the foreign investors; "there were still people involved with the Beijing company who had misgivings about entering into a joint venture with foreigners - a result of the mental shackles imposed by years of 'left-ist' ideas."[10]

In 1982, however, following establishment of the CNAIC, the Chinese formed a group of five department heads to face AMC in the negotiations. This group apparently had "complete negotiating and decision-making authority in the talks... ."[11] Among the new Chinese team was Chen Zutao, then chief engineer at the CNAIC. Chen was the senior CNAIC official taking part in the discussions. On the AMC side were Tod Clare, vice president of the company's international operations, and Ronald Gilchrist, manager of Far East operations.

Though the discussions quickened, there were several areas of disagreement that

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[6] *Beijing Review, op. cit.*, p.22
[7] See *The Christian Science Monitor*, June 14, 1983, p.10
[8] *Beijing Review, op. cit.*, p.22
[9] *Ibid.*, p.22
[10] *Ibid.*, p.21
[11] *Ibid.*, p.22

confounded the Americans. The Chinese, for example, were slow to comprehend the importance of registering the American company's "Jeep" trademark name in China,[12] a step providing penalties for other domestic manufacturers attempting to adopt the brand name. The Chinese were also unfamiliar with standard contract clauses, such as *force majeure*, and AMC officials were forced to explain these to their negotiation partners.

A significant turning point in the discussions came when the AMC team decided to abandon a rough contract outline it had brought to the talks, and began to move toward the Chinese contract format.[13] The Chinese required, for example, a seven-year financial feasibility plan for the venture. AMC was accustomed to planning for only three years of a project, with two more years of rough estimations sometimes added. Clare noted he

> "felt rather uncomfortable about that [seven-year plan], because that's really getting into the unknown. But they wanted seven years. We did seven years and we did an intelligent job with it. And as you look back, it's rather comforting to see the seven-year story in front of you."[14]

As this chapter will show, however, Clare's comfort proved to be short-lived.

After nearly four years of negotiations, the Americans and Chinese finally signed a contract on May 5, 1983. The Beijing Jeep Corporation, Ltd., also known as BJC, was born.

The Venture's Early Years

Under terms of the agreement, AMC contributed $16 million to the $51 million venture, for a 31.35 percent share of the corporation; BAW, which contributed the factory site and equipment and $6.6 million in cash, held the balance of the venture.

[12] *The Christian Science Monitor, op. cit.*, p.10

[13] *Ibid.*, p.10

[14] *Ibid.*, p.10

The new company took BAW's assembly facilities at its southern Beijing plant; the northern factory would continue to produce BAW's own products. BJC's contract was to run for a 20-year term.

The Chinese had several goals in creating the venture. As with most cooperative agreements between China and the West, the Chinese auto manufacturers hoped to acquire valuable technology. AMC agreed to provide not only vital equipment and designs, but also managerial techniques useful to an industry hampered by lax standards that had existed for decades. In the contract, the Chinese put a value of $8 million on AMC's technology, which constituted half of the American side's contribution to the initial capitalization fund (the other half consisted of $8 million in cash).

Foreign exchange earning was also a Chinese goal. Both sides believed exports would be a result of the joint venture, bringing a chance for American repatriation of profits, and Chinese garnering of much needed hard currency.

The Chinese also hoped to develop a new light cross-country vehicle that could be exported. The car previously produced by the Beijing plant was seen as "technically out-of-date and stylistically dull, and therefore not competitive on [the] international market."[15] The contract called for development of a new type of vehicle to correct these shortcomings, one that would appeal to the world market. The Chinese military was hoping this new vehicle could fill its needs for a soft-top transport tool. Until this vehicle was developed, however, the joint venture was to continue producing BAW's model BJ212 for the first five years of the venture.[16]

Both sides soon found the new vehicle was not easy to design. Not only did the prototype have several serious structural defects, but the Americans predicted refinement of a new model would require hundreds of millions of dollars in further

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[15] *Beijing Review*, *op. cit.*, p.21

[16] *Ibid.*, p.23

investment.[17] The Chinese therefore agreed to import AMC's Cherokee XJ Jeep in a disassembled kit form known as a "completely knocked down," or "CKD" vehicle. Unfortunately, this decision came without a firm agreement on the source of foreign exchange currency to pay AMC for the kits. A memorandum stipulated Chinese customers, mainly state-owned work units, would pay hard currency to BJC for the assembled vehicles, and the venture would build up a fund for "localization"- that is, developing machinery in China to produce the Cherokee parts at the Beijing plant. The memorandum, however, never formally superceded the original contract.[18] This error, as we will see, was a primary factor leading to the later crisis.

AMC, of course, also had hopes for the venture. Access to the Chinese market offered a potentially enormous pool of consumers. Poor road conditions seemed to make China a good market for the rugged Jeep model, and low wages for Chinese workers increased profit potential. Hopes for hard currency gain, however, seemed tied to the ability of the venture to export its product. Under the original contract, AMC was expected to wait approximately five years until the new joint venture vehicle was designed and ready for market; until then, the venture would reinvest soft currency profits from sales of the domestically produced BJ212 into BJC. Without exports, though, hard currency that could be repatriated would not be available.

With imports of Cherokee kits, the Americans had shifted their focus from designing the new vehicle to the localization of the Cherokee parts manufacture. With localized production, and low wages at the factory, the Americans hoped to make a reasonable profit on exports of the Cherokee. BJC officials predicted that more than 80 percent of the vehicle would be produced in China by 1988, and that the venture could be exporting some 25 percent of the Cherokee Jeeps by 1990.[19]

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[17] *The New York Times*, April 11, 1986, p.D4

[18] *Ibid.*, p.D4

[19] *Beijing Review*, *op. cit.*, p.24

Despite such predictions, the localization process was painfully slow. The problem with finding local parts to substitute in the imported kits lay with the quality levels of Chinese supplier factories. After decades of isolation, these plants were unfamiliar with high foreign standards, and were furthermore financially unable to raise quality until they were given economy-of-scale orders for their product; they balked at the large investments needed to reach American levels when BJC initially required only a few hundred or a few thousand items. (In 1985, for example, China only imported some 450 disassembled Cherokees).

Until export actually began, then, AMC stood to make money by selling CKD kits to the joint venture at a profit. Such sales provided those eager to tap the "China Market" with immediate gratification.

BJC Crisis

The crisis of 1986 was precipitated by a foreign exchange shortage within the venture. At the time, the Chinese government's supply of hard currency was limited. In 1985, China's balance of trade was hurt by the surge of Japanese motor vehicle imports, and the Chinese were reluctant to allow state-owned enterprises to spend more foreign exchange to finance the kit purchases. Foreign reserves in 1985 were $11.9 billion, off some 29 percent from 1984's reserves of $16.7 billion. The Chinese hoped to pay for the American parts using the non-convertible Chinese domestic currency, *Renminbi* (hereafter RMB), a proposal that was not acceptable to the American side.

Don St. Pierre, who took over as BJC's president in September 1985, found the Chinese unwilling to allow the company to continue the practise of charging Chinese customers $10,000 in hard currency to cover the import cost of one kit (the remaining $9000 of the vehicle's $19,000 price tag, inflated by import duties, could be paid in RMB).[20] Soon, some 1008 kits were sitting at the docks on the American

[20] *Ibid.*, p.D4

east coast.

Foreign exchange was also required to import an engine and stamping plant, machinery vital for localization of production of the Jeep model. The Chinese claimed the original contract did not oblige them to pay for this equipment - this was of course true, because the original agreement did not envisage the necessity of localization of production of a purely American model. Still, the Americans balked at paying an estimated $70 million over three years for localization costs.[21]

As the lack of hard currency became acute, the American side began to look at debts owed the venture. The State Bureau of Supplies owed the company $2 million, a result of non-payment in hard currency for 200 Jeeps ordered by Chinese no longer allowed to spend foreign exchange. BJC was also owed some RMB 30 million by Beijing Auto Works for the venture's other product, the BJ212. Without these funds, according to St. Pierre, the venture would have collapsed.[22]

In order to defuse the situation, St. Pierre took several steps that, at the time, he considered standard procedure. Beginning in the last months of 1985, he first spoke with the Beijing municipal government to try to convince those responsible for financial matters to release foreign exchange to the venture to pay for the imported kits and machinery. He started there because he believed it was the first appropriate level of government he felt should be contacted; furthermore, the municipal government did have its own foreign exchange reserves. When this strategy had no immediate effect, however, he wrote to the responsible central government organizations, including the Ministry of Foreign Economic Relations and Trade (MOFERT), the State Planning Commission, and the general manager of the CNAIC, Chen Zutao.

"The Chinese could not understand the problem, and seemed to be groping in

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[21] *The New York Times*, April 11, 1986, p.D4

[22] Information from Don St. Pierre is based on an interview conducted in Hong Kong in January, 1989.

the dark," according to St. Pierre, who soon became frustrated with the lethargic reaction of the Chinese side. At the end of November, representatives from AMC's Far East division visited China to try to resolve the currency exchange problems. Upon realizing the situation would not be resolved quickly, the Americans presented a concrete challenge: unless the Chinese were willing to allocate foreign exchange to finance the purchase of the kits and localization equipment, AMC would cut off further investment, stop technology transfer, cancel technical training, and recall its foreign experts from China. The Chinese referred to these threats as the "Three Stops and One Removal" *(San Ting Yi Che)*,[23] and CNAIC chief Chen was reportedly "furious" about the threat.[24] On December 17, 1985, though, AMC people met the Chinese ambassador in Washington. The discussions with him were encouraging enough that AMC withdrew its threat to recall experts and cancel training programs, but an end to investment was still being considered. And, the 1008 kits still sat in the docks.[25]

On February 18, 1986, St. Pierre wrote a letter to then-Premier Zhao Ziyang, describing the crisis and including a "veiled threat." St. Pierre rhetorically asked the Chinese premier, "What will world opinion be of the investment climate in China if this venture fails?".[26] The implication, of course, was that other foreign companies would react negatively to a collapse of such a major joint venture.

Two weeks later, St. Pierre still had no reply from the Chinese authorities, and decided to try a different tactic: he would put further pressure on the Chinese by publicizing the venture's problems. In mid-March, St. Pierre spoke with a Reuter's reporter and a correspondent from *Business Week* magazine in Beijing. The first mention of the venture's problems appeared in *Business Week* in the April 7

[23] From "Oh, Beijing Jeep...," by Mei Bo and Zhang Cailin, in *Dongxifang bankuai de zhuangji*, also titled *OK, Beijing Jeep: Widely Exchange Between the East and the West*, Xiamen, Lujiang Publishing House, 1988, p.32.

[24] *Beijing Jeep, op. cit.*, p.177

[25] In "Oh, Beijing Jeep," *op. cit.*, p.32

[26] The Chinese report St. Pierre wrote the letter on March 12, 1986. (*Ibid.*, p. 33)

edition.[27] The story was later picked up by the *Wall Street Journal*, though this article appeared much later in the crisis, on April 30.[28]

When all of these maneuverings failed to resolve the shortage of foreign exchange, St. Pierre left Beijing in mid-April, returning to Detroit to "wind down" the operation. The April 30 *Wall Street Journal* article announced to the world that production at BJC had stopped, pending relief of the hard currency deficiency. This article described the situation as "a big embarrassment to the Chinese government," and quoted P. Jeffrey Trimmer, general manager of Far East operations at AMC, stating that the plant would be closed for at least two months, and that the closure would be extended "one day for each day that AMC doesn't receive a new letter of credit" to pay for the kits.[29] Trimmer added a positive note to his warning, however, hoping that AMC could ride out the problems, and saying that "I can't see us turning our back on China."[30]

Though the Americans perceived little action on the Chinese side in early 1986, one Chinese source from BAW claimed the agencies St. Pierre had contacted actually were working with the joint venture to solve the crisis.[31] Following pressure from BAW, the Beijing municipal planning commission, Beijing's foreign economic relations and trade department, and the state planning commission, MOFERT, and CNAIC had at least three joint meetings from January to March, 1986. The Chinese were concerned by AMC's challenge, even at the early stages. Still, the lack of results from these sessions indicates the Chinese partners in the BJC venture had little leverage when they tried to solve the problem without direct American involvement.

One factor mitigated St. Pierre's threat to some degree: the joint venture

[27] *Business Week*, April 7, 1986, p.50

[28] *Wall Street Journal*, April 30, 1986, p.23

[29] *Ibid.*, p.23

[30] *Ibid.*, p.23

[31] This information is based on an interview held in Beijing in January, 1989.

continued to produce the domestic BJ212 model, as imported parts were unneeded. The venture would not necessarily have collapsed, even if Cherokee production was delayed for a long period of time. Of course, AMC's abandoning production of the Cherokee would probably still have meant an eventual withdrawal by the American company, with the resulting repercussions for the international investment climate that St. Pierre hinted at in his letter to Premier Zhao.

Crisis Resolution

On April 25, 1986, as St. Pierre began talks with his Detroit colleagues on ending the China operation, a telex arrived from Chinese officials. Apparently, the wheels of the bureaucracy had begun turning in the top levels of the Chinese government. On April 4, Zhao Ziyang had reportedly proclaimed that important joint ventures such as BJC should not be allowed to fail, and he called for high level aid to solve the problem. He received support for this effort from such officials as vice premiers Li Peng, Yao Yilin, and Tian Jiyun, and from Bank of China head Chen Muhua.[32] The telex invited AMC to send a high level delegation to China to speak with a group led by vice minister of the State Economic Commission Zhu Rongji. The Americans agreed to meet in China from May 8 through May 13.[33]

The main negotiators on the Chinese side were Zhu Rongji, CNAIC chairman Chen Zutao, and Beijing vice-mayor Zhang Jianmin. BJC's board chairman, and concurrently head of the Beijing Automotive Industrial Corporation, Wu Zhongliang, was notably absent, claiming illness. On the American side were P. Jeffrey Trimmer, Tod Clare, Tim Adams, director of new business development at AMC,

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[32] From "Oh, Beijing Jeep...," *op. cit.*, p.34

[33] *The Chinese suspect the Americans picked these days to coincide with a May 10 visit by Treasury Secretary James Baker to Beijing, and Yao Yilin's May 16 visit to Washington. Baker did in fact discuss the problem with Premier Zhao.* (From "Oh, Beijing Jeep...," *op. cit.*, p.34)

and Don St. Pierre. The main topic of discussion was the number of Cherokees to be produced in the years 1986 to 1990. The Chinese favored limited production to save foreign exchange. The Americans wanted to raise Cherokee output, to both realize a profit and to attain the necessary economies of scale for the localization effort.

Early in the meetings, according to St. Pierre, the American side achieved some satisfaction by forcing a "self-criticism" from Zhao Nailin, a Chinese vice president at BJC. Apparently under pressure from Zhu Rongji, Zhao admitted he had been deliberately misrepresenting the venture's projected foreign exchange earnings, in such a way that the shortage of hard currency to import kits could not have been foreseen. Zhao's goal may have been to force AMC to commit more of its own money to relieve the deficit once the crisis came to a head. St. Pierre noted in an interview that Zhao was probably acting on his own, out of ignorance, and admitted that AMC should have monitored the situation more closely.[34]

The meetings were marked by several threats by the Americans to leave,[35] actions meant to further intimidate the Chinese. In the end, however, both sides reached agreement. The main points of the settlement were:

1) Beijing Auto Works paid its RMB 30 million debt, and the State Bureau of Supplies delivered its payment of US$2 million. AMC was allowed to convert some US$6.9 million worth of its RMB earnings to hard currency, at the official government exchange rate.[36] These steps were the key to ending the immediate cash flow problems, and the joint venture could then pay for the Jeep kits waiting to enter the country.

2) AMC received formal permission to require up to 60 percent of Cherokee

[34] Based on my interview with St. Pierre, 1989

[35] "Oh, Beijing Jeep...," *op. cit.*, p.35

[36] *The Asian Wall Street Journal Weekly*, August 25, 1986, p.4

Jeep payment from Chinese customers in foreign exchange.

3) BJC and CNAIC, rather than AMC, would be responsible for raising capital for localization costs. Funds would come from hard currency sales and Bank of China loans. AMC did, however, pledge to help speed the localization effort.

4) AMC agreed to limit production of the Cherokees, a recognized drain on China's hard currency reserves, to 12,500 vehicles up to 1990.

5) The new Jeep desired by the military would never be possible, both sides agreed, without a large infusion of capital. The Chinese agreed to delay production of such a vehicle.

Post-Crisis Venture

Once the 1986 problems were resolved, officials at BJC set out to put the venture back on track. By August, 1986, St. Pierre was optimistic enough to comment that "[a]s of now, there is nothing holding this company back. We can do the business that we are supposed to do. It is now a matter of execution."[37] Why was he so optimistic?

As noted above, the immediate problems the venture faced were solved in the May agreement. The company had enough money to resume production by mid-August, and it began to look toward increasing the percentage of parts locally produced in China.

St. Pierre's attitude, however, may have been more closely linked to his assessment of pertinent political forces than of the successful crisis resolution agreement. That settlement, brokered by Zhu Rongji, was an important sign of significant government support for BJC, and the political aid remained after the problems were

[37] *Ibid.*, p.4

resolved. Zhu, for example, continued to play a role in the development of the Jeep venture (until he became mayor of Shanghai in 1988). When the Chinese public security bureau was considering buying Japanese vehicles, Zhu convinced the policemen to buy Jeeps instead. However, Zhu was unable to meet St. Pierre's request to further increase the number of import licenses for Cherokee kits.[38]

The association with Zhu was valuable even without his direct intervention. St. Pierre claimed that a mere hint that BJC would appeal to the SEC vice minister would be sufficient to resolve bureaucratic problems. At the time, Zhu was reportedly "virtually running the Chinese automobile industry," according to one assessment.[39] Troubles with slow customs procedures, or with Chinese shipping officials, then, would disappear with such threats. After Zhu's departure for Shanghai, St. Pierre redirected his attention to local Beijing officials, such as vice mayors Wu Yi and Zhang Jianmin.[40]

The support of key politicians was perhaps rooted in a larger Chinese effort to make the company a kind of "model joint venture." In some ways, the Chinese may have come to look on Beijing Jeep as a sort of modern-day "Dazhai," the village held up as a model commune during the 1960s' Cultural Revolution. BJC would be a success story, one to act as source of positive propaganda to attract further foreign investment.[41]

While relying on top leaders for help, St. Pierre also felt his company's position was strong enough that he could become personally involved in relevant Chinese political power games. After the BJC Chairman, Wu Zhongliang, had "disappeared" following an apparent heart attack, St. Pierre tried to arrange for a successor that he preferred. He wanted the Beijing Automotive Industrial Corporation (BAIC) vice

[38] Based on January, 1989 interview with St. Pierre

[39] *Beijing Jeep, op. cit.*, p.273

[40] *Based on January, 1989 interview with St. Pierre*

[41] This argument is suggested in *Beijing Jeep, op. cit.*, pp. 222-235; there is no evidence, however, that the Chinese (or even Americans) actually used the "Dazhai" terminology to refer to the BJC project.

chairwoman, Wang Mei, to take over for Wu as the company's chairman.[42] Not only did St. Pierre see Wang as more knowledgeable, she was also concurrently leading negotiations with General Motors for a possible venture making trucks in China; St. Pierre hoped to get this business for AMC. The American manager mentioned to Chinese auto officials his positive opinion of Wang,[43] and complained to vice-mayor Zhang Jianmin of his dissatisfaction with Wu.[44] In March of 1987, however, Wu reappeared as BJC chairman, though he later lost his position as chief of the BAIC.

St. Pierre also campaigned for the promotion of BJC vice-president Chen Xulin to the venture's presidency. Chen had become a close friend of St. Pierre, and the American had been training him to take over the position. In early 1988, Chen did become BJC's president.[45] After St. Pierre left the venture in 1988, however, his successor, Richard Ott, declined to imitate St. Pierre's aggressive stance toward China's politicians.

With solid Chinese support, the venture made substantial progress. It continued to manufacture the BJ212 model vehicle, and could make RMB profit on its sale.[46] In 1986, the venture made some 24,000 vehicles, mostly 212s. Production rose to more than 26,000 in 1987, 31,000 in 1988, and almost 40,000 in 1989, including 6630 Cherokees. Though the Americans helped improve the design of the Chinese model, the development of the 212 was far from the old dream of creating a completely new kind of Jeep for China.

BJC also moved ahead in its program to localize production of vehicle parts. Figure 4.1 shows the annual increase of local content in the Cherokee model. (Local

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[42] See Chapter Three for more information on the function of the BAIC.
[43] *Beijing Jeep, op. cit.*, p.225
[44] *Ibid.*, p.262
[45] *Ibid.*, pp.225, 281
[46] *Ibid.*, p.228

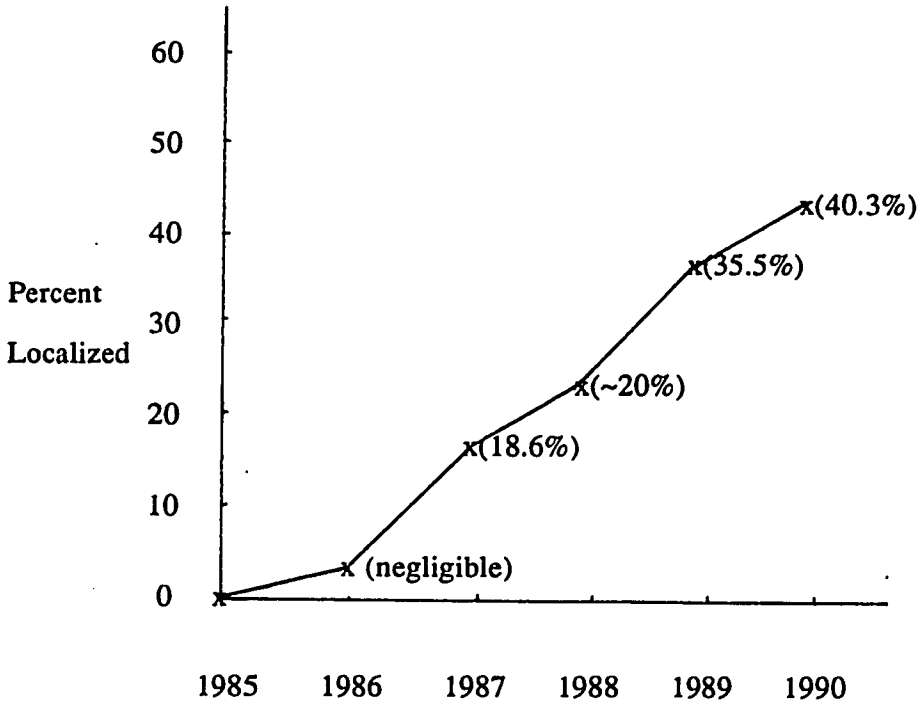

Figure 4.1: Localization of the Beijing Jeep Cherokee

Sources:

1986: *The New York Times*, April 11, 1986, p.D4
1987: Beijing Jeep Company Brochure, 1988, p.9
1988: 1989 interview with Don St. Pierre
1989: *China Daily*, February 14, 1990
1990: *China Daily*, October 12, 1990

content is calculated on the percentage, by cost of parts, of the vehicle manufactured in China). Once BJC reached 40 percent local content, it was theoretically exempt from the requirement to obtain import licenses for its kit parts.

The Beijing municipal government recognized the importance of the localization drive, and had assigned vice mayor Wu Yi to supervise the program.[47] Supplies came from 140 factories across China, with about 40 percent of local parts made in Beijing.[48]

The venture's progress was substantial, and was marked in late 1988 by a visit from Lee Iacocca, whose Chrysler Corporation had purchased AMC in 1987. During his visit, Iacocca proposed raising the American percent holding of the venture from 31.35 to 49 percent. (By early 1991, however, the Americans had only increased their stake to 38.25 percent). Iacocca also suggested that Chrysler and the First Auto Works in Changchun cooperate to make a vehicle in Northeast China,[49] but, again, little progress was made in these plans over the following few years.

In March, 1989, the company faced a second crisis, though one much smaller than that of 1986. After customs officials announced a significant increase in duties on Cherokee parts kits, the Americans protested. They employed tactics similar to those used in 1986, threatening to close the Beijing factory and complain to the press. Beijing municipal officials came to the venture's aid, and, after negotiations, the customs people capitulated.[50]

The venture was not significantly affected by pro-democracy demonstrations in China's capital in 1989. Though most of the American executives left in late May, many had returned within a few months. BJC was, however, hurt by China's economic austerity policy, launched in the autumn of 1988 to continue for some

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[47] *China Daily*, November 20, 1990, p.2

[48] From May, 1990 interview at BJC

[49] *China Daily*, October 17, 1988, p.2

[50] *Beijing Jeep, op. cit.*, p.297

three years. In late 1989, the Chinese government announced plans to spend RMB 350 million (about US$95 million) to purchase some 7440 unsold joint venture automobiles (including those of BJC, Shanghai Volkswagen, and Guangzhou Peugeot); by early 1990, however, it had somewhat reduced the number of vehicles it felt necessary to buy.[51]

By the end of 1990, the company seemed to have recovered from the austerity slowdown. Sales of Cherokees in the first half of 1990 were up by 34 percent over the 1989 period,[52] though the government bailout was probably key to the increase. BJC was named one of the top ten joint ventures, and was listed as the 53rd largest company among all enterprises in China, with sales of US$276 million, and a profit of US$40 million.[53]

Finally, the company demonstrated further strength by completing work on the site's engine factory in late October, 1990. The plant had a capacity of about 100,000 engines, though it would begin producing only about 30,000 in its early years.[54] During 1990, BJC even exported some vehicles (most likely the domestic model, renamed BJ2020); it sent about 350 Jeeps to Thailand, Holland, the USSR and Latin America for a profit of about $25 million.[55]

As the oldest of the auto joint ventures, BJC provides the most data for analysis using the theoretical framework suggested in Chapter One. The following sections use that framework to try to highlight the foreign and Chinese political roles in shaping the development of Beijing Jeep.

Stimuli

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[51] *China Daily*, March 12, 1990, p.2
[52] *China Daily*, July 31, 1990, p.2
[53] *China Daily*, August 27, 1990, p.2
[54] *China Daily*, October 23, 1990, p.1
[55] *China Daily*, December 8, 1990, p.2

As noted in the introductory chapter, the shape of each case under study would potentially be greatly influenced by the types of stimuli exerted on the Chinese bureaucracy by both foreign and domestic elements. The following sections try to characterize the types of factors that shaped the policy process guiding Beijing Jeep's development. We begin with the foreign forces exerted on this process.

Foreign Forces

The American Motors officials who arrived in China in early 1979 represented an established, relatively large American company, one with technology that would be potentially quite suitable for Chinese manufacturers. These features must have inspired some respect from the Chinese assigned to negotiate with the Americans; the AMC people were no small players.

The Americans proposed a joint venture with the Chinese, and were therefore pledging to become integrated in many ways into the country's economic and political systems. At the time, the Chinese authorities preferred the joint venture form of foreign investment, as the government had more control over such entities than it would over wholly foreign-owned enterprises. Foreign investors also had the advantage of securing a partner knowledgeable of the intricacies of operating a business in China.

As one of the earliest joint ventures, BJC would be a kind of test case for foreign investment in China. In this sense, the Americans were offering themselves as a guinea pig; but AMC showed willingness to risk its capital at a time only a few years after China's economic reforms had begun. The venture also represented a potential magnet for further foreign investment, and perhaps a test case for large manufacturing projects.

In the latter years of BJC, AMC officials, led by Don St. Pierre, took an active role in trying to shape the Chinese political landscape. For example, St. Pierre's

attempts to place Wang Mei in the chairmanship of BJC, and Chen Xulin as president of the company, show an acute, and perhaps atypical, interest by the foreign side in trying to affect pertinent positions within the Chinese bureaucracy. St. Pierre's key role, however, was as a successful agitator moving the bureaucracy to solve the 1986 crisis. He may also have been at least partly responsible for BJC chairman Wu's later dismissal from his position as chief of the BAIC.

In sum, the American side presented Chinese decision makers with a large company, one which offered technology, capital, and a chance to set a good precedent for future foreign investment, while at the same time earning foreign exchange through export. Its representatives in China, led by St. Pierre, showed an active interest in shaping the structure of the decision-making hierarchy in the Chinese bureaucracy.

Before examining the actual policy process surrounding the venture, we turn to look at the domestic economic elements that also affected political decision making.

Domestic Economic Forces

By the late 1970s, as discussed in Chapter Two, the Chinese automotive bureaucrats had realized the necessity of modernizing their industry's production capabilities. This step was needed, among other reasons, to stem the tide of imported vehicles, mostly ones from Japan. Any foreign manufacturer, therefore, was potentially a good source of much needed technology and managerial skill.

The first vehicle joint venture would set a precedent for future cooperative projects, as noted above. Therefore, to ensure that the industry could continue to absorb foreign know-how, there was some impetus to encourage the success of the earliest Sino-foreign car company.

Of course, there were limits on the Chinese economy's ability to support any one enterprise or industry. By the mid-1980s, it became evident that automotive

production would entail spending significant amounts of foreign exchange to finance imports of kit parts, and the nation was pressed to relinquish valuable hard currency for this purpose.

The original vision of some of the automotive planners was an export-driven industry, one which could supply the foreign cash reserves needed for technology importation. The ability of the industry to sell its product overseas was, however, overestimated, as quality and price considerations hampered the effort. The failure of the industry to achieve its goal of exporting vehicles, then, had as a consequence the need to siphon hard currency from other sectors of the economy.

When the Chinese economic austerity policy was introduced in the late 1980s, as a reaction to high inflation, the prospects for sales of the high-priced and often expendable joint venture vehicles, including both the domestic and Cherokee Jeep models, were temporarily dimmed. Chinese work units were to severely reduce their purchases of such luxury items.

Again, however, the fear of losing technology import was apparently greater than the desire to limit spending on joint venture products. The government-ordered bailout of the ventures, including BJC, was a response induced by the potential loss of future foreign technology and managerial expertise transfer.

Domestic economic forces for the early 1990s would be characterized in part by the need to replace aging imported taxis, at a minimum, and provide passenger cars for work unit and, perhaps, private use, at a maximum. The Shanghai Volkswagen and Guangzhou Peugeot ventures seemed best suited for most of these requirements, but one official at Beijing Jeep pointed out that Cherokees could be, and in fact were, used as taxis and for intra-city travel.[56] And, of course, Jeeps would still prove useful for rough-terrain travel.

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[56] Based on August, 1990 interview

Government decision-makers were faced with a myriad of foreign and domestic economic stimuli in trying to make policy for the development of BJC. The following section takes a detailed look at the resulting political actions surrounding the development of the first Chinese automotive project.

Government Decision-Making

Political Bargaining

The following discussion is divided into studies of both local and central government politics. It begins with an analysis of the national leadership and its policies toward Beijing Jeep.

The Central Government's Role

It is hard to pinpoint the attitude of many top leaders toward the AMC proposal in the early days of reform, and during the venture's existence from 1983 to the present. At the pinnacle of Chinese power, Deng Xiaoping took pains to stress China's opening to the West, and to encourage foreign investment in his country. He had little, if any, direct influence on the founding of the Jeep venture; and the initial talks in the early 1980s foundered at the same time Deng was touting foreign investment in China. In the venture's later years, Deng failed to meet Lee Iacocca on his 1988 visit to Beijing. During the 1986 crisis, however, former US ambassador to China Leonard Woodcock (who had also previously been head of the United Auto Workers labor union in the United States) offered to approach China's paramount leader to discuss the venture's problems.[57] The Americans declined the offer, fearing that Deng either could not or would not solve the problems.

Zhao Ziyang played a much greater role in shaping the course of the automotive

[57] *Beijing Jeep, op. cit.*, p.215

project. Though he did not figure prominently in the early years of the company, Zhao was instrumental in resolving the crisis of 1986. As mentioned above, St. Pierre's letter to Zhao motivated the then-premier to appoint Zhu Rongji as an intermediary in the crisis talks. Zhao was obviously concerned that the venture should survive.

In early 1988, Zhao visited the factory site, and stressed the importance of technology transfer.[58] He called for higher quality and lower costs of the domestically-produced parts,[59] while noting it was unnecessary to replace every single foreign-made part.[60] Zhao was generally supportive of the venture, mentioning the benefit of import-substitution. Such a stance coincided with Zhao's reputation as a staunch supporter of the open door policy, and of cooperation with foreign investors.

Zhao's chief ally in aiding BJC was Zhu Rongji, of the State Economic Commission. As noted above, Zhu was instrumental in solving the venture's 1986 crisis, and in helping smooth problems in the post-crisis period. Zhu apparently shared Zhao's views on importation of Western technology, and of allowing foreign business to succeed in China. His promotion to Shanghai's mayorship, however, ended his relationship with the Beijing company, as Shanghai Volkswagen then required his allegiance.

As a top official at the SEC, Zhu's support of BJC implies that commission favored the project, at least to some extent. But neither the SEC nor the State Planning Commission actually approved the key 1984 decision to produce Cherokees instead of a new model vehicle,[61] and no Cherokee production was included in the seventh five-year plan (1985-1990).

As a former leader of the Ministry of Foreign Economic Relations and Trade,

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[58] See "Oh, Beijing Jeep...," in *op. cit.*, p.6

[59] *Ibid.*, p.9

[60] *Beijing Jeep, op. cit.*, p.283

[61] *Ibid.*, p.163

and chief of the Bank of China from March of 1985 to 1988, Chen Muhua was potentially key to the success of the auto venture. She appeared at several ceremonies marking advances in the company's progress, and publicly agreed with Zhao Ziyang in 1986 that the venture should be saved. MOFERT officials, however, were not key to the resolution of the 1986 problems, and their authority over deciding a venture's import quotas seems to have been at least temporarily usurped by SEC commissioner Zhu.

It is difficult to find sources of opposition to BJC in the top echelons of the Chinese leadership. Li Peng, who replaced Zhao as premier in 1988, may have been a skeptic of the company's chances, based on his friendship with BJC detractor Chen Zutao (noted in Chapter Three). Li did, however, publicly support the decision to aid BJC in 1986, and he later met Chrysler president Lee Iacocca on his October, 1988 visit to Beijing.

The most prominent critic of the company was found at a lower political level, in the form of CNAIC leader Chen Zutao. Previous discussion described his early enthusiasm for the project, a feeling that turned to disdain for BJC as the company failed to balance its kit imports with vehicle or parts exports, and as the rate of localized production remained low. Zhao Ziyang's 1988 trip to the Jeep factory was, apparently, a response to some of Chen Zutao's public criticism of the joint venture made at a news conference three weeks before Zhao's 1988 visit.[62]

Chen's motivations remain somewhat mysterious. Chapter Three pointed out Chen's earlier fascination with General Motors, and some Chinese officials believe his hostility toward BJC may have been rooted in frustration that China was not dealing with the largest American company. Still, in 1988 Chen called for ventures to produce axles and motors in China, instead of assembled vehicles.[63] His disen-

[62] *Ibid.*, p.283
[63] *Ibid.*, p.283

chantment with the joint ventures continued until 1989, when Panda Motors came to China (see Chapter Seven).

The Chinese military also had reasons to be unhappy with the venture's development. The PLA had hoped for a four-door, soft-top vehicle, and the Cherokee did not fulfill that wish. In fact, the 1986 settlement specifically said such a derivative would *not* be developed.[64] It is difficult, however, to document specific pressure the military may have applied on Chinese officials to forward its desires. Chen Xulin apparently calmed the PLA by noting that the venture was improving the BJ212 model; 10 to 20 percent of that vehicle's output went to the army. Chen later told them a new model might emerge in the mid-1990s.[65] In the mean time, the military *did* buy Cherokees; in 1989, it bought some 2000 vehicles.[66]

We next turn to the local Beijing officials and their attitudes toward the venture. Were they as supportive of the large enterprise as one might expect a local government to be?

Local Politics

As for any city, a new automotive project would represent a potential source of valuable investment and productive capability; multiplier effects could help the whole area's economy. How did Beijing municipality react to the AMC venture?

Early representatives to the venture talks seem to have come mainly from the central government. The most prominent figure on the municipal side, however, was Wu Zhongliang, chief of both the BAW and of the municipal BAIC. One of the first auto officials to visit AMC's Detroit headquarters in 1979, Wu was a key figure in the venture's history. Once BJC was created, Wu was chosen board chairman.

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[64] *Ibid.*, p.217

[65] Based on 1989 interview with Don St. Pierre

[66] Based on 1990 interview in Beijing

In the early years of BJC, Wu was a strong proponent of speeding development of the proposed new model. By late 1984, however, Wu had accepted the American argument that such a vehicle would be too costly, and agreed to the kit imports. Wu, along with other municipal officials, was one of the highest-ranking people to actually give permission for the Cherokee project, and the lack of central government approval was a major problem as the 1986 crisis unfolded.

It is not clear how Wu was able to launch the Cherokee project on his own. One source points out that a representative of the national CNAIC sits on the 11 person BJC board, and that the representative agreed to the 1984 plan to import kits; this implied a tacit CNAIC approval to the BJC board.[67] Still, the decision suggested a degree of independence from central government policy makers that was quite impractical, as the municipality lacked sufficient foreign reserves to finance the necessary purchases.

Wu later appeared to regret his action. In 1985, as the national foreign exchange shortfall became evident, Wu blamed higher-level government offices, such as the Customs Bureau, for failing to allow imports of the needed parts.[68] Of course, by then the venture had already invested in the assembly line and other equipment specifically meant for Cherokee production. As the crisis took shape in late 1985, BAW independently tried to rally central government concern, with little apparent result. During the critical talks in early 1986, Wu disappeared, apparently in the hospital with a heart attack. The top Chinese official of both BJC and BAIC, then, was absent at the crisis resolution.

Beijing was instead represented by vice-mayor Zhang Jianmin.[69] Zhang appeared to be a natural ally of the venture. As a vice-mayor with the city's auto-

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[67] From 1990 interview in Beijing

[68] *Beijing Jeep, op. cit.*, p.177

[69] Beijing mayor Chen Xitong, burdened with the additional duties as a State Councillor in the central government, appears to have played no significant role in policy-making for the Jeep venture.

motive industry in his portfolio, he stood to lose stature if the company failed. During the crisis negotiations, then, the Chinese side could not field a united front, as Zhang seemed much more sympathetic toward BJC than was Chen Zutao, his co-representative.

Zhang Jianmin also had his differences with Wu Zhongliang. Zhang reportedly disliked Wu, and may have influenced Wu's dismissal as head of the BAIC.[70] The Americans at BJC were also frustrated with both the BAIC and BAW; one source claimed the government bodies were guilty of inducing the joint venture to buy local parts at high prices, then accepting kickbacks from the parts manufacturers. In sum, the BAIC seems to have had poor relations with both superior and subordinate levels.

Though the city officials initially played a lesser role than that of the central leaders, BJC turned to the Beijing government in the years after Zhu Rongji and Don St. Pierre had passed from the scene. The 1989 customs clash, for example, was resolved with local officials' aid, rather than central help.

Before moving to a general analysis of the political maneuvering related to the Jeep case, we look for signs of misperception among the Chinese policy makers - did such misperception affect their thinking, and render them less able to make rational decisions?

Misperception

The 1983 decision creating a venture meant to produce a new model vehicle was perhaps clouded by wishful thinking on the Chinese side, though the problem was compounded by some duplicity among the American negotiators. This first important decision led directly to many of the problems that would later plague the

[70] *Beijing Jeep, op. cit.*, pp.262-263

venture's development.

In approving the plan to develop a new four-door, soft top vehicle, the Chinese decision makers might have simply been careless, ignoring information that planning and production of such an automobile would be lengthy, and impossibly costly to such a small enterprise as BJC. Given the number of years the Chinese spent negotiating the contract, however, such an assertion seems unlikely.

The Chinese may have been induced to consciously discount the potentially high costs of such a project by the American assurances such a venture was feasible. As noted above, the "seven-year plan" both sides accepted seemed practical, and must have been fiscally within the realm of possibility. As late as January, 1984, AMC's Tod Clare claimed BJC would be making a "totally new and fresh" export-model Jeep within two to four years.[71] The Chinese, in the end, were victims of their almost blind acceptance of American promises, what one analyst suggested might be a case of a "bait and switch" tactic to deceive the Chinese.[72] (Remarks made by the Americans who created the venture, particularly those of Clare, imply that AMC actually believed to some extent that its plan was feasible, and not simply a deception to launch the venture more quickly).

How were the Chinese so easily fooled? Perhaps the reverence of a large foreign company and its modern technology may have made the Chinese believe anything was possible, and that the Americans would be able to finance the project even if it cost more than the estimates predicted. In the early years of the opening to the West, such confidence in foreign capabilities would be expected; perhaps BJC vice president Zhao Nailin's flawed foreign exchange calculations were partly inspired by his faith in American "deep pockets." In any event, the early Chinese approval of the venture's plan was irrational, and was probably the result of unfounded expecta-

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[71] *Beijing Jeep, op. cit.*, p.138

[72] *Ibid.*, p.156

tions based more on unattainable hopes and dreams, and an exaggerated view of the foreign investors, than on responsible fiscal analysis.

Policy Making Analysis and Conclusions

The central government demonstrated early unity in taking a cautious yet positive attitude toward AMC's proposed joint venture. The talks were slowed by some officials still reluctant to embrace China's opening to the West begun in the late 1970s.

As the country's leadership entered the 1980s, there was general agreement that the auto industry required technological assistance from abroad in order to modernize. This consensus, together with the American promises and resulting misperception of possible achievements, strengthened the generally unanimous public support for the Jeep project in its early days.

As troubles arose in the mid-1980s, however, central government unity gave way to serious schisms. Chen Zutao, chief of the CNAIC, converted from being a supporter of the BJC venture to acting as its most vociferous critic. The company's allies in the central government, including Premier Zhao Ziyang and SEC commissioner Zhu Rongji, proved too powerful for the frustrated Chen, and the Americans obtained their desired concessions following the 1986 crisis.

The pro-AMC outcome was further influenced by the activist BJC president, Don St. Pierre. His tactics pointed out the value of maintaining the Chinese reputation as a safe investment site, further strengthening the hand of those supporting the joint venture. St. Pierre's contacts with central and local leaders served as a useful conduit to resolve future conflicts, such as the 1989 customs duty dispute.

The local government seems to have been saddled playing a junior role in guiding the development of BJC. Once the venture contract had been signed, the BAIC, and its leader Wu Zhongliang, erroneously assumed it could work independently of

the national government to permit importation of Cherokee model kits. Perhaps the mid-1980s atmosphere of decentralization had allowed this misconception.

With the crisis of 1986, the Beijing municipal government forces, led by vice-mayor Zhang Jianmin, rallied to support the local project. These officials faced embarrassment were the venture to fail. Luckily for them, they had powerful allies in the central government who were also willing to aid the venture.

The Beijing city government did seem to perceive significant problems with local government-joint venture cooperation. Wu's removal as head of the BAIC may have been an attempt by Zhang Jianmin to further smooth the way for BJC development.

Though the local government was responsible for much of the day-to-day activities at BJC, such as coordinating parts deliveries and developing local suppliers, the national government took the top billing as policy maker for the venture. This outcome was the result of several factors: first, and most obvious, was the location of the venture in the nation's capital. Because of this, central leaders seemed to develop a natural interest in the project's welfare.

The national government also took a major role in BJC's development as local officials deferred to the central will. Unlike the other ventures this study investigates, including Volkswagen in Shanghai and two others in Guangdong province, Beijing Jeep lay directly in the shadow of the national government. Local officials probably felt intimidated by the proximity of central leaders; and the settlement of the 1986 crisis, and St. Pierre's later dependence on Zhu Rongji reinforce this proposition.

In sum, local government generally played more of a supporting role in policy-making for the auto project. The key central government players began with generally unified optimism about the Jeep venture. As problems arose, however, so did opposing factions within the government; Beijing Jeep was lucky that its supporters

were more influential.

Policy Implementation: Did BJC's Road Get Any Smoother?

The joint venture began with an extended period of contract talks. As noted, there were nearly a dozen government offices overseeing the discussions, and some officials had not yet come to appreciate the potential benefits of foreign investment. Such layers of slow-moving bureaucrats delayed the establishment of the first automotive venture, in spite of the general support for the project from top political leaders.

Once the venture was established, however, and had begun its operation, the decision-making process seemed to accelerate. The local Chinese officials, for example, were very quick to approve the importation of Cherokee kits: the Americans suggested the idea in September of 1984, and by mid-October of that year, the Chinese accepted the plan.[73] Of course, the central government played no role in approving the scheme, but the layers of government overseeing the local officials seem to have evaporated.

Troubles surrounding the 1986 crisis may have intimidated local officials, who in any case lacked the foreign reserves needed to ameliorate the situation. Local government officials then appeared as obstacles to a solution; so frustrated AMC representatives, led by St. Pierre, skipped over the city government, and even bypassed the CNAIC and ministerial levels, to seek quick relief with Zhao Ziyang's office. Once the top leadership learned of the crisis, it acted quickly to reach a solution.

BJC was fortunate to win the favor of SEC vice-minister Zhu Rongji. In future clashes with the Chinese bureaucracy, St. Pierre was able to appeal directly to Zhu for help. Once Zhu left for Shanghai, however, the venture did rely more on the city

[73] *Beijing Jeep, op. cit.*, pp.160, 162

government for needed aid.

Overall, the government displayed a rather significant degree of Steinbruner-type "learning" (see Chapter One for this term's definition) in responding to problems the joint venture faced. The early years of talks were marked by inaction, the result of unfamiliarity with foreign entrepreneurs, and of a general distrust of outside investors. By the mid-1980s, however, the Chinese seemed to have modified their decision-making apparatus; the major local decision to allow Cherokee production was made in record time. The post-crisis years demonstrate the value of AMC contacts with the top leadership; most local-level obstacles could simply be over-ridden by orders from the top. The latter years of the venture, however, show BJC's increasing reliance on local officials to solve problems, indicating that this level of government was then organized well enough to encourage generally smooth implementation of policy decisions.

Summary and Projections

The information presented in the previous sections is summarized in Figure 4.2, a chart based on the theoretical framework outlined in Chapter One.

As noted in the historical section of this chapter, the Beijing Jeep venture achieved a significant degree of success in the aftermath of the 1986 crisis. Its strong gains in vehicle production, steady progress in localization efforts, and its ability to generate a profit testify to the company's positive achievements.

BJC's gains, however, came in the wake of preferential treatment by the central government, and sacrifices made to keep the company viable during the difficult times in 1986, 1989 and 1990. Will the central authorities continue to provide aid on demand to the Chinese Jeep company?

During the middle and late 1980s, BJC achieved status as a kind of "model" joint venture, and its success became important for attracting other foreign

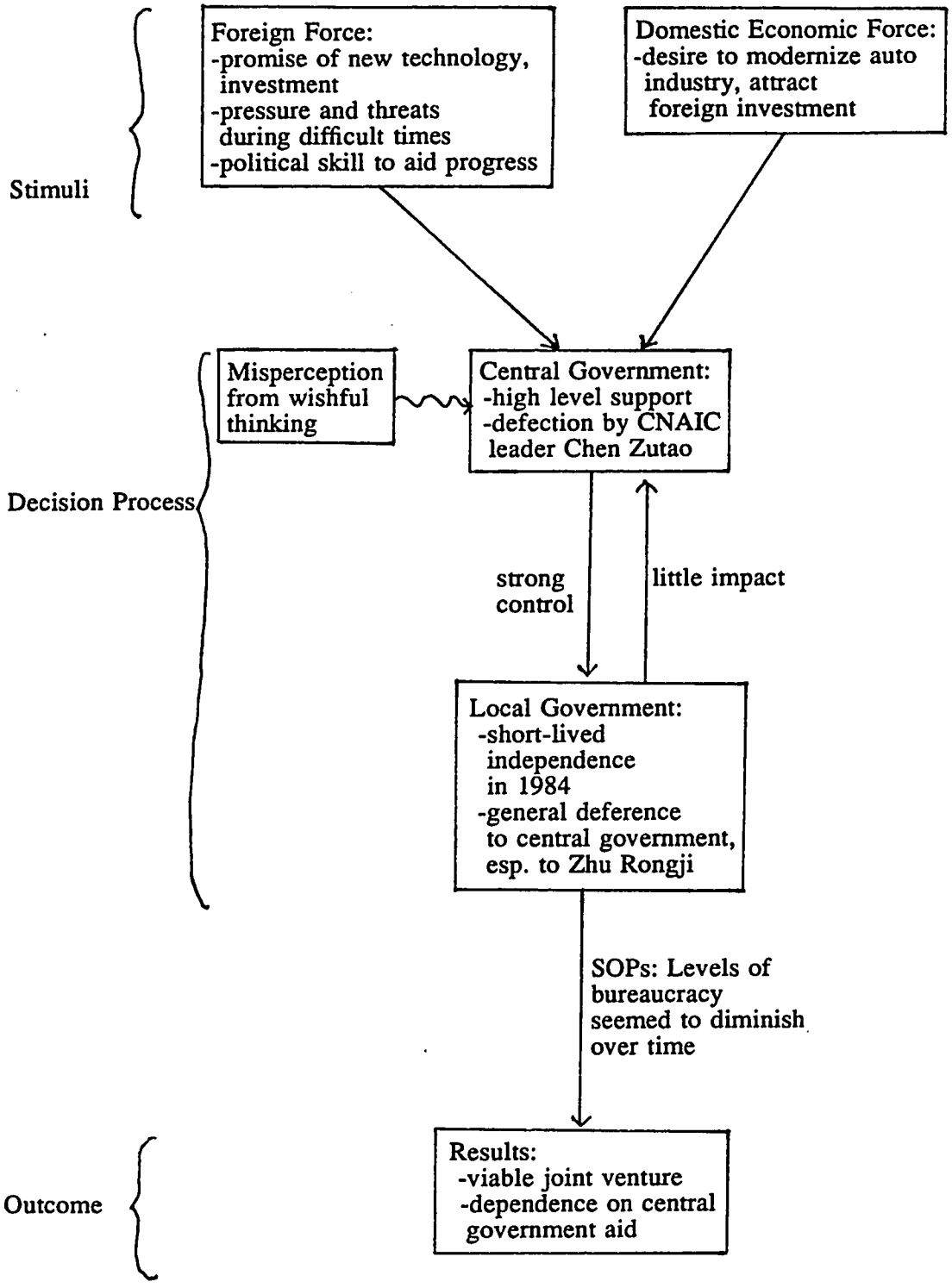

Figure 4.2: A Summary Diagram of the Beijing Jeep Case

investment to China. By 1990, however, the utility of such a "model" was in question: in the wake of the Tiananmen killings, could one single venture really function to attract further foreign business? Was such a modern "Dazhai" any longer necessary?

The answer to these questions is unclear, but, with the proliferation of other joint ventures in the late 1980s, and large-scale investment from Taiwan compensating for losses following the spring of 1989, the importance of Beijing Jeep was certainly diluted. Were the venture again to experience problems of the same magnitude as those seen in 1986, it was by 1991 doubtful the government would react with such vigor to sustain the company. The success of BJC to the time of this writing, however, and solid contacts the Americans had established with Chinese political forces, provided the venture a momentum indicating it might survive, and perhaps even thrive, into the foreseeable future.

Chapter 5:

Shanghai Volkswagen: Success Through Foresight and Local Cooperation

As China's most cosmopolitan city before the 1949 communist revolution, Shanghai had several decades of close contact with western nations. European influence (predominantly British and French) was particularly strong. It seemed fitting, then, that Shanghai would chose a German auto manufacturer to found the city's first foreign vehicle venture.

This chapter analyzes the successful development of Shanghai Volkswagen, one of the largest single foreign-invested projects ever conceived in China. Compared to Beijing Jeep's course, the German venture's progress was steady and smooth, though somewhat slow. How did the Germans avoid the serious troubles that plagued BJC in its early years? Below, we examine the political and economic elements that contributed to Shanghai's success story.

The Shanghai Industrial Setting

Pre-revolutionary Shanghai saw significant industrial growth over the thirty years following World War I. The city was known for its trading enterprises: some 40 percent of China's imports and exports passed through Shanghai in the 1920s and 1930s.[1] Annual industrial growth from 1919 to 1939 reached nearly 14 percent, with textile and light machinery production leading the advance.[2] The municipal banking sector competed with well-established foreign concerns in the city's international treaty settlements, though the Chinese financiers and other business people benefited from foreign capital and expertise.[3] By 1935, about half of all foreign

[1] Marie-Claire Bergere, " 'The Other China': Shanghai from 1919 to 1949," in *Shanghai*, Christopher Howe, editor, Cambridge, Cambridge University Press, 1981, p.4

[2] *Ibid.*, p.4

[3] *Ibid.*, p.10

investment in China was found in Shanghai, and the city produced a similar percentage of the nation's industrial output.[4] Japanese occupation in 1941, however, forced out British, French, and American concerns.

Throughout its years of early development, Shanghai maintained a strong fascination with automobiles and their manufacture. In 1902, the city registered its first two imported passenger cars, both of which were American Oldsmobiles. The Shanghai Automobile and Tractor Associated Company was founded in 1910, and was soon joined by a car and bus repair factory in nearby Anting, and by the Shanghai Chassis Factory, created in 1912. In 1918 the Shanghai Firetruck factory began operation, and was followed one year later by the Shanghai Heavy Truck repair factory. A second wave of manufacturers came three decades later, with the formation of the "7424" assembly factory (in 1941), and the Shanghai Diesel Locomotive Factory (1947).[5]

Following the communist takeover in 1949, Shanghai's heavy industrial sector developed quickly. The textile industry had held the lion's share of Shanghai's 1949 output, constituting 62.4 percent; light industry accounted for 24 percent, and heavy industry only 13.6 percent.[6] Over the first ten years of the People's Republic, however, heavy industry grew by some 42 percent annually, leaving it with 52 percent of the city's industrial output in 1959. Textiles had fallen to account for only 27 percent of production by that year.[7]

The Great Leap Forward brought a further rise in Shanghai industrial growth. A nationwide campaign to produce iron and steel helped feed the machinery manufacturing sector; the city's industrial output soared 50 percent in 1958 and 43 percent

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[4] *Ibid.*, pp.21-22

[5] For details on these factories, all of which still existed into the 1980s, see *Zhongguo qiche gongye nianjian*, (Chinese Automotive Industry Yearbook), Beijing, Jixie gongye chubanshe, 1986, pp.530-537

[6] Christopher Howe, "Industrialization Under Conditions of Long-Run Population Stability: Shanghai's Achievement and Prospect," in Howe, *op. cit.*, p.160

[7] *Ibid.*, pp.160-161

in 1959.[8] This period saw the establishment of more automotive factories, including the Shanghai Automotive Electric Motor Factory, the Shanghai Automotive Transmission Shaft Factory, and, most important, the city's first passenger car factory, the Shanghai Automotive Assembly Plant (later known as the Shanghai Car Plant, or SCP), all founded in 1958.

In the wake of uncoordinated "Great Leap" efforts, Shanghai (and the rest of China) faced severe economic retrenchment in the early 1960s. In fact, from 1959 to 1973, heavy industrial growth slowed to average 6.25 percent per year.[9] Construction of major new automotive factories virtually stopped, though cooperation among the various manufacturers allowed the SCP (Volkswagen's future partner) to produce its first "Pheonix Brand" car in 1958. As noted in Chapter Two, production at the factory remained extremely limited, with output barely reaching one hundred vehicles each year (See Figure 2.1). In 1964, SCP modified the Pheonix, and thereafter sold its vehicles under the "Shanghai Brand" model name.

Shanghai heavy industrial development continued in the late 1960s and early 1970s, with concerted efforts to modernize steel production. By the mid-1970s, the city's steel output trailed only that of the northeast steel town of Anshan; in 1970, furthermore, Shanghai received one of only two modern oxygen furnaces imported into China.[10]

Given Shanghai's commitment to and investment in heavy industry, it is not surprising foreign automotive companies would look to the city as a prime joint venture site. The following section outlines the city's early attempts to arrange such cooperation.

Joint Venture Exploration[11]

[8] *Ibid.*, pp.158, 175
[9] *Ibid.*, p.161
[10] *Ibid.*, p.180

In May, 1978, several months before Deng Xiaoping consolidated his power at the key reformist third plenum of the CCP eleventh party congress, First Machine Building vice minister Yang Keng led an official delegation to West Germany. Though Volkswagen (hereafter VW) was not on Yang's stated itinerary, the Chinese group requested a meeting with VW officials, and asked whether the Germans would be interested in a cooperative automotive project. The Chinese said they desired technical knowledge, modernization of equipment, and, eventually, the ability to export cars. They envisioned a factory capable of producing up to 200,000 vehicles per year. According to Chinese sources, the overtures were inspired by the State Planning Commission, then led by Yu Qiuli.

VW officials responded positively to this initial contact, and preliminary discussion soon followed. The Germans pointed out in these early contacts, however, that existing Chinese production systems were quite outdated, and that the Chinese goals were far too ambitious. The Chinese, perhaps somewhat disillusioned, withdrew from the talks for several months, and the Germans believed they had lost interest.

In March, 1979, however, VW was surprised by an invitation to send a delegation to China. Rao Bin, then FMMB vice minister, greeted them, and renewed his country's cooperation proposal. The Germans again questioned China's ability to produce an export-quality vehicle; the Chinese pointed to Shanghai, however, saying that they were in fact already manufacturing cars. These talks focused attention on the Chinese proposed site in Shanghai. The Germans then decided to convince the Chinese of potential production limitations by staging a manufacturing experiment in that industrial city.[12]

In late 1982, then, the Germans began trial production of their Santana model

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[11] Most of the following discussion of Volkswagen negotiations is based on interviews conducted in Shanghai in 1990.

[12] VW also considered a venture with the Second Auto Works in Hubei, but rejected it because the site had only a rail transport connection, and no port.

vehicle at the SCP. VW shipped completely knocked-down kits (CKDs) to Shanghai, and the Chinese workers assembled them. In conducting this operation, the Germans had several goals. First, they wanted to test the logistics of shipping car kits to China, noting problems with customs regulations, parts storage, etc. Second, they wanted to see how the Chinese reacted to the required quality stipulations associated with the new technology. Finally, VW wanted to establish itself as a serious potential investor in a Shanghai joint venture, with potential access to the domestic Chinese market.

Shanghai officials, who by then dominated the Chinese negotiating team,[13] felt the trial provided useful training for its assembly-line workers. Furthermore, they could see whether the Santana model was appropriate for domestic road conditions.[14] In 1983, then, the experiment produced some 430 vehicles; the following year, the factory assembled about 450, all of which were bought by the Chinese. Furthermore, eight Chinese workers went to Germany for advanced training, and VW sent technicians to Shanghai to give instruction.

As the negotiations and trial operation proceeded, Shanghai automotive manufactures publicly proclaimed their own "Shanghai" brand sedan production system was in fact ill-equipped for future Chinese market requirements. One study in 1982 asserted the SCP lacked the efficiency to meet the demand of emergent taxi companies, government officials, and other work units, and called for improved technology and a better product.[15] In 1983, the factory came in for further criticism, with one writer noting the SCP's efficiency fell far below that of American or

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[13] The Chinese team was led by four officials: Qiu Ke, manager of the Shanghai Automotive Industrial Corporation (SAIC); Jiang Tao, vice chairman of the Shanghai municipal planning committee; Zhou Mengxiang, vice manager of the Bank of China's Shanghai Trust and Consultancy Corporation; and Zhang Xingyue, a deputy manager of the CNAIC. This team represented all four of VW's future joint venture partners.

[14] The Chinese, though eventually accepting the Santana, found its shock absorbers too weak for domestic roads, and its back seats too small for adults to sit comfortably.

[15] Xia Chuanwei, "Shanghai pai jiao che de shi chang fen xi yu xiao shou yu ce," (Analysis of the Shanghai-brand Sedan's Market and Sales Forecast), in *Yuce (Forecast)*. 1982, no.2, pp.38-41

Japanese production levels, and that the vehicle model had hardly changed in two decades. (Like Changchun's luxury Red Flag automobile, the Shanghai brand sedan was originally modeled after the 1950s Mercedes 220 series). Furthermore, the car's price was too high, at RMB 20,000 (US$ 10,300); and its top speed too low (130 km/hour).[16]

The 1983 report stressed not only the need for an improved passenger car, but also proposed a major export plan.[17] In order to reach such a goal, however, cooperation with foreign investors was essential.[18]

Shanghai officials did not limit their contact to German automotive representatives. General Motors, Ford, and various European companies also expressed interest in a Shanghai project. As noted in Chapter Two, Japanese companies investigated the city's prospects in the early 1980s. The German trial operation, however, demonstrated VW's sincerity, and kept the company in the lead for selection as a partner.

While the discussions in Shanghai continued, AMC's talks in Beijing over the Jeep project were nearing a conclusion. As Chapter Four noted, the Americans had promised to help the Chinese develop a completely new vehicle model. Would not the Germans do the same in Shanghai, asked VW's negotiating partners? If not a new model, then the Germans should at least make some concessions in light of the proven American flexibility.

The Germans, however, were unfazed by the Chinese request. They ruled out any possibility of developing a new model, anticipating BJC's problems, and

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[16] Wang Changda, "Dui Shanghai jiao che gong ye fa zhan zhan lue wen ti de tan tao" (Inquiry into Problems of the Shanghai Brand Sedan Industrial Development Strategy), in *Caijing yanjiu* (Finance Research), 1983, no.2, pp.26-30

[17] This particular plan (in *Caijing yanjiu, op. cit.*, pp.29-30) set out a detailed (though, in retrospect, vastly over optimistic) schedule: by 1985, the factory should have exported up to 1000 vehicles, mainly to Hong Kong and Macao; by 1990, it would sell up to 30,000 vehicles per year to overseas Chinese in Southeast Asia; by 1995, Africa and Latin America would buy 50,000 vehicles per year; and by the year 2000, up to 100,000 Shanghai cars would be sold all over the world. (For comparison, in 1990, Shanghai Volkswagen actually produced 18,500 cars, and exported none).

[18] *Caijing yanjiu, op. cit.*, p.27

insisted CKD imports were the only method of producing quality vehicles in Shanghai. The Chinese, apparently impressed by the German frankness and practicality, accepted their position on the issue.

VW officials were struck by early Chinese naivete on other negotiating points. One German representative remarked that in the early stages of the talks, Shanghai automotive officials had difficulty comprehending financial calculations, and often required careful instruction from the foreign side to understand details of the German proposals. VW representatives, though, intent on crafting a clear and precise contract, acted patiently to explain the unclear points.

Finally, the two sides moved toward agreement. VW's partners in the venture were proposed by the central government, though the Germans approved of the choices. VW was to hold 50 percent of the new company, named Shanghai Volkswagen (SVW). The Shanghai Automotive Industrial Corporation (SAIC), which, as noted in Chapter Three had tight control over the Shanghai Car Plant, took 25 percent of the venture. The rest of SVW was owned by the Bank of China's Shanghai Trust and Consultancy Corporation, with 15 percent, and the CNAIC, which held 10 percent. Later sections will comment on the utility and value of each of these partners.

The new company was capitalized at RMB120 million (about US$40 million), with the SCP factory, in Shanghai's suburb, Anting, contributing equipment and about half of its factory space. VW promised advanced technology, but put up most of its RMB60 million in cash. The contract was to run for 25 years. It was signed with much ceremony in October, 1984, during a visit by West German chancellor Helmut Kohl. Premier Zhao Ziyang also attended the signing, showing top-level Chinese concern for the huge foreign-invested project.

SVW's Plan, and Early Problems

The contract VW negotiated with the Chinese was notable for attention to detail, and its ability to predict future difficulties. (One VW representative said West German experiences with socialist East Germany may have contributed to an understanding of command economies and their shortcomings).

Several clauses in the SVW contract differentiated the venture's agreement from that of the BJC project described in the previous chapter. As noted above, for example, the Germans insisted on assembly of imported CKD kits.

Other parts of the contract, however, also demonstrated VW's foresight. Anticipating the problem of paying for imported kits with Chinese yuan remittances, the contract allowed SVW to convert Renminbi into German Marks at the prevailing, official exchange rate until the venture had produced 89,000 cars. Such a clause would help protect the company against the kind of debacle BJC faced when it lacked the ability to pay for Cherokee imports.

The contract took into account the need to localize the Santana model. According to the agreement, however, responsibility for providing quality parts made in China rested squarely with the Chinese; VW had no obligation to hasten the process.

To help balance the foreign exchange flowing out of China to pay for kit imports, the contract called for the venture to export engines produced in Shanghai back to West Germany for use by the foreign partner, VW. It is unclear whether the agreement called for VW to buy a specific number of engines over the life of the contract, but the price VW would pay for each engine was pre-determined. As we will see, this clause also played to the German advantage in a later dispute.

In early 1985, then, SVW moved in earnest to transform production at the Shanghai factory. The first session of the venture's board of directors decided to invest RMB 250 million (about US$85 million) to renovate the SCP's assembly line and body-finishing section.[19] The Santana price was set at RMB 40,000

[19] *China Reconstructs*. North American edition, November, 1985, p.33

(US$13,800), comparable at the time to the cost of a Japanese import vehicle before tax.[20] By the end of the year, production had reached 30 cars per day. The SAIC, which had some 140 subordinate companies in its group, encouraged its parts factories to improve quality to meet VW standards. Several of these suppliers licensed foreign technology to raise standards; one factory collaborating with a West German corporation was able to contribute tires to SVW, and, reportedly, exported some of its product to western nations.[21]

Though the venture had some early success, its first years saw many problems characteristic of foreign-invested Chinese projects. In modifying the SCP facilities, for example, Chinese construction crews were slow: they traditionally measured their achievements in terms of new footage completed, and shunned renovation work. Local banks were inefficient, failing to budget funds to lend SVW.[22]

Perhaps most disappointing was the mixed support among local political leadership. Municipal construction authorities were late in implementing needed infrastructural improvements. City planners were lax in encouraging localization parts projects, and in raising funds to aid the development of the main factory. One report complained Chinese officials had acquired some of the first cars off the assembly line, then sold them domestically for foreign exchange and failed to reimburse SVW.[23]

In interviews, Chinese officials defended themselves against some of these charges. They noted, for example, that reconstruction and redesign of outdated equipment is always time consuming. Furthermore, they asserted the city government did try to solve some of the early problems: vice mayor Li Zhaoji, for example, called local banks together to press for greater cooperation with SVW.[24] Others

[20] *Far Eastern Economic Review*, May 23, 1985, p.75

[21] *China Reconstructs, op. cit.*, p.33

[22] He Ling, "If Things Go On Like This, There'll Never be a Chinese Detroit," translated in *The China Business Review*, (July-August, 1986), p.35.

[23] *Ibid.*, p.35

[24] Based on 1990 interview in Shanghai.

made detailed suggestions for remedying the problems, calling, among other proposals, for a leading municipal group to coordinate automotive development (a suggestion later implemented); relaxation of employment rules to attract all sorts of skilled workers; and acquisition of technology from other manufacturing plants around China to conserve investment funds.[25]

Despite these troubles, SVW production showed steady growth in the company's first years. In 1985, the factory turned out 3356 Santanas. The number more than doubled in 1986, to 8031, and climbed to 10,470 in 1987.[26] Engine production also grew strongly, rising from 352 complete engines in 1987 to 13,085 in 1988.[27] The Shanghai factory had a short experiment making 100 of VW's "Passat Variant" models in 1986, and assembled nearly 1000 "Audi 100" cars in 1986 and 1987. (In 1988, manufacturing efforts for the Audi moved to a different VW venture in Changchun, in northeast China).

Workers at the Shanghai plant were pleased by some special joint venture benefits. Salaries were high, ranging from RMB 140 (including bonuses) to RMB 300 per month; such compensation greatly exceeded most Chinese factory wages in 1986. SVW's allotment of seven days of paid vacation was also attractive to Chinese employees, who had no previous experience with such a perquisite.[28]

In 1988, problems again surfaced for the German venture. The BJC crisis of 1986 had raised central government concerns about CKD imports. These kits were a drain on foreign exchange reserves, and the only method of stanching the outflow of hard currency lay in localizing parts production in China. With the truce over AMC's dispute in place (see Chapter Four), the central leaders turned their attention

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[25] Zhang Wei, *et. al*, "Dui Shanghai jiaoche gongye fazhan de shi dian jianyi", (Ten Suggestions for the Development of Shanghai's Passenger Car Industry), in *Shanghai guanli kexue* (Shanghai Management Science), 1986, no.3, pp.46-47

[26] Shanghai Volkswagen 1989 Annual Report, p.8

[27] *Ibid.*, p.8

[28] Joint Publications Research Service - China Economic Affairs (JPRS-CEA), October 1, 1986, p.47

to the VW venture in Shanghai.

As Figure 5.1 shows, localization of Santana parts in the company's early years proceeded fairly steadily, and was in fact on a par with BJC's progress (see Figure 4.1) and with that of Guangzhou Peugeot (Figure 6.1). Still, CNAIC chief Chen Zutao led a campaign to force more rapid progress in the use of Chinese parts. In 1988, Chen said SVW should move quickly to localize up to 80 percent of the Santana; he implied the volume of raw materials supplies to SVW might be linked to the localization rate.[29]

The problem for SVW finding local parts for its vehicles was the same one BJC had faced three years earlier (see Chapter Four): local quality was too low. The SCP's traditional suppliers of such components as carburetors, cylinders, and chassises were unfamiliar with high foreign standards, and refused to invest funds to raise quality until they were given large, economy-of-scale orders for their product. In its early years, however, SVW required only a few hundred or a few thousand items. In a vicious circle, though, the central government was loathe to allow a larger number of CKD imports until the joint venture reached higher local content rates.

For the Germans, of course, profits were generally greater when local content was low, as this gave VW the chance to export more parts to China. (See Figure 5.2). To overcome this obviously foreign-inspired inertia, and the above-mentioned vicious circle of parts supplies, the Chinese imposed localization taxes on each domestically-sold Santana. In late 1988, then, SVW sold its product to SAIC for RMB 70,000 (US$18,800). The SAIC then resold the sedans to authorized distributors for an exorbitant RMB 140,000 (US$37,600) per car; the RMB 70,000 windfall went to the Shanghai government, which used most of it to subsidize local parts

[29] *Zhongguo qiche bao* (China Automotive News), June 30, 1988; and *Shanghai qiche bao* (Shanghai Automotive News), August 2, 1988, p.1.

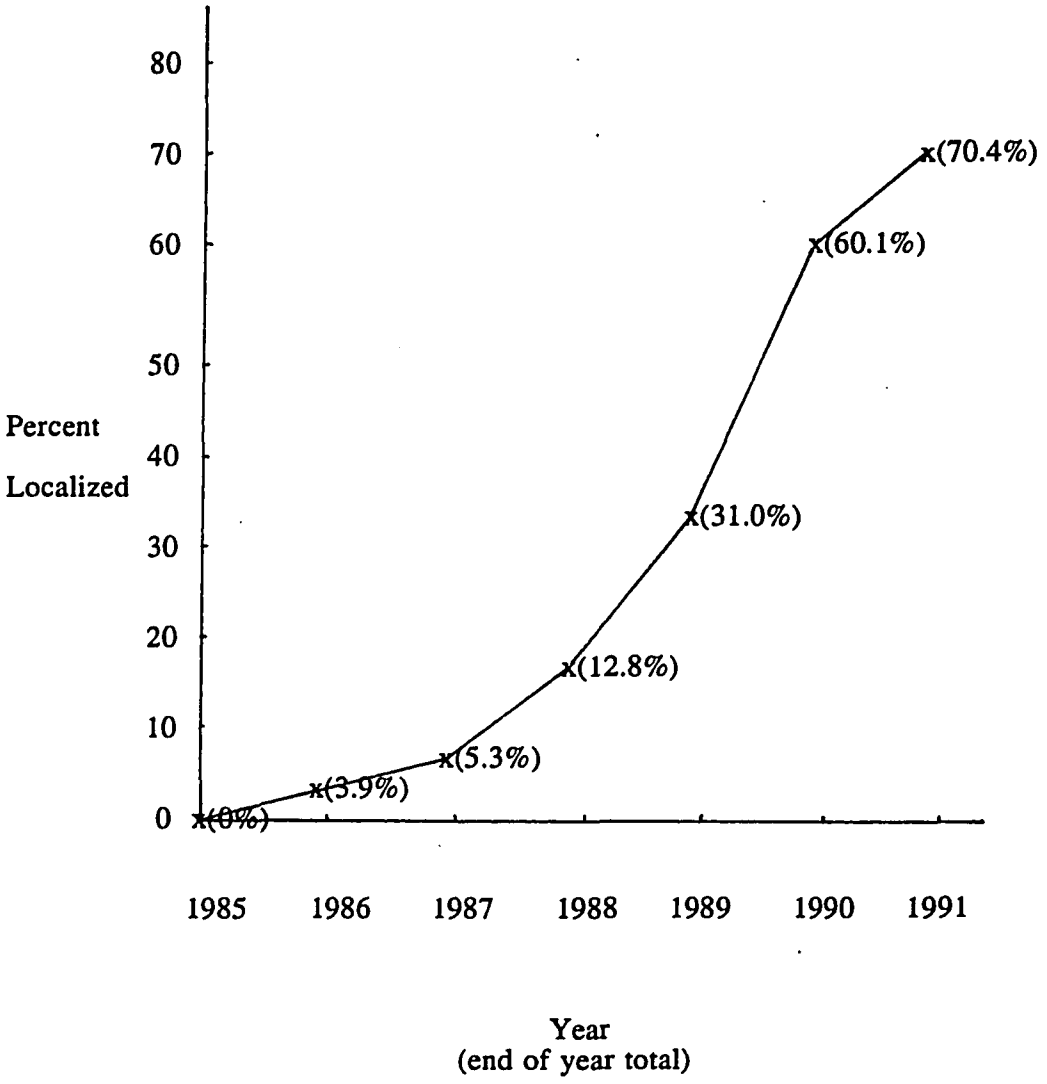

Figure 5.1: Localization at Shanghai Volkswagen

Source: 1992 Correspondence With Volkswagen

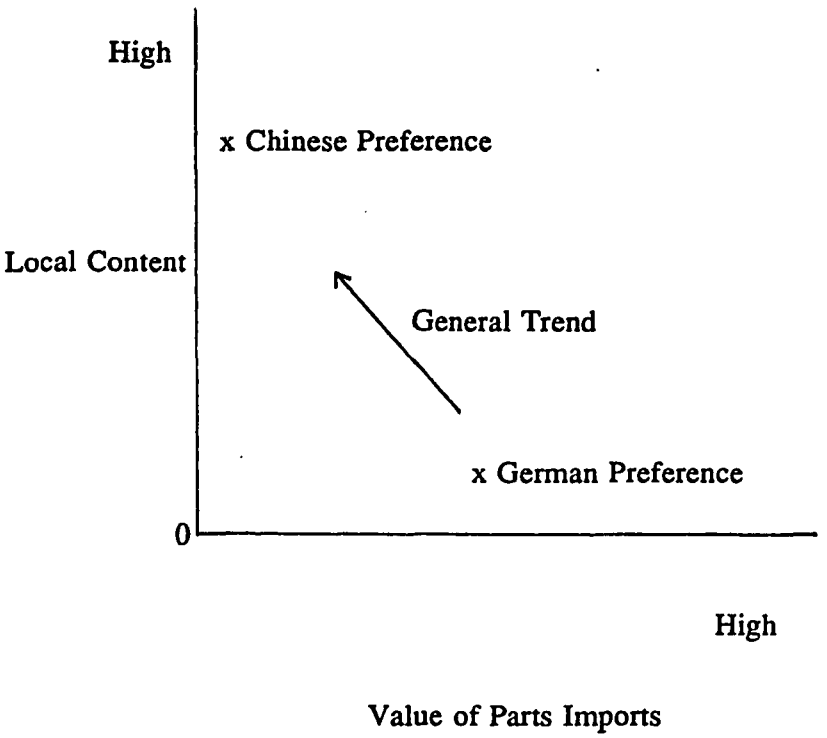

Figure 5.2: Chinese and German Preferences for Kit Imports and Local Content

Note: As local content rose, the value of parts needed by the Chinese would generally decrease; at 100 percent localization, the value of imports is, of course, 0.

suppliers.[30] The Germans would have naturally preferred a lower price for the vehicles, to spur more demand; but there was little they could do to prevent this process.

The Chinese did grant some incentive for the Germans to increase local content. After 40 percent of parts were localized, the imported parts were no longer considered "CKD" kits, and were then taxed at a lower rate. Similar tax reductions were made once the 60 and 80 percent localization barriers were crossed.[31]

In the localization squabble, VW had some further consolation: their contract specifically charged the Chinese with responsibility for providing parts of acceptable quality (which were tested at a special German laboratory transported to Shanghai for this purpose). Furthermore, throughout the Chinese barrage of criticism over localization levels, the Germans refrained from making their problems public. Unlike the Americans at BJC, VW officials patiently allowed the Chinese to find a solution to the problem.

As the controversy over local content abated, the Germans were pleased by the arrival in Shanghai of Zhu Rongji as the city's new mayor. Zhu seemed to make the revitalization of Shanghai industrial development his own private mission. Chapter Three described some of Zhu's steps to aid foreign investors in Shanghai; he also made moves to help SVW in particular.

Even before he was officially named Shanghai mayor, for example, Zhu (then still an SEC vice minister) came to the city in June, 1987, to investigate the auto venture's localization troubles. According to some Shanghai officials, his experience in helping solve Beijing Jeep's crisis (see Chapter Four) made him realize the complexity of successful vehicle industrial development.[32] In the wake of Zhu's visit, the city moved to create its automotive leading small group; it also raised the SAIC

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[30] Todd Thurwachter, "Development of the Chinese Auto Industry: Foreign Participation and Opportunities," US and Foreign Commercial Service document, Guangzhou, China, 1989, p.16

[31] Based on 1990 interview in Shanghai.

[32] Based on 1990 interview in Shanghai.

from a deputy-bureau to bureau level status.

On assuming his duties as mayor in April, 1988, Zhu promoted the founding of a Shanghai taxi company that would exclusively use cars from the SVW plant. The joint venture would sell its vehicles to the company, with a price discount as an incentive. The taxi company was officially founded in 1989; by the following year, the lion's share of sedan taxis in Shanghai were Santana models, and Japanese imported vehicles became more scare on the city's streets.

As noted in Chapter Three, Zhu developed into a strong Shanghai chauvinist in the last years of the 1980s, working hard to promote investment and development in his city. One municipal official noted the major role SVW could play in Shanghai's economic progress: with production of 18,500 cars in 1990, the joint venture already accounted for two percent of the city's output value; at the factory's full capacity of 300,000 vehicles, it would potentially contribute up to 17 percent of Shanghai output.

Once the German venture had acted to overcome its localization troubles, then, it encountered less criticism from central and local officials. Unfortunately, the company was further affected by China's economic austerity measures introduced in late 1988.

Like BJC and Guangzhou Peugeot (Chapter Six), SVW faced a stockpiling of its output, as the central government restricted domestic vehicle sales. Production of some 15,700 vehicles in 1989 fell far short of the contractual projection of 20,000 cars for that year. Furthermore, the factory operated at only 50 percent of capacity in the last part of 1989, and actually halted production in October because of over supply of 3000 vehicles.[33]

Eventually, however, the central government's "emergency purchasing plan" allocated some RMB 1 billion (US$268 million) to buy the inventories of the

[33] *South China Morning Post*, January 6, 1990, Business page 1

various ventures. One SAIC official expressed satisfaction with Beijing's move, commenting that "the central government is certainly relaxing its grip on Sino-foreign automotive ventures and making it easier for state institutions and enterprises to buy vehicles."[34]

As China's economy rebounded in the early 1990s, SVW's development accelerated. The company looked strong in the first years of the decade; its progress is discussed below.

Strength into the 1990s

Like the other major automotive projects in China, SVW had a high public profile as a foreign-investment example. The Chinese hoped to reap positive propaganda from such projects to encourage further investment in other industries. SVW's generally good progress, then, inspired the government to name it number two of China's "Top Ten" joint ventures for 1988 (for comparison, BJC was number three that year, and Guangzhou Peugeot was fifth).[35] SVW continued a strong showing on the list in 1989, as number five, but in 1990 fell to the tenth spot. (BJC fell from third in 1989 to ninth in 1990; Peugeot's company failed to make the list both years).[36]

Production at the Shanghai factory rose quickly. Though 1989 output was limited to 15,688 vehicles (virtually identical to 1988's figure) by the above-mentioned economic austerity policy, 1990 production grew to 18,500, and lept to 35,000 in 1991; 1992 was to see 60,000 Santanas roll off the assembly line, to reach full capacity at the existing plant.[37] Capitalization rose from the initial US$40 million in 1985 to $94 million by 1988. For 1991, SVW projected US$154 million in profits,

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[34] *Ibid.*, Business p.1

[35] *China Daily*, April 25, 1990, p.2

[36] *Ibid.*, p.2; and *China Daily*, June 24, 1991, Business Weekly, p.2

[37] *Financial Times*, January 28, 1992, p.3

a four-fold increase over its 1990 figure.[38] Finally, local content in 1991 exceeded 60 percent (see Figure 5.1).

The venture, however, was not completely free of problems. In 1990, for example, VW and the Chinese disagreed over the price the Germans should pay SVW for engines exported to the home factory in Europe. The Chinese wanted a high price, to earn more foreign exchange; VW officials countered that a price was already stipulated in the venture's contract. It is unclear exactly how the issue was settled, but SVW did ship some 400 engines to Germany in 1990.

Further difficulties loomed as SVW moved to take over the remaining factory space of its partner, the Shanghai Car Plant. The decision to end the SCP's existence came in 1988 after consultation among SVW's shareholders. The Shanghai municipal government, however, took some two years to plan and approve the merger. In June, 1991, the SAIC announced the demise of the SCP, and the retirement of its old product, the Shanghai brand sedan.

SVW's seven years of experience in China probably gave it the ability to integrate the new production area without too much difficulty. Still, the task of converting old machinery and retraining workers seemed daunting.[39]

Finally, the joint venture's most challenging potential problem arose in late 1991, as the company reached its production limit of 89,000 cars, after which it could no longer freely exchange Chinese yuan for hard currency. Though this factor was quite critical in the early and mid-1980s when the venture's contract was written (as the BJC crisis demonstrated), by 1992 it was not quite so troublesome. China had created currency exchange markets, designed particularly for foreign

[38] *International Herald Tribune*, September 11, 1991, p.16

[39] A peripheral problem loomed for outside factories that had previously supplied parts for the Shanghai brand vehicle, and were then required to transform their production. For a discussion of this transition, see Ying Hailong, "Yi Shanghai pai jiaoche yao bu yao xiama wei shili, tan jingying zhanlue ju zhen fenxi de yingyong" (A Discussion of the Use of Management Strategic Matrix Analysis, Using the Shanghai Brand Sedan as an Example of Whether Production Should Cease), in *Shanghai guanli kexue*, (Shanghai Management Science), 1986, no.4, pp.49-51

investors; these markets allowed foreign concerns to change Renminbi to hard currency, though at a premium (of some 10-20 percent). As China moved toward full currency convertibility in the early 1990s, however, the issue seemed to be becoming moot.

In sum, SVW's development presents a striking contrast to the troubled early years of BJC. The following sections trace political and policy-making factors that shaped the venture's successful course.

Stimuli

Foreign Forces

Perhaps most striking in the German approach to the Shanghai automotive project was VW's attention to precise planning. The SVW contract seemed almost clairvoyant in its ability to anticipate troubles. Because of the detailed scheme presented in the charter, the venture avoided problems over CKD imports, foreign currency balancing, rushed localization, and pricing of exported engines.

The negotiation of the contract was characterized by frankness on the foreign side. Unlike the Americans in Beijing, VW representatives refrained from promising difficult deeds in order to quickly secure agreement. Thus SVW could immediately embark on CKD assembly, and avoid arguments over design of a China-specific vehicle. Such early German sincerity probably nurtured Chinese support for solving later problems.

In addition to the helpful contract clauses, the 1984 agreement also displayed some insightful German understanding in accepting joint venture partners. With the SAIC, Bank of China, and CNAIC, SVW had a beneficial blend of both local and national shareholders; their respective contributions to the company are highlighted in later sections.

Finally, the Germans were careful in their selection of Shanghai as a factory site. The city had a long history of automotive manufacture, and was the major passenger car producer in China as the nation opened its doors to foreign investors. Below is more detail on the domestic economic factors characterizing the SVW venture; it is noted here, however, that VW did analyze and choose Shanghai over at least one other site, the Second Auto Works in Hubei.[40]

Domestic Economic Forces

As the SVW venture was conceived and developed in a time period nearly identical to that of Beijing Jeep, many structural similarities exist in their economic environments. Both ventures were founded on the basis of contributing foreign technology to China. The two major factors differentiating the projects in this category, however, were the vehicle type produced, and the developmental stage of the chosen factory site.

Chapter Two pointed out that the Chinese were desperate in the early and mid-1980s to stem floods of imported Japanese vehicles by developing their own modern automotive industry. Many of the imported vehicles were passenger cars, used as taxis and for transport of high- and middle-level political leaders.

With BJC producing sturdy Jeeps capable of riding difficult terrain, then, the two ventures were apparently designed to respond to different markets. BJC's product would be adequate primarily for rough-road transport and goods delivery. Shanghai's Santanas would mainly fill the demand niche of intra-city passenger conveyance. Though BJC officials interviewed insisted their Cherokee model was quite suitable to take taxi duties, its high chassis and rough appearance made it an undesirable choice for such service. The market forces for BJC, then, behaved differently from those SVW encountered.

[40] In late 1990, France's Citroen announced plans to produce passenger cars at the Hubei complex.

The German venture's market outlook was bright. Until Peugeot's factory in Guangzhou began producing sedans in large numbers, SVW would have an enormous potential nationwide demand; at a minimum, it would substitute for Japanese vehicles. In the future, furthermore, a rapidly developing Shanghai economy and its population of more than 10 million would in itself be a valuable captive market for SVW automobiles.

Besides Shanghai's advantage as a potential market, its heavy industrial infrastructure made major contributions to facilitating SVW's development. A large number of parts factories, together with the extant Shanghai Car Plant, and the city's steel and other heavy industries, cried out for the final ingredient necessary for rapid development: modern technology and management skills. Shanghai's local conditions, then, not only attracted the Germans to the city; they also helped ease later problems the venture encountered. When the Chinese complained the rate of localization was too low, for example, SVW could turn to relatively advanced municipal suppliers to help ameliorate the troubles. Shanghai city leaders, furthermore, had experience in guiding heavy industrial development, and were another source of aid to the new company.

Again, Shanghai had advantages in this aspect over BJC and the other case study ventures, Guangzhou Peugeot and Panda. Chapter Four already noted some of the difficulties BJC had with finding quality suppliers; Chapters Six and Seven will show the other two companies initially found even more rudimentary local industrial conditions for their projects in southern China.

Government Decision Making

Political Bargaining

Beijing's Role

Like the BJC venture, VW's project required the approval of most of China's top political and planing organizations. The Shanghai auto plan therefore had to pass by the CNAIC, MOFERT, Ministry of Finance, Bank of China, and the State Planning and Economic Commissions (in addition, of course, to the Shanghai government) before the State Council approved it.

The highest political leaders seemed to have played little active role in shaping the project. Unlike BJC, the Shanghai company had no serious crisis, and therefore felt less need to appeal to top leaders for aid. Zhao Ziyang's presense at the contract signing ceremony, however, indicated his general support.

Political changes later in the life of the venture may have portended benefit for SVW. In 1989, the city's communist party secretary, Jiang Zemin, was elevated to become the national party secretary. SVW sources note he was not particularly helpful to the car factory during his several years of political power in Shanghai; still, Jiang's new authority would most likely speed the city's overall economic development, allowing peripheral benefits to the joint venture.

In 1991, former mayor Zhu Rongji became a national vice-premier. As already noted, Zhu had taken several steps to aid SVW while in Shanghai; his background had shown him to be generally sympathetic to foreign automotive projects. Furthermore, SVW officials felt his contacts developed during his previous tenure in Beijing were quite valuable to the company, and that he could at times lobby for some preferential treatment. His removal from Shanghai undoubtedly diluted his ability to help the company solve specific problems; his return to the capital, however, did give SVW a powerful voice at high central levels, and overall, may have been a positive development for the factory.

The State Planning Commission played a major role in determining allocations of kit imports, a factor critical to SVW's development and localization success. As noted, the Chinese government rescued the country's automotive joint ventures in

the depths of 1989's austerity by purchasing stockpiled vehicles. The State Council and the SPC, which played the major roles in this policy change, further granted SVW 2000 additional CKD import licenses for 1990; as mentioned above, production nearly doubled in 1991. This sympathetic regulation implies the top central planners hoped to see SVW succeed.

At lower central government levels, SVW found a mixed bag of allies and adversaries. The Bank of China (BOC), subordinate to the ministry-level People's Bank of China, had a natural inclination to support the project, and could help by granting quick guarantee approval to foreign loan requests. As a bank, however, the BOC had relatively little influence over other central policy-making processes.

The CNAIC must have felt some schizophrenia over the SVW venture. As a partner in the company, it stood to reap financial benefits from the project, and therefore had an incentive to see it prosper. On the other hand, the CNAIC leader, Chen Zutao, harbored the same scepticism about foreign auto investors that became manifest during the BJC crisis. One SVW source sensed Chen had a predilection for "other manufacturers" (most likely a reference to General Motors, which, as Chapter Three noted, Chen greatly admired). Furthermore, Chen's hostility toward the 1986 BJC settlement seemed to carry over to his 1988 attacks on SVW's local content rate; perhaps he took on the Germans out of a personal sense of spite over his previous bargaining loss. With Chen's retirement at the end of 1988, however, the attitude of the new CNAIC leadership toward SVW was unclear.

As noted above, the machine-building ministry (FMMB) was the first to send representatives to Germany to propose a Shanghai joint venture. FMMB vice minister (later minister and CNAIC chief) Rao Bin was apparently a major proponent of the project. In the subsequent contract negotiations, however, the ministry deferred to the Shanghai government and VW's future joint venture partners. Major negotiating points, however, were nearly always referred to Beijing, where the FMMB

apparently could sway the direction of the talks. Thereafter, the ministry seemed to take little direct interest in SVW, though it could of course shape the venture through its subordinate, the CNAIC.

Like the other joint ventures studied in this thesis, then, SVW depended on the central government for production approval, loan guarantees, some raw materials supplies, and sales allocation. To win favor in Beijing, the Germans often relied on local politicians to help influence central leaders. The city government itself, however, was also crucial in solving many of the company's smaller problems. The following section examines Shanghai's role in carrying out both of these functions.

The Shanghai Municipal Role

For influencing central government policy, SVW had, as mentioned, two natural allies in its partners, the Bank of China and the CNAIC. Shanghai mayor Zhu Rongji, however, also used his influence, based on his previous posting in Beijing, to aid SVW.

On occasion, for example, the central government's allocation of steel to the venture was insufficient. According to SVW sources, Zhu was key to increasing the company's steel quota to satisfy its needs. Such action obviated the need to turn to black market sources, apparently the only recourse when central supplies were too low.

As SVW moved to absorb the remaining space of the Shanghai Car Plant, final permission for the acquisition depended on State Council and CNAIC approval. Chinese sources note, however, that mayor Zhu's opinion could effectively overrule that of the CNAIC, and that it would hold great weight in the State Council. Zhu apparently supported the merger as he left his mayor's post in April, 1991, and the consolidation began in June of that year.

Of course, most local political action related to SVW was directed at solving

problems on a smaller scale. The previously mentioned municipal automotive small group took the lead in coordinating the city's automotive policy. Ceremonially led by Zhu, the group in late 1990 included vice mayor Huang Ju, who succeeded Zhu as mayor in 1991. Huang, therefore, had some expertise and interest in the industry, and was then likely to extend this concern to his tenure as mayor.

The rest of the small group in 1990 consisted of representatives from the municipal planning, economic, international trade and construction commissions, and the SAIC leader, Lu Ji'an. Each of the municipal bodies played a role in SVW's development: the international trade commission helped regulate the company's foreign exchange; the economic and planning commissions charted the long-term localization process.

Second only to Zhu Rongji in securing municipal support for SVW was SAIC head Lu Ji'an, who also held the post of SVW board chairman beginning in 1987. Lu had been a deputy economic commission chief in Shanghai since the early 1980s, and had simultaneously held the top SAIC position. With national moves to separate government and industry, however, Lu relinquished his commission post in 1989. Chinese sources, however, note his power to influence municipal planning officials remained strong. Lu could, for example, help ensure a reliable municipal supply of electricity and water for the automotive plant by using his connections in the city government.

Under the various commissions came two bodies specifically designed to aid the SVW project. The Shanghai Localization Office was to consult with venture managers on ways to speed the localization process. A "Shanghai Santana Commonwealth" included local research institutes and universities, and was designed to coordinate city-wide efforts to improve production of the German-designed vehicle. Of all the ventures examined in this study, SVW was the only one receiving advice from such an institutionalized forum.

In general, Shanghai seemed to take great pride in the progress of the German auto company. Local political appeals to the central government, combined with concrete steps to solve problems, helped the company reach significant production levels and high profits by the early 1990s. The funding of the Shanghai Volkswagen taxi company, noted above, was one of several important steps the city took to guarantee the venture would succeed. As Shanghai itself moved to reclaim its stake as China's most developed and cosmopolitan city, then, SVW appeared as an important building block in reaching this goal.

Misperception

Probably the best method of avoiding misperception is to emphasize exchange of accurate information and truthful intentions. The German representatives stressed such communication, leaving few surprises to stall SVW's progress.

The joint venture contract was quite detailed, and anticipated many of the problems the company would face. As noted above, SVW avoided most of the complications that plagued BJC.

The only indication of Chinese "wishful thinking" lay in their apparent perception of significant flexibility in the contract. Once the Germans had agreed to a price for engines sold to them from the SVW factory, for example, they believed it was a solid commitment. The Chinese, however, insisted in 1990 that the selling price was too low, and apparently wanted to ignore the contract stipulations. It is unclear exactly how this dispute was settled, though with SVW's high profitability, the Germans were probably willing to make some concession beyond the stated contract terms.

The German trial venture in the early 1980s also served to dispel over-optimistic notions of what the venture could accomplish. Both sides had a chance to experience the levels of technology and quality standards that could be applied in

Shanghai, giving more realistic expectations for the company's first years of operation.

In general, the SVW case shows a clarity of purpose and achievement unmatched by BJC and the other ventures discussed in Chapters Six and Seven. The mutual understanding played a significant role in avoiding perceptual problems typical between the Chinese and western foreign investors.

Policy Process Conclusions

The key to coherent policy making for the SVW project lay in thoughtful planning by the German representatives, and in their amenable Chinese counterparts who cooperated in writing the venture's original contract. When problems arose, the document provided guidance (generally in VW's favor) to indicate a rational course of action.

The central government placed great importance on SVW, and, as was the case with BJC, wanted to see it succeed. Chen Zutao's personal predilections made manifest some ambivalence to such foreign projects, however, and the calls for speedier localization were the major form of political pressure from Beijing. The 1989 central bailout of SVW (and other auto manufacturers), though, showed a consensus behind supporting automotive development.

Finally, local decision makers also displayed some hesitancy over SVW in its early years, moving slowly to take some necessary steps to solve problems. Misperception of their obligation may have contributed to their sloth. The new mayor Zhu Rongji, however, rallied city officials to support the project, placing its prosperity (along with that of other foreign investments in Shanghai) high on his agenda. With Zhu's ability to influence Beijing officials in their policy making, SVW's future looked bright.

In sum, policy making in this case was somewhat fragmented at the central

government level. Local unity came under the leadership of an activist municipal leader and, in a city geographically removed from Beijing, was vital to the success and development of the joint venture project.

Policy Implementation: Zhu Rongji's Catalytic Role

This final section looks to see how quickly the Chinese involved with the venture progressed on the bureaucratic learning curve. What forces helped change set operating procedures?

The early negotiations for SVW were characterized by typical delays, as lower-level officials were obliged to report many of their bargaining positions back to central leaders in Beijing. The contract talks subsequently lasted more than five years.

As the discussions moved from the late 1970s into the early 1980s, however, German representatives noted the Chinese partners' eagerness for understanding detail, and that they seemed to become faster at comprehending financial and technological points. The willingness of the Chinese to accept CKD imports showed some improved sophistication, and ability to put faith in a foreign business concept (a difficult step in light of the then-recent Maoist policies of xenophobic self-reliance).

Once the venture was created, early problems of an indifferent municipal bureaucracy began to plague the corporation. Zhu Rongji, however, was able to break the standard political attitude of hesitancy and stultifying inaction. How could he disturb such a pattern?

Zhu seemed to possess a natural leadership quality, one linked to his early childhood hardships and college career (see Chapter Three). The ability to attract respect, then, played a significant role in his drive to transform Shanghai's political attitude toward automotive development.

Perhaps more important, however, was Zhu's lack of participation in the radical

Maoist political stages of Chinese politics, stretching from 1957 to 1978. Zhu had thereby avoided much of the experience of operating in a highly politicized bureaucratic setting; on his re-emergence in 1978, he could take a fresh outlook on Chinese policy making, one perhaps based on ideas cultivated over some two decades of political banishment. In sum, Zhu had little patience with the bureaucratic roadblocks he found in Shanghai, and sought to quickly clear them to allow the city to prosper.

Summary and Projections

Figure 5.3 puts the SVW case in the context of this dissertation's theoretical framework.

As noted, then, local political support, in particular that of Zhu Rongji, and SVW's precise contract, helped make the venture a profitable and growing enterprise. With Zhu's return to Beijing, however, what were the company's prospects in the early 1990s?

Zhu's replacement as mayor, Huang Ju, seemed to have shared the former mayor's interest in the vehicle sector, as he played a leading role in the city's automotive small group. The continued prominence of SVW and SAIC chief Lu Ji'an, furthermore, also hinted of local support into the future.

Perhaps even more promising for the venture, however, was the emphasis the central government began to place in the early 1990s on making Shanghai once again a city of great prominence, one to compete with Hong Kong in economic success. Promised national investment in Shanghai would improve the city's technical capabilities and infrastructure, and most likely attract further significant foreign investment.

Such progress would help guarantee the future success of SVW. The company could look forward to a larger pool of capable parts suppliers, able to deliver goods

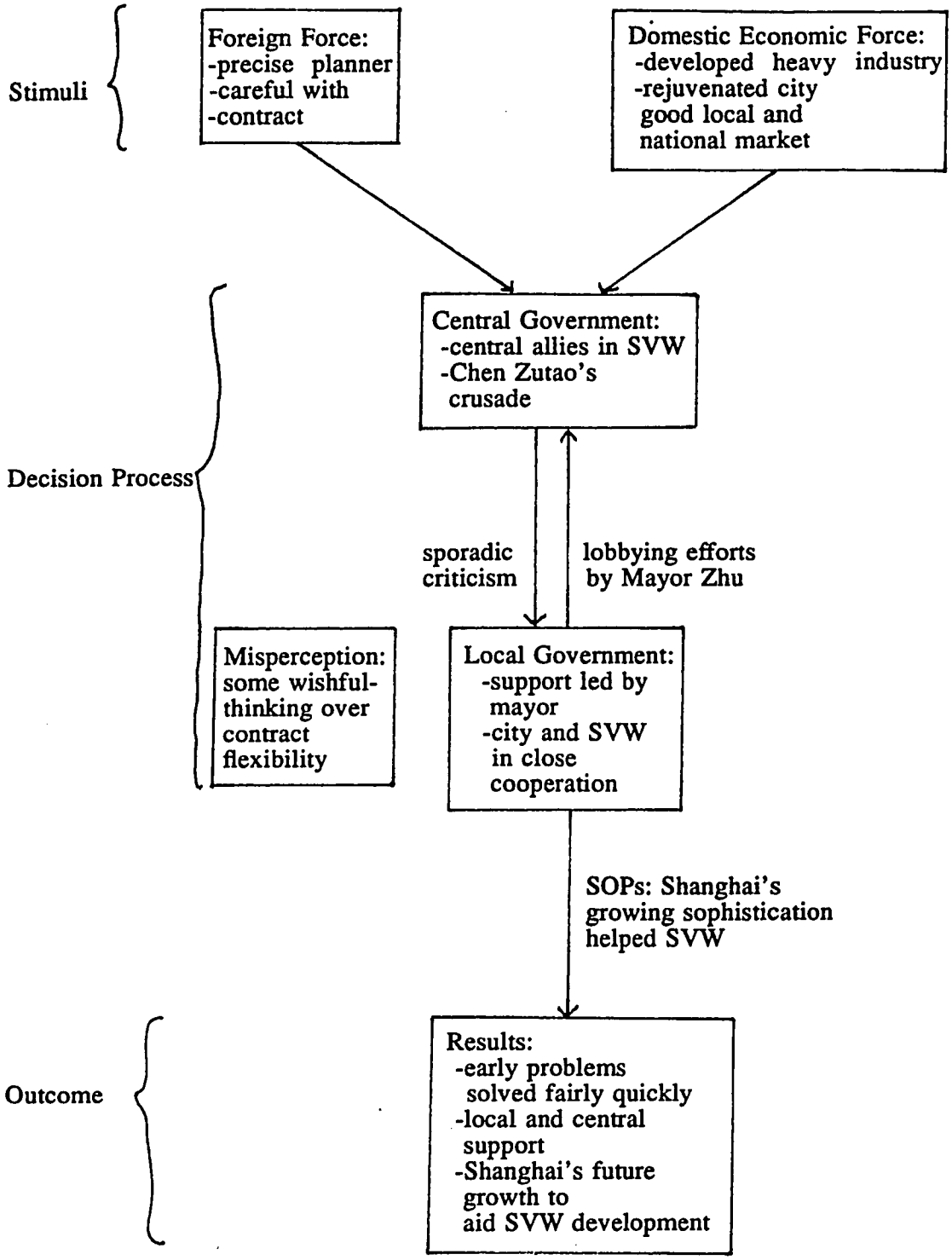

Figure 5.3: A Summary Diagram of the Shanghai Volkswagen Case

on a more modern transportation system. A higher standard of living in Shanghai would create a bigger potential sales market for the venture's vehicles. Finally, a more prosperous city government would probably be quicker to respond in an emergency with required aid, should the corporation need municipal assistance.

As Shanghai developed, so would SVW. In the early 1990s, the company's future looked promising.

Chapter 6:

Guangzhou Peugeot: An Island in Guangdong Province

Guangzhou Peugeot's location in wealthy Guangdong Province gave it some great potential for rapid development and freedom from central government scrutiny. "Heaven is high, and the emperor is far away," says a well-known Chinese proverb. Still, the venture did have to rely on Beijing providing vital financial favors. With Guangzhou's status as a *jihua danlie* (independent planning unit), moreover, the governor of Guangdong also became a kind of distant emperor to the city; this relationship further shaped the political landscape surrounding the southern joint venture.

As the most recently founded and, generally, least publicized of the passenger car joint ventures, the Guangzhou Peugeot Automobile Corporation (GPAC) presents less empirical and analytical evidence than do the other studies in this thesis. Interviews and some limited press coverage, however, paint a picture of a company in which both foreigners and Chinese overcame their geographical isolation and initial industrial deficiencies by using skillful political and organizational tactics. This chapter begins with a brief history of GPAC, then discusses the political maneuvers.

The Birth of Guangzhou Peugeot

With the exception of the Panda Motor Company's home in Huizhou, Guangzhou presented the least developed infrastructure for an automotive factory among the case studies in this dissertation. Lying at the mouth of the Pearl River Delta, the fertile Guangzhou area had a tradition of agricultural production, with rice, fruit, vegetables and tea grown in abundance. The surrounding region was also known for

its fish supplies. Guangdong province had few deposits of coal ore, a deficiency that discouraged the development of widespread heavy industry; inadequate transportation prohibited utilization of Northern Chinese coal.[1]

Guangzhou's automotive industry therefore had little on which to build. The city itself began earnest road construction only in the 1920s, and fewer than 900 cars plied municipal streets in 1933.[2] As noted in Chapter Two, however, the Canton Bus Company had engaged in some vehicle manufacture, and in importing British and American cars and busses, though on a very small scale.[3] In 1943, a forerunner of the larger Guangzhou Automotive Manufacturing factory appeared as a general machinery plant.[4]

The 1949 communist revolution brought some hopes to Cantonese desirous of greater industrial capabilities, though the southern Chinese obtained little immediate satisfaction. In 1956, Guangzhou's food-processing industry still constituted 42 precent of local industrial production; textiles took 12 percent, and only 11 percent came from machinery and metals processing.[5] Rapid industrial development was hindered by the great costs of converting the light industry.

The Great Leap Forward era of the 1950s ushered in efforts to change Guangzhou from a "consumption city" to an industrial base for south China.[6] The year 1962 saw the founding of the Guangzhou-Panyu Red Bridge Bus Assembly Factory. Construction of Peugeot's future partner, the Guangzhou Automotive Manufacturing plant (GAM) began in the adjacent Huangpu zone of the city in 1966, and was completed two years later. GAM built 3.5 ton Red Guard freight trucks and, later, East

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[1] Ezra Vogel, *Canton Under Communism*, Cambridge, Harvard University Press, 1969, p.17

[2] *Ibid.*, p.27

[3] This factory apparently was re-christened in October, 1949, and continued production as the "Guangzhou Bus Company" into the 1990s.

[4] Li Huiqin, *"Zen yang geng wei you xiao di li yong wai ci."* (How to Use Foreign Capital More Effectively), in *Guangzhou yanjiu*, (Guangzhou Research), 1986, No.4, p.44

[5] Vogel, *op. cit.*, p.16

[6] Ezra Vogel, *One Step Ahead in China: Guangdong Under Reform*, Cambridge, Harvard University Press, 1989, p.197

Wind busses.

The reform era of the 1980s accelerated the movement of heavy industry to the Guangzhou area. Between 1978 and 1985, agricultural output increased by 51 percent, but heavy industrial output more than doubled, from RMB 2.9 billion to RMB 5.9 billion.[7] Plans in Guangdong province called for establishing automotive parts factories and more assembly plants. As investment dollars poured in from neighboring Hong Kong, the southeastern province was ripe for rapid industrial growth.

Such reforms were only beginning to emerge, however, in the early 1980s, when Guangzhou officials approached France's Peugeot SA to discuss an automotive joint venture.[8] Initial contact came at a French auto fair in Guangzhou in the spring of 1981, and, despite Peugeot's inclination to find a Chinese partner in the more industrialized northeast, concerted talks with Guangzhou municipal officials on a joint venture soon began. The French found the southern Chinese eager to expand automotive industry in their region.

Even in the early 1980s, Guangzhou presented a promising site for the French investors. Successful agricultural reforms were already making Guangdong farmers wealthier, enabling many of them to purchase light trucks imported from Japan.[9] A joint venture had the potential to service this new market.

The French were not alone in looking to Guangzhou; American and Japanese automotive companies were also interested in the developing southern city.[10] Chinese officials note, however, that US economic ties with China were still generally progressing slowly in the early 1980s. Furthermore, as Chapter Two pointed out, Guangzhou automotive cadres found the Japanese more interested in selling

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[7] *Ibid.*, p.208

[8] The rest of this section, unless otherwise noted, is based on interviews held in Guangzhou in 1990 and 1991.

[9] Todd Thurwachter, "Development of the Chinese Auto Industry: Foreign Participation and Opportunities," US and Foreign Commercial Service document, Guangzhou, China, 1989, p.17

[10] One source reports up to 10 foreign companies vied for the Guangzhou venture site. See Li Huiqin, *op. cit.*, p.44

their cars to nascent taxi fleets than in delivering the technology needed to develop a healthy joint venture.

The Chinese side in the following four years of negotiations with Peugeot consisted mainly of officials from the future joint venture partner, GAM. Members of the municipal machinery and electronics bureau *(jidianju)* represented the city government, but the central authorities in Beijing played little role in the talks. The chief of the CNAIC in the early 1980s, Rao Bin, however, reportedly supported the GPAC proposal.

In 1983, Peugeot delivered sample vehicles of the type it hoped to produce in China; the first sent was a 504-model one-ton truck. The Chinese tested the truck for its quality and suitability to domestic road conditions. The model's low compression engine (and that of the model 505 station wagon, later added to the company's production plan) were capable of burning the lower octane gasoline commonly found in China.[11] Unlike Shanghai Volkswagen's development program, however (see Chapter Five), there was no experimental assembly of vehicles in Guangzhou.

By this time, Beijing Jeep's talks had already ended, with the announcement that the Americans would help develop a completely new vehicle for the Chinese market. According to officials in Guangzhou, however, the event had little impact on the GPAC discussions. Unlike negotiators in both Beijing and Shanghai, the southern Chinese never suggested that the joint venture should or could fashion a new model. Both sides agreed it would be too expensive, and neither wanted to embark on such a project.

The early stages of the venture talks focused on the company's product and technology, with several sessions lasting up to six weeks at a time. The final phases of negotiation turned to salary levels and finances; one Peugeot official implied

[11] Thurwachter, *op. cit.*, p.17

these discussions were somewhat hurried.

Final agreement came in early 1985, and the contract, calling for 20 years of cooperation, was signed in March of that year. GPAC's initial capital was $52 million, making it France's biggest joint venture in China. Peugeot took a 22 percent share of the company, with GAM holding the largest investment of 42 percent. Other foreign partners included the National Bank of Paris, with four percent, and the World Bank's International Finance Corporation (which supplied a $29 million loan) at eight percent. The rest of GPAC was owned by the Guangzhou Branch of the Industrial and Commercial Bank of China, with four percent, and the China International Trust and Investment Corporation, a central government entity, holding the remaining 20 percent. The Chinese therefore held 66 percent of the venture, and took 6 of 11 seats on the board of directors.

Though Peugeot held nearly a quarter of the company, it made no capital investment, instead contributing manufacturing equipment, plant design, and manufacturing licenses. The main Chinese partner, GAM, supplied the plant's land and building, together with $4.3 million. GPAC thereby inherited about two-thirds of the GAM factory space.[12]

By early 1985, then, GPAC had all the rudiments for a viable automotive venture. How did it fare?

GPAC's Development, 1985-1991

Following GPAC's contract signing in March, 1985, the company's board held its first meeting in September. The venture's development plan had three stages: first, it would reach a target annual production capacity of 15,000 504 model trucks; the second stage would raise production to a total of 30,000 vehicles, adding the 505 model station wagon. Finally, the third stage envisaged annual production of

[12] *Ibid.*, p.17

50,000 trucks, station wagons, and a model 505 four-door sedan. The company was further contractually obliged to export one-third of its output; the rest could be sold to domestic Chinese buyers.

GPAC's contract also included an ambitious localization program. Over the first five years of production, the venture was to reach 90 percent local parts content for exported vehicles, and 98 percent localization for domestically sold automobiles.

At the birth of GPAC, China's GAM employed more than 3000 workers, still producing the plant's East Wind busses and Red Guard trucks.[13] Peugeot's early plan was to spend two years modernizing the plant and adding new equipment. The foreigners further planned training programs for Chinese, sending more than 100 of them to France to learn techniques of management, engineering, electronics, parts supply and new technology.[14]

Like Volkswagen's Shanghai venture, GPAC's first troubles were rooted in poor conditions at the old GAM facility. Equipment was outdated, and workers' training levels fell far below what the French had expected.[15] Peugeot had to compensate by dispatching more of its expensive foreign managers to Guangzhou, and by training many more Chinese in Europe than initially planned.[16]

At the production level, further problems arose. Chinese resentful of the expatriot managers' high salaries and benefits were slow to take orders. GPAC reportedly fought battles with GAM over factory space (GAM continued to produce busses in its remaining one-third of the plant). Furthermore, the Chinese were ever eager to increase the size of GPAC's labor force beyond what the French wanted.[17] The French, on the other hand, wanted to spur production and pay their employees more than the average auto worker earned at a state factory; but the Chinese at

[13] *Ibid.*, p.17
[14] *Ibid.*, p.18
[15] *Ibid.*, p.17
[16] *Ibid.*, p.17
[17] *Ibid.*, p.17

GPAC feared resentment from the GAM employees working nearby.[18]

Faced with such early and, generally, unexpected troubles, the key problem of parts localization, faced by both Beijing Jeep and SVW, was nearly unavoidable. Initially, GPAC could find no sources of tires, glass, or other relatively simple items that reached its quality standards; even local paint failed to meet Peugeot's requirements.[19]

The reliance on imported vehicle kits quickly sparked problems similar to those encountered by BJC. In late 1986, production stopped for more than two months, as Peugeot and its Chinese partners disagreed over the price GPAC should pay for the CKDs.[20]

Unlike BJC, Guangzhou Peugeot suffered no shortage of foreign exchange. The company's problems were found in the growing strength of the French franc. GPAC's contract called for the Guangzhou Light Automotive Sales Company (GLASC), a corporation primarily concerned with marketing Peugeot's products, to purchase kits at a fixed franc price. From mid-1985 to early 1987, however, the franc appreciated some 110 percent against the Renminbi, making it more difficult for GLASC to sell the more expensive assembled vehicles in China.[21]

In July, 1986, GLASC asked Peugeot to lower its CKD price, but the French balked. The disagreement resulted in nearly six months of negotiations. GPAC's contract stipulated the 1985 purchase price to be 47,000 francs, and the 1986 price to rise to 53,580 francs. With the franc's appreciation, however, the price rose from about US$5060 in 1985 to US$8500 by the end of 1986. Eventually, the two sides agreed on a price of 48,000 francs, and orders resumed in early 1987.[22]

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[18] *Asian Wall Street Journal Weekly*, February 2, 1987, p.15. By 1987, however, GPAC workers had received a 30 percent pay raise, still less than the French proposed.

[19] Thurwachter, *op. cit.*, p.17

[20] *Asian Wall Street Journal Weekly*, February 2, 1987, pp.1, 15

[21] *Ibid.*, p.1

[22] *Ibid.*, p.15

Throughout the disagreement, as mentioned above, the venture apparently never lacked hard currency. The municipal government had pledged its own foreign exchange reserves to GLASC for kit purchases, and encouraged Guangzhou banks to sell hard currency to the auto marketer at official rates.[23] Furthermore, GPAC could rely on its World Bank partner, the International Finance Corporation, to supply needed hard-currency loans (though the central government's Bank of China had to guarantee such transactions).

As with the Volkswagen venture, the municipal government also took the responsibility for investing in parts supplies development to foster the localization process, which began in earnest in 1988. By 1990, the parts for about 19 percent of GPAC's light truck (model 504), and 16 percent of its station wagon (model 505) came from domestic suppliers. (See Figure 6.1). From 1988 to 1990, the city invested some RMB 200 million to develop localization industry, allowing GPAC to source car seats, head lights, dashboards, carpets, and other items within China. Guangzhou municipal industry had much to gain by the joint venture's success, because by 1991, the venture's own factory made 30 percent of the Chinese-manufactured parts, Guangzhou-area suppliers contributed 20 percent, while the remaining 50 percent came from other domestic sources, mainly outside of Guang-dong.[24]

Despite GPAC's ability to address its localization troubles, the joint venture faced early problems with its contractual commitment to export vehicles. As the percentage of local content rose, the French became reluctant to send cars out of China that might have contained sub-standard Chinese-made parts, fearing the effect on the Peugeot brand reputation (as noted in Chapter Five, Shanghai Volkswagen had shared such a concern). By mid-1990, then, virtually no GPAC automobiles had

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[23] *Ibid.*, p.15

[24] Gearboxes, for example, came from Hangzhou.

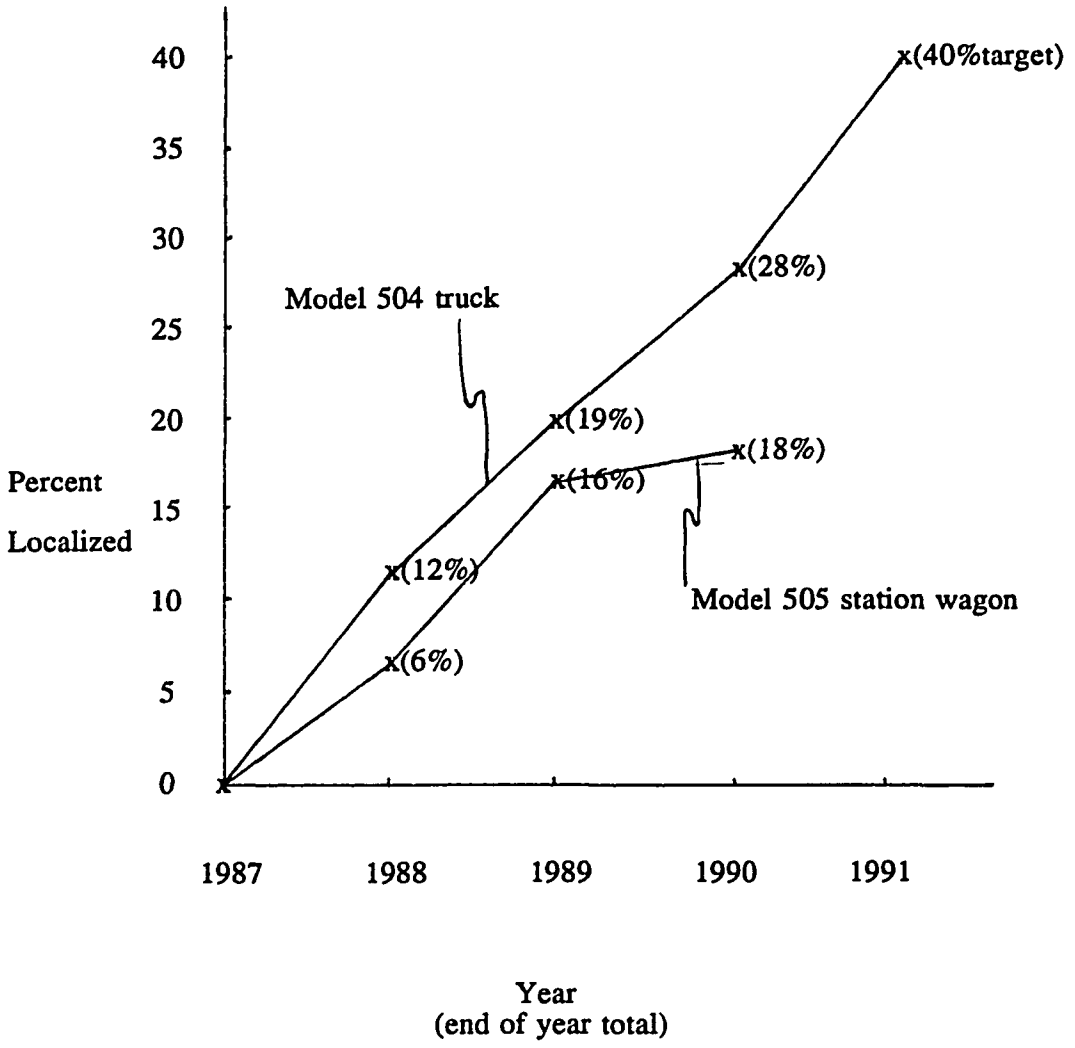

Figure 6.1: Localization at Guangzhou Peugeot

Sources:

1988: Todd Thurwachter, "Development of the Chinese Auto Industry: Foreign Participation and Opportunities," US and Foreign Commercial Service document, Guangzhou, China, 1989, p.17
1989: 1990 interview in Guangzhou
1990: *China Daily*, February 4, 1991, p.2
1991: *Overseas People's Daily*, April 24, 1991, p.3

been sent beyond China's borders.[25] Exports were further inhibited by the high price of the venture's product, which was buoyed by the shipping costs associated with the kit assembly process. The company thereby failed to meet its contractual pledge to export one-third of its product, and gave little promise of achieving such an ability in the foreseeable future.

Guangzhou Peugeot faced renewed problems in 1989, as China's national economic austerity program discouraged domestic automotive sales by prohibiting factories and firms from buying vehicles without a permit. On November 4 of that year, GPAC stopped production after fulfilling its quota of 4700 units. Though it had hoped for additional kit import licenses, the central government failed to allow more CKD's into Guangzhou.[26] "Originally, they granted us too few import licenses," complained one Peugeot employee. GPAC managers had believed they could persuade the central government to allow more CKD permits, but the Chinese refused. "They are controlling the economy very tightly" said the venture's source.[27]

The company was further disturbed in 1989 by the hesitancy of CITIC, one of its Chinese partners, to raise its equity investment. When GPAC moved toward the second stage of its development plan in September, 1989, GPAC called for a further investment of FF250 million (or about US$39 million); CITIC was to contribute 20 percent. But China's large trading company had financial problems of its own. "CITIC is in deep trouble-they cannot do anything for us and cannot make further contributions to the equity," said GPAC's French general manager, Bruno Grundeler, in late 1989.[28] (By June of 1990, however, CITIC had contributed its "phase two" equity. In mid-1991, CITIC also helped arrange a loan that further financed GPAC's second stage).[29]

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[25] Some 50 vehicles were shipped to Vietnam that year, according to a GPAC source. In early 1991, the company exported 10 cars to Hong Kong. See *China Daily*, April 8, 1991, Business Weekly, p.2.

[26] *South China Morning Post*, January 6, 1990, Business Section, p.1

[27] *Newsweek*, (Asia edition), December 4, 1989, p.49

[28] *South China Morning Post*, October 20, 1989, Business section, p.4

[29] *China Daily*, March 7, 1991, p.2

Financial problems also arose as the central government imposed localization taxes (similar to those faced by SVW, described in Chapter Five). In October, 1988, the tax added RMB 25,000 (about US$6700) to the price of each car; with an additional consumption tax of RMB 20,000 (US$5360) a model 505 station wagon cost RMB 200,000 (US$53,600) in early 1989. GPAC's Grundeler complained, to no effect. "We told them they would kill the industry, but they ignored us," he said at the time.[30] GPAC, which had held fifth place in 1988 in the ranking of China's "Top Ten" joint ventures, disappeared from 1989's list,[31] perhaps indicating some doubt among central government planners of the company's viability.

These developments contributed to a general feeling of gloom at the venture. One foreign manager commented in late 1989 that "if we had to make the decision to come to China over again, knowing what we know, we wouldn't come."[32]

By January of 1990, however, GPAC had gained some respite from the central government. The Chinese granted permission to construct 5000 vehicles in 1990, enough, according to a GPAC manager, to allow the corporation a profit. The Bank of China loaned the venture needed capital, and the central government allowed more state enterprises to purchase vehicles. "We have no financial problems at the moment and will be getting additional export credits from France in the near future," said Grundeler, who, at the time, was "very optimistic about the future. It certainly can't be any worse than 1989."[33] In October, 1990, GPAC's partner, the National Bank of Paris, showed its confidence by loaning the company $15 million.

As Figure 6.1 notes, by the end of 1990 localization rates had reached 28 percent for the model 504 truck, and 18 percent for the 505 station wagon.[34] The central government, perhaps partly as a reward for such progress, nearly doubled

[30] *South China Morning Post*, October 20, 1989, Business section, p.4

[31] *China Daily*, April 25, 1990, p.2

[32] From anonymous source, December, 1989.

[33] *South China Morning Post*, January 6, 1990, Business section, p.1

[34] *China Daily*, February 4, 1991, p.2

GPAC's production limit for 1990, raising their kit import limit from 4700 to 8000. In early 1991, the venture bought more equipment from France to expand production of the model 505 sedan.[35] The company failed, however, to make China's "Top Ten" joint venture list in 1990 for a second consecutive year.[36]

Though GPAC faced significant economic problems in its early years, ones nearly as severe as those confronting Beijing Jeep, it managed to survive with a combination of central government aid, local lobbying efforts (discussed in more detail later in this chapter) and foreign cash infusions. The following sections look more closely at the political dynamics that shaped the company's development.

Stimuli

Foreign Forces

Peugeot representatives originally sought an automotive partner in the industrialized northeast of China. There, close institutionalized links between the established factories and the central government would have forced the French to take an active interest in courting Beijing officials.

In the relative isolation of Guangzhou, however, the foreigners soon grasped the importance of solidifying local political friendships. As an area new to heavy industry, the southern automotive managers were less beholden to central authorities, so the French coalition of partners was able to exploit local needs for managerial guidance and financial support in ways more meaningful than those AMC or VW could have applied.

Peugeot's choice of foreign partners was resourceful and rational. The Paris Bank and IFC were logical choices to provide monetary aid when needed.[37] On the

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[35] *Ibid.*, p.2

[36] *China Daily*, June 24, 1991, Business Weekly, p.2

[37] Foreign loans, however, still required a guarantee by the central Bank of China.

Chinese side, GAM was of course the best available automotive partner in Guangzhou. It is not clear how CITIC and the Guangzhou industrial bank came to be GPAC partners, but their choice seems to have been a poor one: CITIC had chronic troubles in the late 1980s, and the industrial bank's functions may have been superfluous with the French financial forces in reserve. Given the various troubles GPAC faced in its first years, a partner with closer ties to the central government might have been more useful.

As later sections will show, however, the foreigners were able to utilize municipal contacts very effectively to sway Beijing's policy in their favor. In the early 1990s, as southern China's economic and political power were beginning to show signs of schisms with Beijing, such local allies appeared to have been a very valuable investment for the future of the French foreign firm.

Domestic Economic Forces

By the mid-1980s, China had already signed joint venture projects with AMC and VW; the rash of vehicle imports during these years, however (described in Chapter Two) left the Chinese amenable to further cooperative production. A retrospective examination of foreign automotive ventures, though, indicates Peugeot may have arrived at a disadvanageous period in the economic demand cycle.

Following GPAC's 1985 contract, China signed no more major passenger car joint venture agreements for nearly six years,[38] indicating a weakened market for automobiles. Considering the glut in the passenger car market during the retrenchment year of 1989, the French may have found a more receptive market had they begun production somewhat later.

The impetus for the project, of course, lay more in the economic conditions of southern China than in those of the nation as a whole. As mentioned above,

[38] Panda Motors, discussed in the next chapter, was wholly-foreign owned.

Guangdong's rapidly developing economy cried out for foreign investment, and proved irresistible to the Peugeot team seeking a partner.

The lack of heavy industrial infrastructure in the Guangzhou area proved one of the most serious handicaps to the GPAC corporation. The venture encountered outdated factory equipment, and a lack of suitable suppliers in the immediate Guangzhou area. In some sense, GPAC was meant to fill a vacuum, though the necessary development work was substantial.

The wild card in the domestic economic environment was Hong Kong, and the Pearl River delta area southeast of Guangzhou. After Hong Kong returned to Chinese control in 1997, the former colony would be a ready market for Peugeot's nearby manufacturing plant. GPAC expected an edge over Volkswagen manufacturers, as transport costs from northern China would add to the price of selling in Hong Kong and its rapidly developing environs. If Hong Kong were smoothly integrated into the Chinese economy, therefore, the French venture stood to receive a big boost.

Government Decision Making

Political Bargaining

Beijing's Role

By early 1985, the Chinese central leadership, facing staggering vehicle import bills, seemed to have acquiesced to the notion of foreign-invested automotive projects. Unlike some of the early hostility Beijing Jeep encountered, GPAC sources reported general goodwill among top officials. Zou Jiahua, for example, appeared to have been somewhat of an ally to the venture, helping in May, 1990 to get central approval for GPAC to move into the second phase of its production.[39]

[39] Based on 1990 interview in Guangzhou.

As Chapter Seven notes, GPAC officials felt some threat from the incipient Panda Motor Company forming in the eastern part of the province. Leaders who opposed or had some reservations about Panda's production plans (including Zou and, to some degree, Li Peng) expressed implied support for GPAC's right to sell its product to the southern Chinese market.

Significant expressions of central support came in 1989, at the height of the venture's despair. As noted, the central officials approved the purchase of back-logged Peugeot cars and trucks siting in Guangzhou storage lots. Perhaps more important, however, was the permission the company received to import an additional 3300 kits in 1990; this number stood in contrast to the mere 2000 extra kits allotted SVW, and some 1000-2000 kits for BJC.[40] In general, however, top officials showed little interest in the Peugeot project; one GPAC employee asserted central leaders did not comprehend problems the company faced, and seldom came to tour the factory.

Day-to day central concern for the joint venture, then, appeared to focus on the ministerial level. CITIC, one of the company's partners, had ministerial ranking at its formation. According to GPAC sources, however, CITIC was more of a burden to the company than a benefit.

As noted above, CITIC was reluctant in the late 1980s to fulfill its obligation to raise its equity in the corporation. The unwillingness to contribute the required capital came at a critical juncture for GPAC, and may have pushed the joint venture closer to the brink of bankruptcy.

Perhaps more significant, however, was CITIC's general uselessness in influencing central policy to remedy GPAC problems. Foreign and Chinese employees at the Guangzhou company said CITIC actually had little power to sway Beijing officials on policy issues, such as the granting of import licenses. In light of this,

[40] Based on 1990 interview in Guangzhou.

GPAC very seldom called on CITIC to help solve problems.

The foreign trade ministry, MOFERT, played a decisively greater role in determining GPAC's development, though not necessarily in a positive way. In the spring of 1990, the venture moved toward implementation of the second phase of its development plan. According to GPAC sources, MOFERT claimed the right to unilaterally approve the recapitalization of the corporation; the ministry felt the State Council and SPC need not act on the matter. As the intra-governmental conflict continued, GPAC suffered from the delay in receiving higher production permission. Finally, MOFERT acknowledged it alone could not approve the expansion plan, and, with higher certification, the venture moved to its second manufacturing phase.[41] A GPAC official put MOFERT's action in the context of a larger conflict, one between northern central government leaders and southern enterprises and politicians seeking the maximum degree of independent policy making ability.

While MOFERT used GPAC as a tool to assert its authority over joint venture development, the CNAIC seemed detached from shaping its progress. Both CNAIC and GPAC officials interviewed placed little importance on the central automotive corporation's involvement in the Guangzhou factory. As Guangzhou was forming its municipal automotive small group in late 1990, there were no plans to include a CNAIC representative. A GPAC official indicated, however, that CNAIC would be welcome in the group, as the venture sought a channel of influencing the corporation's decisions.

A CNAIC official noted the distance from Beijing was a decisive factor in reducing his organization's influence in Guangzhou. Southern aloofness may have also been a factor. Still, a GPAC representative pointed out that, should CNAIC want to affect the venture's course, it could appeal to the State Planning Commission; the alliance of Zou Jiahua and CNAIC chief Cai Shiqing in the early 1990s

[41] Based on 1990 interview in Guangzhou.

made such a control process more viable.

Before summarizing the powers of the central authorities, we turn to the provincial and municipal levels of government, ones which, as mentioned above, were critical to success in an area far from Beijing's close observation.

Local Politics

The attitudes of the Guangdong provincial and local Guangzhou governments toward GPAC displayed distinct differences. We turn first to the provincial level.

Most sources interviewed indicated Guangdong authorities were generally unsupportive of the GPAC project. The root of this attitude lay in Guangzhou's designation as a *jihuadanlie* (independent planning unit), as noted at the outset of this chapter. As such an entity, Guangzhou reported its economic plan directly to Beijing, leaving provincial authorities with little control over the city's development. Guangzhou, then, had a natural incentive to ignore surrounding provincial areas, leaving Guangdong ambivalent about its capital city's progress.

In the case of GPAC, Guangdong leaders originally opposed the venture's founding, according to Chinese sources, fearing the automotive company would siphon off central funds intended for the province. Prominent among those later indifferent to the venture was Ye Xuanping, governor from 1985 to 1991.[42] Over his term in office, the province sought to develop the Sanxing automotive group in the southern Guangdong city of Zhanjiang over GPAC, to avoid a Guangzhou monopoly in the vital industry.[43]

Chapter Seven describes the province's other major planned automotive corporation, Panda Motors. Panda was located in Huizhou, a city that was not a

[42] Ye's action is particularly striking considering that he had been mayor of Guangzhou from 1983 to 1985, a position some analysts say would have influenced him to favor the GPAC project had he not been promoted.

[43] Sanxing's productivity, however, was much smaller than that of GPAC. In 1990, it made only 1600 vehicles (mostly light trucks), and planned to manufacture only 2000 in 1991. See *China Daily*, April 22, 1991, Business Weekly, p.2

jihuadanlie; that project, then, was far more attractive to provincial authorities. As the later chapter notes, Guangdong leaders took several steps to further Panda's development, including the establishment of a special government office to coordinate measures to aid Panda.

GPAC, by contrast, enjoyed little of the provincial attention lavished on Panda. There was no special office in Ye Xuanping's organization to help GPAC solve problems.[44] Several sources further indicated that Guangzhou's planning status lent a natural inclination for the municipality to rely on itself to solve problems, with little dependence on Guangdong's help. One provincial official noted GPAC was "Guangzhou's project," and further implied Panda was much more of a Guangdong concern.[45] (One GPAC source noted, with some dismay, that his venture was not consulted in the province's process of approving Panda).

Guangzhou municipal officials, then, were key to GPAC's survival and prosperity. As Chapter Three mentioned, the city arranged its personnel ranks with the automotive sector in mind: vice mayor Xie Shihua had been GPAC's first board chairman, from 1985 to 1987; and the venture's chairman in 1990, Xie Gancheng, was simultaneously the deputy chief of Guangzhou's machinery and electronics bureau.

GPAC officials uniformly praised local cadres, in particular for their actions that influenced both provincial and central government policy. In early 1990, for example, Guangdong's provincial price bureau was slow to approve the price of the venture's model 504 pickup truck. Vice mayor Xie lobbied the bureau to speed its decision process, allowing GPAC to sell the truck at the certified rate.

Xie Shihua was also key to obtaining concessions from the central government. In 1990, for example, Xie made a special trip to Beijing to lobby for increased kit

[44] The Guangdong Automobile Industry Office, however, was charged with coordinating all of the province's automotive industry.

[45] Based on 1991 interview in Guangzhou.

import permission. He was responsible in part for the extra 3300 licenses subsequently allowed GPAC.

The municipal government also took many local actions to aid the venture. As noted above, the city was willing to contribute its own hard currency reserves to GPAC when needed. Furthermore, though Guangdong lacked a provincial unit to aid GPAC, Guangzhou created a special city office to coordinate the joint venture's development. In 1991, this office organized localization supply efforts, and city investment in parts manufacture. These tasks were of greater benefit to the joint venture than the work of GPAC board chairman Xie Gancheng's municipal machinery and electronics bureau, which formulated industrial regulations and tallied and reported statistics. (Xie's knowledge of the bureau's work, however, undoubtedly was of value to the company).

In sum, then, GPAC highlights the ironic phenomenon of a provincial capital city operating its industry at odds with its surrounding province. Though municipal officials seemed able to supply the needed support for the automotive venture, the lack of cooperation with Guangdong most likely portended some inconsistent development of the economy in the southern Chinese province.

Misperception

Southern Chinese officials seemed to have avoided the kind of wishful thinking found among negotiators of the Beijing Jeep venture. They realized, as Shanghai cadres negotiating for the SVW company did, that an automotive venture would require imported car kits and a localization process. The timetable for achieving high rates of local content, however, was overly ambitious, though not entirely unrealistic.

The generally rational approach Guangzhou leaders took to development of GPAC may be based on previous experience with foreign investors. By 1984,

Guangdong province claimed 492 joint ventures and 1735 cooperative ventures.[46] Guangzhou had 27 joint ventures, including the large American investment by Beatrice Companies to process food, and 219 cooperative ventures.[47] (For rough comparison, all of China had some 931 joint ventures by the end of 1984).[48] The experienced southern municipal officials were therefore better able to forecast problems, such as those of hard currency balancing and localization funding.

In the GPAC case, more misperception may in fact be attributed to the foreign investors. Peugeot seemed to think that relatively higher standards of living in southern China would guarantee rapid equipment modernization; they were subsequently frustrated with the slow process of improving GAM's out-dated factory, and educating poorly-trained workers. Peugeot officials also initially believed raw materials were available on free markets, and were surprised that the company was dependent on centrally planned allocations.[49]

In general, then, GPAC's problems were based more in unexpected structural economic problems, such as the fluctuating currency exchange rate and China's austerity measures in the late 1980s, rather than in irrational decision-making clouded by Chinese misperception. As noted, however, the foreigners' impression of a rapidly-developing southern economy may have raised expectations of technical competence to unrealistic levels.

Policy Process Conclusions

The Guangzhou Peugeot case points out the significant degree of policy independence achievable in a rapidly developing city far from Beijing. Still, GPAC

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[46] *Guangdong tongji nianjian* (Guangdong Province Statistical Yearbook), Guangdongsheng Tongjiju Bian, 1985, p.275

[47] *Guangzhou nianjian* (Guangzhou Yearbook), Guangzhou nianjian bianzuan weiyuanhui bianji chuban, Guangzhou, 1985, p.299.

[48] *Almanac of China's Economy, 1985-1986*, Hong Kong, Modern Cultural Company Limited, 1986, p.132

[49] *Asian Wall Street Journal Weekly*, February 2, 1987, p.15

could not act completely without central approval.

China's top central leaders paid little attention to the southern auto venture. Unlike Beijing Jeep, the company was not a national showcase; unlike Shanghai Volkswagen, GPAC was not in a city with close industrial ties to the capital. Furthermore, GPAC's French banking connections made it less dependent on China's centrally controlled foreign cash reserves.

The venture, then, only caught central concern at major development stages; the conflict between MOFERT and the SPC over GPAC expansion approval illustrates this point. The central leaders, of course, also wanted to maintain as much control as possible over the far-away factory, and required municipal officials to pay a kind of homage in lobbying for a greater number of import licenses.

Local officials were key to GPAC's success. The French did well to develop friendships in the city government; and the municipal officials had their own interests in mind in seeing GPAC prosper. Once the foreign investors overcame early misconceptions about the possibilities of manufacturing in southern China, the venture partners developed a good cooperative relationship.

The most surprising element in GPAC's political support was the indifference and, at times, opposition displayed by Guangdong provincial officials. In granting Guangzhou planning independence, the reform process encouraged competition, but also divisiveness, in the southern economic development drive. Coordinated policy making became more difficult, and GPAC may have suffered from the province's devoting its expertise and resources to helping Panda Motors and the Sanxing group.

Policy Implementation: GPAC's Course

The most impressive, and at the same time generally effective, standard operating procedure in the political decision making for the GPAC case was the use of

local officials as conduits to higher levels. Municipal cadres had a vested interest in seeing the venture succeed, and the French exploited their willingness to influence Beijing to win aid during China's economic retrenchment period, a higher number of import licenses, and other concessions. Guangzhou typically relied on a vice mayor (Xie Shihua) to solve problems with both the central and provincial governments.

This type of policy process stands in contrast to that of the Beijing Jeep case, in which problems were solved by leaping over local levels to reach central leaders. Here, Guangzhou's industrial history and distance from the capital determined the style of policy making necessary for success.

With generally rational methods of shaping government policy toward GPAC ingrained early on, the local officials apparently found little need, or even possibility, to modify their behavior. Southern officials greeted with the first foreign investments in the late 1970s most likely were unfamiliar with the customs and requirements of capitalist entrepreneurs, and undoubtedly had to adjust their policy making to accommodate the foreign business style. By the time GPAC had established itself, however, officials in Guangzhou seem to have learned useful procedures for solving policy problems particular to such projects. Structural difficulties remained, of course: it was difficult to quickly modernize equipment or instill notions of quality in local managers and workers. In general, however, most of the policy "learning" process had taken place before GPAC operation began, leaving the venture with a supportive local bureaucracy capable of accomplishing required tasks.

Summary and Projections

Figure 6.2 summarizes this chapter in the context of the dissertation's theoretical framework.

For the Guangzhou Peugeot venture, the most limiting factor was the company's

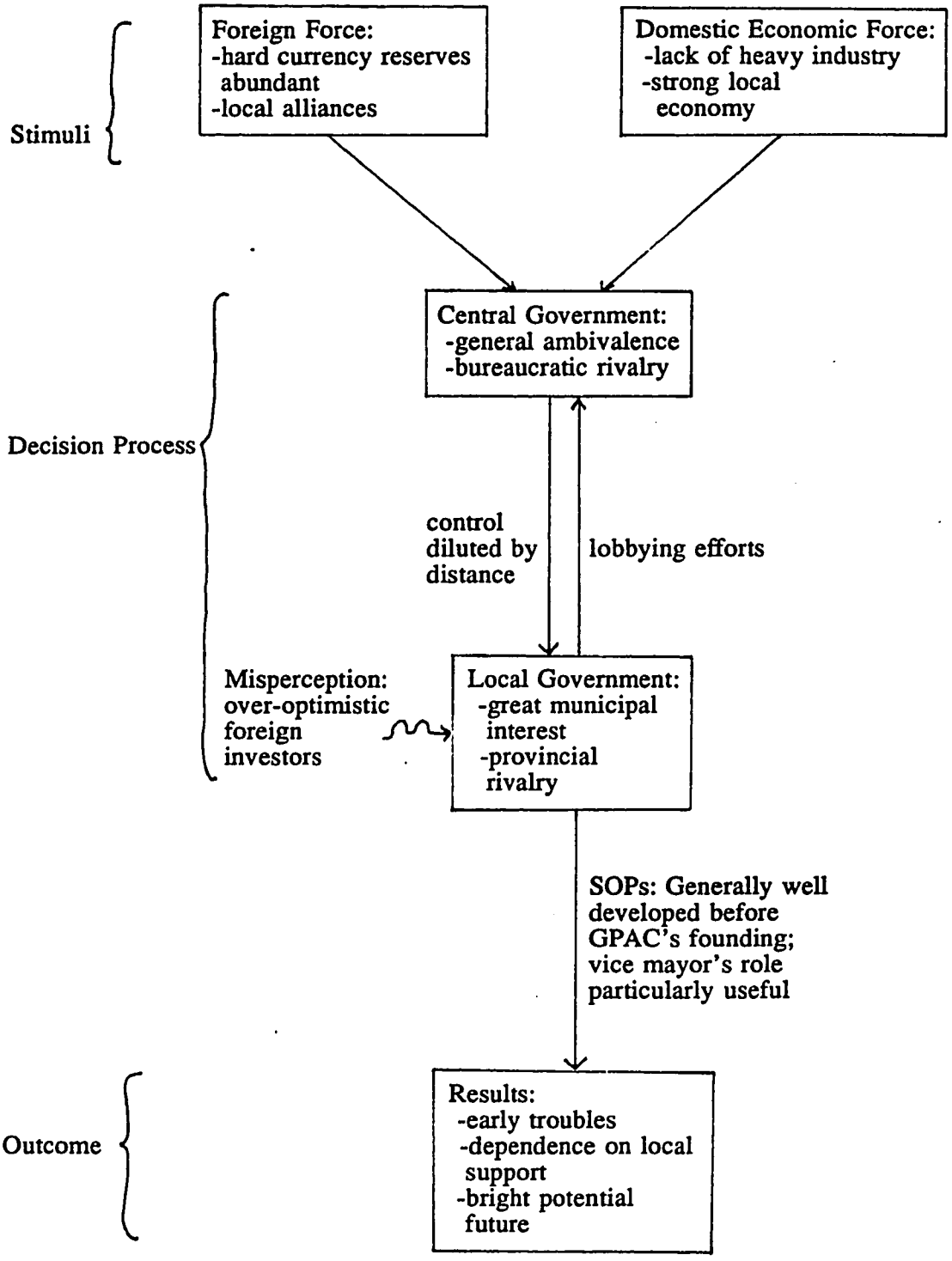

Figure 6.2: A Summary Diagram of the Guangzhou Peugeot Case

distance from areas with developed heavy industry. This factor led directly to foreign frustrations in the early production stages. As time passed, however, the local and foreign investment in regional localization projects helped ameliorate this problem.

Guangzhou's distance from Beijing was also an obstacle at times. The venture depended on the central government for key elements of its development (import licenses, purchases by government units, etc.), and was hampered by the difficulty of cultivating political ties in the remote capital.

In GPAC's weakness, however, lay great potential future strength. The integration of Hong Kong into China's southern economy promised greatly expanded technical capability and market sales in the early years of the next century. The wealth of local Chinese private business people also was rising quickly in southern China, and, with uninterrupted progression, would leave many of them prosperous enough to purchase a private vehicle by the end of the decade.

Were China's decentralization and economic reform processes to continue, furthermore, Guangzhou's isolation from Beijing could offer GPAC another advantage: as central restrictions and powers declined, local resourcefulness and ability to solve problems could allow the company to function more smoothly than other ventures more dependent on central aid and guidance. Thus, while a company like Beijing Jeep might flounder without central support, GPAC could still prosper in distant Guangzhou, far from Beijing.

Chapter 7:

China's Biggest Panda

In late December of 1988, Dr. Charles Kim, president of Panda Motors Corporation, arrived in Huizhou, Guangdong Province. He soon found that he had reached the end of a long search for a home for his fledgling automobile company. Fewer than two years later, Panda, the largest wholly foreign-owned enterprise in China, had made giant leaps over bureaucratic hurdles, while at the same time emerging as a wild card in China's automotive development plans.

This chapter traces the history of Panda from its initial approaches to the Chinese government, through its clever development of ties to the Chinese, and its ability to solve serious problems quickly and effectively. As in previous chapters, analysis focuses on the foreign and domestic stimuli acting on the political decision makers, the actions of the politicians, and the resulting development of the automotive project. First, however, we turn to an historical narrative of the Panda company.

Panda's Development

The seeds of the Panda project were planted in preliminary discussion among South Korean and Korean-American investors (many of whom remain anonymous) in 1986. The actual company did not appear, however, until September of 1988, when Panda was incorporated in Delaware under an umbrella organization called the Virginia Business Enterprise Group.[1] With headquarters in Vienna, Virginia, the automobile company was a coalition of several companies worldwide, including HWH Holding Group of West Germany, which manufactured automobile parts; the

[1] Much of this information is based on interviews conducted in China in 1990. Some of the discussion appeared in a different form in my essay, "China's Elusive Panda," in *The China Business Review*, July-August, 1990, pp.44-47

Tong Il Company, a South Korean transmission maker; and an automotive design firm based in the US.

Though many companies participated in forming the Panda organization, the force behind the project was actually the South Korean-based Unification Church. The church's leader, Reverend Sun Myung Moon, publicly stated his desire to "create an automobile production city in Southern China in order to enhance the People's Republic of China's export opportunities."[2] Panda was also "meant to create a constructive relationship with the top leadership in Beijing so that we might become partners in a new Asian-Pacific era ... ."[3] Moon, furthermore, disclaimed the suggestion that Panda was merely out for profit:

> "The purpose of this investment is not so that I can establish a foothold in China as a way of making a fortune for myself. It is my principle that not so much as a penny of the profits from the China project will be taken out of China. These profits will be reinvested in China to construct the International Highway of Peace and to bring China up to international standards in other areas of high technology.[4]

The above-mentioned "International Highway" is based on a 1981 Moon proposal to construct a roadway from Tokyo to London, a route including a tunnel from Japan to South Korea. The road would traverse North Korea, then pass Dandong in northeast China on its way to Beijing, Moscow, and eventually on to Western Europe. Whether or not this scheme was actually practical, the Unification Church did seem intent on pursing it, perhaps with the goal of leaving a lasting memorial to the achievements of Moon's church. In 1988, in fact, representatives of the Unification Church approached China's Transportation Ministry with a proposal to build a stretch of highway from Dandong to Beijing. These plans actually received

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[2] *International Herald Tribune*, December 14, 1989, advertisement

[3] *Unification News*. December, 1989, p.7

[4] *Today's World*. April, 1990, p.19

tentative approval from then-CCP leader Zhao Ziyang, Premier Li Peng, and State Planning Commission chairman Zou Jiahua, before being sent to the Transportation Ministry for further consideration.[5]

Panda Motors commenced on a drive to raise funds for its automotive project, and soon had reportedly raised at least $200-300 million, much of it in loans from South Korean and Japanese banks. At its 1988 incorporation in the US, the company had registered capital of $100 million.

Panda apparently chose the US, rather than South Korea, as its home because China and South Korea lacked diplomatic relations and economic treaties to guarantee the safety of the investment. In assembling the company's top management, the Unification Church recruited Douglas MacArthur II, a former US ambassador to Japan and nephew of the famous World war II general, to be the company's board chairman. Real management power seemed to rest, however, in the hands of former South Korean general Pak Bo-Hi, treasurer and vice chairman of Panda and a chief aide to the Reverend Moon. The president of Panda was Dr. Charles Kim, a Korean-American with several years of experience in automotive parts exports. Dr. Kim was also reportedly the brother-in-law of the prominent South Korean politician (and former opposition leader) Kim Young Sam.[6]

After Panda had assembled its management team and raised funds, it composed a project feasibility study for the Chinese. Panda presented its project as a wholly foreign-owned enterprise (WFOE), rather than as a joint venture. The company took this route in part to avoid lengthy negotiations with a Chinese partner; furthermore, it recognized that under China's austerity program introduced in mid-1988, there were in any case few funds for a Chinese company to contribute. A WFOE would

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[5] Based on 1990 interview

[6] See *Shei lai chengbao zhongguo? (Who Will Contract For China?)*, by Su Ya and Jia Lusheng, Guangzhou, Huacheng chubanshe, 1990, p.358

have other advantages, as will be seen below.

Once Panda had chosen to manifest itself as a WFOE, it was bound by a 1986 Chinese law governing such entities. This law specified that Panda was to "export all or most of their products."[7] Panda therefore promised in its study to export 100 percent of the cars it was to manufacture in China. Reports vary on the company's projected market, but future sales sites reportedly included Southeast Asia, Eastern Europe, and perhaps India.[8] In any case, Panda promised to make a small, low-priced vehicle, in the $5000 price range, so it would therefore probably not be competitive in the industrial world's marketplace, already dominated by Japanese and South Korean manufacturers producing slightly more expensive but higher-quality products.

In its presentation to the Chinese, Panda further pledged to invest up to US$1 billion over 10-15 years to develop several factories in the chosen production site. Panda representatives also promised to develop a new car model, but were unclear as to the exact type of vehicle they would produce. (In fact, as late as October of 1990, Chinese officials in Huizhou were still ignorant of the type of car that would roll off the assembly line).

The company had ambitious production goals. For its first assembly plant, Panda forecast manufacture of 50,000 cars by the end of 1990, 200,000 by the end of 1991, and a capacity of 300,000 vehicles reached in 1992. The venture would function initially as an assembly plant, importing much of its needed parts and raw materials. It reportedly promised, however, to localize up to 10 percent of its vehicle's composition each year. To this end, the company hinted it might be willing to invest in local parts supplying factories, to help suppliers reach the required quality standards.

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[7] See Article 3, "The Law of the PRC on Wholly Foreign-owned Enterprises," reproduced in *The China Business Review*, July-August, 1986, pp.52-53

[8] *Cincinnati Enquirer*, October 3, 1989, p.C6, and *Washington Post*, December 4, 1989, p.1

Panda's feasibility study also outlined requirements for its factory site. First, because the company's cars were to be exported, the production area would have to be near a fairly well-developed port, deep enough to accommodate large ships. Ideally, it would also be close to roads and railways, to allow shipment of incoming parts. Panda reportedly promised to construct its own factory, along with housing and other needed structures, but it expected the Chinese to help with roadways and public transportation facilities.

One element omitted from Panda's proposal was reference to the Unification Church. Perhaps the project backers felt Chinese knowledge of the church connection would hamper chances for the venture's acceptance. The official Chinese reaction to the affiliation with the religious group was that the government did not discriminate against investors based on their religion. "There is no link between a person's religious belief and his investment in China," said one government leader in a later reference to the project.[9] As of mid-1991, there was little evidence Panda sought converts in China, though one foreign writer did claim the venture had such a goal.[10] Panda officials denied such conjecture.[11]

By the end of 1988, then, Panda had all it required to approach a prospective Chinese production site: money, a production plan, and a list of the plant site's requirements. Company representatives, led by Dr. Kim, turned first to some of China's more industrially-developed cities, including Changchun, Shiyan, Beijing, Dalian, Qingdao, and, as a first choice, Shanghai.[12] These cities held promise of future parts supplies capability, a necessary feature should Panda seek to accomplish its localization goals.

It is unclear why the above-mentioned cities rejected Panda's proposal.

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[9] *San Francisco Examiner*, July 9, 1990, p.A11

[10] See "Sun Myung Moon's Mission in Retreat," by Anson Shupe, in *The Wall Street Journal*, November 1, 1989, p.A12

[11] *Far Eastern Economic Review*, November 1, 1990, p.31

[12] Based on October, 1990 interview in China

Shanghai Mayor Zhu Rongji reportedly felt the project was unnecessary, and would only be a waste of his city's resources and efforts.[13] Zhu and others apparently also took note of the short history of the auto company, and their doubts about Panda's viability grew.

In Panda's opinion, however, the sites that rejected Kim were in any case suboptimal for the project. Shanghai, for example, lacked the necessary land for the new factory. Shiyan's proposal to ship vehicles on barges down the Yangtze did not appeal to Panda.[14]

When Dr. Kim arrived in Guangdong province's Huizhou in December, he received a much warmer reception than he had in previous site visits. Why was Huizhou eager to impress Panda?

Though Huizhou, a city of some 2.2 million people, lies in the booming Pearl River Delta of Guangdong, it had been slow to implement economic reforms, and felt a desire to catch up with its prosperous neighbor, Shenzhen (See map, Figure 7.1). Huizhou authorities had been strong supporters of Mao Zedong's policies, and city leaders were loyal to Lin Biao until his fall in the early 1970s. The city delayed implementing reforms until 1984, by which time it was obvious surrounding areas were leaving Huizhou behind. A new leadership saw the need for foreign investment to compete, and such investment from 1988 to 1990 averaged US$294 million each year, four times that of each of the four years from 1984 to 1987.[15]

The city was also attractive to Panda officials; for several reasons. First, Huizhou is close to Hong Kong; by sea, the port of Autou is only 47 nautical miles from the British colony. The Shenzhen special economic zone is also quite near. Second, because the land near the factory site is hilly, there was little agricultural activity, so the development of industry would not be accompanied by the difficulties arising

[13] *Hong Kong Standard*, September 7, 1989

[14] Based on October, 1990 interview in China

[15] "Foreign Cash Boost," in *China Trade Report*, volume 29, January 1991, p.8

Figure 2.10: Locations of the Major Passenger Car Producing Factories, Functioning and Planned, 1991

from displaced peasantry. Furthermore, Autou represents a natural port site, and the regional government saw much potential for developing shipping import and export.

Dr. Kim's first meetings were with a Huizhou delegation led by vice mayor Lin Xushen and municipal party secretary Deng Huaxuan. Kim presented the officials his feasibility study, together with some detailed financial information. Local municipal technicians also examined the plans, and apparently gave a favorable report.

Huizhou officials knew Panda was a new company, but were impressed by the presense of Douglas MacArthur II as Board Chairman. One high-ranking Huizhou official commented in an interview that he believed MacArthur would not work for a bad company.[16]

The Huizhou government may also have felt there was little substantial risk involved in the Panda project. Panda officials have pointed out that, were the project to fold after a year or two, the region would still benefit from infrastructural improvements brought by construction investment. Construction workers would receive salaries; and, if the project did successfully begin production, plant workers would gain valuable skills. Furthermore, if Panda managed to turn a profit, it would pay taxes.[17] By February of 1989, then, Huizhou's enthusiastic officials had approved the project.[18]

In the early months of 1989, the central government's State Council sent a small group of specialists *(zhuanjia xiaozu)* to Huizhou to investigate Panda's plans. According to article six of the 1986 WFOE law mentioned above, the State Council or its agents had to approve the project before it could proceed. After ascertaining that Panda's finances were in order, and that raw materials would be imported, and automobiles exported, the group approved the new venture.[19] Still, Beijing leaders

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[16] October, 1990 interview in Huizhou

[17] E. Harwit, *op. cit.*, p.45

[18] Based on October, 1990 interview in Huizhou

[19] *Wen Hui Bao*. Hong Kong, September 15, 1989, p.2

needed some further prodding, and only after sustained lobbying by Huizhou mayor Li Jinwei and vice mayor Li Hongzhong would the State Council actually allow the project to go ahead.[20] One of the project's key supporters at this time reportedly was Communist Party secretary Zhao Ziyang.

Dr. Kim returned to Huizhou in March, 1989, as the project sailed through Guangdong's provincial bureaucracy. On March 7, the province gave its approval in principle, pending further research. Ten days later, the provincial government approved Panda's feasibility study and company organization; on March 20, the Guangdong foreign economic relations and trade commission (COFERT) signed on. Finally, on March 23, Panda got its operating license *(zhunshengzheng)* from the province.[21] Only three months after its initial presentation in Huizhou, Panda was then officially established.

Progress and Problems

Once the project had been approved, Huizhou authorities began to promote spending designed to aid the new auto company. The city government allocated RMB 200 million (about $54 million at the 1989 exchange rate) to build two thermal power plants capable of producing 60 megawatts of power. The authorities also promised the required port, one capable of serving ships weighing 35,000 dead weight tons.[22]

Panda moved forward with its plans throughout the turbulent events during Beijing's 1989 spring student demonstrations. The June 4th killings, however, brought pause to the company officials working in China. On June 5, Panda administrators appeared for the first time at the commercial section of the US consu-

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[20] Todd Thurwachter, "Development of the Chinese Auto Industry," US and Foreign Commercial Service Report, Guangzhou, China, 1989, p.18

[21] Based on October, 1990 interview in Huizhou

[22] *China Daily*, September 20, 1989, p.2

late in Guangzhou, obviously shaken and hoping for advice. The fall of their supporter Zhao Ziyang may have contributed to their anxiety.

The crisis time soon abated for the Panda people, however, and the company carried on with its plans. On June 27th, 1989, Panda held its ground-breaking ceremony in Huizhou; present at the event were MacArthur, Dr. Kim, Pak Bo-Hi, and Guangdong vice governor Kuang Jie, who led the Chinese delegation.[23] Panda's inauguration, held fewer than four weeks after the Tiananmen square incident, was to provide Chinese propaganda organs with a grand example of new foreign investment in the face of contract cancellations and world economic isolation. In a series of articles, the official press emphasized the huge scale of the "American" investment.[24] One publication later claimed that "Panda had rendered a great service in breaking [foreign] economic sanctions."[25] No Chinese public media, however, reported the company's ties to the Unification Church, though Chinese leaders knew of the connection by early 1989.[26]

Panda's investment, though of great propaganda value, was actually not revealed until the middle of September, 1989. One possible reason for this delay may have been Panda's fear of publicity before it had established itself; the company may also have wanted to avoid criticism for beginning a project so close to the Tiananmen events.

A further reason for delaying the announcement, however, may have been central government hesitation over the project's viability. On July 9, 1989, vice governor Kuang Jie went to Beijing to report to Premier Li Peng. Li was apparently annoyed that Panda had avoided steps to coordinate its project with the national automotive agencies and the State Planning Commission. On July 19, then, Li Peng

[23] *Shei lai chengbao zhongguo?, op. cit.*, p.358

[24] See for example *Renmin Ribao* (Haiwaiban) (Overseas People's Daily): September 19, 1989, p.3; November 4, 1989, p.2, and November 21, 1989, p.1

[25] *Shei lai chengbao zhongguo?, op. cit.*, p.360 (my translation)

[26] The first foreign accounts of the Unification Church ties came in late September, 1989.

personally organized a second central government delegation to visit Huizhou, this one led by Chen Zutao, by then retired from his duties as chief of CNAIC. The group stayed for 10 days, studying the site and examining documents on Panda's background. At the end of the investigation, Chen recommended approval of the venture, citing his admiration of MacArthur's participation, and Panda's pledge to export 100 percent of its product.[27] One source quoted Dr. Kim as saying at these meetings that "if we lacked the ability to export, we would not have invested hundreds of millions of dollars to build a factory."[28] Li Peng is said to have later emphasized this promise, proclaiming that "not one" Panda car would be sold within China.[29]

The company's first goal was to prepare the Huizhou site's land for construction. Panda had leased six square kilometers, rented for 50 years at RMB 10 per square meter per year.[30] The chosen land was hilly, though, so construction teams were hired to flatten and pack the earth for the factory's foundation. This work was finished on about 400,000 square meters by the spring of 1990, and Panda began the construction of its assembly and stamping buildings later that year.

Panda had also rented the whole 25th floor of Hong Kong's new Bank of China building, apparently as its Asia headquarters. By early 1990, the company had only some 10 employees working there, though, in addition to about 15 in the US, seven to ten in China, and others in various international offices. The Huizhou staff was led by senior vice president Xu Liyun, a Chinese citizen with permanent US resident status.

Panda's next mission was to acquire machinery for its China factories. In late 1989, it bought stamping equipment from a closed General Motors factory in Hamil-

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[27] *Ibid.*, p.359

[28] *Ibid.*, p.359 (my translation)

[29] Based on interviews held in Beijing, 1990

[30] Based on an October, 1990 Huizhou interview

ton, Ohio, and also purchased GM's 4-cylinder engine tooling.[31] Up to the end of 1990, Panda refused to reveal the type of vehicle it would produce with this equipment, though it apparently planned to keep to the small model vehicle envisaged in its initial proposal.

The venture made steady progress in completing the factory's outer steel frame, but had discovered by early 1990 that the port facilities at Autou would not be ready to receive the large ships needed to carry the plant's equipment. On January 12, 1990, Dr. Kim met in the morning with Wang Renzhong, deputy director of the NPC standing committee, apparently to discuss the venture's troubles. Later that day, Kim and vice president Xu met with Guangdong governor Ye Xuanping and vice governor Kuang Jie; Chen Zutao was also present, sent by Beijing to advise Guangdong on Panda's affairs.

At this meeting, Kim expressed concern over the pace of construction of the needed Autou port. During the coming year, Panda planned to import some 1200 40 foot containers, and in 1991 wanted to bring in stamping presses, parts of which weighed up to 175 tons. The Autou port had only a single 3000-ton class wharf, and no equipment to handle containers. Kim asked for immediate dredging of the harbor, so ships could at least arrive at the shore. The only alternative to this would be for Panda to ship its equipment to Hong Kong or Guangzhou, then transship the machinery to Autou in smaller vessels. This would be much more expensive.

Governor Ye listened to Panda's problems, and asked about other troubles. The Panda representatives expressed concern over their ability to recruit workers for the factory, noting they would need some 100,000 employees. Ye commented that the training period would take a minimum of one year.

The Guangdong governor went on to suggest a "shadow cabinet," headed by Chen Zutao, that would work closely with Panda to try to solve the type of

[31] E. Harwit, *op. cit.*, p.44

problems that were mentioned at the meeting. He said the government would attempt to hurry construction of the needed port facilities, perhaps in conjunction with the Transport Ministry. Finally, according to a transcript of the meeting,

> "the governor again praised Dr. Kim's determination to succeed, and promised the province's full support. The project was so critical to the province that failure was absolutely unthinkable. Yet, the governor advised Dr. Kim to be more realistic with his timetable, appreciating that China was not the US."[32]

Before the meeting closed, Panda officials thanked Ye for contributing his calligraphy for Panda's logo.

Early the next month, a delegation of nearly a dozen former American Congressmen, led by Democrat Richard Ichord of Missouri and Republican Robert Wilson of California, journeyed to China. Wilson and Ichord were reportedly paid lobbyists for Panda,[33] and their meetings with Premier Li Peng and Party Secretary Jiang Zemin received much media attention in China, in the wake of the US travel ban on high-ranking American officials going to China. It is unclear whether Wilson and Ichord won any concessions for Panda, but the ex-Congressmen made a visit to Huizhou after leaving Beijing. In any event, both Li and Jiang benefited by the positive feelings generated in being seen meeting important Americans.

Soon after the Congressmen left China, Premier Li Peng toured the Panda facilities as part of a February inspection tour of Guangdong. Li was greeted by a small model of future factory buildings at the Huizhou site. The series of visits was a success for Panda, as Li later promised RMB 30 million (about US$6.4 million) of state money to help develop the Autou port.

A trip for Guangdong and Huizhou officials in the spring of 1990, to visit Panda facilities in the US, may also have generated good will. Travelers on this voyage

[32] Based on anonymous source in Guangzhou

[33] Based on a February, 1991 interview with an American national security council advisor in Washington, D.C.

reportedly included Huizhou mayor Li Jinwei, Guangdong vice governor Kuang Jie, and Panda advisor Chen Zutao.

The auto company plodded along until June, when Shell Oil announced plans to form a joint venture petrochemical plant off the coast of Huizhou. Panda representatives complained that fumes from the factory might affect the paint applied to the company's cars. The new joint venture, however, projected to cost $2.4 billion, was also a high priority investment in the area, and Panda's objections apparently did little to influence the progress of the large project's negotiations. Guangdong did show its continuing concern for the venture, though, by creating the provincial Panda Automotive Small Group Office in Guangzhou in September, 1990.[34]

Panda's most serious problem rose to the fore gradually as 1990 drew to a close. Where would the company sell its vehicles? In a mid-October interview, Huizhou municipal officials expressed anxiety over their belief that Panda had no certain market for the cars it would produce. They indicated that even Dr. Kim was unsure where his company would be selling. Panda treasurer Pak Bo-Hi journeyed to Beijing in the autumn to meet CCP secretary Jiang Zemin.[35] On this trip, he asked for permission to sell 30 percent of the company's output within China.

While such a proposal was permissible under WFOE laws, Panda's previous promises to export all of its cars may have made a policy switch politically difficult. It is not known what reply the Beijing leadership gave Pak, though one source reports the Chinese government might allow Panda to sell some of its vehicles domestically if the company were in serious trouble.[36]

The company was also plagued by tardiness in finalizing its vehicle design. As mentioned above, Panda's project plan omitted reference to the exact model the company would be manufacturing, and Panda officials questioned about their

[34] Based on January, 1991, interview

[35] *Far Eastern Economic Review*, November 1, 1990, p.24

[36] Based on May, 1991 interview

production plans declined comment.[37]

Finally, Panda's future was threatened in 1991 by the weak world auto market brought on in part by global recession. In March, Panda temporarily halted its plant construction because of the weak international market. By then, the company had spent some US$106 million to finish the factory building's steel frame.[38] Some of Panda's investors reportedly were reluctant to further finance the transport and installation of equipment for the venture's factory, fearing the inability of the company to market its cars, and doubtful that Panda even had the ability to decide on a practical design.[39]

To analyze the Panda project, we now again turn to the model developed in Chapter One. First, we examine the stimuli that made Panda possible.

Stimuli

Foreign Forces

Panda's initial approach to several Chinese cities was met with a lukewarm response. These cities realized that the company was an unknown player, one that was proposing a complex project with little apparent experience or background. Panda's feasibility study was extremely weak, as, for example, it could not say exactly what type of vehicle the company would manufacture. Furthermore, the reluctance of Panda to publicize its connections to the Unification Church may have added to the suspicion of potential local sites.

As a wholly foreign-owned enterprise, Panda may also have carried undesirable features. Local politicians might have preferred a joint venture, because that kind of investment brings more control to the municipal officials. Furthermore, in some of

[37] Based on October, 1990 interview in Huizhou

[38] *Far Eastern Economic Review*, March 28, 1991, pp.6-7

[39] From May, 1991 interview

the cities Panda approached, including Shanghai, Shiyan, and Changchun, there were already joint ventures operating or under discussion, and the local governments may have feared competition with the established factories.

On the other hand, however, status as a WFOE also stood to benefit a local city. The venture could probably be approved and begin operation somewhat faster than could a joint venture, as lengthy negotiations, such as those faced by the other automotive joint ventures, would be avoided.

Panda's greatest asset in its approach to the Chinese, though, was its promise of lucrative monetary investment. At a time of economic austerity, little central government money was available to begin new local projects. Panda's promise of $1 billion, paid in hard currency, would be a tempting prize for the cities approached.

Besides its financial resources, Panda's most useful tool was its skill in approach to the Chinese political system. The company realized it could make much faster progress as a WFOE than as a joint venture. This was key to deflecting SPC opposition (discussed below), as procedures for approval of WFOE's were considerably less stringent.

When Panda encountered trouble from central government officials, the company made effective use of its lobbyists, Wilson and Ichord, to gain sympathy and concessions from Beijing. The ability to win the confidence of such an important player as Chen Zutao also reflects well on Panda's persuasive skills. In sum, once the new auto company had overcome problems in finding a suitable site, it used its monetary and political skill effectively to make rapid progress in gaining approval and support.

Domestic Economic Forces

At the time Panda approached China about building a new factory, the country was just beginning an economic retrenchment, which significantly restricted the

spending power of the central government. There was, therefore, an impending investment vacuum, and Panda's pledge promised to help alleviate the shortfall.

The large amount of spending could have an impact in several ways. First, workers needed for constructing the factory would find immediate employment. If the plant began producing cars, employees of the company would gain useful technical and managerial skills. Of course, the salaries earned by the factory workers would help stimulate the local economy.

Further benefits might be gained from multiplier effects of such a large manufacturing concern. Parts suppliers in the factory area would be needed, and such companies would provide additional employment. The infrastructural improvements at the Panda plant site would also have beneficial effects for the local economy.

The Panda project did potentially carry some economically harmful attributes. Because the company lacked a joint venture partner, Panda would probably have to draw skilled workers away from the established auto joint ventures, and the domestic state-owned factories, to engage employees in the manufacturing process. Employees interviewed from both Beijing Jeep and Shanghai Volkswagen expressed interest in working for Panda; they sought higher salaries and more freedom they envisaged in working for a WFOE.[40] Such a migration could have damaging effects on the auto manufacturers outside of Huizhou.[41]

If Panda failed completely, the Chinese economy as a whole might also be adversely effected. As the Beijing Jeep case demonstrated, the international reputation of China's investment climate was still quite vulnerable. When projects with such great investment as Panda faltered, other foreign investors could not help but

[40] In fact, Huizhou officials confirmed Panda was considering paying some of its Chinese employee payroll in US dollars.

[41] Panda officials claimed they could train their own workers, if necessary, to avoid such hostility from other factories. They also said workers trained by foreigners would lack "bad work habits" typical of Chinese laborers. From a February, 1990 interview.

reconsider their own plans. Of course, the Panda project was from the beginning somewhat unorthodox, so it was not clear what the effect of a Panda collapse would have on the whole of China's investment climate.

The above analysis assumes Panda would keep to its pledge to export all the vehicles it produced. If, however, one supposed Panda could sell its cars on the Chinese internal market, as the company actually desired in late 1990, other domestic factors appear for brief consideration. First, the joint ventures and domestic producers would probably suffer from competition with the wholly foreign-owned enterprise. The Chinese domestic producers would lose some of their market share.

On the other hand, however, Panda cars sold within China might bring some substantive benefits to the economy. Assuming Panda could produce on the scale it predicted (a possibility based on the company's ability to avoid initial demands to localize, and on the utilization of modern factory equipment), Panda's cars could theoretically represent viable import substitution for the thousands of Japanese cars needed to replace aging taxis in the early 1990s. Panda cars would be assembled with Chinese labor, and transportation costs would probably be lower than for imported vehicles. Furthermore, the new venture's cars would be smaller than the Santana model (with a 1.3 liter engine versus Volkswagen's 1.8 liter Santana), and such models might be somewhat more appropriate for China's narrow and crowded streets.

In comparison to the earlier joint venture auto projects, the stimuli represented by the Panda representatives, and the domestic forces acting on the central government at the time, were probably somewhat less imperative. By the late 1980s, China already had made substantial progress in absorbing advanced passenger car technology, and joint venture production was showing gradual progress toward satisfying the nation's needs. These two vital domestic factors were therefore less salient at

the time Panda officials approached the Chinese authorities.

The foreign representatives of Panda, however, were able to stimulate the Chinese political system in ways different from those adopted by the joint ventures. In by-passing negotiations for a Chinese partner, the WFOE would have far greater latitude in interacting directly with the pertinent Chinese authorities. Panda people were free to move quickly, pinpointing the officials who could make the important concessions needed by the foreign venture; and, once found, these cadres were subjected to the pressures Panda felt would bring the desired response. Panda's identity as wholly foreign-owned, combined with a certain political acumen on the part of its representatives, made the company a formidable force in shaping the actions of the pertinent members of the automotive decision-making officials. The next section focuses on the actual political process that pushed the Panda project forward at a rapid clip.

Government Decision-Making

Political Bargaining

As with previous cases, we look at the positions of the pertinent political organizations and individuals, and see how their interaction affected outcomes. First, we discuss the role of the central government, before turning to local political actors.

Beijing's Role

At the top, the State Council seemed to present little initial opposition to the Panda project. Zhao Ziyang, as party secretary, was reportedly a supporter of the plan, though he was busy with events surrounding political demonstrations soon after the venture was proposed and approved.

Premier Li Peng seems to have felt early ambivalence toward the company.

Under his stewardship, the State Council reportedly did investigate the proposal in early 1989, when the first small expert group toured Huizhou and recommended State Council approval. Perhaps Li had not paid proper attention to this investigation, for by mid-July Li's attitude was that "it is not that I oppose [the project], but that if it is done, it should be done well,"[42] and he dispatched a second group to Huizhou for further information.

Li appears to have been greatly influenced by the report of this second group, which included his trusted friend, Chen Zutao. The Premier's attitude seems to have shifted from suspicion to muted support, as shown by Chen's later posting to Guangdong as a special advisor, and by Li's visit to Huizhou and promise of financial assistance. (Still, the top leader's approval was conditional on Panda's pledge to export its product).

Li's opinion was influenced by more than just the July report. As mentioned above, the Panda-engineered visit by former US Congressmen to Beijing was of some vital propaganda use to the Premier, and to new party secretary Jiang Zemin, and the ploy probably further influenced the government leaders. But a more important factor may have been the encouragement of then-CNAIC vice president Bo Xiyong, who took an instant liking to the auto proposal, reportedly feeling it had great practical potential. Bo proceeded to champion the merits of the company directly to Li; and the Premier, a personal friend of this son of elder leader Bo Yibo, took his advice to heart.

While the top government leaders seemed to stand behind Panda, SPC chairman Zou Jiahua led the opposition. His stance was most likely based on a report the SPC had commissioned to a private foreign research organization, assigned to investigate the Panda project and the company's background.[43] The report, citing Panda's

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[42] *Shei lai chengbao zhongguo?*, *op. cit.*, p.359 (author's translation)

[43] Based on 1990 interview

suspect background and poorly outlined production plan, gave a negative opinion of Panda, and from that time on Zou seems to have fought the project.

The SPC also had political motivation for fighting the venture. As a WFOE, Panda could, and did, argue that it would operate completely outside of the national economic plan. Because of this, the SPC theoretically lacked jurisdiction over the auto venture, and thereby lost its right to veto the proposal. Panda therefore represented an inherent threat to the planning body, one which could set a very dangerous precedent for future wholly foreign-owned enterprises in China. Zou's attitude, then, was most likely based on protecting the prerogatives of his bureaucratic entity.

One should note that Zou was the brother-in-law of Guangdong governor Ye Xuanping, one of Panda's biggest supporters. Though scholars often assign such familial bonds great importance in analyzing political actions, in this case the ties seem to have made little difference in either administrator's stance.

Though Zou's administrative portfolio included only the SPC chairmanship, he retained great influence at his former Ministry of Machinery and Electronics Industry, and at the MMEI's subordinate organization, the CNAIC. Once Chen Zutao had retired from the leadership of the CNAIC, Zou's ally Cai Shiqing was apparently willing to comply with SPC wishes. By late 1989, then, the CNAIC had issued instructions to its staff to refrain from aiding the Panda organization. Furthermore, the auto bureaucracy also apparently attempted to prevent its employees and workers at the state-owned auto factories in Changchun and Wuhan from leaving their posts to work for the new venture.[44]

Though the new CNAIC leadership took part in a drive against Panda, there is evidence that the organization lacked unanimity in its efforts. First, CNAIC vice president Bo was an early supporter of Panda, and his position did not change,

[44] Based on 1990 interview, Beijing

though by late 1990 he had moved to the more sympathetic Ministry of Aeronautics and Aerospace (MAAS). Other sources report a kind of "underground" within the CNAIC, consisting of lower-ranking officials supporting Panda, perhaps in the hope of obtaining a future position in the company.[45] Such a force may have been further influenced by the former chief of CNAIC, Chen Zutao, who had by then become an advisor assigned to aid Panda. Chen reportedly harbored a great dislike of SPC chairman Zou, and may have relished the opportunity to help foster a project he knew was opposed by the SPC. In fact, there are some signs that by late 1990 CNAIC opposition to Panda had faded somewhat, as one Panda official reported that a CNAIC-subordinate company had bid to supply the venture with spare parts.[46]

Though the SPC and CNAIC represented the main opposition to Panda, other ministries supported the company. The aeronautics ministry, MAAS, was an early fan of the auto venture, as its civilian production units stood to earn money from selling parts. The MAAS minister, Lin Zongtang, saw such sales as a way to counteract cuts in military spending that hurt the expansion of his ministry's production.

MAAS took several concrete steps to demonstrate its interest in sales to Panda. In late 1989 or early 1990, the ministry arranged for flights around China in special government planes to show Panda representatives the facilities that could supply parts to the venture. Later, in 1990, the ministry appointed Bo Xiyong, reportedly a personal friend of minister Lin, as vice president of its Civilian Production Development Company. Finally, the ministry put in a bid, competing with the CNAIC, to become the exclusive parts supplier to Panda.

The Transport Ministry may have played a peripheral role in the development of the auto company. As noted above, the Unification Church had approached the ministry in 1988, proposing the construction of some portions of its "International High-

[45] Based on 1990 interview

[46] Based on October, 1990 interview with Richard Cummins, Chief Executive Officer of Panda's China office.

way" in China, and the ministry apparently favored the proposal. When Panda later had trouble in speeding the construction of the vital Autou port, Guangdong governor Ye suggested the Transport Ministry might somehow aid the port's progress. One Chinese automotive official suggested a kind of *quid pro quo* might have emerged to link these issues, with Panda potentially receiving Transport Ministry help in exchange for progress on the highway project which, as of late 1990, was still on the Chinese planning agenda.[47]

Before analyzing the implications of the central government machinations, we next turn to the influences exerted by the local authorities in Guangdong and Huizhou, to see the role they played in the political process.

Local Politics

For Guangdong province officials, Panda represented a chance for developing a region near the rapidly developing Shenzhen special economic zone (SEZ), and one which would be under closer provincial control than Shenzhen. After achieving SEZ status, Shenzhen (like Guangzhou, as mentioned in Chapter Six) was declared a *jihua danlie* (independent planning unit), and could then make its economic plans with far less provincial influence. Huizhou, however, was not a *jihua danlie*, so more credit for and control over its growth would rest with Guangdong authorities.

In addition to the desire to see Huizhou develop for these reasons, Panda represented a kind of provincial challenge to the growing Peugeot venture in Guangzhou. As discussed in Chapter Six, this rivalry seemed particularly ironic, considering that Guangzhou is the capital city of Guangdong. Still, the competition gave provincial officials further incentive to help the Panda cause.

Support for the new company seemed to be unanimous within the Guangdong

[47] Based on interviews in Beijing, 1990

government, though governor Ye and vice governor Kuang were the main Panda boosters. The quick approval granted the venture was the earliest manifestation of the province's goodwill, and Kuang's July, 1989 visit to Beijing demonstrated further support for the project. Ye's meeting in early 1990 with Panda officials, detailed above, shows how deep the governor's concern ran.

Perhaps the most telling sign of Guangdong's support for the project was the founding in September, 1990, of the above-mentioned provincial automotive work group assigned to help Panda. This organization was to coordinate the development of the new venture with potential resources in the rest of the province. It was specially created by the governor's office to help with problems that Huizhou could not solve alone.

One example of provincial intervention came in late 1990. Panda wanted to have permission to operate a 700 horsepower boat in the waters around Autou; the Guangdong regulations limited boats to 60 horsepower. Once the special work group was informed of the problem, however, it moved quickly to grant an exemption for the auto company.[48]

As noted above, Huizhou city also had many reasons to support Panda, and few to oppose the company. Like any city during the austerity policy of the late 1980s, Huizhou welcomed the cash infusion, and the benefits that would accompany such a large construction and production project. Also cited earlier were the city's pledges of municipal investment in power and port facilities.

Perhaps Huizhou's more important contribution, however, was the effort to lobby the central government mounted by local leaders. Mayor Li Jinwei's journey to Beijing seemed key to Panda's gaining initial central government approval, as did vice mayor Li Hongzhong's moves to convince those with technical expertise of the project's viability. This local support probably was instrumental in persuading the

[48] Based on January, 1991 interview in Guangzhou

State Council to grant the new enterprise the required approval.

In one instance, the interests of the city actually ran counter to those of the national government. By late 1990, the Autou port was deep enough to allow 3000 ton ships to enter the harbor. Beijing had approved dredging the harbor to a depth of eight meters, to allow in 10,000 ton ships. But the city had plans to deepen the harbor to 11 meters, to permit 35,000 ton ships passage. One source hinted Huizhou might go ahead with the unauthorized dredging, later presenting the central government with a *fait accompli* that might not fit into the central government's plans for regional port development.[49]

The Huizhou leaders were probably taking the biggest political risk of any officials in backing Panda. Were the project to fail, national repercussions would not be very great, as there was little central government money diverted to help the project, and the effect on the investment climate in China would probably be minimal. Local officials, however, would be embarrassed by their miscalculation of Panda's potential. Furthermore, the municipality would be forced to spend time and money to convert the infrastructure left by Panda to other uses. Huizhou would also be left with the many unemployed workers from a failed venture.

Before concluding the discussion of political posturing over Panda, we turn briefly to look for evidence of misperception among the central and local decision makers. Was their thought process clouded in any way?

Misperception

Considering the experience Chinese leaders had from the three extant auto joint ventures, the enthusiastic welcome extended by many of them is somewhat surprising. Would not Panda, with no actual car company or experience behind it, prove to

[49] Based on 1991 interview

be a far greater strain on rational auto development than had been the slowly progressing Shanghai Volkswagen project, not to mention the ill-conceived Beijing Jeep company? Were there then mitigating factors that blurred the perception of the new venture in the eyes of the Panda supporters?

One element does seem to supplement the list of reasons, noted above, for the Panda boosters to have adopted their stance: namely, the prevalence of a kind of unnatural obsession to attract money, in whatever form it might take. The affliction may have been accentuated by the prevailing austerity policy, yet it probably did also play some role in the approval of the earlier automotive joint ventures (and, potentially, in any other type of foreign investment involving large monetary infusions).

In the Panda case, the Chinese supporters seem to have been somewhat blinded by the promise of a huge investment. Because of this, many officials appeared to have formed a kind of mental block to some of the shortcomings of the company itself, and to its plans in China. One foreign source familiar with the project reported that many Guangdong province officials affiliated with developing the venture believed that Panda was a large American auto manufacturer; and Panda, for its part, was probably loathe to shatter such an illusion. Huizhou officials did not worry of the enormous cost the company would of necessity have to endure to create a new model vehicle, believing that, though two years after arriving in China the company had yet to name the type of car it would produce, there would be no problem on the issue. Some of Panda's support, therefore, was at least partly based on the irrational belief that large amounts of money guaranteed success.[50]

One surprising perception twist appears in the analysis of Chen Zutao's stance. Though Chen had been a bane to the Beijing Jeep and Shanghai Volkswagen

[50] Such support, however, could be a double-edged sword. When Huizhou officials seemed reluctant to move on Panda's complaint about potential fumes from the proposed Shell oil refinery, the politicians may have been reacting to the size of the Shell investment which, at $2.4 billion, would be twice that of Panda's fiscal promise.

ventures, he appeared as one of Panda's staunchest supporters. His attitude may have been based partly on his apparent faith in the virtues of exporting automobiles, and his opposition to allowing foreigners a share of the domestic market. In criticizing Beijing Jeep and SVW, Chen's referent was quite clear, as both ventures were obviously initiating domestic sales on a scale unforeseen in the planning stages of the companies. Panda, however, promised to export all of its product, and its status as a WFOE seemed to lend the credence of Chinese law to this pledge. If Chen's past experience influenced his stance on Panda, his support, even in light of the inherent weakness of the company and its plans, is not surprising, though it may be somewhat irrational.

Policy Process Conclusions

The Panda case vividly displays many of the political processes associated with bureaucratic politics and irrational influences within the decision making process. At the central government level, we see the emergence at the top of a small group, led by Li Peng, Bo Xiyong, and Chen Zutao, supporting the Panda project for various personal reasons. The main central government opposition had a more bureaucratic-political tinge, as Zou Jiahua hoped to defend his ministry's prerogatives against the upstart wholly foreign-owned enterprise. The CNAIC was torn between the commands issued from above, initially emanating from the powerful Zou, and its own inclination to help Panda - and itself - by selling parts. Peripheral players included the MAAS and the Transport Ministry, both of which had incentives to support Panda in order to help advance their ministerial goals.

From such a setting emerges a picture of fragmentation, and of top leaders subject to manipulation by the foreign investors. The State Planning Commission seems to have been the only body reacting to rational, apparently objective input in the form of the foreign firm's feasibility study it had commissioned. The SPC,

however, was also subject to bureaucratic pressures, ones which may have made its stance somewhat less than completely objective. The main Panda supporters apparently had rather narrow goals in mind in advancing the project, and their clever manipulation by the Panda officials testifies to great political acumen on the part of the foreign forces. The troubles Panda encountered in early 1991 tend to highlight the lack of rational judgement in the top leaders' decision process.

Local officials in Guangdong and Huizhou were dependent on the Beijing politicians for both project affirmation and material support. The united front of provincial and municipal cadres lobbying the pertinent members of the central government seems to have been of invaluable aid to Panda. At the times when it appeared central government help would be slow in coming, the local officials even dared to push forward, though cautiously, on their own.

Finally, the positive political response to Panda was nourished by a general aura of enthusiasm for the company, based partly on the Chinese fascination with Panda's monetary pledge. Though other factors worked in the foreign project's favor, the respect generated by Panda's seemingly unlimited fiscal resources added to the company's political support.

Policy Implementation: Panda's Path

In contrast to the previously discussed cases of automotive joint ventures, Panda, as a WFOE, was far less at the mercy of the Chinese political system. The relatively quick implementation of government policies reflects the luxury of Panda's greater degree of independence.

Without a joint venture partner, Panda was relieved of the obligation to consult with lower-ranking automotive officials who lacked decision making powers and, more importantly, had spent decades entrenched in a slow-moving political process. The new foreign investors were also fortunate that Huizhou politicians,

unaccustomed to large, heavy industry projects in their region, were also apparently generally free of the bureaucratic shackles that contributed to delay in development of such ventures.

At the local level, then, the relative absence of standard operating procedures (SOPs) left from the pre-reform era, combined with the lack of a joint venture partner, seems to have been a factor in allowing officials to move Panda along the bureaucratic conveyor belt more quickly. The venture's quick approval, and its progress in developing its factory facilities testify to this assertion.

The central government's actions may also have depended on Panda's independent status. As noted, the company representatives could directly approach the pertinent top leaders for the help required. Furthermore, Panda was able to avoid such large institutions as the SPC and CNAIC, as neither had to approve the company's plans, and, at least in the early stages, their help was unnecessary. Implementation at this level effectively excluded those offices that would tend to rely on slow and perhaps inappropriate SOP responses. For comparison, one should note the above-mentioned Shell refinery, a joint venture project, was still under negotiation in early 1991 after more than three years of discussions.[51]

Though the Panda case is noteworthy for a minimal amount of political intervention, is there any evidence that the bureaucracies involved actually displayed the type of "learning" that represents behavior different from and more rational than that of the past? Probably the biggest sign of rational advance by any governmental body is seen in the SPC's actions toward Panda. The planning commission's study, done by an outside source, displayed the shortcomings of Panda's plans. Though bureaucratic goals may also have played a role in the planning commission's opposition to the project, the SPC showed competence in accepting the negative opinion of a neutral source, even though rejection of the venture would cost the nation millions of

[51] *China Trade Report. op. cit.*, p.8

dollars in hard currency investment. It is not clear whether such outside studies preceded the other Chinese automotive projects; in any case, though, the process of rejecting a venture based on such projections of problems similar to those previously encountered (such as obvious planning problems by the foreign investor) is novel, and a sign of advancement, in the automotive policy sector.

Except for the SPC, however, the rest of the pertinent political branches seem to have made little progress. Both central government leaders and local officials fell into a pattern similar to that which characterized the Beijing Jeep case in particular, and the other auto ventures to a lesser extent: a foreign firm arrives in China with grand plans and promises of large investment. Then, when difficult times arrive, often because of poor planning, the Chinese government is obligated to come to the rescue.

Though Panda seemed at first to fall outside of the usual pattern, there were enough elements visible that the bureaucracy should have seen impending problems. The continued susceptibility to a kind of "monetary" misperception, however, and SOPs that were probably designed more for absorbing any money offered than for rationally choosing ventures, shows that little progress was made from the approach the Chinese took to the AMC bid in the early 1980s, to the actions taken toward Panda at the end of the decade.

Summary and Projections

Figure 7.2 summarizes the main arguments of this chapter in the context of the study's theoretical framework.

Probably the most striking feature of the Panda case was the speed with which the venture was able to move through, or often past, the Chinese bureaucracy. Actually, this summary diagram has few elements that are necessarily peculiar to Panda alone. It is likely, then, that unless China's investment rules change, other wholly

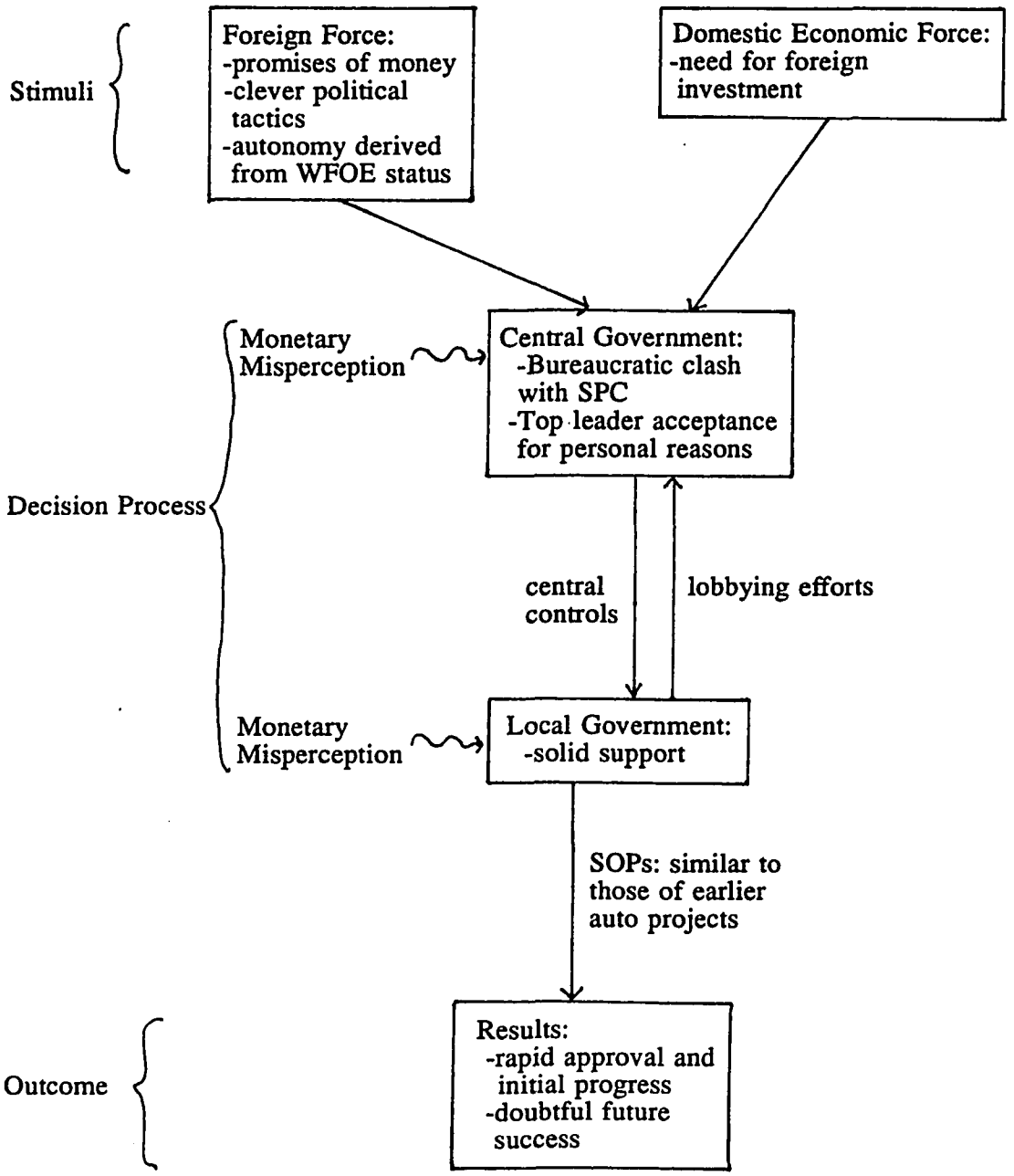

Figure 7.2: A Summary Diagram of the Panda Case

foreign-owned enterprises might be able to follow Panda's path, to achieve rapid progress in establishing themselves and solving problems. Such companies would, however, need to develop the kind of political acumen which seemed innate to the Panda representatives.

As of this writing, Panda had faltered for precisely the reasons the SPC felt suspicion toward the company: the company had failed to formulate a practical plan for construction of a vehicle model that still had not been designed; furthermore, there was little market for the venture's product even if it were to roll off the Huizhou assembly line. Therefore, any company that wished to emulate Panda's success with the Chinese bureaucracy, and remain a viable and profitable entity, would need to make its plans much more carefully and rationally than did Panda.

Chapter 8:

Conclusion

The four case studies in this dissertation chronologically parallel the development of China's "open" policy from the end of the 1970s to the early 1990s. In looking at the record of the foreign-invested passenger car industry, then, we can measure the progress of the relevant industrial bureaucratic sectors over the whole period of reform.

This final chapter begins with a brief review of political developments leading to the changes inaugurated in the post-Mao era. It then returns to the dissertation's theoretical framework to synthesize elements of central and local political decision making, and evaluates the learning process over the nearly 15 years of Chinese interaction with foreign auto companies outlined in the cases.

Following this analysis, we look toward the future of China's automotive industry and its associated policy making, and the problems and prospects for foreign investors. The chapter concludes with suggestions for further research on other Chinese industrial sectors.

The Evolution of Automotive Policy Making

The automotive industry in China was deeply rooted in centrally-led, mostly Maoist-inspired policies over its first three decades. As Chapter Two noted, then, the People's Republic looked to its socialist brother, the Soviet Union, for aid in kindling its first large-scale production plants in the early 1950s.

Radical central policy dominated later in that decade, as Soviet experts were expelled from China, and the proper role of even Chinese technical experts came into question. Local political forces were responsible for developing policies suit-

able to their own conditions; the parameters of their actions, however, were limited by central government restrictions. Thus, a rapid proliferation of automotive assembly plants was favored by regional leaders, but also conformed to Mao's advocation of local self-reliance.

The early 1960s continued the pattern of central rule, though the direction strayed from the Maoist path. The development of the CNAIC, contact with Western firms, and emphasis on expert influence anticipated the reforms that took hold in the late 1970s. The officials advocating these proposals in the early 1960s, including Liu Shaoqi, Deng Xiaoping, and their allies, were often the same figures who promoted similar projects in the 1970s and 1980s.

Chapter Two outlined the reversion to Mao's line during the Cultural Revolution, and subsequent stifling of expert automotive opinions. Again, local leaders were free to contribute to the sprawl of industrial development by founding their own factories.

By the mid-1970s, the central government did turn to foreign nations to satisfy vehicle requirements, through imported automobiles; the Chinese also began to see the need for technology transfer to their inefficient industry. Only the death of Mao and the introduction of economic reforms, however, heralded full-scale cooperation with foreign investors.

One major feature that dominated the reform era was decentralization of economic decision making. Each of the case study chapters focused on the particular role of the central and local governments in shaping the various ventures; below, however, we look at the studies on a continuum to see the actual trends in central and local powers over the first decade and a half of post-Mao economic change.

Central Automotive Decision Making: A Summary

Political Bargaining at the Center

The initial decisions to reorganize the automotive bureaucracy with the passing of the Maoist creed came from the very top leaders. The early 1980s, then, saw the reappearance of the CNAIC, and opening to foreign automotive companies. Both policies reflected ones first pursued in the early 1960s.

Which leaders were responsible for these changes? As Chapter Three pointed out, China's elder statesmen held the highest authority to make major structural changes in the bureaucracy, and in foreign economic policy. Deng Xiaoping, of course, was well known for advocacy of technology import from capitalist nations, and for greater reliance on expert knowledge. Based on Chapter Three's profiles, however, top leaders concerned with heavy industry were also likely associated with the early post-Mao moves. Thus, Bo Yibo, one of the elder leaders throughout the 1980s and into the early 1990s, was a key proponent of both the CNAIC and automotive modernization in general. Very few of the top leaders, in fact, seemed to oppose the reorganization of the industry or greater technological contacts with the West.

Still, the early experiences of Beijing Jeep, and, to some extent, Shanghai Volkswagen, showed some lingering central doubts about the national emphasis on joint ventures. In BJC's case, the government was reluctant to bail the foreign company out of its foreign exchange balancing problems. SVW had to suffer under threats over its slow localization pace.

On closer examination of these automotive problems, however, one finds it was the quasi-ministerial levels, rather than the top leaders, that most handicapped the foreign ventures. In the cases of both BJC and SVW, it was Chen Zutao, as CNAIC chief, who led the auto bureaucracy against the companies; he opposed import concessions for AMC, and campaigned for faster local content in Shanghai. MOFERT, furthermore, failed to rescue Beijing Jeep; as regulator of foreign exchange, it could have moved with more alacrity to ameliorate the venture's predicament.

BJC's problems were solved when Zhao Ziyang and Zhu Rongji intervened, effectively overruling the CNAIC chief and the MOFERT leadership; SVW could breathe easier in 1989, after Chen Zutao took forced retirement, likely at the insistence of his former boss and one of China's rising stars, Zou Jiahua. Leaders at the commission level and above, then, acted effectively to remove obstacles to foreign investment that originated at the ministerial level and below.

By the late 1980s, the central government was generally united in its acceptance of foreign automotive corporations. The CNAIC played a less antagonistic (though greatly reduced) role in regulating the ventures; Guangzhou Peugeot seemed to barely notice the national corporation. The central commissions took steps that stifled automotive sales in 1989; this move, however, was part of a general economic austerity program, and should not be viewed as a targeted attack on the auto industry.[1]

The Panda case illustrated one final attempt of Chen Zutao and others to split central policy making. Though the commission level authorities (Zou Jiahua) expressed grave reservations about the project, Chen was able to mobilize top-level support (from Premier Li Peng and Bo Yibo's son) to gain central approval. The failure of the Panda project is unfortunate from our analytical viewpoint, as its continued existence and progress would have provided useful data on an instance of sharp disagreement among top central and commission-level leaders. Still, the venture did help illustrate the effects skilled foreign business people could have on China in the latter reform years; the following section traces the development of the foreign forces and the central political reaction.

In sum, the central government decision process resembled Graham Allison's "Model III" (see Chapter One), as bureaucrats struggled to protect their institutional

[1] The policies also hit the steel production, power generation, and agricultural sectors. See Richard Brechor, "The End of Investment's Wonder Years," in *The China Business Review*, January-February 1990, pp.27-29.

prerogatives. Though the top central leaders were eventually able to impose their wills, bureaucratic resistance was sometimes surprisingly strong. The highest leaders, however, apparently felt their own interests lay maintaining an open door to foreign investment; tactics foreign business people employed on their own behalf helped the top officials manipulate the bureaucracy to achieve their goals, as is discussed below.

Trends in Foreign Investor Impact on Decision Making

Top-level suspicion of foreign investors was reinforced in the early 1980s by AMC's deceptive (or perhaps simply ignorant) promise to build a new car model at the Beijing Jeep plant. The hard bargaining that followed probably strengthened the resolve of skeptics toward joint ventures with capitalists; Chen Zutao's 1988 attacks on SVW may have been a lingering effect of the Jeep crisis.

In general, however, central leaders seem to have been favorably impressed by the contributions foreign corporations could make to the development of China's automotive industry. Zhao Ziyang and Zhu Rongji were therefore quick to come to the aid of Beijing Jeep. With Volkswagen's honesty and commitment to quality, Zhu Rongji, as mayor of Shanghai, was again a major supporter of the auto industry; moreover, he was able to use his connections in the central government to win favor for SVW. During the 1989 austerity, Beijing was reluctant to see any of the major auto joint ventures suffer, and gave favorable treatment to BJC, SVW and Guangzhou Peugeot.

As the case study chapters noted, then, the foreign investors were quick to find effective methods of influencing central policy. The Americans in Beijing found sponsors close to home, and effectively by-passed many local city officials and lower-level national bureaucrats. SVW and GPAC, however, relied on municipal sponsors to pull strings in the capital; this local political role is summarized below.

Finally, Panda representatives were bent on winning favor at all levels, and had a good deal of success in their lobbying efforts; Panda failed mainly because of its own internal problems.

How did foreign investment strategy vary by nationality? From such a small sample, it is impossible to generalize about the differences in American, French, German and South Korean approaches. An earlier study by Victor A.T. Koh in 1986, however, noted that Chinese managers surveyed found West German investors honest and dependable; the French were seen as hard working but rather inflexible and offering equipment at prices too high; and Americans received good marks for honesty and willingness to share knowledge. (The study omitted South Korea).[2] Though Koh's findings do not strictly correspond to the data in this thesis, the case study results show some correlation.

Over the twelve years after VW and AMC made their first bids for automotive cooperation in 1978, foreign investors in general became more sophisticated, and better able to wrest favorable treatment from central leaders. Though the early years were most difficult, by the time Panda lobbyists appeared, a combination of Chinese economic maturation and a blossoming refinement of foreign lobbying brought favorable results for the outside investors. Future foreign automotive investors would be wise to take heed of some of the tactics employed by the ventures chronicled in this dissertation.

Effects of Domestic Economics on Central Policy

The original impetus for inviting foreign automotive investment in China was based in the looming prospect of endless Japanese car imports. Post-Mao central leaders, then, were generally united on the need to open to the West, as Chapter

[2] Victor A.T. Koh, *Cultural Expectations for International Marketing and Business in the People's Republic of China*, Ph.D. dissertation, Ohio State University, 1986, pp.301, 307-308, 284

Two noted. (Even under Mao, the Chinese had begun overtures to European and Japanese companies on technology import to inspire a more modern domestic industry).

An invisible economic hand, then, guided central policy through the 1980s. At each crisis or trouble point with the foreign ventures, central leaders stifled their instinct to close the nation's doors to the profit-hungry capitalist corporations, instead following the economic dictum of modernization at all costs. Though at least one venture (GPAC) teetered on the brink of collapse in the 1989 austerity drive, the national leaders rescued all of the auto manufacturers; the invisible hand shook central officials into realizing the alternative was a renewal of treasury-draining buying sprees of Toyotas and Nissans.

Where will economic forces lead the central policy makers in the future? Chapter Two cited projections of increased needs for passenger cars and light trucks in China. Consideration of such requirements most likely inspired a second Volkswagen venture in Changchun and a Citroen contract in Hubei; both projects (described below) were slated to begin production in the mid-1990s. So long as the demand for vehicles was high, and the number of producers low, the central leaders would be inclined, sometimes perhaps grudgingly, to allow foreign ventures to exist and even prosper.

One further question remained over the joint venture projects: what would happen at the expiration of an auto corporation's contract? BJC's agreement was due to expire in the year 2003; SVW's in 2009; and GPAC's in 2005. (As a wholly foreign-owned enterprise, Panda's project had no time limit). Again, however, economics indicated the contracts might be extended. China would still be a developing country even in the early years of the 21st century, and would therefore still rely on advanced Western technologies. Though it stood to approach the technical levels of capitalist nations after several decades of modernization efforts, it

would probably be forced to rely on the joint venture partners' continued technology infusions for at least a few years beyond the joint venture agreements' time limits. By then, if profit levels of the early 1990s were any indication, the foreign companies would have earned handsome returns on their investments.

Trends in Central Misperception

The degree of the perception problem among central leaders manifested itself in a parabolic pattern over the decade of the 1980s. Misperception found in the Jeep case seemed to diminish in the SVW and GPAC contracts, but reappeared with the arrival of Panda.

Chapter Four showed how the Chinese were so eager to conclude a foreign joint venture contract that they allowed wishful thinking to cloud their perception of American ability to fulfill promises. Volkswagen frankness dispelled such ideas among the Chinese negotiators, and, by the time GPAC talks neared conclusion, the Chinese seem to have learned the limits of foreign capabilities.

Panda's ability to fool top leaders with pledges of money shows that problems of misperception lingered, even after more than a decade of the "open" policy. Li Peng, Jiang Zemin, and others were swayed by the large monetary figures in Panda's proposal. Zou Jiahua was alert enough to question the foreign company's background; this hesitancy of the central bureaucracy may have saved the nation from blind support of a very questionable project.

By 1990, then, top Chinese leaders were still susceptible to clouded thinking induced by smooth-talking foreign investors. Such perception problems appeared to lessen as contacts with the West increased; still, the country was poised to continue accepting irrational projects unless central leaders took a more objective view of foreign investment proposals.

Before further speculation on the future of central policy making, we turn to look at trends in local government toward automotive development.

Local Automotive Decision Making: A Summary

The power of local political units varied widely over location and, to a lesser extent, over time. We first examine the geographic variable.

Significance of Location

Beijing Jeep's joint venture was, obviously, geographically closest to the central government organs of power. In such a location, the temptation to skip consultation with local authorities was strong.

As Chapter Four showed, Beijing municipal officials were in fact a poor recourse for problem solving. Though AMC managers approached the city government officials during the 1985 crisis, they found there was little the municipality could do beyond offering vice mayor Zhang Jianmin's moral support. In the wake of this early failure, the foreigners turned to the central authorities, and used direct channels to the central government to settle problems that later arose. Though it is uncertain whether, given time, municipal authorities could have developed into a reliable working partner for BJC, the possibility of developing close contacts with central leaders clearly existed, and promised a more reliable and powerful resource of necessary aid.

Other ventures further from Beijing had no such firmly intimate ties to central leaders.[3] Chapters Five, Six, and Seven pointed out local support, then, was the key for the other companies to solving both small-scale, limited problems that relied on

[3] SVW and GPAC did, to be sure, have representative offices in Beijing; these stations, however, tended to be staffed by less senior Chinese and foreign employees of the joint ventures and foreign companies (VW and Peugeot), and mainly were assigned to spot central government political trends, help coordinate visits of venture officials to Beijing who came for information gathering, etc.

municipal funds or initiatives, and broader troubles that needed central support.

In Shanghai, mayor Zhu Rongji motivated his city to support SVW; Zhu's connections in Beijing also helped. In Guangzhou, vice mayor Xie Shihua played a similar role. Finally, Panda had the support of both Huizhou officials (vice mayor Li Hongzhong) and Guangdong provincial leaders (governor Ye Xuanping and several of his aides). The two southern ventures, more distant from the capital than Shanghai, seemed somewhat more dependent on local support than did SVW: their ties to the CNAIC and national ministries were more tenuous. Still, the key factor was that the three auto companies lay in sites with strong political and economic bases of their own (with the exception of the rapidly-developing Huizhou region), and therefore could often rely on their local resources to advance, without recourse to central support.

The implications of this type of relationship with the central government for future development are unclear. The following section, however, discusses changes in local support over the past decade, and makes projections into the future.

Evolution of Local Politics

Shanghai municipal officials were disorganized in addressing SVW problems in the mid-1980s, as Chapter Five indicated. The city leadership's attitude was transformed by two significant events: first, Zhu Rongji galvanized Shanghai to seize the chance of developing a lucrative, high technology heavy industry. Second, central targeting of Shanghai as a site for rapid modernization and foreign investment made city leaders more respectful of the role SVW played in building the local economy.

GPAC found a welcome local political climate even as it began talks in Guangzhou. Municipal officials had already experienced several years of foreign contracts, and were accustomed to many of the problems of incorporating new ventures in the

area, and of wresting concessions from Beijing. Changes in local policy toward the automotive sector over the company's first six years were therefore not significant.

Panda Motors arrived in Huizhou as the area was joining boom times in the Pearl River delta. Municipal officials acted boldly in helping the company win central approval, and in accommodating the auto company's needs at the factory site. The actual involvement of Huizhou leaders with Panda lasted only about two years, however, so it is difficult to document evolution of local policy there.

Finally, the Beijing Jeep case seems to indicate a withdrawal of local interest in an automotive venture. The city and BJC's partner, Beijing Auto Works, both took responsibility for the company's initial plan to produce Cherokees from CKD kits; after the crisis of 1985 showed the city unable to meet its obligations, and the Americans turned to the central government for aid, the local Beijing leaders were relegated to a more minor role in fostering BJC's development. At least until Don St. Pierre left the company in 1989, Beijing Jeep looked first to central government leaders (Zhu Rongji and others) for needed assistance.

The immediate future indicated a stronger role for local governments in Shanghai and Guangzhou. As those two cities capitalized on foreign investment and rapid economic development, their financial independence from Beijing would potentially grow ever greater. Hong Kong's return to China promised more benefit to the southern cities, including Huizhou (where a resuscitated Panda stood to prosper). Only the Beijing local government would find difficulty asserting its own objectives, as it lay under the watchful eye of central leaders.

Modification of SOPs: Has the Policy Process Advanced?

The case study chapters in this thesis described the various bureaucratic processes foreign ventures faced, not only in having their contracts approved, but in solving financial and technical problems at their factories. Did standard operating

procedures (SOPs) become more sophisticated over time? Did the bureaucracy as a whole "learn," and implement more rational political programs?

Some local governments did seem to improve their approaches to resolving the companies' troubles. Zhu Rongji had some success in seizing the reins of control in Shanghai, allowing SVW access to higher municipal authorities during times of difficulty. Guangzhou and Huizhou, already generally comfortable with foreign investors, showed only slight advance. Beijing city officials actually changed very little: BJC decided to jump over the municipal SOPs, and found central policy processes more receptive.

The central leaders implemented somewhat more erratic procedural processes. Though AMC had to run a gauntlet of national bureaucratic agencies to win initial approval for its project, none of them detected the faults in the contract that doomed BJC to eventual crisis. Central leaders looking at the GPAC and SVW proposals seem to have been more careful, though in neither case could they have learned from the 1985 BJC problems, which came after those contracts were signed.

The Panda project's approval was symbolic of the kind of procedural problems that still plagued Chinese decision making in the late 1980s. Panda by-passed the important State Planning Commission by appealing to central leaders; the short-circuiting of the system led to disorganization and conflict among central automotive agencies. It is important to note, however, that had Panda complied with the SPC's conception of proper SOPs (that is, a requirement of SPC certification), the project may have been amended or even canceled, allowing China to have avoided some of the resultant wasted effort and confusion over Panda's actual abilities to produce cars.

The difficulties with Panda may have been rooted in the general bureaucratic reorganizations in the automotive sector (and in other parts of the Chinese central government) over the 1980s; many of these changes were noted in Chapter Three.

By the time Panda arrived with its proposals, the CNAIC had relinquished much of its authority, local governments had gained expertise, and top central leaders were so eager to embrace foreign investment they had lost some faith in the bureaucratic control mechanisms. SOPs had advanced to some degree, as the ability to sustain BJC, SVW, and GPAC showed; but by 1992, little had changed to prevent another approval of a poorly conceived Panda-type plan. As the following section indicates, certification of China's next two large-scale vehicle projects may have put the country on the road to further troubles in the automotive sector.

Automotive Policy and Development into the Next Century

As the preceding paragraphs have indicated, the foreign passenger car ventures that existed in 1992 (BJC, SVW, and GPAC) stood to prosper should political and economic conditions remain stable. This section discusses possible scenarios of political and economic instability, and speculates on the resultant impact on the car companies.

By the end of the 1990s, China's revolutionary elder leaders would most likely have all died (or be in very fragile health in their middle or late 90s). As Chapter Three and the various case studies indicated, elder leaders interested in the development of heavy industry and the success of joint ventures included Deng Xiaoping, Bo Yibo, and Gu Mu, all of whom were soon to pass from the scene. What would lie in their wake?

The leadership level under the elders, as of early 1992, included Premier Li Peng, CCP secretary Jiang Zemin, vice premiers Zou Jiahua and Zhu Rongji, among others. Li and Jiang were typically labeled "conservative" by many China political scholars; Zou was called a "moderate;" and Zhu was dubbed a "liberal." As this dissertation has noted, however, all of these leaders at one time or another expressed varying degrees of support for development of the automotive sector (though Zou

was at times somewhat hesitant). The development of an import substitution vehicle industry was, in fact, seldom in question over the 1980s, as Chapter Two noted.

In the event of a peaceful transition of power within communist ideological parameters, then, the foreign ventures had little to fear from the demise of Deng Xiaoping's generation. The support of the elder cadres had been key to earlier advances in the late 1970s and 1980s, but those leaders had apparently effectively transferred their beliefs on automotive development to the potential succeeding leadership group.

Were a smooth transfer of power to either conservative or liberal communists not to materialize, what might be the consequences? Certain key elements of a new regime would probably be critical in determining the fate of the foreign automotive corporations; namely, how politically and territorially cohesive would the nation be under a non-communist government?

Political instability is a natural bane to any business operation. The auto companies in China would likely lose their carefully-nursed personal political connections instantly, and be faced with leaders unfamiliar with their particular problems. New national import regulations, tax codes, quality standards, and other rules stood to seriously disturb steady growth. Modifications in stringent communist rules on workers' rights to strike, or to change jobs, would also work against the automotive investments.

In the event China disintegrated geographically in a manner similar to that seen in the Soviet Union in the 1990s, the ventures would experience further difficulties. Each company depended on parts shipped from outside the plant and, in some cases, from manufacturers in distant provinces. A schism between northern and southern provinces, for example, would have greatest impact on GPAC (or perhaps Panda), which took parts from central provinces. (Of course, any of the companies could always rely on necessary parts sent from the home company in a time of crisis,

implementing a "de-localization" process). The ventures would be further affected by disruption in long-distance sales networks, new "quasi-national" regulations, and other myriad problems.

Still, the macroeconomic trend in China generally favored continued automotive industrial growth under even difficult circumstances. The country had a good potential market for its vehicles, a need for import substitution to protect its foreign reserves, and the allure of multiplier effects from efficient parts manufacture. Such conditions implied that even a new regime would find a place for the automotive corporations.

One economic problem did loom over the future success of the foreign manufacturers. In early 1991, China signed new joint venture contracts with France's Citroen in Hubei, and with Volkswagen in Changchun. Citroen took part of a US$800 million venture designed for production of up to 300,000 cars by the end of the century; VW's plant, also costing some US$800 million over five years, was to produce 150,000 cars each year by 1996.[4]

The problem lay in China's ability to absorb all of the vehicles envisaged by these projects. GPAC's capacity was some 100,000 light trucks and sedans, SVW's was 300,000 Santanas, and Tianjin's Daihatsu factory projected manufacture of up to 80,000 cars. State Planning Commission projections for national car requirements forecast 480,000 vehicles sold per year by the year 2000.[5] Unless the country could reach export quality standards by this time, and, perhaps more importantly, find a market for its product, the nation faced either a glut of automobiles within its borders, or several factories operating below capacity. China would have solved its import substitution problems, but wasted money in constructing unnecessary production facilities.[6]

[4] *China Daily*, April 8, 1991, Business p.3

[5] *China Daily*, March 12, 1991, p.2

[6] One source in China's planning sector claimed the Citroen project was approved at the personal insistence of elder leader Li Xiannian, a native of Hubei province. As this thesis did not focus on the two newest auto ventures,

This last potential problem brings us back to a challenge policy makers had never quite met throughout the decades of China's automotive development: that of formulating a cohesive national policy to guide the industrial sector's progress.

Chapter Two and the case studies showed the shortcomings in central attempts to rationally develop the country's vehicle production facilities. Following an almost geometric proliferation of assembly and parts production plants in the 1960s and 1970s, the reintroduction of the CNAIC was meant to add order to the nation's manufacturing system. As CNAIC's power faded in the late 1980s and early 1990s, however, central planners again lost control of economic levers. Perhaps market forces, leavened by the introduction of joint ventures, could bring order to the vehicle industry's development. If not, China stood to see further bumps on its road to a modern, efficient, and rationally ordered automotive sector.

Suggestions for Further Applications of the Theoretical Framework

The theoretical framework employed in this thesis considered foreign investor strategies and macroeconomic factors in the nation and at local venture sites as independent variables in the policy-making formula. Central and local governments were dependent variables, though different local governments did affect central policy using their own particular methods. The model also considered the role of personalities in decision making, bureaucratic loyalties, and problems of misperception in implementing the joint venture agreements.

As China's opening to foreign economic interaction broadens and deepens, the need to explore cooperation with foreign investors becomes more vital. As Chapter One noted, concentration on industrial issue areas provides a useful focus for such studies.

Other areas for scholars to explore, then, would include, for example, China'

it is difficult to substantiate or elaborate on the assertion.

rapidly developing foreign-invested electronics industry. The "foreign forces" variable would require us to examine and compare various approaches to Chinese central and local officials; how did the foreign investors evaluate the technology level and needs of Chinese manufacturers? In looking at "domestic economic forces," we must spot trends in the industry's historical development, domestic market potential, and ability to export. The decision-making process evaluation sheds light on important leaders in the industry, and their backgrounds and institutional loyalties. It also searches for standard operating procedures embedded in the institutions, and looks for evidence of learning. Finally, the model helps predict the future development of the industrial sector.

An array of such studies would present a fascinating spectrum of Chinese foreign economic policy making. With nearly every central leader and important city included in such a collection, one would have a very wide gaze on the processes Chinese use in developing industries in need of foreign technology infusions. The fruits of comparative analysis would be valuable: one could, for example, isolate causes of success in one area of foreign economic cooperation, and contrast them with failures in other areas. The work would build on the previously cited Koh study, comparing the approaches and strategies of various foreign investors.

Of course, China's industrial development is not static, and such comparative studies would naturally be hampered by the passage of time, changes in personnel, reorganization of bureaucratic sectors, and other developments. Still, results comparable to those obtained in this dissertation would undoubtedly be of value to potential investors in the industries under investigation, as well as to scholars of China's modern political and economic development.

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