

**Volkswagen Cars, Politics, and Culture in the Post-1978 China:
The Social Construction of Success**

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ABSTRACT

Volkswagen (VW) is one of the first foreign carmakers that made direct investments in China after 1978. From its entry in the Chinese market to the year of 2009, VW enjoyed popularity, high reputation, and undisputed leadership in the Chinese passenger car market, and achieved a great commercial success. Most previous accounts attribute VW's success in China to VW's wise business operation or Chinese government's support. This study guided by the methods and theories of technology studies, especially the actor-network theory (ANT), takes into account technical, socioeconomic, political, or cultural factors simultaneously. By selecting one of VW's successful joint ventures with China – Shanghai Volkswagen (SVW) – as a case to do in-depth investigation, it examines the relationship between heterogeneous actors (both humans and nonhumans) and the pathways of SVW development, and has found that all of the SVW establishment, production, marketing, and development were shaped by a range of diverse social and material actors, including the central planners, local government, VW, local suppliers, Chinese consumers, and VW cars, and depended on Chinese particular political and cultural context; VW's success in China presents a story of co-construction of power and actor-networks.

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List of Abbreviations

ANT	Actor-network Theory
CCP	Chinese Communist Party
CKDs	completely knocked down kits
CNAIC	China National Automotive Industrial Corporation
FAW	First Auto Works
FAW-VW	First Auto Works-Volkswagen
FDI	foreign direct investment
FMMB	First Ministry of Machine Building
GM	General Motors
JVs	joint ventures
MNC	multinational corporation
NDRC	National Development and Reform Commission
R&D	research and development
SAIC	Shanghai Automotive Industrial Corporation
SEC	State Economic Commission
SKDs	semi-knocked-down kits
SOEs	State-owned enterprises
SPC	State Planning Commission
SVW	Shanghai Volkswagen
TVEs	township and village enterprises
VW	Volkswagen
WTO	World Trade Organization

Chapter 1 Introduction

The Volkswagen Group is aiming to become the global No 1 in the automotive industry, both in economic and ecological terms, by 2018. Our 100 percent commitment to the Chinese market is vital as we seek to achieve our ambitious goals. As world celebrates 125 years of automotive history this year, I am firmly convinced that great new chapters of this story are now being written in Chinese. Volkswagen is proud to be a part of this endeavor.¹

--- Martin Winterkorn, 2011

Volkswagen (VW) is one of the first foreign carmakers that made direct investments in China after 1978. In October 1984, VW signed a joint venture agreement with China to establish its first joint venture in the Chinese car market – Shanghai Volkswagen (SVW). VW's partners were the Shanghai Automotive Industrial Corporation (SAIC), as well as the Bank of China, and the China National Automotive Industrial Corporation (CNAIC). SVW's main products were the Santana models and the manufacturing facility was built in Shanghai. The joint venture then achieved success in localization of the Santana parts and components as well as selling their products. The Santana cars nearly dominated government and taxi sales and became the top selling cars in China for about 20 years. In 1991, VW signed another Chinese automaker in Changchun – First Auto Works (FAW) to form its second joint venture in China – FAW-VW and produced the Jetta models. In 1995, Audi AG joined the

¹ Martin Winterkorn (chairman of the board of management of Volkswagen AG), "Auto Special: Volkswagen and China Auto Industry: Partnering for A Sustainable Future," *China Daily* April 18, 2011, p. 7.

partnership and began offering the Audi line of cars. Both the Jetta and Audi models also became Chinese favorite cars. VW have achieved popularity, a good reputation, and long-term leadership in the Chinese passenger car market. By the end of 2000, VW controlled 53 percent of market share in China.² Although since China's accession to the WTO in 2001, the competition in the Chinese car market turned fierce and VW's market share fell to 24 percent in 2004, and then to less than 20 percent after 2005, VW is the only foreign manufacturer to have made a profit in China for over two decades.³ As one analyst said, "when most of his competitors had failed or had marginal success, VW had enjoyed leadership right from the time of market entry in 1985."⁴

VW, at least from its entry in the Chinese market to the year of 2009, achieved great commercial success in China. So far, it has generally been accepted by most accounts about VW development in China that the success of VW was not due to its cars' technical superiority but its early entry in China: it entered the Chinese car market when China needed cars; its early entry not only allowed its first joint venture – SVW – to gain the pioneer status from the Chinese government, which brought preferential treatment in some policies and regulations by low tax rate, foreign currency pre-allocation and material supply,⁵ but also helped the VW

² Yan Xiaohong, "Dazhong yu Yiqi Lianshou Shinian, Shichang Zhanyoulv da 50% yishang" ("VW Works with FAW, Market Share Reaches More Than 50%"), *Xinhua News* August 30, 2001.

³ Ashok Som, "Volkswagen in China: Running the Olympic Marathon," *EBF* no. 30, 2007, p. 46-9.

⁴ *Ibid.*, p. 46.

⁵ Chunli Lee, Jin Chen and Takahiro Fujimoto, "Different Strategies of Localization in the Chinese Auto Industry: The Cases of Shanghai Volkswagen and Tianjin Daihatsu," Working Paper for the MIT 1996 IMVP Sponsors Meeting Sao Paulo,

cars to dominate the Chinese car market easily. Yet these explanations, which have been offered in both popular and scholarly accounts, do not quite add up to a full answer. Examined more carefully, it is clear that the “early entry” strategy would not guarantee VW to succeed. Like VW, American Motors Corporation (AMC) and PSA Peugeot Citroen, also were among the first foreign automakers entering China after 1978, but they experienced failure in developing joint venture partnership and marketing their cars,⁶ which does not show “The early bird catches the worm.” So, a closer examination of the history of VW in China is needed to reveal that much more factors were involved in shaping the course of VW development.

This study aims to provide quite a different and more complex story about VW’s success – one that supports the idea that, while technology obviously has an

Brazil, 9-12 June 1996, p. 12.

⁶ VW, together with American Motors Corporation (AMC), and the French carmaker PSA Peugeot Citroen, were the first foreign auto manufacturers which made direct investments in China after 1978. In January, 1984, Beijing Automobile Industry Corporation (BAIC) and AMC established Beijing Jeep Corporation (BJC) which became China's first automotive joint venture. In 1985, Guangzhou Auto Works signed with PSA Peugeot Citroen to form Guangzhou Peugeot Automobile Company (GPAC). Compared with the success of SVW, these two joint ventures experienced failure. Beijing Jeep was built on less solid mutual foundations than Shanghai-Volkswagen. Because of the divergent aims of two partners, the project was filled with difficulties. With Chrysler’s purchase of AMC in 1987 the Beijing partnership began to break up, and ended with the Westerners’ departure. In 2005, the corporation was relocated and integrated into Beijing-Benz DaimlerChrysler Automotive Co Ltd. For details of the cooperation between Beijing and AMC, see Jim Mann, *Beijing Jeep: The Short, Unhappy Romance of American Business in China* (Simon & Schuster, 1989). Guangzhou Peugeot, in order to capture the short-term profitability, preferred to import KD kits and assembly the car in China with little effort in developing local component suppliers, which caused the complaints from Guangzhou government. By 1996 the Guangzhou government decided it no longer wanted a French foreign partner. In 1997 Peugeot retreated and Honda took over. For more information about Guangzhou Peugeot, see Eric Harwit, *China's Automobile Industry: Policies, Problems, and Prospects* (Armonk, N.Y.: M.E. Sharpe, 1995).

impact on society, social factors, in their turn, also have a forceful impact on technology. It focuses on the relationship between social forces and the pathways of technological development, and concerns how VW's success was constituted by the social, political and cultural factors in China's transformation period at the start of 1978, and what actors (both humans and nonhumans) were involved in this construction process and how to be involved.

In what follows, the foundation on which this study is built will be explained. Then the research method as well as the structure of this study will be presented.

1.1 Literature Review

This section first makes an analysis of the existing studies on the case of VW in China, and then gives the theoretical framework of this study.

Previous research

Much research has been done on VW's story in China, especially the case of its first joint venture – SVW. Among the existing accounts, most take VW's business strategies and management experience in its projects with China as main concerns and aim to draw out the understanding of how a foreign company succeeds in China.⁷ In such accounts VW as a foreign investor is given full attention and

⁷ For example, Johannes Wyrwoll and Ralf Hanschen, "Business Development in China: Volkswagen's Involvement in this Emerging Market," in Markus Hofer and Bernhard Ebel, ed., *Business Success in China* (Berlin: Springer, 2007), p. 223-243; Ernie Tadla, *How to Live and Do Business in China* (Victoria, BC: Trafford Publishing, 2007); Chunli Lee, Jin Chen, and Takahiro Fujimoto, "Different Strategies of Localization in the Chinese Auto Industry: the Cases of Shanghai Volkswagen and

regarded as the only one actor whose economic behavior, including investment strategy, marketing strategy, production, technology transfer, as well as management models in the joint ventures, shapes its fate in China. For instance, the case study of SVW offered by Diane Long and David Upton⁸ sheds light on how VW's pioneering managers and technical staff tried to communicate with their Chinese partners to win their trust and collaborate with them to build up a local supply network, how they got over the culture shock to manage the relationship with the Chinese workers and engineers, and how they continuously improved the quality of their cars to win a good reputation in China. In this study, VW as a multinational corporation (MNC) from Germany, its business strategies and practices in developing its joint venture in China are highlighted, but the roles of other social actors in the SVW project are ignored.

A few exceptions provide the perception that political forces should also be considered in the VW's story. Eric Harwit's book, *China's Automobile Industry: Policies, Problems, and Prospects*,⁹ provides a detailed description and analysis of how Chinese political players and institutions influenced foreign direct investment (FDI) in the auto industry. It looks at the central bureaucratic institutions that constitute China's automotive policy-making structure, examines the interaction of local governments with the Beijing leadership, and provides brief biographies of three political leaders closely identified with the automotive industry (the

Tianjin Daihatsu," Working Paper 97-F-2, January 1997.

⁸ Diane Long and David Upton, *Shanghai Volkswagen* (Boston, MA.: Harvard Business School, 1996).

⁹ Eric Harwit, *China's Automobile Industry: Policies, Problems, and Prospects* (Armonk, N.Y.: M.E. Sharpe, 1995).

contemporary Vice Premiers Zhu Rongji and Zou Jiahua, and automotive czar Chen Zutao). It argues that conflict among top commissions and the subordinate ministries, disagreement among central policy makers and local automotive structures, as well as personal backgrounds of the key political figures all could influence automotive policy formulation and implementation and determine the nature and extent of FDI in this sector. Harwit offered his arguments based on the examination of the early history of four joint venture projects: Beijing Jeep, Shanghai Volkswagen, Guangzhou Peugeot, and Panda Motors. Of these four projects, until 1993 did SVW make great progress in parts and components localization and successfully developed into a profitable and growing enterprise. Its achievement unmatched by Beijing Jeep and the other ventures resulted from the cooperation between the national and local decision makers, local political support, and the mutual understanding between the Chinese and foreign investors. The emphasis of Harwit's work is on the bureaucratic decision-making process behind the joint ventures, and the lesson of the four case studies is that to establish a successful joint venture in China the foreign company must have not only an appropriate Chinese partner, but also good connections with Chinese political players (at the local or at the central level, preferably both). The roles of foreign partners in the joint venture projects, however, have been underestimated.

In his work *Changing Lanes in China: Foreign Direct Investment, Local Governments, and Auto Sector Development*,¹⁰ Eric Thun gave a further examination of how Chinese political institutions, especially local governments, affected the core

¹⁰ Eric Thun, *Changing Lanes in China: Foreign Direct Investment, Local Governments, and Auto Sector Development* (NY: Cambridge University Press, 2006).

projects of auto joint ventures and the use of FDI. Based on case studies of the local governments in five leading Chinese cities (Shanghai, Beijing, Guangzhou, Wuhan and Changchun) and their auto industry, Thun argues that local political institutions and organizations played an important role in affecting industrial development outcomes. In his study of the SVW case, Thun analyzes how Shanghai municipal government's supportive policies and institutional patterns related to investment in the auto sector benefited SVW's development and helped it achieve large market shares and high supply localization rate. Same as Harwit's book, this work, because it intends to highlight the role of local political actors in shaping the ability of auto industrial firms to meet the challenges of development, neglects the presence of other social factors in the local auto sector. Therefore, its arguments were criticized "not convincing."¹¹

Following Harwit's and Thun's books, Gregory Chin's *China's Automotive Modernization: the Party-state and Multinational Corporations*¹² is the third book to look at the role of Chinese political bodies in the auto industrial development. Different from Thun's findings regarding the contributions of local political actors in the auto sector, the book describes how Chinese top leaders intervened with Chinese automotive policy making, especially the 1994 Automotive Industry Policy, to shape the foreign investment and technology transfer from MNCs in the auto sector and spur the modernization of China's auto industry. SVW is selected as one

¹¹ Le-Yin Zhang, "Review: *Changing Lanes in China: Foreign Direct Investment, Local Governments, and Auto Sector Development*," *The China Journal*, No. 60 (July 2008), p. 182-3.

¹² Gregory Chin, *China's Automotive Modernization: the Party-state and Multinational Corporations* (UK: Palgrave Macmillan, 2010).

of the cases to show how central state authorities employed strategies to push VW to contribute to building a modern local parts supply network in the Shanghai area.

These three books, although highlight the contributions of Chinese political actors (both of the local and the central) to the development of SVW, only look at the early history of SVW up until the early 1990s, without any examination of SVW's story since the mid-1990s. Besides, they focus on examination of the influence of the political actors on SVW's early production and foundation of the local supply network, and in their view, the political actors influenced the auto sector including SVW only via policymaking. They do not recognize the political bodies were the biggest car buyers in China and the official car consumption behavior also affected the direction of the public consumption and VW's market share. More importantly, they fail to notice the interaction between the political actors and the auto manufacturers such as VW, as well as the roles of other actors in shaping the development of an auto project. All of these issues, however, will be examined in this study.

Theoretical Framework of This Study

This study has been guided by the methods and theories of technology studies. The relationship of technology and society has long pre-occupied the history and sociology of technology. The major insight of this scholarship is that technology is a social product. Based on critique of the assumption of a "linear structure of technical development" – technology progressing as a succession of steps from the birth of an idea (invention) to its commercialization by way of its development – more and

more scholars in technology studies have shown that various social factors impinge on technical development; right from the start of the process of technological innovation, technical, social, economic, political, or cultural considerations have been inextricably bound up into an organic whole.¹³ Technological design, production, innovation, and consumption are all shaped by the social, political and cultural factors. The development of technology neither is according to its own internal logic, nor reflects a single rationality, for example an economic imperative, or the political imperative of a ruling elite, but is influenced by a range of diverse actors.¹⁴ Concerning this point, Wiebe Bijker and Trevor Pinch in their case studies have sought to identify instances where technologies could be designed in more than one way, with choices between different technical options, and to explain why one way of designing the artifact triumphed. This, they point out, is rarely a simple “technical” issue, but is patterned and shaped by the particular “selection environment”: in other words, social factors enter into such explanations. They use the notion of “interpretative flexibility” to show the impossibility of separating the definition of technical problems from their social-cultural context.¹⁵ Thomas Hughes’s “seamless web” – a metaphor for the inseparable connections among technical, social, and economic aspects of large-scale technological systems – also

¹³ Michel Callon, “Society in the Making: The Study of Technology as a Tool for Sociological Analysis,” in Wiebe Bijker, Thomas Hughes, and Trevor Pinch, ed. *The Social Construction of Technological Systems: New Directions in the Sociology and History of Technology* (Cambridge MA/London: MIT Press, 1987), p. 84.

¹⁴ Robin Williams and David Edge, “The Social Shaping of Technology,” *Research Policy* 25 (1996): 865-99.

¹⁵ Wiebe Bijker and Trevor Pinch, “The Social Construction of Facts and Artifacts: Or How the Sociology of Science and the Sociology of Technology might Benefit Each Other,” *Social Studies of Science*, Vol. 14, No. 3 (August 1984), p. 399-441.

demonstrates how those connections define and propel systems.¹⁶ Thus, from such social construction perspective, a “success” or “failure” of technology must be seen neither necessarily for its intrinsic technical superiority or deficiencies, nor due to the practices of one player. Rather, the outcome relates to the interactions among a range of diverse players within the large social contextual setting.¹⁷ In order to garner the fullest insights into the processes of technological development, we can, and must, therefore, take into account and examine technical, socioeconomic, political, or cultural factors simultaneously.

Given the heterogeneous interactions between society and technology, this study has been strongly inspired by the actor-network theory (ANT) led by Bruno Latour and Michel Callon in investigating, describing, and analyzing these interactions. The studies by Latour and Callon are distinguished from other social construction studies in that they advocate approaching technology research without the limiting artificial divisions between human, nonhuman, science, nature and society. They use the notion of network to describe the associations of heterogeneous actors, both social and technical entities, which interact more or less.¹⁸ Within this theoretical framework, scientists or technologists are treated not simply as scientists or technologists but as multifaceted entrepreneurs who, with skills and competencies, engage in political, sociological and economic activities, as

¹⁶ Thomas Hughes, “The Seamless Web: Technology, Science, Etcetera, Etcetera,” *Social Studies of Science*, Vol. 16 (1986), p. 281-92.

¹⁷ Robin Williams, Roger Slack, and James Stewart, “Social Learning in Multimedia,” EC Targeted Socio-Economic Research Project, Research Centre for Social Sciences, the University of Edinburgh, January 2000, p. 47-8.

¹⁸ Bruno Latour, “Technology Is Society Made Durable,” in John Law, ed., *A Sociology of Monsters: Essays on Power, Technology and Domination* (London: Routledge, 1991), p. 103-131.

well as in those practices traditionally assigned the label “scientific” or “technical.”¹⁹ In order to extend their influence beyond the laboratory, scientists or technologists through processes of “translation” enroll other human and nonhuman elements into networks. Networks are able to expand from the center into the surrounding terrain through enrollment. With extension of networks, the world would be reshaped to resemble the special settings in which scientific facts or technological artifacts were made, and hence, facts and machines come to be able to survive in the world beyond the laboratory walls, and be developed from local knowledge in laboratories to worldwide accepted knowledge.²⁰

In terms of “translation,” it is the means by which one entity – whether that be an individual like Pasteur, a small group like the three researchers of St Brieuc Bay or an institution like the Electricité de France – defines others for enrollment or alignment of the entities in a network. “ ‘A translates B’. To say this is to say that A defines B. It does not matter whether B is human or nonhuman, a collectivity or an individual. Neither does it say anything about B’s status as an actor. B might be endowed with interests, projects, desires, strategies, reflexes, or afterthoughts.”²¹ In the process of translation, the translator sets itself up as a spokesperson, identifying and defining other entities, and expressing in one’s own language what others say and want, why they act in the way they do and how they associate with each other,

¹⁹ Ibid.; Callon, 1987, p.84-7.

²⁰ Bruno Latour, *Science in Action: How to Follow Scientists and Engineers through Society* (Cambridge, MA: Harvard University Press, 1987); Bruno Latour, “Give Me A Laboratory and I Will Raise the World,” in Mario Biagioli, ed., *The Science Studies Reader* (New York: Routledge, 1999): 258-75.

²¹ Michel Callon, “Techno-economic Networks and Irreversibility,” in John Law, ed., *A Sociology of Monsters: Essays on Power, Technology and Domination* (London: Routledge, 1991), p. 143.

in order to bring them into the network or align their points of view to ensure them faithful to their alliances. For example, in his study of Louis Pasteur's lab, Latour has shown how Pasteur firstly translated farmers' interests, and enrolled them in strong associations with the microbes; then with his translation of other actors's interests and enrollment of them, networks were extended, and gradually through the French society; finally, the society had been transformed, Pasteur's lab conditions were set up everywhere, and Pasteur's microbe theory thus was hardened into facts.²² A successful process of translation can generate a shared space, equivalence and commensurability.²³ It aligns the actors and makes each of them share a vested interest in the activities of the other and form durable interactions. The higher the degree of alignment of a network, the more its actors work together, and the less their very status as actors is in doubt.²⁴ For Latour, a network exhibiting alignment among actors is a strong and stable actor-network which exerts domination. "When actors and points of view are aligned, then we enter a stable definition of society that looks like domination. When actors are unstable and the observers' points of view shift endlessly we are entering a highly unstable and negotiated situation in which domination is not yet exerted."²⁵ Power is not a possession, but an arrangement of assent; not a cause of collective action, but a consequence.²⁶

Callon, in his study of the electric vehicle (VEL), further points out that an

²² Latour, 1999, p. 258-75.

²³ Callon, 1991, p. 145.

²⁴ Callon, 1991, p. 148.

²⁵ Latour, 1991, p. 129.

²⁶ Bruno Latour, "The Powers of Association," in John Law, ed., *Power, Action and Belief: A New Sociology of Knowledge? Sociological Review Monographs* No. 32 (London: Routledge & Kegan Paul, 1986), p. 173.

actor network is reducible neither to an actor alone nor to a network; rather, “An actor network is simultaneously an actor whose activity is networking heterogeneous elements and a network that is able to redefine and transform what it is made of.”²⁷ He argues that if we see a network as an architecture with sequences of points and lines, we must view each point as a network which in turn is a series of points held in place by their own relationships.²⁸ So, in his view, the whole world can be seen as composed of heterogeneous networks. He indicates that technologists always attempt to carry out their plans in the context of heterogeneous actor networks, which are made up of heterogeneous actors – humans and nonhumans. The success of their plans or the durability of a network depends not only on the durability of the bonds between the points, but also on that each of its points constitutes a durable and simplified network.²⁹

The ANT provides an insight in understanding of VW’s story in China, and *will be used as a tool for interpretation and analysis of this case*. Applying the concept of actor network to the whole process of VW development from the foundation of VW’s joint venture with China to its domination of Chinese car market, VW’s success can be viewed as the formation of a stable network in China. Its development will thus be investigated by looking at alliances and interactions of the diverse actors including human and nonhuman entities such as political agencies (both the central and the local), VW, joint ventures, local parts and components suppliers, engineers,

²⁷ Callon, 1987, p. 93.

²⁸ Ibid., p.96.

²⁹ Ibid.

customers, and VW cars. The research questions of this study will be addressed by examining how these multiple actors were enrolled into the network and shaped the network into a stable one, and how extension of the network influenced the Chinese society in return.

But it should be noted that this study will not completely follow the ANT, because in both Latour's and Callon's studies, the ANT is applied to investigate the development process of technology including design, production, innovation, and consumption. The case of VW in China, however, is essentially a story of technology transfer. VW invested money, automotive assembly technologies and cars in China, in the form of joint venture. Although the joint venture like SVW also undertook designing cars for Chinese market, their task mostly focuses on localization of models introduced by VW. Therefore, in the ANT, it is scientists and technologists who always act as translators or spokespersons through translations enroll other actors to build up networks. This point, however, does not work for the case of VW in China. Besides, the ANT grants agency to nonhuman, and was criticized to favor the shaping of human social life by nonhuman things, and imply that social actors do not have an equal degree of agency with humans.³⁰ This study, although identifying VW cars as actors which can enroll other entities, does not de-prioritize the social nor give an autonomous voice to "things."³¹ It believes that these voices in actuality depend on the mediation of human actors, and thus will highlight the significance of

³⁰ Jan Golinski, *Making Natural Knowledge: Constructivism and History of Science* (UK: Cambridge University Press, 1998), p. 41.

³¹ Vicky Singleton and Mike Michael, "Actor-Networks and Ambivalence: General Practitioners in the UK Cervical Screening Programme," *Social Studies of Science* Vol. 23, No. 2 (May, 1993), p. 231; Paul Edwards, "Review: Aramis, or the Love of Technology," *Isis*, vol. 88, No. 2 (Jun., 1997), p. 322-4.

the social actors in the development of VW in China, and investigate the relationship between the social and cars. Sheila Jasanoff points out that the ANT neglects the very questions about people, institutions, ideas and preferences that are of greatest political concern: “Who loses and who wins through the constitution of networks? How are benefits and burdens (re)distributed by or across them? How willing or unwilling are participants to change their behavior or beliefs because of their enrollment into networks?”³² Such treatment of human agency, however, will be introduced in this study.

The methodological approach to investigate actor-networks is to observe and record the interactions, connections and effects of actors involved in the shaping of technology.³³ But as Callon indicates, an actor network is a network of simplified entities that in turn are other networks. Then a recognized problem with the ANT is that even in the least complex of cases, both the number of actors and the number and types of interactions are unmanageable if all are considered equally and no constraints are imposed on the analysis. Comber et al. comment: “Even for small activities the possible number and dimension of all potential interactions (from strong to weak) of actors (human and non-human) at any particular point in time (as networks evolve) is very large.”³⁴ With respect to the case of VW, the production and consumption of cars are extensively related to other industries and social

³² Sheila Jasanoff, “Ordering Knowledge, Ordering Society,” in Sheila Jasanoff, ed., *States of Knowledge: The Co-production of Science and Social Order* (London: Routledge, 2004), p. 23.

³³ Latour, 1987.

³⁴ Alexis Comber, Peter Fisher and Richard Wadworth, “Actor-Network Theory: A Suitable Framework to Understand How Land Cover Mapping Projects Develop?” *Land Use Policy* Vol. 20 (2003), p. 304.

livings, so there include more relevant *specific* actors in the network of VW than we could list here, such as the State Council, Shanghai municipal government, VW, VW cars, parts suppliers, Chinese engineers, official car users, first VW users, China's middle class consumers, etc., and each of these actors might be simplified network. But regarding the aim of this study, instead of giving a *whole* picture of VW's development process, it seeks to show that taken individually, business strategies, politics or technological reasoning is insufficient to explain the success of VW in China, and VW's success should not be attributed to the operation of one actor as the previous research demonstrates, either; but rather such success results from the contribution of multiple social and material actors in Chinese particular political and cultural context. Therefore, the most important actors and interactions that constitute VW's network will be delineated and investigated in this study. In terms of how to identify the significant actors and interactions, this task depends on the analysis of the acquired texts documenting VW's history in China. Specifically speaking, this study's data sources mainly come from VW's annual reports, Chinese government's industrial policies, the interviews and biographies of key figures participating in the VW's projects in China, news reports and archives, and online forums about cars. Based on these supporting texts, this study identifies key social actors including the Chinese political authorities and institutions (both the central and the local), VW, and Chinese customers as well as material actors –VW cars – and will examine their roles and relationship in construction of the VW's network in China.

1.2 Research methods

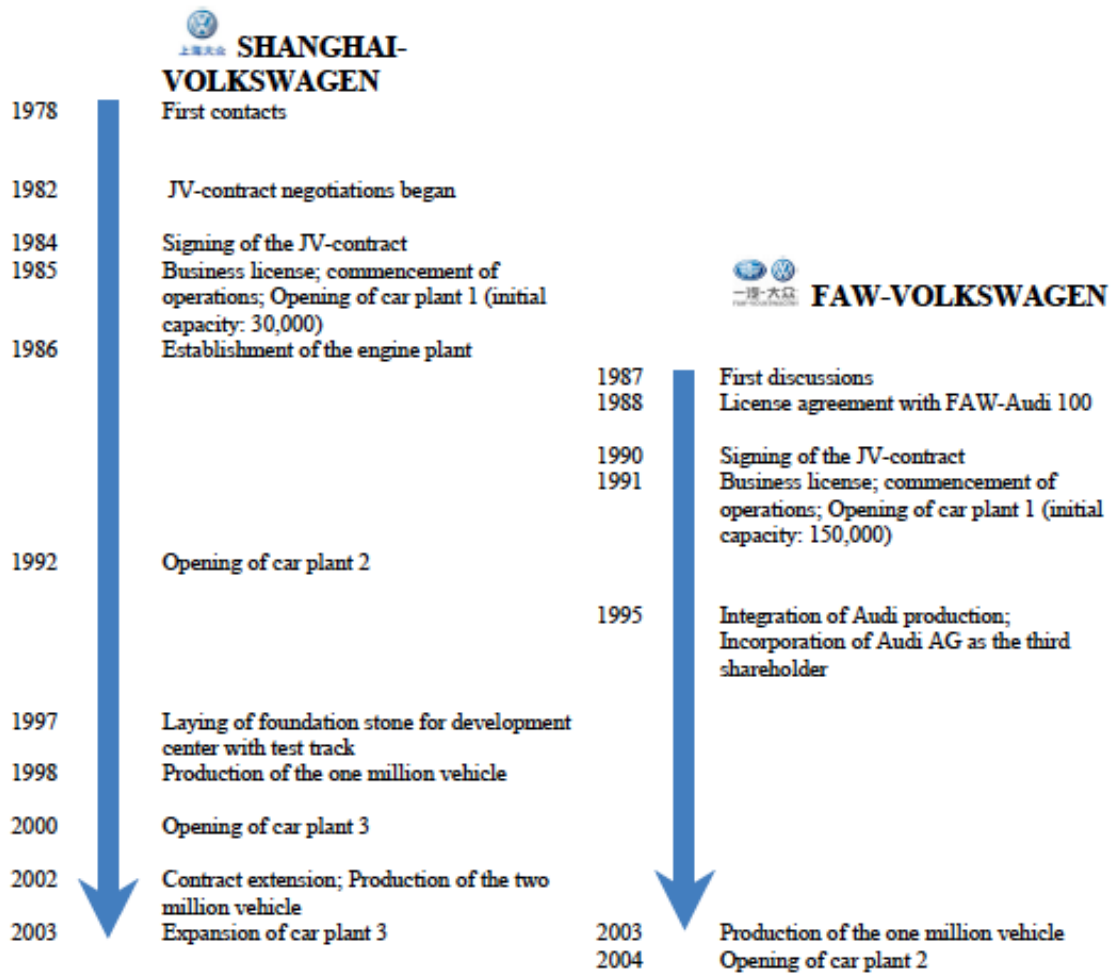
VW has established two joint ventures in China – SVW and FAW-VW (see Figure 1.1). Each joint venture has its own Chinese partners, car plants, local supply network, and sale and service network. They produce different car models or brands – SVW’s classic cars are the Santana models while FAW-VW’s main products are the Jetta models and the Audi cars. Both of them are big car manufacturers in China – as of 2009, SVW’s annual production capacity amounted to 660,000 cars³⁵ while FAW-VW’s was over 300,000 units.³⁶ Their sales combined contributed to VW’s leadership in Chinese car market, and at the same time each of them individually held top market share. Since it started production in 1985, SVW dominated the Chinese car market and ranked top one seller until 2005. FAW-VW also was one of the biggest three in auto market share in China. For example, in top 10 passenger car manufacturers in China in 2002, SVW ranked No. 1 and FAW-VW was No. 2.³⁷ So, the two joint ventures are actually two cases in the VW’s story.

³⁵ “25nian 500wanliang, Shanghai Dazhong Dingxia Nianchanxiao Baiwanliang Mubiao” (“5,000,000 for 25 Year, Shanghai Volkswagen Set up the Goal of One Million Sales per Year”), *Xinxi Shibao (Information Times)* October 22, 2009.

³⁶ “Yiqi Dazhong, Shinian Muo Yijian” (“FAW-VW, Success over the Last Ten Years”), *Qilu Wanbao (Qilu Evening News)* March 31, 2011.

³⁷ CAAM (China Association of Automobile Manufacturers), ed., *Zhongguo Qiche Wushi Nian (The 50th Anniversary of Chinese Auto Industry)*(Shanghai: Shanghai Pictorial Publishing House, 2003), p. 192.

Figure 1.1 Historical Development of Volkswagen’s Joint Ventures in China



Source: Volkswagen Group China; Cited in Johannes Wyrwoll and Ralf Hanschen, “Business Development in China: Volkswagen’s Involvement in this Emerging Market,” in Markus Hofer and Bernhard Ebel, ed., *Business success in China* (New York: Springer, 2007), p. 231.

This study will select the case of SVW to do an in-depth study, by which to draw the implications for VW’s success in China. To choose SVW instead of FAW-VW as the focused case lies in two reasons: first, SVW was established at the beginning

of China's reform era. As VW's first joint venture in China, its progress in certain pioneer work, including the relationship with the Chinese governments, the supply localization, and marketing the brand, greatly benefited the construction of FAW-VW.³⁸ Its story thus can much more mirror what VW experienced in post-1978 China than FAW-VW's. Second, SVW is the case studied by most of the accounts about VW in China. In order to tell a story of VW different from the previous research, this study also concentrates on SVW, but using the ANT framework.

1.3 The List of Chapters

Callon in his study of the case of the electric vehicle in France indicated: "The history of the production of a new technology can be divided into a number of periods corresponding to the different social groups (or systems) that have taken charge of its development. The way in which problems are formulated ... are transformed from one period to another, as are the identity of those involved, the strategies they deploy and the interests they defend."³⁹ This point also applies to the case of VW in China.

This study will trace the development of SVW from its foundation to the year of 2009. According to SVW's progress and the actors (social and technical) involved,

³⁸ Thanks to SVW's impressive achievement in the supply localization, VW won the support of the central government in competition for the "big project" – establishment of a JV with FAW, and finally successfully got this project. The details will be presented in Chapter 3. In its early years, SVW's marketing efforts plus its first generation consumers' contributions made VW brand popular in China, which benefits the sales of VW cars produced by FAW-VW later.

³⁹ Michel Callon, "The State and Technical Innovation: A Case Study of the Electrical Vehicle in France," *Research Policy* vol. 9 (1980), p. 360.

four major periods can be distinguished– SVW foundation (1978-1984), early production and marketing (1985-1994), rapid expansion (1995-2001), and struggles for development (2002-2009). This study will examine that in these very different periods the actors' action, interests, and strategies, as well as their shaping of the SVW project. In line with it, this study is structured chronologically, and at the end of each chapter, the ANT analysis of the case is furnished for further understanding the interactions among the actors as well as those between the actors and the SVW development.

The second chapter traces back the foundation of SVW, and examines why the project of SVW was launched, how VW was involved in this project, and what role the Chinese central authorities played in this project building. Chapter 3 focuses on SVW's supply localization in its early production period, with primary attention to that in China's planned economic system, how the Chinese political actors intervened SVW's production, and how the state agencies and figures, shanghai local government, and VW cooperated and negotiated in building up local supply network. Chapter 4 examines how VW created its market in China in the 1980s and the early 1990s – what the Chinese ideologies of the car were, how VW marketed its car, who was VW's first consumers and how they became, and how the first generation buyers shaped SVW's market growth as well as VW cars. Since the mid-1990s, Chinese central government issued new strategies and policies for developing the auto sector, which caused the big flow of foreign investment to enter China, and the Chinese market became highly competitive. Chapter 5 offers an analysis of how these changes influenced SVW's development and why faced with

fierce competition VW cars still dominated Chinese car market during the period of the late 1990s and early 2000s. In the first decade of the twenty-first century, Chinese independent automakers grew up, which along with the rise of popular nationalism drove China's auto industrial policies to support for independent development and Chinese homegrown brands. Meanwhile, Chinese consumers began to be aware of Chinese branded cars. Then how did VW respond to these changes for continuity of its success in China? Chapter 6 examines this point. Finally, the concluding chapter returns to the central concerns of this study, dedicates to an in-depth "actor-network" understanding of SVW's development, and offers main arguments.

Chapter 2 The Foundation of Shanghai-Volkswagen

In the pre-1978 period, China adopted the center-led economic planning system, in which the central government completely controlled and monitored the operation of the micro-economy, and left local governments and enterprises little autonomy for their development, financially or administratively.¹ Almost all economic projects were proposed by the central ministries. The proposal then was submitted to the appropriate planning commission for registration and permission. Using a competence level set by the center, the planning commission was scheduled to examine and then to permit or reject the project, based on the criteria of industrial priority, the project's importance, and financial availability.² Although theoretically, local governments could propose projects, the local project had to be managed by the ministry in charge. Production, consumption and distribution were all centrally planned. Taking the automotive industry for example, one state planner explained: "In this early period, ... everything in the auto industry was determined according to planned measures. There was no competition, no market. How many vehicles to produce; what and how many to distribute, and to which organization, was all

¹ Jae Ho Chung, "Studies of Central-provincial Relations in the People's Republic of China: A Mid-term Appraisal," *China Quarterly* vol. 150 (1995), p. 487-508; Simon Xiaobin Zhao and Chaolin Gu, "A Policy Review on Spatial Strategy of Regional Development in China 1953-92," *China Report* vol. 31 (1995), p. 385-410.

² X Zhao and L Zhang, "Decentralization Reforms and Regionalism in China: A review," *International Regional Science Review* vol.22, no. 3 (1999), p. 253.

planned.”³ In the late 1970s and 1980s, China was still a planned economy. Although during the early 1980s, with the economic reforms undertaken, some fiscal and administrative power was shifted from the Center to local governments,⁴ the central control over the industries significant to the national economy, including the auto industry, was not weakened. An auto joint venture (JV) project was still proposed by the central ministries and needed the permission of the State Planning Commission. The decisions regarding JV partnership, location, and vehicle type were all made according to state planning priorities, rather than any form of systematic market analysis.⁵ Chinese automotive enterprises just implemented the government’s decisions without resistance.⁶

This chapter examines that in the context of centrally planned China how the auto joint venture – Shanghai-Volkswagen (SVW) – was founded. It seeks to address why and by whom the SVW project was launched, what role the Chinese political authorities played in building the SVW network, how VW was involved in this

³ Interview with a National Development and Reform Commission (NDRC) auto industry planner done by Gregory Chin in Beijing, November, 2005. See Gregory Chin, *China’s Automotive Modernization: the Party-State and Multinational Corporations* (UK: Palgrave Macmillan, 2010), p. 56.

⁴ In the early 1980s, China, nationwide, practiced the contract-responsibility system, in the sense of administrative decentralization. Under the contract-responsibility system, a certain proportion of profit was allowed to remain in the enterprise treasury; local governments were allowed to arrange their revenues according to their own wishes, provided that they remitted to the center all taxes stipulated by the responsibility contract. The increase of enterprise profit retention and decentralization of revenue collection created one unavoidable trend under existing administrative structure: a reduction of central budgetary control and an increase in the financial power of local governments. But the increase in profit retention did not necessarily give enterprises sufficient autonomy in their management and resource use. For more information, see X Zhao and L Zhang, p. 255-261.

⁵ Chin, p. 55-6.

⁶ Ibid.

network, and how the Chinese actors and VW interacted and negotiated to align their points of view for the SVW project. This chapter is divided into four parts. The first part provides the background information of this case study, including the overview of Chinese passenger car industry before 1978, and the central government's power in the auto sector in the late 1970s and 1980s. The second part looks at the reason why the SVW project was launched, and why and how China adopted the form of joint ventures with foreign automakers. The third part examines why and how VW was chosen to be the partner of the JV, when China reached out to the world's large automakers at the time. The fourth part presents the disagreements and compromises between the two parties in the negotiation of the JV agreement.

2.1 Background of the SVW Project

SVW is not only VW's first JV with China, but also the earliest JV producing sedans in Chinese auto sector. At the end of 1970s when the SVW project was launched, there was not even one auto JV in China. The country's auto industry lagged far behind the Western and Japanese ones in terms of technology and management. But starting in the late 1970s Chinese central government began looking to the world for advanced technology and foreign capital to modernize the auto industry. This section firstly offers a brief history of China's auto industry, especially of China's passenger car production before 1978, and then describes in the late 1970s and 1980s what agents of the central government controlled the auto sector.

Chinese Car Production Before 1978

China did not have its own auto industry until the 1950s when the leaders of Chinese Communist Party (CCP) decided to establish the modern industrial system, which the auto industry was to be an important part of.⁷

On October 1, 1949 when the Chinese communists came to power and announced the birth of “new China,” they were faced with the task of economic rehabilitation and growth. For China was not only the most populous country in the world, it was also one of the most backward and impoverished.⁸ The tiny modern industrial sector, built largely under foreign imperialist auspices in the early 1900s, had been ravaged by more than a decade of Japanese invasion (1937-1945) and civil war (1945-1949).⁹ The economic backwardness and industrial underdevelopment not only made it difficult for China (as Mao Zedong put it) to “stand up” in the world as a powerful and modern nation, but also contradicted the material preconditions for socialism defined by Marxism– the Chinese communists’ long-standing belief.¹⁰

⁷ China encountered automotive manufacturing experience in the early 1900s when vehicles were all imported, but the foreign vehicle providers, including German and Japanese, thought it was expensive to ship the complete products to China, so they established several assembly plants in larger cities (including Beijing, Shanghai, and Tianjin) to put the imported parts together. In 1936, the Chinese government controlled by Chinese Nationalist Party intended to make a collaboration with German Mercedes-Benz to establish a state-owned Chinese auto manufacture company. But with the outbreak of the Sino-Japanese War in 1937, this project had to be given up. Before the end of the Civil War in 1949, China did not have its own auto manufacturers. For more details, see Xiao Shengfa et al. ed., *Qiche Wenhua (The Automobile Culture)*(Beijing: Mechanical Industry Press, 2009), p. 30-2.

⁸ Maurice Meisner, *Mao's China: A History of the People's Republic* (NY: The Free Press, 1977), p. 59.

⁹ Ibid., p. 59; 117-8.

¹⁰ In Marxist theory, socialism is a historical impossibility under conditions of economic backwardness. Marxist proposition is that socialism presupposes capitalism, and socialism becomes a real historical potentiality only on the basis of

However, the Soviet historical experience, namely, to employ the power of a socialist state industrializes a backward country, gave Chinese decision-makers a model to use for modern industrial development. Hence, Beijing sought to develop heavy industry and “to build a powerful country with a high degree of socialist industrialization.”¹¹ The automotive industry was on the list. In the view of Chinese communists, the auto industry was important for the country, not only because both of industrial production and agricultural development needed trucks to transport raw material, products, machines, or rural produce, but also due to the consideration that with the beginning of the Cold War, an automotive industry was needed to enhance military mobility.¹² In order to develop their freight transport capabilities, the Chinese decided to exclusively manufacture trucks at their new government-owned auto plants.¹³

In July 1953, with the financial and technical help and support of the Soviet Union, China’s first auto manufacturer – First Auto Works (FAW) – was founded in Changchun, and in 1956 produced trucks called “Jiefang” (*Liberation*), which was a

the material and social accomplishments that only the full development of modern capitalist forces of production brings about. For Marx, the large-scale capitalist development and organization of modern industry, a high level of specialization in the division of labor based on the complexities of modern technology, and the collectivistic patterns of social labor thereby produced, are the essential prerequisites for socialism. See Karl Marx, *Capital*, Vol. I (Chicago: Kerr, 1906).

¹¹ Li Fuchun, *Report on the First Five Year Plan for Development of the National Economy of the People's Republic of China in 1953-1957*, delivered on July 5 and 6, 1955 at the Second Meeting of the First National People's Congress (Beijing: Foreign Languages Press, 1955), p. 48.

¹² Eric Harwit, *China's Automobile Industry: Policies, Problems, and Prospects* (Armonk, N.Y.: M.E. Sharpe, 1995), p. 16-7.

¹³ *Ibid.*, p. 17.

four-ton Soviet model “ZIS 150.”¹⁴ Over time, other automotive companies were also established, such as the Shanghai Automobile Assembly Plant in 1958 and the Second Auto Works (later renamed Dongfeng) in 1969. Inspired by the spirit of the “Great Leap Forward” (1958-60) which emphasized geographical self-sufficiency and development of domestic grass-roots production bases in each province, almost every province established its own automotive plants. In 1964, China had 417 factories producing trucks, cars, motorcycles, and basic automotive parts; by 1976, the number increased to 1,950.¹⁵ But the productivity of these plants was very low. Of some fifty factories capable of production of trucks or other vehicles, 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.¹⁶ What is more, they mainly produced trucks. Passenger car production was very limited. In 1958 FAW produced its first passenger car named “Hongqi” (*Red Flag*), a luxury vehicle modeled on Chrysler’s model 1955 sedan.¹⁷ That same year, the Shanghai Automobile Assembly Plant began manufacture of its “Phoenix” model passenger car which was modeled on Daimler-Benz’s model 220S.¹⁸ Actual production, however, was negligible; in 1960, the whole nation produced only ninety-eight of its own cars; in 1961, it produced only five.¹⁹ Cars accounted for less than 1 percent of

¹⁴ Ibid.

¹⁵ *Zhongguo Qiche Gongye Nianjian (China Automotive Industry Yearbook)* (Changchun: Jilin Kexue Jishu Chubanshe, 1991), p. 119.

¹⁶ Harwit, p. 21.

¹⁷ Ibid.

¹⁸ Jiang Zhiwei, “Shanghai Dazhong Erqi Gongcheng Jianshe Jishi” (“The Documentary of the Second Phase of SVW”), *Shanghai Auto News* June 22, 2008, p. 7.

¹⁹ *Zhongguo Qiche Gongye Nianjian (China Automotive Industry Yearbook)*, 1991, p. 124.

Chinese automotive production, with truck and other vehicles heavily dominating manufacture, which can be seen from the structure of annual auto production from 1959 to 1969 shown as Table 2.1, for example.

Table 2.1 Structure of Automobile Production in China, 1959-1969

Year	Total	Truck	Jeep	Sedan
1959	19,601	18,938	281	101
1960	22,574	21,294	569	98
1961	3,589	3,169	290	5
1962	9,740	9,160	311	11
1963	20,579	20,500	67	11
1964	28,062	27,542	102	100
1965	40,542	38,054	378	133
1966	55,861	48,478	770	302
1967	20,381	16,996	599	144
1968	25,100	19,076	1599	279
1969	53,100	40,616	4845	163

Source: Zhongguo Qiche Gongye Nianjian (China Automotive Industry Yearbook), 1991, p. 124.

The passenger cars were primarily intended for a small number of high-ranking government officials, as private car ownership was essentially prohibited.²⁰ To compensate for the low domestic car production volume, China imported an average of some 1,000 cars per year from 1954 to 1965, mostly from Eastern Europe.²¹ But with the launch of the Cultural Revolution (1966-1976), car was regarded as a luxury good symbolizing the bourgeois lifestyle and conflicting with the proletarian austerity tradition, and thus its imports virtually vanished until 1977.²²

Central Government Control in the Auto Sector

China's main political structure is comprised of two vertically integrated, but interlocking institutions: the CCP (or Party), headed by the Party Politburo and its Standing Committee; and the state government apparatus, headed by the Premier, who presides over the State Council. The nominal leader of the CCP is the General Secretary (or the President), but control of the Party is held collectively by its Standing Committee. Throughout China, Party and government structures closely parallel one another, with Party committees and representatives present not only in government agencies, but also in most organizations and institutions. The Chinese political system is organized hierarchically on five different levels: state, ministry and province, prefecture or municipality, county, and

²⁰ Private car ownership was prohibited during the 1950s and 1960s in China mostly due to the Chinese communists' ideologies of the car, which will be given detailed discussion in Chapter 4.

²¹ Barry Richman, *Industrial Society in Communist China* (NY: Random House, 1969), p. 566.

²² *Zhongguo Qiche Gongye Nianjian (China Automotive Industry Yearbook)*, 1991 ed., p. 536; 1994 ed., p. 425.

township. Since the village is the grassroots, it is not considered as a part of the hierarchy. The primary organs at the state level include the National People's Congress (NPC), the Politburo and its Standing Committee, the President, the State Council, the Supreme People's Court and the Supreme People's Procuratorate. The NPC is the highest organ of the state power and its permanent organization is the Standing Committee of the NPC. The NPC and its Standing Committee exercise legislative power. China's governmental apparatus managed by the State Council is divided into two parts – a system of ministerial organizations and a system of geographic organizations. The ministerial system is generally organized by the type of activity, such as the Ministry of Communications, Ministry of Commerce, and the Ministry of Foreign Affairs. In addition, the ministries include many special agencies, including bureaus such as the General Administration of Customs, and the National Tourism Administration. The ministries are structured into hierarchical layers with offices at the provincial and local levels. Ministries are often also divided according to areas of responsibility. For example, the Ministry of Agriculture is divided into 18 departments, including the Department of Animal Husbandry and the Bureau for Agricultural Food Quality and Safety. The other part of the Chinese government – the system of geographic organizations – consists of the layers of provincial, municipal, county, and township governments. Each level in the hierarchy is responsible for overseeing the work carried out by lower levels on the administrative strata.

The agents of the central government related to the auto sector in the late 1970s and 1980s have been shown in Figure 2.1. The State Council, as highest state

administrative authority, stipulated the tasks and responsibilities of various ministries and several commissions, and exercised unified leadership over the work of the ministries and commissions.²³ The State Council submitted proposals, including ones in auto sector, to the NPC or its Standing Committee. It approved large joint venture projects, and certified import quotas for vehicles and for disassembled vehicle kits.²⁴ The State Planning Commission (SPC),²⁵ under the State Council, was responsible for formulating and implementing the national economic plan, including the auto industry development plan. It examined and approved major projects proposed by the ministries, which also included auto projects. The State Economic Commission (SEC), founded in 1956 and reorganized in 1982 which emerged with the State Machine Industry Commission, the State Energy Commission, and the State Council's Finance and Trade Group, had the functions of formulating and implementing industrial policies, including policies towards the auto industry, and providing macro-management guidance for

²³ For more information about the State Council, see *Xinhua News*, available online: http://news.xinhuanet.com/ziliao/2002-01/25/content_253773.htm

²⁴ Harwit, p. 46.

²⁵ The SPC was founded in 1952, and of vital importance in the economic planning system. In 1988, the SPC was reorganized with the merger of the SEC, and positioned as a high-level macro-management agency, without the micro-management functions. In 1998, it was renamed as the State Development Planning Commission (SDPC). In 2003, it was restructured as the National Development and Reform Commission (NDRC) which then merged with the State Council Office for Restructuring the Economic System (SCORES) and part of the State Economic and Trade Commission (SETC). The restructured organization gained greater responsibility and power in overseeing China's economic development. For more information about the history and principal functions of the SPC, see http://baike.baidu.com/view/667626.htm?fromenter=%B9%FA%BC%D2%BC%C6%CE%AF&fr=ala0_1_1

enterprises of various economic sectors.²⁶ The First Ministry of Machine Building (FMMB), founded in 1952, took charge of developing civilian machinery production and had administrative responsibility for the automotive sector. It had bureaus devoted to automobiles, machine tools, shipbuilding, electrical machinery, and other products. In 1988, it merged with the Electronics Ministry to become the Ministry of Machine Building Industry (MMBI).²⁷ It is the direct supervisor of the CNAIC. The CNAIC itself, although assumed an agency of the State Council, approached the State Council and SPC only through its superior ministry.²⁸ Founded in March 1982, the CNAIC was responsible for implementing the central auto policies, and managing the auto industry.²⁹ The leaders of CNAIC were appointed by the State Council, and the first president was Rao Bin (1982-1985), and the second Chen Zutao (1985-1988). Rao and Chen both have engineering background and worked for FAW and the Second Auto Works.³⁰ In 1993, responding to the State Council proclamation calling for a separation of China's political and industrial sectors, the CNAIC became

²⁶ See <http://iask.sina.com.cn/b/13310618.html>. Zhu Rongji was appointed as the vice-director of the SEC from 1983-1987. For Zhu Rongji's resume, see *People's Daily* September 18, 1998, also available online:

<http://web.peopledaily.com.cn/leader/rb/b1031.html>

²⁷ Martin Posth, *1000 Days in Shanghai* (Singapore: John Wiley & Sons, 2006), p. 70.

²⁸ Harwit, p. 49.

²⁹ Zhang Mao, *Rao Bin Zhuanji (Biography of Rao Bin)* (Beijing: Huawen Press, 2003), p. 507-8.

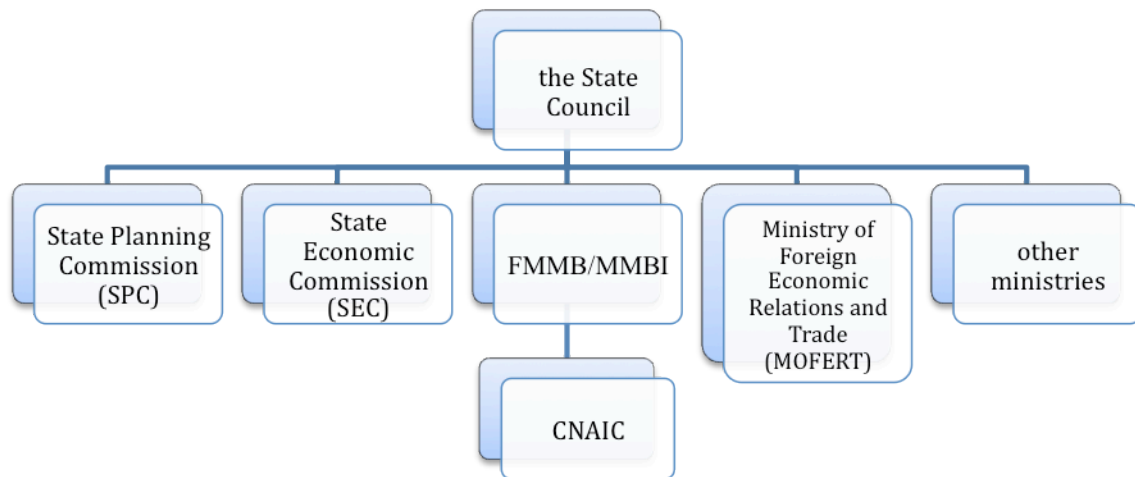
³⁰ Rao Bin was appointed as the president of FAW from 1953-1959, and as the president of the Second Auto Works from 1969-1977. Chen Zutao served as the engineer of FAW from 1953-1962, and as the chief engineer of the Second Auto Works from 1972-1980. See Rao Bin's resume at

<http://baike.baidu.com/view/305149.htm>; Chen Zutao's resume at

<http://baike.baidu.com/view/1326958.htm>

a large State-owned enterprise without political control over the auto industry.³¹ The Ministry of Foreign Economic Relations and Trade (MOFERT), established in 1982, had responsibility for foreign relations, and managed foreign trade, foreign investment, foreign aid, and international economic cooperation.³² It also took an interest in insuring the foreign exchange balance by joint ventures.³³

Figure 2.1 The Agents of the Central Government Related to the Auto Sector in the Late 1970s and 1980s



Source: the official websites of ministries; <http://baike.baidu.com>; *Xinhua News*; Harwit, p. 43-66; Posth, p. 65-166; Zhang, p. 507-8.

³¹ The CNAIC official website:

<http://www.at188.com/wholesale/index.asp?cmyid=10239>

³² The MOFERT was the predecessor of the Ministry of Commerce. For more information about the history and functions of the MOFERT, see <http://baike.baidu.com/view/69152.htm>

³³ Harwit, p. 54.

2.2 Auto Joint Venture Entering China

In December of 1978 when the Third Plenum of the CCP's Eleventh Central Committee was held, the Chinese leaders decided to halt the mass political campaigns like the Cultural Revolution, and shift the emphasis of the Party's work to economic development. The goal of the Party was to lead the whole nation to realize the "Four Modernizations" (in agriculture, industry, national defense and science and technology). They began economic reforms and adopted the Open Door policy to absorb foreign capital and access to foreign advanced technology and management experience.³⁴

In the late 1970s, China was a relatively poor, developing country, and foreign currency was scarce. But modernization, including setting up factories, purchasing foreign technologies, and importing production equipment would cost money – not just Chinese *Renminbi* but also foreign currencies such as US dollars. In order to earn foreign exchange which was in short supply but much needed for further modernization in China, in 1978, the SPC formulated a plan of transfer of a foreign sedan assembly line to a Chinese auto factory. The purpose of this plan was to let the Chinese carmaker rely on foreign technology to transform its outdated manufacture technology, and then take advantage of low cost Chinese labor to assemble the imported completely knocked down kits (CKDs) and finally export cars

³⁴ *Zhonggong Shiyijie Sanzhong Quanhui Gongbao (Reports of the Third Plenum of the Chinese Communist Party's Eleventh Central Committee)*, Dec. 22, 1978, Xinhua Net: http://news.xinhuanet.com/ziliao/2005-02/05/content_2550304.htm

for foreign exchange.³⁵ Rao Bin, then Vice-Minister of the FMMB, suggested to do the transfer to Shanghai Auto Plant. In Rao's view, the city of Shanghai had the experience of running large industrial enterprises in the 1920s and 1930s and owned a strong industrial base; besides, Shanghai Auto Plant was one of the few sedan manufacturers in China.³⁶ The SPC accepted Rao's suggestions. Then the FMMB together with the Shanghai First Bureau of Machine and Electronics as well as the Shanghai Tractor Automobile Corporation (STAC)³⁷ submitted a report to the State Council, requesting to transfer a foreign sedan assembly line to Shanghai and transform Shanghai Auto plant. Yu Qiuli, then Vice-Premier allowed the FMMB and Shanghai automotive officials to contact with the foreign automakers and explore the possibilities of technology transfer.³⁸ With the approval of the high-ranking leader, the FMMB sent invitations to the world's large automakers to attract them to do technology transfer. General Motors (GM) expressed interest in investment in China. Thomas Murphy, then CEO of GM, asked the FMMB whether it was possible to do the collaboration by means of the Joint Venture rather than just technology transfer.³⁹ JV, for the Chinese leaders was a new concept, and they did not have a clear idea of what it was. GM executives explained it to them in details, and offered a

³⁵ Carl Hahn, *Meine Jahre mit Volkswagen (40 years at Volkswagen)* (Chinese version) (Shanghai: Shanghai Far Eastern Press, 2007), p. 117.

³⁶ At the time in China, there were only two sedan manufacturers – Shanghai Auto Plant and Changchun's FAW. See Zhang, p. 464.

³⁷ The Shanghai Tractor and Automobile Corporation (STAC) was renamed to Shanghai Automobile and Tractor Industry Corporation (SATIC) in the mid-1980s, and has been known as the Shanghai Automotive Industrial Corporation (SAIC) since 1990. It was one of Volkswagen's future partners in the SVW project.

³⁸ Xu Maochange, *Chelun shang de Shanghai (Shanghai on Wheels)* (Shanghai: Shanghai Joint Publishing Co., 2007), p. 151.

³⁹ Ibid.

metaphor: JV was like marriage to form a family.⁴⁰ At the time, Chinese auto officials were reluctant to do the JV. As one official of the State Council said, “Given the explanation [of the GM executives], we think the idea of JV is interesting, but at the same time we know it is impossible to do it: you are capitalists, and we are communists, so how could we do the JV together? Especially as they mentioned, JV is like marriage, like family. Is it possible to get marriage between the capitalists and the communists?”⁴¹ However, when the report about the GM’s JV proposal was submitted to Deng Xiaoping, the paramount leader of CCP, Deng encouraged *greatly* expanded trade relations, foreign investment and technology transfer,⁴² and thus made a comment: “Yes, we can do auto joint ventures.” “Not only sedan but also truck projects can take the form of joint venture.”⁴³ Under Deng, establishment of JVs with foreign automakers began being accepted by Chinese automotive officials, and the Shanghai sedan project decided to adopt the form of JV.

2.3 Why Volkswagen?

⁴⁰ Ibid., p. 152.

⁴¹ These words came from Li Lanqing who was one official of the State Council and participated in the foreign investment projects at the time, and became Vice-Premier in 1993. The Chinese citation is in Xu, p. 152, and this translation is given by the author.

⁴² In Deng’s view, China, if wants to develop into a powerful and wealthy country, must *boldly* learn and absorb the advanced technology and management methods of the world including the developed capitalist countries. See Deng Xiaoping, *Build Socialism with Chinese Characteristics* (Beijing: Foreign Language Press, 1985); Deng Xiaoping, “Zai Wuchang, Shenzhen, Zhuhai, Shanghai deng Di de Tanhua Yaodian, 1992, 1, 18 – 2, 21” (“Speeches at Wuchang, Shenzhen, Zhuhai, and Shanghai, Jan. 18 – Feb 21, 1992”), in Qiu Xiangdong, ed., *Gaige Shijian yu Sikao* (Jinan: Shandong People’s Press, 2004), p. 202-4.

⁴³ The Chinese citation is in Xu, p. 152-3, and this translation is given by the author.

Although it is GM that first put forward the proposal for a car JV with China, the one at last signing the JV contract with Shanghai auto officials was not GM. The reasons came from the change of China's strategies in the auto sector.

As mentioned before, in China, sedans served only high-ranking officials instead of the general public. The sedan production volume as well as the domestic demand for sedans had been very low until the end of the 1970s. The opening to the outside world, however, gave rise to trading business and the lucrative tourism industry, which created a huge demand for better quality passenger cars to serve as business vehicles and taxis. China's car imports thus had a big leap. The number of the imported passenger cars in China increased from 52 vehicles in 1977 to 667 in 1979, and to 19,570 in 1980.⁴⁴ In 1981 the SPC issued temporary limitations on the import of cars but they had a very short term effect on the market. In 1985, due to Hainan's illegal vehicle import binge,⁴⁵ China's car imports amounted to 105,775 units, mostly from Japan (see Figure 2.2).⁴⁶ The increasing vehicle importation put

⁴⁴ *Zhongguo Qiche Gongye Nianjian (China Automotive Industry Yearbook)*, 1991 ed., p. 536.

⁴⁵ In 1984, the State Council issued "Minutes of Discussion on Acceleration of the Development of Hainan Island," and allowed Hainan to use locally retained foreign exchange to import locally needed goods, and also to be exempted from a 260 percent import duty imposed on the rest of the country, in order to spur Hainan development. But the Hainan local government took advantage of its special status to import tens of thousands of Japanese cars and then resold the vehicles to buyers on the mainland. Both the PLA Navy South China Sea Fleet and the army cooperated with the local government to smuggle the cars into China using their helicopters and gunboats. For more information, see "1985nian Hainan Qiche Zousi An" ("Hainan Car Smuggling in 1985"), *Hexun News*, available online: <http://news.hexun.com/2008/1985hnqczs/index.html>

⁴⁶ *Zhongguo Qiche Gongye Nianjian (China Automotive Industry Yearbook)*, 1991 ed., p. 536. In November 1985, the central government imposed new limitations on car importation, and required the car buyers to receive the approval of both the CNAIC and the SPC's Office for Import Investigation before they could get the import

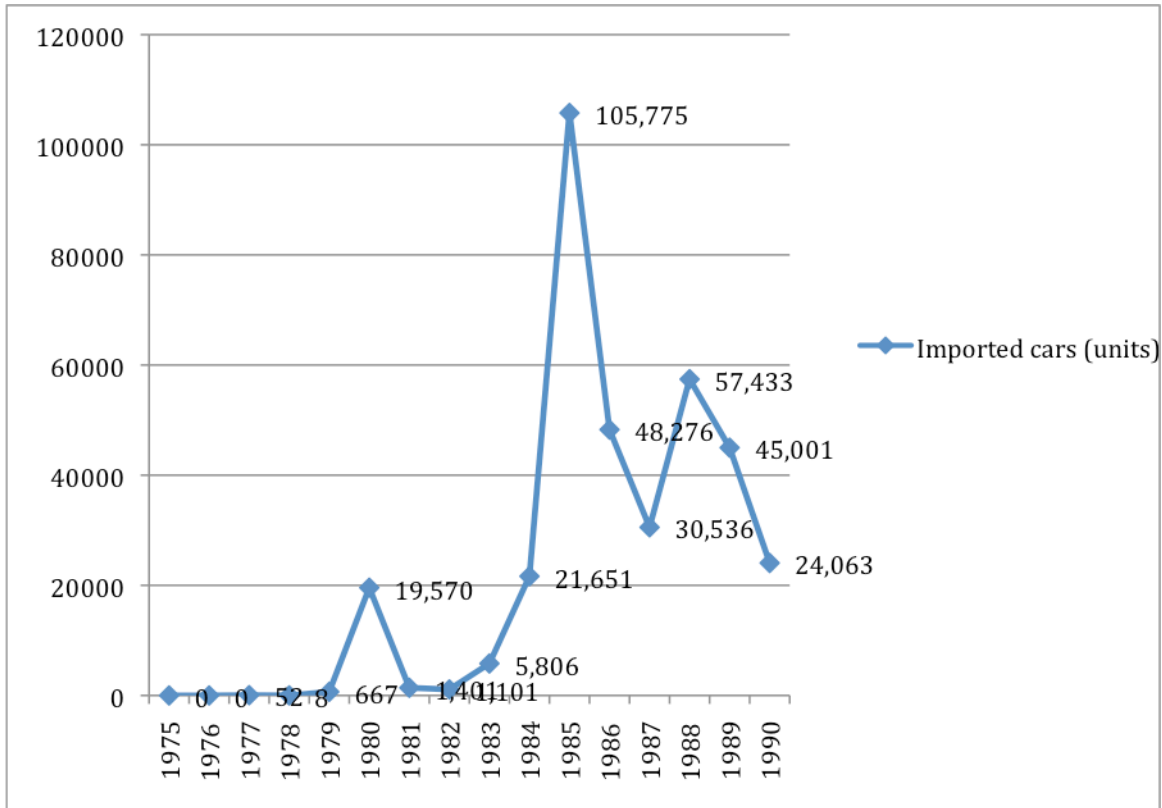
serious pressure on China's stock of foreign exchange at the time, something that seriously worried the central government. To supply the domestic demand and save foreign exchange, Chinese leaders determined to remedy the automobile dilemma and modernize China's own car industry. They shifted the goals of creation of a JV with one foreign large automaker from car assembly to establishment of a modern car production base with domestic supply network. According to Jiang Tao, then vice-director of Shanghai Planning Commission and manager of the Shanghai auto JV project, the Chinese specific strategic goals for the project were:

"1. The first modern, comprehensive center for the automotive industry should be built in Shanghai. 2. Besides a state-of-the-art car, and high capacity car manufacturing facility, China would need to establish a number of automotive spares and supplies factories with a high technical standard to be able to produce parts and other components locally. 3. The joint venture company would need to set up a development center. Eventually the Chinese should be able to set up own development facilities for brand development."⁴⁷

license, which significantly curtailed car imports. See Todd Thurwachter, "Development of the Chinese Auto Industry: Foreign Participation and Opportunities," Guangzhou: U.S. and Foreign Commercial Service document, 1989, p. 5.

⁴⁷ Posth, p. 6.

Figure 2.2 China Annual Passenger Car Imports, 1975-1990



Source: *Zhongguo Qiche Gongye Nianjian (China Automotive Industry Yearbook)*, 1994, p. 425.

China changed the strategies and goals of the auto JV project, but GM was only interested in making cooperation with the Chinese to set up a parts and components factory in China for its cars.⁴⁸ The big US automaker discounted the actual size and growth potential of the internal Chinese car market, and did not think China was a viable export base for either parts production or complete units in

⁴⁸ Xu, p. 153.

the Asian region, due to poor worker quality, inadequate production facilities, and infrastructure.⁴⁹

Meanwhile, a Chinese delegation led by Rao Bin, including Shanghai municipal leaders and Chinese automakers, also reached out to the large automakers in Japan and Europe for the JV project. Since the late 1970s, Japan not only provided substantial financial and technological assistance to China for the Chinese Modernization projects,⁵⁰ but also became the primary source of China's imports of passenger cars,⁵¹ and the Chinese appreciated the quality of Japanese cars. However, Japan's big producers focused on the US market and were increasing their share in European market. Toyota and Nissan questioned the size of the Chinese auto market. Toyota saw the Chinese market as "small and unpredictable," and saw no export potential.⁵² So they preferred to continue exporting to China, while investing heavily in the United States.⁵³

⁴⁹ Chin, p. 65.

⁵⁰ In 1979 the Japanese commercial banks offered China \$8 billion in credits. Besides, by 1984 the Japanese government has committed itself to providing \$3.6 billion in official development loans and over \$4.4 billion in Ex-Im bank loans. These credits have been an important factor in upgrading China's industrial sector and have helped finance several key modernization projects, such as building and expanding railway system, constructing hydroelectric power projects, and a steel complex. From 1978 to 1985, Japan also signed many agreements on technical assistance and cooperation with China, including technical assistance for China's railway modernization, coal liquefaction and electronic communications, in addition to mutual cooperation in the projects of nuclear energy. See Richard Nanto and Hong Kim, "The Development of Sino-Japanese Relations," *Current History* September 1986: 276-7.

⁵¹ In the early 1980s, most of the China's imported cars came from Japan. Toyota alone sold around 40,000 vehicles to China in 1984. Harwit, p. 39.

⁵² Chin, p. 62.

⁵³ Harwit, p. 40-1; Chin, p. 62.

Gregory Chin in his studies of China's auto modernization argued that without the prospect of a sizeable domestic automobile market in China, Chinese authorities had weak bargaining power over the world's leading automakers to lure them to invest in manufacturing in China. Even the perception of "market potential" was not enough.⁵⁴ However, the choice of the JV partner is not one-way but two-way job. When the large automakers said no to China for the joint auto manufacture project, China also said no to the foreign producers whose interests and objectives were in conflict with China's goals of auto modernization. Volkswagen, however, was one foreign automaker that recognized the potential Chinese car market as well as expressed the willing to serve China's modernization goals.

When the Chinese delegation approached VW for the JV project, the German executives, especially Dr. Carl Hahn, VW's chair and CEO, showed explicit interest in the project. In Dr. Hahn's view, China was an enormous potential auto market, and would become the real market of the 21st century, so it was important for VW "to gain a foothold in China and secure first-entry benefits."⁵⁵ More importantly, by entry into China, VW would not only access the Chinese market, but also regard China as a beachhead in Southeast Asia to compete against Japan for a share of Asian markets.⁵⁶ For VW, it may be accurate to say that it was the international competitiveness from the Japanese automakers and its lost in the US market that drove it to turn its attention to the Chinese market and decide to invest in China.

⁵⁴ Chin, p. 55-76.

⁵⁵ Hahn, p. 118-9; Chin, p. 95.

⁵⁶ Ibid.; Xu, p. 155.

As early as 1965, Toyota had started to target its own product – the Corona car – to compete against the VW Beetle in the United States. The Corona was designed to appeal to US car buyers who wanted an affordable, two-door hardtop, minus the shortcomings of the VW Beetle. It was under \$2000 in price, had a quiet engine with twice the horsepower of the Beetle, and had more space in the back seats, making for a more comfortable ride for adults.⁵⁷ Sales of such inexpensive and attractive cars increased very quickly, from only 6400 units in 1965 to 130,000 by 1969, putting Toyota second only to front-running VW, and its Beetle.⁵⁸ By 1970, Toyota's share of the US import market had climbed to 13 percent and its marketing area covered the East Coast and Midwest.⁵⁹ Nissan, following Toyota's steps, also brought the US its cars – the Datsun 510 and the Datsun 240Z. Rising demand for both models helped Nissan become the third largest importer to the US in 1978, behind VW and Toyota.⁶⁰ At the end of the 1970s, Honda, Japan's third largest automaker, benefited from the US fuel shortages resulting from the Arab oil embargo of 1973-74 and depending on the good sales of its fuel-efficient car – the Civic – in the US market displaced VW as the third largest importer to the US.⁶¹ All three Japanese automakers used their inexpensive, high-performance, and attractive cars to fight for and maintain their market gains and sent VW on a precipitous fall in the US. In order to compete against the rising Japanese producers and expand its operations to Asia, VW chose to invest and partner with China.

⁵⁷ Leslie Hiraoka, *Global Alliances in the Motor Vehicle Industry* (Westport: Quorum Books, 2001), p. 45.

⁵⁸ Chin, p. 72.

⁵⁹ Chin, p. 73.

⁶⁰ Hiraoka, p. 46.

⁶¹ Chin, p. 73.

Although VW concerned the Chinese market rather than China's auto industry, what the Chinese cared about was that the Germans were aware of China's strategic goals for the auto industry and expressed the willing to help China to achieve the goals. So, for both sides the JV project became "win-win". In the words of Jiang Tao: "Thanks to this cooperation, Shanghai was able to establish a state-of-the-art automobile industry, and Volkswagen to leverage the opportunity of accessing the market."⁶² This mutual beneficial foundation caused China to make the decision to do the cooperation with VW for the Shanghai auto JV project.

2.4 Negotiation for the Joint Venture Agreement

When China and VW began to negotiate the specific issues of the project, it was Jiang Tao, the vice-director of Shanghai Planning Commission, who was Chinese chief negotiator. The negotiation team included managers of Shanghai Auto Plant, leaders of STAC and Chinese engineers. Although Beijing did not send representatives to stay at the negotiating table, the negotiation team was supervised by the FMMB and they should report the negotiation issues to the central ministries for permission.⁶³ In Jiang's view, he never expected the occurrence of so many disagreements, not only between two sides, but also among Chinese leaders as well as in VW board.

In the early 1980s, the Chinese policymakers who rose to prominence with Deng Xiaoping were not a monolithic entity. Although Deng held the flag of economic reforms and the Open Door, some Chinese authorities still had serious

⁶² Posth, p. 6.

⁶³ Ge Bangning, "Santana Tanpan Neimu" ("Inside the Santana Negotiation"), *Qiche Shangye Pinglun (Auto Business Review)* December 9, 2008.

reservations about far-reaching change and linking to the outside world. Western observers have tended to divide them broadly into two opposing camps, “the conservatives” and “the reformers,” with the former embedded in the state planning bureaucracies and therefore insisting on preserving the primacy of central state planning and opposing to radical transformations.⁶⁴ The conservatives held cautions about foreign investments since they believed “Foreign capitalists are capitalists. They never do business for profits lower than the average profit which can be had in international markets... Capitalists will not do business for profits lower than average.”⁶⁵ Thus, although the Shanghai auto JV project had the approval by Deng,⁶⁶ some conservative authorities still held negative attitude toward cooperation with the Germans in car manufacture. They argued that sedans were luxury goods and not what China needed most. In addition, they doubted the German’s intentions for the project and suspected that in this project, the Germans would get high profits and China would only have financial loss.⁶⁷ They were worried that the cooperation was not good for China. By sending a report to the

⁶⁴ The most politically important of the conservatives was Chen Yun, who was among the three highest-ranking party leaders during the early Deng era. For more information about the political clashes between Chen and Deng, see Maurice Meisner, *The Deng Xiaoping Era: An Inquiry into the Fate of Chinese Socialism, 1978-1994* (NY: Hill and Wang, 1996), Chapter 9, 10, and 15.

⁶⁵ Chen Yun, “The Economic Situation and the Lessons We Have Learned” (Speech to the Central Working Conference of the Central Committee of the Communist Party of China, December 16, 1980), in *Selected Works of Chen Yun, Vol. III, 1956-1994* (Beijing: Foreign Language Press, 1999), p. 276.

⁶⁶ In September 1982, on the report of Shanghai JV project by the China National Automotive Industrial Corporation (CNAIC), Deng Xiaoping made the comments: “We can create joint ventures in sedan manufacture, and in the heavy-duty vehicle manufacture as well.” See Li Anding, “Deng Xiaoping Paiban Jiaochē Hezi” (“Deng Xiaoping Said Car Manufacture Could Do Joint Ventures”), *Lingdao Wencui* (*Leadership Digest*) July 2008, p. 102.

⁶⁷ Xu, p. 156.

State Council, they attacked against the JV project and called for a stop.⁶⁸ Bo Yibo, then Vice-Premier, who had expressed some caution in cooperation with foreign firms,⁶⁹ when he received the report, asked the Shanghai project team to give a response. Rao Bin, who was not only a major proponent of the project but also the supervisor of the project in the central government, held the meeting of Shanghai municipal leaders along with the project team to work out a financial report. In their report, they calculated the economic benefits of the cooperation with VW and pointed out that from this project, China would gain 86 percent of the total profits while the German only 14 percent.⁷⁰ Rao also wrote to Bo to convince him of the significance of this project for China's auto modernization. With Rao's efforts, the Shanghai project finally got the support from the State Council.⁷¹

Although Dr. Hahn decided from the outset that VW would introduce their most current model of that time to China,⁷² the Chinese representatives in the negotiation still emphasized that China needed the latest model and technology suitable to Chinese conditions. VW recommended China Golf and Jetta, the two models popular in Germany at the time.⁷³ But China needed sedans mainly to serve government, business, and taxi. In the Chinese's view, both Golf and Jetta were small for being government and business vehicles. So they selected the Santana (a sedan

⁶⁸ Ibid.

⁶⁹ Bo Yibo, "Guowu Weiyuan Bo Yibo Tongzhi zai Zhongguo Qiche Gongye Gongsì Dongshìhui dì Yìcì Hùiyì shàng de Jiānghuà" ("State Council Member Bo Yibo's Speech at the First China National Automotive Industrial Corporation (CNAIC) Board Meeting [summarized]), p. 3-7.

⁷⁰ Xu, p. 156.

⁷¹ Ibid.

⁷² Hahn, p. 119.

⁷³ Yan Guangming, "Santana Tanpan Fengyun Lu" ("Facts of Santana Negotiation"), *Jingji Cankao Bao (Economic Information Daily)* April 19, 2002, p. 8.

version of the Passat MK II) – the medium-size, four-door, and three-box car.⁷⁴ The Chinese representatives also asked VW to take into account the localization of the Santana model, and called for the transfer of technology, training, and equipment for local component supply to reach 90 percent.⁷⁵ The Germans were aware that the localization was one of China's strategic goals for this project and so accepted it. But they built in the agreement that responsibility for providing quality parts made in China rested squarely with the Chinese; VW had no obligation to hasten the process.⁷⁶

In terms of foreign exchange, VW was aware of China's burden on national foreign exchange reserves. In order to show VW's sincerity and in favor of Chinese authorities, the Germans offered to purchase engines produced in Shanghai and use them in cars manufactured in Europe.⁷⁷ The earnings generated from such exports would support the use of foreign currency by the JV for importing the kits and later the foreign components used for assembly in China.⁷⁸ But the Germans insisted that the quality of engines must meet VW standards.⁷⁹

What China wanted actually was that the JV could not only balance its foreign exchange accounts, but also earn foreign exchange for China's modernization program by export of cars. They, according to the state planning, called for the JV to commit to produce 150,000 cars per year, in which 70,000 cars would be

⁷⁴ Ibid.; Hahn, p. 119, 123.

⁷⁵ Chin, p. 95.

⁷⁶ Harwit, p. 97.

⁷⁷ Chin, p. 90; Posth, p. 8.

⁷⁸ Ibid.

⁷⁹ Harwit, p. 97-8.

exported.⁸⁰ China's production/export proposal, however, raised one more crisis of this project. In the VW board, some executives thought that if did as China proposed, this project would be a big-size one and need a large investment; but given China's auto conditions and VW's financial difficulties, it was risky to do so.⁸¹ They greatly opposed to do the large investment and then stopped any contact with China, although Dr. Hahn tried to convince them that going into China was worth the risk. In order to keep the project alive for the auto modernization goals, the Chinese representatives got the permission from the FMMB to change the annual production plan from 150,000 cars to 20,000 cars,⁸² and the Germans also got Rao Bin's promise on behalf of Beijing that the central government would support and protect the car development by imposing tight import restrictions; if the domestic demand increased in the future, China would expand the cooperation with VW; the central government would invest some amount of foreign exchange in the JV project, although China had foreign exchange shortage.⁸³ Given China's sincerity, the VW board agreed to do the cooperation and resumed the negotiation with China. The annual production capacity was then set into 30,000 cars.⁸⁴

China and VW also could not share the same opinion on legal issues. Since the JV agreement should have arbitration clause for future disputes, but China's Joint Venture Law was very brief and did not give legal interpretation for many issues, VW preferred to use the German law for arbitration. But China argued that the JV

⁸⁰ Yan, p. 8.

⁸¹ Ibid.; Xu, p. 157.

⁸² Ibid.

⁸³ China's promises were in Rao Bin's letter to Dr. Hahn. See Zhang, p. 520.

⁸⁴ Posth, p. 9.

project was in China and both parties should do arbitration in accordance with Chinese law, which was not a simple legal issue, but about China's sovereignty. Then the Germans suggested the law of the third party – Switzerland. But China insisted for Chinese law. To make VW accept Chinese law, the Legislative Leading Group of the State Council in China worked out the *Enforcement Regulation of Joint Venture Law* in 1983. After reading the Enforcement Regulation, the Germans finally agreed to use Chinese law for arbitration.⁸⁵

In October 1984, the negotiations and compromises between the two parties ended with signing of the agreement in Beijing. VW's partners in the JV, proposed by the central government though the Germans approved of the choices, were the Shanghai Automotive Industrial Corporation (SAIC),⁸⁶ the Bank of China's Shanghai Trust and Consultancy Corporation, and the CNAIC. The agreement, valued at RMB255 million, established a 25-year Sino-German partnership with 50% equity provided by VW, 25% by SAIC, 15% by the Bank of China, and 10% by CNAIC.⁸⁷ To keep their promise of investment of foreign exchange in the JV, the central government made the Bank of China involved in the project and become a

⁸⁵ The negotiation between China and VW on the legal issue came from Xu, p. 158-9 (in Chinese).

⁸⁶ SAIC was named Shanghai Tractor and Automobile Corporation (STAC) in 1984. The STAC was the automotive group with political functions. It was placed under the leadership of Shanghai Economic Commission, and its president reported directly to the Mayor. It took charge of management of auto companies and supply firms in Shanghai, which essentially mirrored the CNAIC. In 1995, The STAC was renamed SAIC, and did reforms to become a large State-owned enterprise without political functions. See Eric Thun, *Changing Lanes in China: Foreign Direct Investment, Local Governments, and Auto Sector Development* (NY: Cambridge University Press, 2006), p. 103; Zhang Ji'er, "Muyu Gaige Chunfeng, Zhagen Kaifang Retu" ("Review of Reforms And Opening"), *Dazhong Xinwen Bao (SVW News)* August 29, 2006.

⁸⁷ Harwit, p. 96; Posth, p. 9.

shareholder.⁸⁸ To ensure the project get more tangible and intangible support from the central government, the CNAIC became one of the partners with VW. The new joint venture was named Shanghai Volkswagen (SVW). Premier Zhao Ziyang also attended the signing, showing top-level Chinese concern for the huge foreign-invested project.⁸⁹

Summary and Analysis

In the story of SVW foundation, it is the SPC rather than the technologists that launched the project of transformation of the car industry and thus started to formulate an auto network in the late 1970s. Due to its administrative responsibility for the automotive sector, the FMMB was inevitably enrolled into the network by the SPC. Then under the suggestion offered by the FMMB, the project was settled down in Shanghai, which brought Shanghai municipal government and Shanghai automakers into the network. The aim of this project originally was defined by the SPC as to rely on foreign technology to transform the outdated Chinese car manufacture, and then take advantage of low cost Chinese labor to assemble the imported CKDs for export. But influenced by the shortage of domestic auto supply, this aim was re-defined by Chinese central authorities as establishment of China's own modern car production base with domestic supply network. With this goal, the actor of the FMMB together with Shanghai municipal government and Shanghai automakers sent their representatives overseas for a foreign partner of the auto

⁸⁸ The Bank of China was the agency of the central government with responsibility for management of foreign exchange until 1989.

⁸⁹ Harwit, p. 97; Posth, p. 10.

project. Unlike the American and Japanese automakers, VW viewed China as an enormous potential car market, and was well aware that its operation with China would not only help it access the Chinese market, but also enable it to compete against Japan for a share of Asian markets. Therefore, for accessing the Chinese and Asian market, VW was *willing* to participate in the auto project. After a long time of negotiation of this project's specific issues, the Chinese actors and VW finally aligned their points of view about the project and signed the JV agreement in October 1984, which caused the birth of SVW, and thus enrolled SAIC, the Bank of China's Shanghai Trust and Consultancy Corporation, and the CNAIC into the network. In addition, according to the agreement, the Santana cars as artifact actors also were introduced by VW into the network.

In this network building process, due to China's central planning system, Chinese top political authorities played an important role. They defined the aim of the auto project, identified the actor status of Shanghai municipal government and of Shanghai automakers by power rather than through "translation" of their interests or desires. Engineers and technologists in this period of China did not have a voice about the project unless they were attached with political power like Rao Bin. VW, although interested in the project for market strategies, could not enter the network until they shared the agreement about the project with Beijing through negotiation. Furthermore, even Beijing itself was not a monolithic entity but rather an actor-network which linked with multiple entities and needed alignment. The controversy about the JV project between "the conservatives" and "the reformers", for example, led to agreement because first the top leader Deng Xiaoping said "yes"

to establishment of JVs with foreign automakers, and then the State Council, the highest state administrative authority, finally decided to support the cooperation with VW. Therefore, the foundation process of SVW is actually a story of power relations. Actor enrollment, actor alignment, and the network stability were all through power and control, which, again, resulted from China's particular central planning context in the late 1970s and early 1980s.

Chapter 3 Easy Alliance?: Shanghai-Volkswagen in the Triple

Power

The SVW plant was located one hour outside the city of Shanghai in Anting, Jiading County. The joint venture began production in September of 1985 with the assembly of CKD Santana cars. The SVW JV agreement designed the venture for co-determination from the outset, with equity and management responsibilities to be shared 50:50 by the two parties, which also applied to appointments to board and executive committee: half of the ten members on the board of directors were appointed by the Chinese, and the other half by Volkswagen; in the executive committee: two Chinese, two Germans.¹ Moreover, the board of directors and executive committee were chaired by the Chinese, and the Germans were appointed as the deputies. Although VW used to think that it was the Germans who should be the boss of SVW, they had to accept this partnership under Chinese leadership for their global tactics.²

However, according to the JV agreement, it was the Germans who were in charge of production and technological R&D, while the Chinese were responsible for sales.³ Therefore, VW, as the foreign parent company, exerted the direct influence

¹ Martin Posth, *1000 Days in Shanghai* (Singapore: John Wiley & Sons, 2006), p. 15.

² Posth, p. 16.

³ Jiang Tao and Qiu Ke, "Gaige Kaifang Gei Shanghai Qiche Gongye Dailaile Shuguang, Shanghai Dazhong Tanpan zhong Jige Zhuyao Wenti de Huigu" ("Opening and Reforms Shed Lights on Shanghai Automotive Industry, Review of Several Main

over the car production and decision making of SVW. Meanwhile, as agencies of the governments, the CNAIC, the Bank of China and SAIC were involved as partners in the venture, which not only ensured SVW to obtain the support from the central and local power, but also provided Chinese political actors with opportunities to engage in operations of SVW.

Although VW and their Chinese partners aligned their points of view about the specific issues of SVW through negotiation before building up alliance, there still existed conflicts and negotiations among the actors when SVW began production. Especially in the process of the Santana parts and components localization, VW and the Chinese central and local actors interacted with each other for the purpose of enrollment of local suppliers and stabilization of the network. This chapter aims to present how SVW's development and its supply localization process were shaped by domestic forces and the foreign partner – VW. It focuses on the period from the opening of SVW in 1985 to the early 1990s in that during this period did SVW achieve great progress in supply localization. This chapter is divided into three parts. The first part looks at Shanghai's economic and political context in the 1980s with a focus on the relationship between the central government and Shanghai municipal government, which gives the background information of the SVW localization drive. The second part examines how the central and local actors as well as VW as a foreign parent company influenced SVW's localization process. The conflicts, negotiations and cooperation between the domestic and foreign forces are presented. The third part offers an account of how the central and local forces

Issues during the Construction of SVW"), *Shanghai Automobile*, Vol. 12, 1998.

provided SVW with a protected market for development and of how Shanghai suppliers were enrolled into the network.

3.1 Central – Shanghai Relations in the 1980s

Shanghai occupied a unique position in the Chinese economy. Unlike cities such as Guangzhou and Wuhan, which were dominated by trading firms and light industry, as early as the late 1920s and early 1930s, Shanghai had the experience of running large industrial enterprises. Prior to 1937, large-scale modern industrial production in the city accounted for approximately half of the total for all of China. In 1932-1933, there were 2,435 modern factories in China, and 1,200 of these were in Shanghai.⁴ The city became an important base of modern industry in China. Since 1949, Shanghai, as a key industrial city, had been China's undisputed economic center for almost three decades, supplying the whole country with industrial products, skilled personnel, as well as a huge amount of revenue. In 1978, Shanghai alone accounted for one-seventh of the industrial output, and one-sixth of the revenue of the country.⁵ In the 1953-1978 period, the annual growth rate of Shanghai's national income amounted to almost 9 percent, the No.1 in China and much higher than that of other provinces (see Table 3.1).

⁴ The factories in Shanghai dominated the national production of textiles, machinery, vehicles (including boats), chemicals, metal working, etc. A "modern" factory is defined as one that employs 30 or more people and uses power-driven machinery. See Rhoads Murphey, *Shanghai: Key to Modern China* (Cambridge: Harvard University Press, 1953), p. 166.

⁵ Hua Jianmin, ed., *Kuashiji de Gongcheng: Shanghai Jingji, Shehui yu Chengshi Fazhan Guihua Yanjiu (A project Straddling across the Century: An Economic, Social and Urban Development Planning Study of Shanghai)* (Shanghai: Shanghai Renmin Press, 1995), p. 6.

Shanghai's ranking in the national economy, however, fell rapidly in the 1980s. Beginning 1983, Shanghai's national income fell behind its neighbors Jiangsu, Shandong, and Guangdong.⁶ In the period of 1979 -1989, the annual growth rate of Shanghai's national income was only 7.6 percent, not only much slower than other coastal provinces, but also below the national average (see Table 3.1). In the market, Shanghai's industrial products were no longer competitive and challenged by those made in other areas.⁷

Table 3.1 Growth Rate of National Income in Shanghai and Selected Provinces (%), 1953-1989

	Shanghai	Shandong	Jiangsu	Zhejiang	Guangdong	China
1953-1978	8.7	5.7	5.6	5.6	5.3	6.0
1979-1989	7.6	10.4	11.0	12.8	11.6	8.7

Source: Guojia Tongjiju Gongye Jiaotong Wuzisi (National Bureau of Statistics), ed., *Quanguo Gesheng, Zizhiqu, Zhixiashi Lishi Tongji Ziliao Huibian (A Compendium of Historical Statistical Data of the Nation's Provinces, Autonomous Regions and Municipalities)* (Beijing: Zhongguo Tongji Press, 1991), p. 47.

⁶ Xu Maochange, *Chelun shang de Shanghai (Shanghai on Wheels)* (Shanghai: Shanghai Joint Publishing Co., 2007), p. 165.

⁷ *Ibid.* p. 165-6.

In terms of the reason why Shanghai's economy declined during the 1980s, some scholars attributed it to the excessive fiscal contribution of the municipality.⁸ It is estimated that between 1949 and 1980 as much as one-sixth of total central government revenue came from Shanghai.⁹ The city, therefore, had little money to invest in infrastructure. Some argued that the planned economy weakened Shanghai's once vibrant entrepreneurial spirit because of its dependence upon the state for the allocation of funds and materials, which raised Shanghai's economic difficulties.¹⁰

Needless to say, the bad fiscal treatment and loss of autonomy would contribute to Shanghai's predicament in the 1980s. But in the pre-reform period (1949-1978), the power of fiscal administration was entirely centralized by the central government. Almost all revenue generated in the society was required to be handed over to the Center, and local governments only retained very limited revenue for the local expenditure.¹¹ In the centralized economic system, not only local governments but also enterprises had little autonomy. This situation was uniform nationwide. Shanghai's economic decline, therefore, was a story beyond fiscal and economic issues. It was more importantly influenced by the political relationship between the central government and Shanghai, which played a crucial role in the city's political and economic fate.

⁸ Yue-man Yeung and Sung Yun-wing, ed., *Shanghai: Transformation and Modernization under China's Open Policy* (Hong Kong: The Chinese University of Hong Kong, 1996), p. 124.

⁹ Ibid. p. 154.

¹⁰ Lynn White, *Shanghai Shanghai?: Uneven Taxes in Reform China* (Hong Kong: Centre of Asian Studies, University of Hong Kong, 1991), p. 23.

¹¹ X Zhao and L Zhang, "Decentralization Reforms and Regionalism in China: A review," *International Regional Science Review* vol.22, no. 3 (1999), p. 252.

Shanghai, as one of the three municipalities in China, had an administrative status equal to that of a province. Given its political and economic significance and the fiscal contribution to the nation, since 1949, Shanghai had been given political advantage in the central power, and had high representation on the Central Committee and the Politburo, the party's highest decision-making body, for three decades.¹² The central support of Shanghai inevitably benefited the city's economic development.¹³ However, because Shanghai acted as a bastion of the radical politicians "Gang of Four" in the Cultural Revolution, since the late 1970s, with the fall of the "Gang of Four", Shanghai not only lost its access to the highest political level,¹⁴ but also was under the tight central control. In 1980, China began fiscal reform by increasing fiscal decentralization to the provincial-level administration. But Shanghai, together with Beijing and Tianjin, were left out and required to adhere to the old fiscal arrangement with the center government which left them with little autonomy as well as with a small revenue base. Shanghai, under this fiscal arrangement, its share of total revenue was the lowest among the three

¹² For example, on both of the 9th Central Committee (1969-1973) and the 10th Central Committee (1973-1977), the members from Shanghai were ten, approximately 3.5 percent of total committee members. In the decade of 1970-80, there were six Shanghai municipal leaders elected into the Politburo. For more information, see Yue-man Yeung and Sung Yun-wing, p. 62.

¹³ A typical example is Baoshan Steel Plant in the late 1970s, at that time the largest and most modern steel plant in China. Its original site was to be Tanshan, Hubei province, located on one of the three national richest iron ore mines. Instead it was finally located in a suburb of Shanghai, far from any iron ore base, in contrast to most feasibility studies and as a result of pressure imposed by Shanghai elite who occupied all key decision-making positions. Zhao and Zhang, p. 255.

¹⁴ On the 12th Central Committee (1982-1987), there were only three members from Shanghai, approximately 0.86 percent of the total committee members. In the early and middle 1980s, none of Shanghai's leaders was elected into the Politburo. See Yue-man Yeung and Sung Yun-wing, p. 62.

municipalities: while Beijing and Tianjin were allowed to keep about 30 percent of their revenue for local spending, Shanghai only a little over 10 percent of its revenue.¹⁵ Shanghai lost the support of the central government in the first half of the 1980s as well. In the early 1980s, when the SVW project was in negotiation, some central authorities strongly opposed setting up this project in Shanghai, and argued that First Auto Works (FAW) in Changchun should do it.¹⁶ Thanks to Rao Bin's much lobbying of the State Council, the Shanghai project finally lived on.

Although in China it is the central party that selected the top provincial leaders, which was due to China's political hierarchical system,¹⁷ and the central party's main concern was to appoint leaders who could effectively accomplish the party's objectives rather than promote local interests, the lack of promotion to the central power raised Shanghai municipal leaders' interest in local development. Shanghai's top leaders in the early 1980s were eager to re-invigorate the city and bargain for local interests. They not only submitted the central planners the strategic plan of Shanghai's development,¹⁸ but also supported local industrial modernization projects including the SVW project.¹⁹

¹⁵ Lin Zhimin, "Reform and Shanghai: Changing Central-local Fiscal Relations," in Jia Hao and Lin Zhimin, ed., *Changing Central-local Relations in China: Reform and State Capacity* (Boulder: Westview Press, 1994), p. 245.

¹⁶ Jiang Tao, "Cong Shiyantian dao Zhongguo Qicheye de Huangpu Junxiao" ("From the Trial Field to the Pioneer of China's Auto Industry"), *Zhongguo Zhengjuan* January 6, 2009. Available online: http://www.cnstock.com/08zhongguorz/2009-01/06/content_3977041.htm

¹⁷ The detailed information about China's political hierarchical system is given in Chapter 2.

¹⁸ Yue-man Yeung and Sung Yun-wing, p.76.

¹⁹ Jiang, p. 2; Zhang Mao, *Rao Bin Zhuanji (Biography of Rao Bin)* (Beijing: Huawen Press, 2003), p. 577.

Shanghai's rapid economic decline starting the early 1980s as well as the municipal leaders' efforts in the city development attracted the central government's attention. Central policy began to undergo important changes in the mid-1980s. After Deng Xiaoping's first southern tour to Central and South China in 1984, Shanghai was granted a series of preferential policies which most of the provinces did not enjoy, including raising the revenue retention ratio, increasing the foreign exchange retention ratio, and decentralizing more financial power to Shanghai.²⁰ In February 1985, the central government decided to open three of China's most important deltas, including the Yangzi Delta (where Shanghai is located), for foreign investment as part of a broadening of the Open Door policy. Like Deng Xiaoping, most top central leaders visited Shanghai in the 1980s. In January 1985, Zhao Ziyang, Premier at the time, declared that the "transformation and revitalization of Shanghai should be put on the agenda of the central authorities."²¹

The central government's change in policy towards Shanghai also was reflected in the appointment of leaders. Since the mid-1980s, an increasingly technocratic leadership had emerged in Shanghai. Compared with their predecessors, the new top leaders appointed by the central party not only were university-educated, but also had backgrounds appropriate to industrial development.²² Benefiting from the preferential policies offered by the central

²⁰ Yue-man Yeung and Sung Yun-wing, p. 76-7.

²¹ Yue-man Yeung and Sung Yun-wing, p. 77.

²² For example, Jiang Zemin, appointed as Shanghai's mayor from 1985-1988 and party secretary from 1987-1989, graduated from the Department of Electric Motors of Jiaotong University in Shanghai, had a position in the Shanghai Ministry of

planners, they, different from their predecessors, enjoyed more autonomy in local economic management such as enterprise production and material marketing, and began to control a larger share of fiscal resources, which brought them incentives to undertake major efforts to confront Shanghai's economic problems and mobilize resources to develop the city.²³ Although they sometimes put local interests over central ones for local economic growth, the new leaders, like Jiang Zemin and Zhu Rongji, were skillful to do the balance between upholding the central objectives and maximizing local interests, which made them please the clients in Shanghai as well as the bosses in Beijing.²⁴ With Jiang's promotion to the Politburo in 1987, Shanghai's leaders' involvement in the central party bodies increased gradually.

The central government's re-support of Shanghai's development and Shanghai's new energetic leadership core not only brought hope for Shanghai's revitalization, but also promoted the city's auto industry development.

3.2 Conflicts and Cooperation in Localization

Machine-Building Industry in the early 1950s, and served as director of the FAW power plant from 1956-1962. Zhu Rongji, who followed Jiang as Shanghai's mayor from 1988 - 1991 and party secretary from 1989-1991, graduated from the Department of Electric Motor Engineering Department of Qinghua University and had positions in industry, academics, on the State Economic Commission, and on the State Planning Commission. Huang Ju, the vice-mayor in the 1980s, also graduated from the Department of Electric Motor Engineering Department of Qinghua University, and served as a technician and engineer at various Shanghai industrial factories during the 1960s and 1970s. He succeeded Zhu as mayor of Shanghai in 1991. For more biographic information, see <http://baike.baidu.com/>

²³ Lin Yifu et al., "Decentralization and Local Governance in China's Economic Transition," The Conference of the Rise of Local Governments in Developing Countries, London School of Economics, May 2003.

²⁴ Yue-man Yeung and Sung Yun-wing, p. 71.

As we mentioned before, one of China's strategic goals for the SVW project was to establish a number of auto spares and supplies factories with a high technical standard to be able to produce parts and other components locally. The modern local supply network was not only indispensable and significant for China's auto modernization drive, but also helpful for China's foreign exchange difficulties by reducing the import of auto parts and components. However, as of the mid-1980s, the Shanghai's, or even the whole country's supply base was too weak, and still at the level of the 1950s.²⁵ Besides, due to the influence of the pre-1978 auto policy which focused on heavy-duty vehicle production, Chinese automotive suppliers produced parts for trucks and not for cars, which needed a fundamental shift, not only in parts design but also in the technology.²⁶ Therefore, according to Wang Rongjun, the Managing Director of SVW in 1986, "In the beginning there wasn't a single local parts supplier which could produce a part we could assemble into the Santana."²⁷ The German magazine *Der Spiegel* reported the SVW's early status as "Shanghai-Volkswagen seems to be thrown on a solitary island to do the production – there is not any parts factory."²⁸

Upgrading local supply firms and improving the quality of local components to meet the Santana standard were proved extremely difficult and expensive. Beyond technology and know-how, there was the question of finance. A large amount of money was required to purchase foreign knowledge and technology as

²⁵ Zhang Hanshou, "Santana zai Jiakuai Guochanhua" (Santana Speeds up Localization"), *China Auto News* June 9, 1988, p. 1.

²⁶ Ibid.

²⁷ Ibid.

²⁸ Yan Guangming, "Shangqi de Lu Ji'an Shidai" ("Lu Ji'an and the SAIC"), *Qiche Ren (Auto People)* April 28, 2009, p. 2.

well as train the employees in new methods of production. Therefore, initial localization was very slow. As of the end of 1986, two years after the start of production at SVW, only 4 percent of Santana's parts were produced in China.²⁹ Despite the slow start, the SVW supply localization had got the dramatic progress during the course of the next decade (see Table 3.2). By 1995, the quota of locally built parts amounted to 88.6 percent, and one year later, the local content rate increased to 90 percent.

Table 3.2 Percentage of Components Localized by Shanghai-Volkswagen

Year	Contracted Localization %	Actual Localization Realized %
1985	26.8%	2.7%
1986	-	4.0
1987	-	12.6
1988	50.9	30.6
1989	-	-
1990	-	60.0
1991	83.3	70.4
1992	-	76.0
1993	-	82.3
1994	-	-

²⁹ Posth, p. 160.

1995	95.0	88.6
1996	-	90

Sources: For 1985,1991, and 1995, Diane Long and David Upton, *Shanghai Volkswagen* (Boston, MA.: Harvard Business School, 1996), p. 15. For 1986, Posth, p. 160. For 1987, Wang Enpeng, “Santana Jiaochu Guochanhua de Xinqidian” (“The New Start of the Santana Localization”) *Qiche yu Peijian (Autos and Supplies)* no. 1, 1988, p. 3. For 1988, *Dazhong Xinwen Bao (SVW News)* August 29, 2006.³⁰ For 1990 and 1993, Office of Shanghai Chronicles, ed., *Shanghai Tongzhi (Shanghai Almanac)* vol.17, chapter 10.³¹ For 1992, Jiu Ling, “Shanghai Santana Jiaochu Guochanhua Gongtongti Disici Huiyi zai Hu Jvxing” (“Minutes of the Fourth Meeting of the Shanghai Santana Localization Community”) *Qiche yu Peijian (Autos and Supplies)* no. 12, 1991, p. 8. For 1996, *Shichang Bao (Marketing News)* December 25, 1999, p. 6.

In the SVW supply localization process, what roles the central authorities and institutions, Shanghai municipal government, and VW played, and how they dealt with the conflicts between them and made cooperation to successfully push the localization speedier will be presented below.

The central government vs. VW

³⁰ Also available online:

http://www.csvw.com/csvw/xwzx/dzxw/dzxwb/issuse_content/7487.shtml

³¹ Also available online:

<http://www.shtong.gov.cn/node2/node2247/node4579/node79315/node79320/userobject1ai104230.html>

As Chapter 2 showed, according to the SVW JV agreement, VW had no obligation to hasten the localization process.³² Besides, VW also had a financial interest in doing business with pre-existing suppliers outside of China, because international suppliers operating at high volumes could offer lower prices than Chinese suppliers, and this increased VW's profitability both in China and internationally.³³ Therefore, when SVW began production in 1985, VW did not have much motivation to help SVW build local parts supply capacity. Due to the poor quality of local parts, SVW had to depend on purchase of German CKD sets to do assembly; what's more, in its early production phase, SVW also needed to import 60 percent of the production equipment,³⁴ all of which brought extra burden on China's shortage of foreign exchange. In the early 1986, China's foreign exchange situation became worse by the influence of the RMB – U.S. – German exchange rate fluctuations and the depreciation of the Chinese currency. In China, it was the central government that controlled foreign exchange supply. So, in 1986 when the SVW managers found that the total investment amount of 500 million German marks budgeted for in the 1984 feasibility study was not going to be enough to cover actual start-up and operating costs,³⁵ and tried to convince the central authorities of big increase in investment, the State Council, after several months of discussion in political institutions of SEC, SPC, MOFERT, MMBI, and CNAIC, approved the increased SVW investment program to show the top support of SVW,³⁶ but Chinese authorities at the same time realized

³² Harwit, p. 97.

³³ Thun, p. 102.

³⁴ Posth, p. 68.

³⁵ Ibid.

³⁶ Posth, p. 69-70, 72.

the urgency of SVW supply localization. When they asked the German representatives at SVW the localization progress, the German, however, put across an unequivocal message: "According to the agreement, the Chinese side is responsible for that."³⁷ In order to speed up localization of purchase parts for the Santana, the central authorities applied significant pressure over VW and forced the Germans to contribute to it.

CNAIC, as a partner and equity holder of the SVW project, attended meetings of SVW's Board of Directors and directly monitored the localization progress. The president of CNAIC Chen Zutao not only face-to-face criticized the German for their making little effort in localization and indicated openly that supply localization was the job of both sides,³⁸ but also raised public criticism of VW about their inadequate contributions in the *Journal of Commerce*, which has caused considerable irritation in Germany, and even alerted the offices of chancellor and foreign minister.³⁹ Li Peng, then Vice Premier, and Premier Zhao Ziyang both talked to the German leading manager of SVW and emphasized that the JV should work hard to achieve parts and components localization.⁴⁰ The vice-president of the SPC, Huang Yicheng, also gave a criticism of the Germans at SVW and pointed out that VW need some pressure to push SVW localization.⁴¹ The most effective pressure was said to come from Zhu Rongji, then vice-director of the SEC. He not only appointed Lu Ji'an, the vice-director of Shanghai Economic Commission, as the head of the SVW board, but

³⁷ Posth, p. 72.

³⁸ Posth, p. 160.

³⁹ Posth, p. 167-170.

⁴⁰ Posth, p. 174.

⁴¹ Posth, p. 163.

also in June 1987 announced confidently: “If the quota of parts made in China does not increase to 40 percent in a short time, we will close Shanghai Volkswagen.”⁴² Zhu’s warning drove VW to react promptly. Dr. Hahn, the CEO of VW, visited SVW and announced publicly: “I come to Shanghai for three things – the first is localization, the second localization, and the third still localization.”⁴³ He talked with Chinese authorities including Li Peng, Chen Zutao, and members of the SPC to express how seriously VW took the partnership and was trying to develop it, and promised the Chinese that VW would put a great deal of effort into local content to achieve higher volumes and to improve the foreign exchange balance.⁴⁴ Given the weak local supply base, VW contacted their European suppliers, and tried to get them interested in coming to China to manufacture their parts with local suppliers in a JV or co-production partnership, or to transfer technology directly to the local supply company.⁴⁵ The German and Chinese executives at SVW worked together to sort the parts into categorized groups and listed potential local suppliers for each category.⁴⁶ VW also proposed the Chinese partners to use Germany’s Senior Expert Service (SES) to provide systematic and hands-on training for the local suppliers. SES managed a roster of retired German experts and could supply SVW with

⁴² Posth, p. 162; “Lu Ji’an: Zhenzheng de Shanghai Qiyejia” (“Lu Ji’an: the Real Shanghai Enterpriser”), *China Auto News* December 13, 2004, p. 8.

⁴³ Chen Hongliang, “Fang Hong: Bukan Chengshou de Santana zhi Xin” (“Fanghong: the Overwhelming Santana Heart”), *Qiche Shangye Pinglun (Auto Business Review)*, available online: <http://auto.sohu.com/20081014/n260024892.shtml>

⁴⁴ Posth, p. 163.

⁴⁵ Long and Upton, p. 7; Chin, p. 85.

⁴⁶ Chin, p. 86.

technology transfer professionals at favorable rates. VW's proposal was accepted, and SES was proven to offer great help in localization process.⁴⁷

Except for the pressure, the central institutions also gave VW incentives to drive them to engage in SVW localization. Beginning 1985, the SEC were formulating a plan of establishment of a JV between the FAW and a foreign automaker, which was regarded by VW as a good chance to expand their production capacity and head towards mass production in China.⁴⁸ When the Germans went to Beijing and talked to the SPC, MOFERT, and CNAIC about their interest in this "big project," they got the response that there were couple of foreign automakers in competition for this project; SVW is an important project, but VW should take a more active role and localization must make quicker progress.⁴⁹ The Chinese gave the Germans the implied message that they preferred VW but were still not entirely satisfied with VW's contribution in localization, which caused the Germans to believe that VW should become more involved in local content so that the Chinese would keep themselves committed to VW, and not look to the Japanese or others.⁵⁰ In 1991, thanks to SVW's great progress in supply localization, VW got the big project and signed their second Chinese automaker – FAW.

Shanghai municipal government vs. VW

Shanghai municipal government almost had the same organizational structure as the central government (see Figure 3.1). In the centralized economic system, local

⁴⁷ Chin, p. 89; Posth, p. 161-2; *Chinese Business Review* September 1992.

⁴⁸ Posth, p. 77, 79.

⁴⁹ Posth, p. 82, 84.

⁵⁰ Posth, p. 158.

authorities lacked of autonomy and initiatives for developing their economies, and they were merely passively waiting for giving from the central government. As mentioned above, since the mid-1980s, Shanghai's leaders have received strong incentives and the increased autonomy for local development. The auto industry, due to its creation of extensive industrial linkages and employment, was regarded as a key to transformation and revitalization of Shanghai.⁵¹ The municipal government not only tried to drive the SVW project alive through the negotiation process, but also actively engaged in the auto part and component localization. Shanghai's Mayor always opened the office's door for the SVW's executives,⁵² and was responsible for the centralized control of the institutions that managed the local auto industry. In order to speed up the SVW Santana localization progress, in September 1986, Shanghai municipal government formed a "Santana Localization Small Group" under the leadership of Shanghai Economic Commission.⁵³ In July 1987, the municipal government strengthened the political power in auto sector, and set up the "Support the Construction of SVW Leading Small Group" (*Zhiyuan Shanghai Dazhong Jianshe Lingdao Xiaozu*) to promote the development of SVW and the auto supply industry.⁵⁴ This group, directly underneath the Mayor's office, was headed by Huang Ju, then Vice Mayor, and composed of the directors of every government office that might potentially affect the city's auto industry.⁵⁵ The Santana Localization Small

⁵¹ Xu, p. 164-8.

⁵² Posth, p. 59; Thun, p.112.

⁵³ Thun, p.110.

⁵⁴ "Santana Fazhan Guiji" ("Santana Development Path"), *Shichang Bao (Marketing News)* December 25, 1999, p. 6.

⁵⁵ The Leading Small Group was composed of 22 members: two vice mayors, the directors of Shanghai's Economic Commission, Planning Commission, Science

Group was transformed into an office, under the leadership of the Leading Small Group, and directed by Lu Ji'an, who kept his position as vice-director of Shanghai Economic Commission and at the same time was appointed as the president of SAIC and the general manager of SVW.⁵⁶ The Localization Office dealt with the auto industry on a daily basis – it was in a sense the head office for the local industry. It worked with local supply firms to upgrade their technical capabilities by providing the necessary financial backing and specific advice concerning the equipment and technology that had to be imported. The Office also took advantage of its high-level linkages to the municipal government to assist local firms when they needed official approvals for development or import licenses for new equipment.⁵⁷ However, a problem that was particularly intractable would lead to a meeting of the Leading Small Group. Intractable problems were more often than not issues relating to coordination between various government agencies, hence a meeting involving the directors of every related agency usually had the power to work out promptly a solution and give assistances to the local auto development.⁵⁸

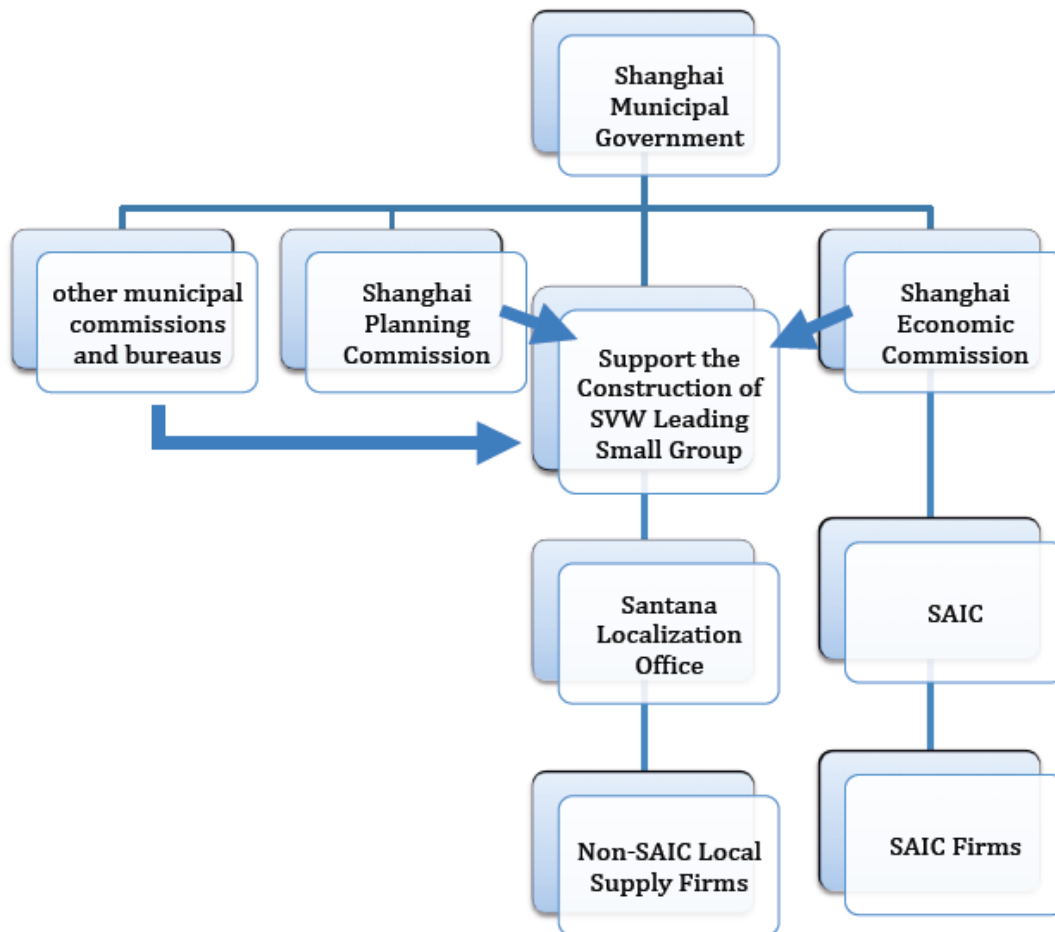
Commission, and Construction Commission, the directors of the Customs Department, Personnel Department, and Finance Department, the directors of three banks (Bank of China, Construction Bank, and Communications Bank), the directors of the Personnel Bureau, Finance Bureau, and every industrial bureau (Electric, Light, Second Light, Chemicals, and Textiles), the president of SAIC, general manager of SVW, and the head of Anting County. See Thun, p. 110-1.

⁵⁶ Thun, p. 111; Posth, p. 162; “Lu Ji’an: Zhenzheng de Shanghai Qiyejia” (“Lu Ji’an: the Real Shanghai Enterpriser”), *China Auto News* December 13, 2004, p. 8.

⁵⁷ Thun, p. 113-7.

⁵⁸ Thun, p. 112.

Figure 3.1 Shanghai Municipal Government and Auto Sector until mid-1990s



Source: Thun, p. 111; *Shichang Bao (Marketing News)* December 25, 1999, p. 6; *China Auto News* December 13, 2004, p. 8.

Shanghai municipal government gave strong backing to SVW and helped the JV out of various difficulties from trifles like the German experts' housing to big problems like financial crisis. In 1986, in order to improve the SVW's foreign exchange balance, Li Zhaoji, then Shanghai's Vice Mayor, gave SVW permission to sell the Santana cars for foreign exchange in the "Foreign Trade Centers" that had been set up in nearly every province, although according to the JV agreement, it was

the SAIC that was responsible for selling the cars.⁵⁹ In May 1988, under the permission of the headquarter of Bank of China in Beijing, Shanghai Bank of China and VW supported SVW to issue bonds in RMB to raise investment capital. It was the first time in China's history that a joint venture with a foreign capital holding had issued bonds in Chinese currency (see Figure 3.2), which helped SVW to survive from cash shortage caused by China's restrictive credit granting and monetary policy.⁶⁰

Figure 3.2 The Bond Issued by SVW in 1988



Source: <http://news.sina.com.cn/c/2008-12-15/093216849506.shtml>

⁵⁹ Posth, p. 148-9; p. 172.

⁶⁰ Posth, p. 73-5.

However, partly due to the drive of the city's modernization and partly under the central pressure,⁶¹ the Shanghai leaders were so eager for rapid progress in the use of local parts that they complained the Germans stuck with their high quality standards. They thought that VW should produce more parts in China as soon as possible, and SVW could produce cars equipped with lower quality parts for the domestic market first and then raise the standards later.⁶² But VW refused to lower their quality requirements, and did not agree to adapt the technical specifications to reflect China's special circumstances.⁶³ They worried about the effect of poor-quality products on the company's reputation, and insisted on using VW's hallmark quality. The Shanghai authorities also criticized the complexities of VW's quality testing procedures, since some parts were tested for over a year in Germany without any message, which led the Chinese to suspect that VW was delaying the approval of parts produced in China with the aim of keeping the German CKD quota as high as possible for as long as possible.⁶⁴ They suggested testing parts in Shanghai instead of Germany. But VW thought that Shanghai did not have the

⁶¹ In 1987, Zhu Rongji gave a personal phone call to Shanghai's mayor Jiang Zemin, alerting him to the fact that: "We have to be aware of the bitter lesson – we have practically made no progress in localization in three years." The Shanghai municipal government then set up the Support the Construction of SVW Leading Small Group, and Jiang announced publicly: "We should do everything to speed up the localization." See Posth, p. 162; Xu Maochang, "Zhongguo Zao: 100wanliang Santana de Guangrong" ("Made in China: the Glory of 1000 thousand Santana Cars") *Dazhong Xinwen Bao (SVW News)* August 29, 2006.

⁶² Posth, p. 158.

⁶³ Posth, p. 158-9; Xu, p. 161-2.

⁶⁴ Posth, p. 158; "Daidong Shenghuo de Chelun" ("Drive the Wheels of Life") *CCTV* April 1, 2004, available online: <http://www.cctv.com/geography/special/C11546/20040401/101384.shtml>

equipment nor sufficiently qualified experts to do the testing, and in order to maintain the high quality of the parts, the testing should be done in Germany.⁶⁵ In Posth's words, in terms of quality, "we can be as stubborn as mules, with no compromises."⁶⁶

The arrival of Zhu Rongji in Shanghai as the mayor in April 1988 ended the dispute on quality. In Zhu's opinion, high quality standards were imperative to the long-term success of SVW. He asked the local suppliers to follow VW's quality standards and warned them to avoid using incorrect or defective material, in Zhu's words, "[to do localization is] not to build vegetables and melons" into cars.⁶⁷ In order to produce high quality local parts and accelerate the localization progress, Zhu launched two measures: First, in July 1988 the Santana Localization Community was created. It consisted of 105 supply firms and 16 research centers, and served to foster closer ties between SVW and its suppliers and perhaps more importantly among the suppliers themselves. The organizing principle behind the community was the relentless pursuit of quality. To this end, the community held a meeting every year to open communications between SVW and suppliers as well as provide a forum within which members (in and outside of SAIC) could raise problems and discuss potential solution.⁶⁸ Second, in 1988 under Zhu's leadership, the Shanghai government began the process of capital accumulation for local suppliers by creating what it called an "auto component tax" (*Qiche Lingbujian Shui*). For every

⁶⁵ Ibid.

⁶⁶ Posth, p. 158.

⁶⁷ Xu, p. 162; Posth, p. 165.

⁶⁸ Ye Ping, *Zai Santana Gongtongti Dijiuci Chuanti Huiyi shang de Jianghua (Minutes of the Ninth Meeting of the Santana Localization Community)*, November 6, 1996.

Santana car sold, a tax of RMB28,000 would be levied. This special local tax got the approval of the SPC and was retained in Shanghai. The accumulation of tax formed a localization fund controlled by the municipal government's Santana Localization Office. From 1988 to 1994, Shanghai collected over RMB8 billion. Working together with SAIC and SVW, the localization office could use this amount of money to assist the local suppliers that required investment capital to upgrade technology and equipment.⁶⁹ Both of the localization community and the localization fund made great contributions to the development of local supplies industry, and the Santana localization started a dynamic progress from 1988 (see Table 3.2).

3.3 Development in a Protected Market

During the period from the mid-1980s to the early 1990s, the development of SVW and its local suppliers greatly benefited from the protected environment offered by the central government and Shanghai municipality.

On September 23, 1985, the CCP's National Congress issued "Guanyu Qiwu Jihua de Jianyi" ("Suggestions on the Seventh Five Year Plan") which claimed that the auto industry was one significant pillar industry of national economy, and should be developed quickly.⁷⁰ In 1987, the State Council launched an auto plan

⁶⁹ Posth, p. 165; Wang Rongjun, "Guochanhua Jijin de Youlai" ("The Origin of the Localization Fund") *Qiche Shangye Pinglun (Auto Business Review)* August 12, 2009, also available online: <http://auto.sina.com.cn/news/2009-08-12/1044515670.shtml>

⁷⁰ The official copy is available online: <http://www.docin.com/p-23544284.html>. Pillar industry refers to an industry which the Chinese government identified as being critical to national economic development. Together with the auto industry,

which stated that the central government would fully support the development of the six auto producers including the SVW and control the entry of any other new passenger car factories into the auto sector.⁷¹ To further stimulate domestic production, since 1985 the government has tightly restricted vehicle imports and adopted a series of measures including centralized approval, limited import quotas, and strict license management.⁷² On March 20, 1993 the State Council approved the establishment of China's Imports of Automotive Center, which was responsible for control and management of auto imports.⁷³ Besides, tariffs on vehicles were extremely high: prior to 1994, tariffs ranged from 200-240 percent.⁷⁴ In 1994, China reduced many tariffs, but for domestic auto development, remained high in the auto sector. Compared with the average tariff across all industries in 1995 of 21 percent, tariffs on auto trade were 129 percent.⁷⁵

The Shanghai municipal government, in 1987, announced that the auto industry was the first pillar industry of Shanghai's economy.⁷⁶ In 1991, in order to support SVW to expand its production capacity, SAIC determined to integrate Shanghai auto industry resources and make the Shanghai Auto Plant emerged into

there are other three pillar industries – mechanical-electronics, building materials and petrochemicals.

⁷¹ Xiao Li, "1987nian San Da San Xiao Qiche Shengchan Jidi Queli" ("In 1987 Establishment of Three Big and Three Small Auto Producers"), *JCAuto* September 24, 2009, available online: <http://www.jcauto.com.cn/2009/0924/32569.html>

⁷² Chen Ping, "Jinkou Qiche Shichang Huigu he Zhanwang" ("Review and Outlook of Import Car Market"), *Zhongguo Shang Bao (China's Business News)* July 10, 2003.

⁷³ Ibid.

⁷⁴ Thun, p. 86.

⁷⁵ Chinese Academy of Engineering and National Research Council, *Siren Jiaoche yu Zhongguo (Personal Cars and China)* (Washington, D.C.: National Academies Press, 2003), p. 27.

⁷⁶ Office of Shanghai Chronicles, ed., *Shanghai Nianjian 1996 (Shanghai Yearbook 1996)* chapter 9, p. 1.

SVW. SAIC's proposal was approved by the municipal government and finally by the CNAIC and the State of Council. On November 25, 1991, the *Shanghai* sedan, produced by the Shanghai Auto Plant and riding in China for over 30 years, was officially discontinued.⁷⁷ For the SVW development, Shanghai's leaders, especially Zhu Rongji, also encouraged the founding of a Shanghai taxi company that would exclusively use cars from SVW. In December 1988, under Zhu's support, the taxi company was created and by the next year, most of aging Japanese imported taxis in Shanghai were replaced with the Santana cars.⁷⁸

The Shanghai's authorities were so committed to their auto industry and their city that they, in the Santana localization efforts, initially recommended only suppliers that were based in Shanghai. However, both of the SPC and CNAIC, for the speedier localization, asked SVW to "look national" and find the most suitable part and component suppliers in China.⁷⁹ The municipal government, although adopted the central planners' approach,⁸⁰ still preferred the local sources, and defined any

⁷⁷ The Shanghai Auto Plant, the successor of the Shanghai Automobile Assembly Plant, produced the first sedan branded *Phoenix* in 1958, which was modeled on Daimler-Benz's model 220S. In 1963, its name was switched to *Shanghai*. By November 25, 1991 when the *Shanghai* sedan was officially discontinued, the Shanghai Auto Plant totally produced 77,041 units. See Jiang Zhiwei, "Shanghai Dazhong Erqi Gongcheng Jianshe Jishi" ("The Documentary of the Second Phase of SVW"), *Shanghai Auto News* June 22, 2008, p. 7.

⁷⁸ Harwit, p. 103, 111; Wu Jinkang, "Nanyi Geshe Dazhong Qing" ("The Story about SVW Taxis and Me"), *Dazhong Net*, available online: <http://www.96822.com/zhengwen/035.htm>

⁷⁹ Posth, p. 159; Chin, p. 81; Dong Jiafang et al., "Shanghai Dazhong Qiche Youxian Gongsi" ("The SVW Corporation"), available online: <http://www.docin.com/p-2573651.html>

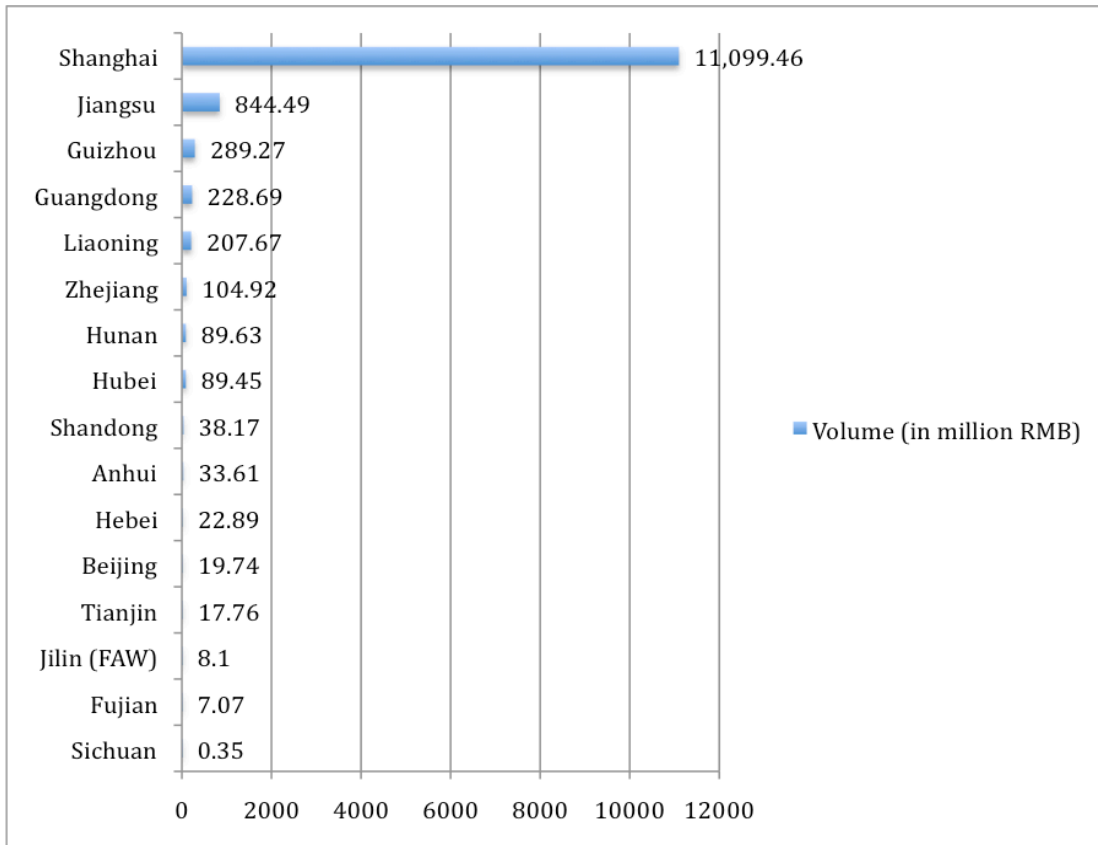
⁸⁰ In 1987, Jiang Zemin, then Shanghai's mayor, declared that SVW should look for suppliers beyond Shanghai. See "Shanghai Dazhong: Santana de Chenggong shi Guochanhua de Chenggong" ("SVW: Santana's Success was the Localization Success"), *Bandao Dushi Bao (Island Urban News)* December 15, 2008, p. 2.

part purchased outside of Shanghai as import. Both SAIC and the Santana Localization Office carefully monitored SVW's sourcing practices, and examined the list of parts that SVW was importing either from abroad or elsewhere in China to determine which could be produced by Shanghai factories. To insure that local suppliers were being utilized as fully as possible, they required that once there was local capability to manufacture a particular part, SVW had no choice but to use the Shanghai suppliers.⁸¹ Thanks to the municipal government's support, the local suppliers grew up quickly. Although initially SVW sourced 80 percent of a particular component outside of Shanghai, by 1997, approximately 90 percent of parts and components for the Santana were manufactured within the municipal borders of Shanghai (see Figure 3.3).⁸²

Figure 3.3 Shanghai Volkswagen Purchasing Volume by Province, 1997

⁸¹ Thun, p. 113-5.

⁸² Thun, p. 71.



Source: Shanghai Volkswagen; Thun, p. 106.

Summary and Analysis

When SVW began production in 1985, it had to address the supply localization. As a big and significant project serving China's goal of automotive modernization, SVW's localization efforts were intervened greatly by Chinese central authorities, and thus more State actors, due to their responsibilities for the auto sector, were involved into the network and exerted power to push the supply localization, such as the SEC and the MOFERT. Shanghai municipal government, thanks to the central government's re-support of Shanghai's development since the mid-1980s, was granted a series of preferential policies and enjoyed increased autonomy in local economic management. Because choosing the auto sector as a prime candidate for

city development, they gave strong backing to SVW. They not only helped SVW out of various difficulties including financial crisis, but also established special fund and government agencies responsible for the SVW project to accelerate the localization of the Santana. Meanwhile, under the pressure and incentives from Chinese central political actors, VW also contributed to the localization job.

In SVW localization process, there still existed conflicts among the actors for specific issues including VW's involvement in the localization and the quality standards of local parts. It is through power that the conflicts were dealt with and the actors' points of view were aligned. China's top leaders – Premier Zhao Ziyang, and Vice Premier Li Peng – and Vice-president of the SPC, President of CNAIC, and Zhu Rongji, then Vice-director of the SEC, all urged and forced VW to contribute to the SVW localization. Although according to the SVW JV agreement, VW had no obligation to hasten the localization process, under Chinese political actors' power, VW had to engage in this process. Again, the dispute on quality of local parts between VW and Shanghai municipal authorities did not end until Zhu Rongji was appointed as Shanghai's mayor in April 1988 and exerted his political power to ask the local suppliers to follow VW's quality standards.

Furthermore, Chinese central government as the policymaker also launched a series of policies and plans to stimulate SVW's development, such as control and management of auto imports, and tariffs. Shanghai municipal government, took advantage of their administrative and fiscal power not only to support the development of local suppliers, but also to identify and define the suppliers of SVW for the purpose that more parts and components manufactured within the

municipal borders of Shanghai were used by SVW. Although they committed themselves to the SVW localization for different reasons, the interactions and negotiations among Chinese central authorities, Shanghai municipal actors, and VW through the intermediary of *power* finally caused the dramatic development of local supplies industry since the late 1980s, by which more Chinese suppliers, especially a number of Shanghai suppliers, were enrolled into the network.

Chapter 4 Volkswagen and Their Created Market

Since the mid-1990s, along with the deepening of the reform of the economic system,¹ the liberalization of economy was increasingly extended and the situation of the auto industry has changed greatly. State plans and allocation of resources have gradually been replaced by market mechanisms. Rather than direct intervention in the management of enterprises, the governments (both the central and local ones) mainly through policy-making indirectly macro-controlled economic activities.² They have reduced the categories of products for planned production, eliminated the restriction that enterprises were only allowed to engage in production but not in business operation, and abolished the practice of the state fixing of prices.³ As a result, the rights of enterprises to purchase, produce and sell have been extended, and enterprises have had their own economic decision-making powers and independently undertook the risk of their decisions. Meanwhile,

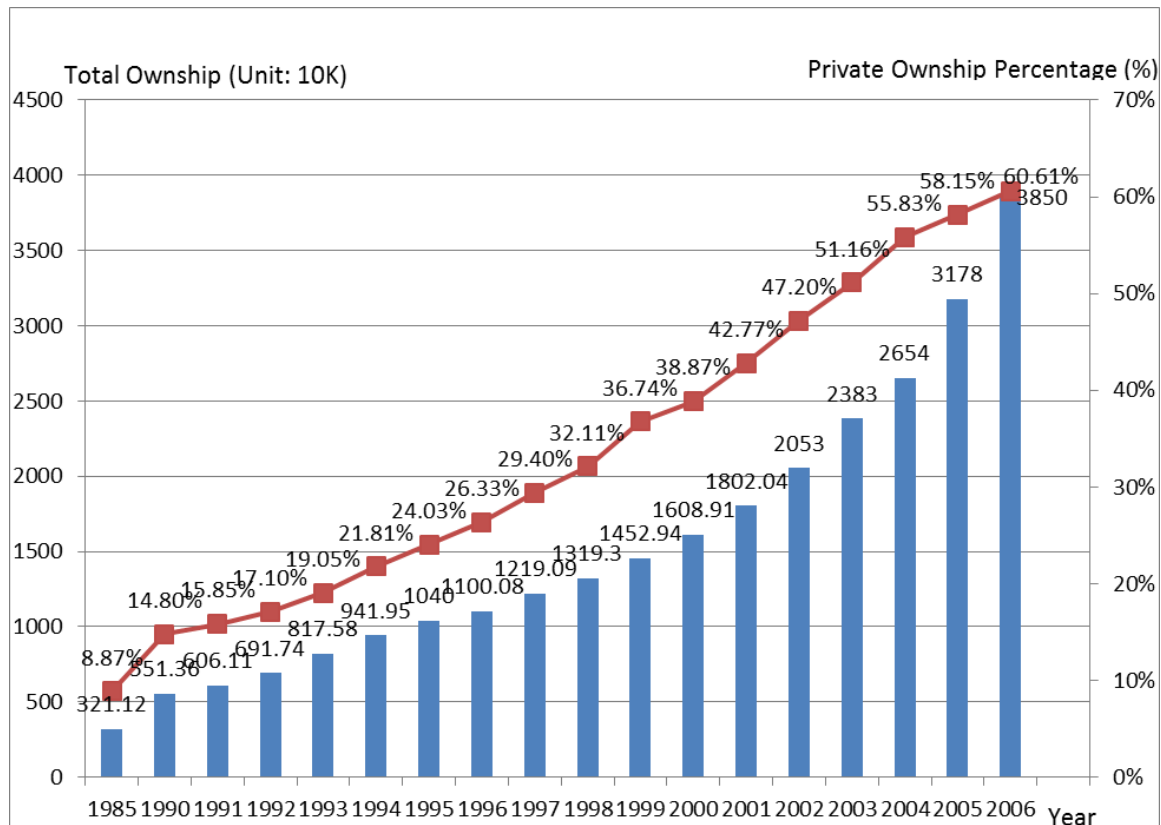
¹ In October 1992, at the 14th National Congress of the Chinese Communist Party, President Jiang Zemin delivered a report which outlined the major tasks in economic and social development for the 1990s, and at the first time declared that the aim of China's economic reforms was to transform the highly centralized planning economy to the socialist market economy in which the regulatory function of the market would be strengthened considerably. For more information about socialist market economy, see Xi Jieren et al., ed., *Shehui Fazhanguan Baike Cidian (Encyclopedia of Scientific Development)*, (Shanghai: Shanghai Cishu Press, 2007).

² In SVW case, the CNAIC was reformed into a large State-owned enterprise without political functions in 1993, while the SAIC did the same reform in 1995.

³ For example, since the mid-1990s, SVW has taken charge of sales of its own cars. In 1994, the SPC announced that car manufacturers were permitted to adjust the retail price of their products taking the state-stipulated upper limit into consideration. See "Zhongguo Guochan Qiche Jiage Quanmian Fangkai" ("Liberalization of China's Domestic Car Price"), *Asian Times* June 29, 2001.

benefiting from the post-1978 reforms, the Chinese new rich groups began to emerge during the 1980s. They entered the car market and became private car owners in the early 1990s. Since the end of 1990s, the Chinese private car owners gradually became the major consumers in the car market (see Figure 4.1). As important actors, they were involved in the shaping of the auto market. In China, the real competitive car market evolving from the state-planned one was being established, and almost has been in place by the early 2000s.⁴

Figure 4.1 Ratios of Private Car Ownership among Overall Car Ownership in China, 1985-2006



⁴ On July 12, 2005, Ma Kai, then director of the National Development and Reform Commission, announced at a high-level reform forum in Beijing that China has basically completed the transition to the socialist market economy from highly centralized planning economy after 26 years' endeavor on reform. See "China Has Socialist Market Economy in Place," *People's Daily online* July 13, 2005.

Source: National Bureau of Statistics of China⁵

This chapter together with the next following one aim to examine that in the course of Chinese car market's transformation from the centralized planning one to the highly competitive one, how VW cars' market growth was influenced by socio-cultural factors, what actors were involved in shaping the SVW development, how they were involved, and how they interacted with each other. This chapter focuses on the period of the early 1990s and the mid-1990s, while leaves the examination of the period between the late 1990s and the early 2000s to the next chapter. It is divided into three parts. The first part offers an account of the representations of the car in China's history for the purpose of providing the context of Chinese culture of car ownership and consumption. It explores what images of the car the Chinese held and how the images changed with China's social transformation. The second part looks at how VW contributed to promotion of its car consumption in China, and how the Volkswagen first consumers' social class and positions shaped the Chinese images of VW cars, which further influenced VW cars' market growth. The last one focuses on the examination of how the private VW car ownership emerged in China in the 1990s. Base on the analysis of the social stratification and the structure of China's new rich social groups which resulted from the economic reforms, it presents a picture of who the first private car owners were, why they became VW car owners, how the social and cultural factors influenced their consumption behavior, and how their consumption shaped VW cars.

⁵ Data available online: <http://www.stats.gov.cn/tjsj/>

4.1 The Changing Representations of the Car in China

In China, the passenger car, especially sedan, is called *Jiaoche* (轿车). Although none of the existing Chinese dictionaries provides interpretation of why the car was translated into *Jiaoche* and of whom did this, some historical research⁶ has shown that the name of *Jiaoche* came from the car's first use in China. In 1901, Yuan Shikai, then the governor of Zhili Province, purchased a German-made car as a gift to celebrate the birthday of Empress Dowager Cixi (see Figure 4.2). Since never seeing the car, Cixi was very curious about it and asked for the name. The ministers knew that Cixi was ambitious about power, and her usual transportation means was *Jiaozi* (轿子)⁷ which was always used by the powerful and wealthy figures in China (see Figure 4.3), so they gave the car the name *Jiaoche*, literally a *Jiaozi* on wheels.

Although the car could drive Cixi everywhere she wanted and faster than *Jiaozi*, Cixi could not bear that the driver sat in front of her, which let her feel that her power and superior status were challenged. In her view, the driver as her servant should kneel in front of her, but in that case, the driver could not work. So, she abandoned the car and used *Jiaozi* again. This historical interpretation makes it clear that the car, since its entry in China, has been given the sign of power.

⁶ Xiao Shengfa et al. ed., *Qiche Wenhua (The Automobile Culture)*(Beijing: Mechanical Industry Press, 2009), p. 30; Shi Gong, "Zhongguo de Xiaoche Wenshenme Jiao 'Jiaoche'?" ("Why Is the Car Named 'Jiaoche' in China?"), *Renmin Net* November 2, 2009.

⁷ *Jiaozi*, if translated into English, is called "sedan chair." Most of sedan chairs are made of wood, bamboo, rattan, etc. They can be lifted by two persons, four persons, eight persons or even sixteen persons.

Figure 4.2 The Car as A Birthday Gift for Cixi, 1901



Source: <http://www.jcauto.com.cn/2009/0918/31851.html>

Figure 4.3 Cixi's *Jiaozi*



Note: Cixi (center) sitting in her *Jiaozi* which was lifted by eight servants.

Source: <http://our80s.com/history/detail.asp?ID=2826>

Although the car was not accepted by Cixi, it still took a root in China. In the early twentieth century, despite the high price of the car due to importation, the Chinese car ownership increased quickly. Take Shanghai as an example, in the year of 1901, there were only two cars in the city. But by 1911, the car ownership amounted to 1400, and during the 1930s, approximately 30,000 cars ran in Shanghai, including the vehicles used by the foreigners in concession areas.⁸ The car, in some Chinese eyes, stood for the modern civilization. Hu Shi (1891-1962), one of the leading and influential intellectuals during the New Culture Movement (between the mid-1910s and 1920s), gave a speech in the 1920s.⁹ He criticized that the Chinese were still using the rickshaw, which showed China was not a civilized country, and argued that the number of cars demonstrated the degree of civilization. Liang Desuo (1905-1938), the editor-in-chief of the journal *Da Zhong (the People)*, also called for the use of the car and abolishment of the rickshaw in modern China.¹⁰ Since in the early twentieth century, cars as luxury goods were only afforded and owned by Chinese ultra-rich and high-ranking governmental officials, the car was always linked with power and wealth, and used to show the owner's high social status. Representing its owner the car enjoyed privileges on the road, and never yielded pedestrian. Even if it crushed any poor pedestrian to death, its owner did

⁸ Xu Maochang, "Bidi Feichu de Chesheng Lunying" ("Cars and Wheels in Words"), *Shanghai Chengshi Daobao (Shanghai City Guide)* June 19, 2009.

⁹ Ibid.

¹⁰ This argument was in his article "Shanghai de Niaokan" ("The Bird's Eye View of Shanghai"), *ibid.*

not pay any criminal penalty but some money. So, in the poor people's words, "We hate cars... [the car] crushed a poor child to death like killing a dog."¹¹

In popular culture of the early twentieth century, the car was frequently employed in critiques of its owner – the bourgeois and their materialistic lifestyle. The contemporary novelist Zhang Henshui (1895-1967), whose works emphasized realistic description, often interposed people from different social strata, and thus were highly popular amongst the Chinese public from the 1920s to 1940s, attacked fiercely against the wealthy elite's luxury life in his novel *Zhi Zui Jin Mi* (*Wanton and Luxurious Living*).¹² Based on a story of how a low-level government staff's wife dreamed of the wealthy life and tried to realize her dream at the price of her family but finally lost everything she had, Zhang criticized the corrupt bureaucrats and capitalists whose only interest was in material advancement and the luxurious comfortable life; they ignored the suffering of the poor and dismissed the contemplation of spiritual and intellectual matters as a waste of resources. In Zhang's words, the lifestyle the haute bourgeois enjoyed was to dress in superior quality clothes, sit in the imported car, and go to the big house to play the game of Majiang,¹³ served by many servants, and surrounded by the beautiful women. The car thus became a metaphor for haute bourgeois materialistic life, which not only appeared in literature and film during the period of 1920s – 1940s (see Figure 4.4),

¹¹ Cited from the novel of Mu Shiyong (1912-1940), "Zanmen de Shijie" ("Our World"), *Xin Wenyi* (*New Literary*) Vol.1, No.6, February 15, 1930.

¹² Zhang Henshui, *Zhi Zui Jin Mi* (*Wanton and Luxurious Living*), (Beijing: Renmin Wenxue Press, 1987).

¹³ Majiang is a popular four-player game that originated in China. It is always played as a gambling game although it may just be played easily for recreation.

but also was adopted by the Chinese Communists for the political purpose in a series of socialist campaigns after the foundation of new China.

Figure 4.4 The Car and Its Owner in 1932



Note: Zhang Zongchang (third from right), then governor of Shandong province, a warlord and corrupt bureaucrat, proudly posed with his car, friends, women and servants (standing on the rear of the car) in 1932.

Source: Jinan Dang'an Xinxu Wang (Jinan Archive Net)¹⁴

Since the CCP came to power in 1949, the Chinese communists began undertaking the socialist transformation of the economy, and had gradually nationalized the bureaucratic property and the privately owned productive assets

¹⁴ Available online:

<http://www.jndaxxw.gov.cn/dangan/zhuanti/jinanjiuying/suiyuelueying/sy/114-3.asp>

by the mid-1950s.¹⁵ The cars that were owned privately before also became national property. Those cars, plus the ones offered by foreign friends as gifts¹⁶ and coming from the war looting,¹⁷ were used only by the high-ranking government leaders. When China began producing its own cars in the 1950s, the cars only supplied some governmental needs, because private car ownership was prohibited. Even the high-ranking officials did not own the cars, and all of the cars were state-owned and just assigned to the officials for their job's requirements. Such prohibition of private car ownership had to do with the Chinese communist's ideologies of private property during the period of the 1950s-1960s. According to the 1956-version *Chinese Communist Party Constitution*, the CCP aimed to achieve the highest ideal of communism that was total public ownership.¹⁸ This created the

¹⁵ Sha Jiansun, ed., *Zhongguo Gongchan Dang he Ziben Zhuyi, Zichan Jieji (The CCP and Capitalism and Bourgeois)*, (Jinan: Shandong Renmin Press, 2005).

¹⁶ In 1950, Stalin gave the Chinese communist leaders several sedans made in Soviet Union as gifts. See Yang Dongxia, "Mao Zedong Zuoche Chuanqi Jianzheng Zhongguo Minzu Qiche Gongye Fazhan" ("Mao Zedong's Car Legend Witnessed the Development of National Auto Industry in China"), *Guoji Online* November 21, 2005.

¹⁷ Xiaoli, "Qiche Heshi Jinru Zhongguo" ("When the Car Was Introduced in China"), *JCAUTO* September 18, 2009.

¹⁸ Communism in theory stands for total public ownership and rejects private property and personal profit. According to Marxism, "Private property must, therefore, be abolished and in its place must come the common utilization of all instruments of production and the distribution of all products according to common agreement – in a word, what is called the communal ownership of goods. In fact, the abolition of private property is, doubtless, the shortest and most significant way to characterize the revolution in the whole social order which has been made necessary by the development of industry – and for this reason it is rightly advanced by communists as their main demand." See Karl Marx and Frederick Engels, *The Communist Manifesto* (Signet Classics, 1998), Section "The Principles of Communism."

Chinese communist's two different approaches to public property¹⁹ and private property, namely, the inviolability of public property, but the neglect of private property and even banned private property.²⁰ Moreover, the CCP advocated a radical egalitarianism and tried to reduce socioeconomic inequalities. But the presence of private property easily generated inequality. So, owning personal cars during this period not only violated the communist belief of total public ownership, but also meant standing apart from the egalitarian socialist community, and thus was not permitted.

Meanwhile, the Chinese communists took advantage of the central-controlled media including the newspaper *People's Daily* to propagate their idea that driving the personal car represented a clear sign of bourgeois lifestyle. The CCP always reminded the people of the on-going class struggles between the bourgeois and the proletariat in the field of ideology, and asked the Chinese to work hard for the socialism and keep away from the bourgeois lifestyle pursuing luxury and leisure. The car in the political movements played a symbolic role in the communist criticism of the bourgeois, which especially popularly appeared in literature and film in the Cultural Revolution (1966-1976). Under such propaganda, even the use

¹⁹ Public property refers to the property owned by the state or the collective and dedicated to the use of the public. It is in contrast to private property owned by an individual person.

²⁰ See the *Chinese Communist Party Constitution*, adopted at the 8th CCP National Congress, September 26, 1956, Chapter Introduction. The official copy is available online: http://news.xinhuanet.com/ziliao/2002-03/04/content_2391956.htm; Zhang Jian, "Hefaxing he Zhongguo Zhengzhi" ("Legitimacy and China's Politics"), *Zhanlue yu Guanli (Strategy and Management)* Vol. 5, 2000. Since 1921 when the CCP was born, the *Chinese Communist Party Constitution* has been revised or amended seventeen times.

of the official cars was strictly controlled, and those who were entitled to use cars could only use them for work and socialist construction. Any use for personal errands or showing off the privileged living conditions was forbidden and regarded as the survival of bourgeois lifestyle. For example, in 1966, two letters by foreign friends were sent to Beijing complaining that the officials of Chinese embassies and consulates abroad were living in big houses and driving the luxurious cars. On September 9, 1966, as a response to the two letters, Mao Zedong gave an instruction to Chen Yi, then minister of the Ministry of Foreign Affairs, asking him to do a revolution in Chinese embassies and consulates abroad, pushing the officials and staff to abolish the old bourgeois lifestyle and to hold the proletarian austerity tradition. In September 11, the party committee of the Ministry of Foreign Affairs sent an order “Puo Sijiu, Li Sixin” (“Abolish the Four Old Things, and Adopt the Four New Things”) to the embassies and consulates calling for “hard work and plain living,” restricting their lifestyle, and limiting the use of cars.²¹

Due to the CCP’s strict regulation of the car use, during the pre-reform period, the Chinese public had the impression that in China the car only served the high-ranking officials for the socialist construction. Since the Chinese communist leaders enjoyed high respect by the people, the car used by them became the symbol of the prestige, and was always linked with the proletarian revolution and socialist construction, which was shown in media of the 1950s and 1960s (see Figure 4.5).

²¹ Zou Yimin, “Yixiang Mao Zhuxi dui Waijiaobu de ‘Jiujiu Pishi’” (“Chairman Mao’s ‘September 9 Instruction’”), available online: <http://www.wyzxsx.com/Article/Class14/200909/102003.html>

Figure 4.5 The Car for the Socialism in the 1950s



Note: On June 20, 1958, the workers in the Beijing First Automobile Accessories Factory proudly and gladly saw the first car they made (actually a modification of VW Beetle) was driving to Zhong Nan Hai where the central government was located for the use by central leaders, which was regarded by them as their contribution to the China's socialist construction.

Source: Taiping Yang Qiche Wang (Pacific Auto Net)²²

²² Cited online: http://news.runsky.com/2009-09/08/content_3380693.htm

The Chinese communist's image that the person car was a luxury good and stood for the bourgeois life was alive in China until the mid-1980s. When the SVW project was in negotiation during the early 1980s, some authorities wrote to the State Council, and argued against the project. The idea they held was that car consumption was "capitalist tail", and not what China needed.²³ However, with economic reforms and the Open Door policy going further, China was more closely linked to the world market. Especially that its neighbors Japan's emergence as an industrial superpower and South Korea's economic growth had all come to be associated with the development of large auto industries made the Chinese communists realize that the mass-produced automobile was a key attribute of industrialization and economic development. Then a number of the auto JV projects including SVW, Beijing Jeep, Guangzhou Peugeot, and Tianjin Daihatsu were established in the mid-1980s. On September 23, 1985, the CCP's National Congress issued "Guanyu Qiwu Jihua de Jianyi" ("Suggestions on the Seventh Five Year Plan") which claimed that the auto industry was one significant pillar industry of national economy, and should be developed quickly.²⁴ This point was confirmed and announced officially in the Seventh Five Year Plan (1986-1990) launched in April 1986. Hence, car production got strong support in China and the Chinese images of the car began to change. In the 1990s, China's economic reforms were speeding up and the Chinese living standards became higher so that the new rich social groups who could afford and also had desire for cars emerged. In 1991, the call for

²³ Xu Maochange, *Chelun shang de Shanghai (Shanghai on Wheels)* (Shanghai: Shanghai Joint Publishing Co., 2007), p. 156.

²⁴ The official copy is available online: <http://www.docin.com/p-23544284.html>.

development of private car ownership appeared in the influential official newspaper *Jingji Ribao* (Economic Daily). A series of articles charted a new path for car production. They pointed out that in order to promote car production, China should develop a private car market rather than only depend on the existing purchasers – namely, government officials.²⁵ In July 1994, the State Council launched China’s first *Automobile Industrial Policy*. In this policy, it was the first time that the Chinese government clearly encouraged the private car ownership,²⁶ and stated: “any locality and department should not employ administrative and economic means to intervene in the personal purchase and use of legitimate vehicles; rather they should take positive measures in the license management, parking, gas stations, driving training schools and other facilities and systems to provide support and protection.”²⁷ The personal car thus completely got rid of the symbol of the bourgeois lifestyle, and became a legitimate commodity in China.

4.2 Shanghai-Volkswagen as a Pioneer in Chinese Car Market

When VW entered China in the mid-1980s, what it was faced with was a virgin market – no competition, no individual consumer, and everything about production and sale was state-planned. SVW not only had to produce the number of cars the state specified, and needed to request the approval by the central government if they wanted to increase volumes, but also had no chance to handle the retail price

²⁵ Cited in *China Daily* (North American ed.) June 29, 1991, p. 4.

²⁶ China State Planning Commission, *Automobile Industrial Policy*, July 1994, Clause No. 47. The full text is available online:

<http://business.sohu.com/2004/06/02/31/article220353167.shtml>

²⁷ Ibid. Clause No. 48.

and sales of their cars. They only provided the ex-factory price, and SAIC, according to the state stipulation about the upper limit for the retail price, was responsible for the price setting.²⁸ SAIC also controlled sales of the Santana produced by SVW. SVW turned over almost all of their Santana cars to SAIC, and SAIC turned over all the cars to the Commodity Administration Bureau (CAB) until 1988.²⁹ CAB, as a goods distribution office that belonged to the central government, officially allocated the cars to provinces and cities, based on an official plan.³⁰ The cars finally filtered down to the local level and were sold to authorities, taxi companies or other state-owned enterprises (SOEs). After 1988, however, due to the fiscal and administrative reforms by increasing fiscal decentralization to the localities and enterprises, the turn-over rate to the central government decreased to 20 percent, leaving 80 percent of the cars to be sold by SAIC itself.³¹ Since the mid-1990s, along with the strengthening of market economy and the decrease of the state planning, SVW has taken charge of sales of its own cars. Although in 1994, the SPC announced that car manufacturers were permitted to adjust the retail price of their products taking the state-stipulated upper limit into consideration, most of Chinese carmakers relied on market situation for price setting.³²

²⁸ Martin Posth, *1000 Days in Shanghai* (Singapore: John Wiley & Sons, 2006), p. 145.

²⁹ Chunli Lee, Jin Chen and Takahiro Fujimoto, "Different Strategies of Localization in the Chinese Auto Industry: The Cases of Shanghai Volkswagen and Tianjin Daihatsu," Working Paper for the MIT 1996 IMVP Sponsors Meeting Sao Paulo, Brazil, 9-12 June 1996, p. 8.

³⁰ Posth, p. 148.

³¹ Lee, Chen and Fujimoto, p. 8.

³² "Zhongguo Guochan Qiche Jiage Quanmian Fangkai" ("Liberalization of China's Domestic Car Price"), *Asian Times* June 29, 2001.

According to the JV agreement, it was the Germans in SVW who were in charge of production and technological R&D while the Chinese were responsible for sales,³³ since the SAIC insisted that the Germans did not understand the Chinese market and should stay away from sales.³⁴ But VW never gave up their efforts in marketing. They set up an after-sale and marketing team in SVW, led by Leo Ober, who had successfully established the Volkswagen sales network in Nigeria.³⁵ Based on the principle “Service goes first, sale later,” the team was assigned a task of working out the key issues for building up SVW service network in China, including where and how to set up service stations for the customers all over China, how to organize the spare parts service, how to conduct repairs, which tools needed at the service stations, where and how to find enough companies capable of providing service, as well as how to train the service staff.³⁶ In 1984, SVW began to set up the first service stations and provide a supply of spare parts. By the end of 1990s, it had approximately 500 stations and over 10,000 service workers, and had owned the biggest car service network in China, which even covered the remote regions.³⁷

Meanwhile, VW tried to advertise their products to the Chinese consumers in an unofficial way. On the one hand, they actively held the auto shows and presented the Chinese their new products. In July 1985, SVW’s first auto exhibition in Shanghai

³³ Jiang Tao and Qiu Ke, “Gaige Kaifang Gei Shanghai Qiche Gongye Dailaile Shuguang, Shanghai Dazhong Tanpan zhong Jige Zhuyao Wenti de Huigu” (“Opening and Reforms Shed Lights on Shanghai Automotive Industry, Review of Several Main Issues during the Construction of SVW”), *Shanghai Automobile*, Vol. 12, 1998.

³⁴ Posth, p. 144-5.

³⁵ Posth, p. 149.

³⁶ Ibid.

³⁷ Zuo Zhijian, “‘Zhongcheng Yingxiao’ Dizao Pinpai Bulao Shenhua” (“Loyalty Marketing’ Created the Myths of A Brand”), *21 Shiji Jingji Baodao (21st Century Economic Report)* September 16, 2002.

not only showed the Shanghai-made Santana, but also introduced other model cars produced by VW, which gave the Chinese the first opportunity to see closely the latest cars from the West.³⁸ Although at the time there were some imported Japanese cars running on the road, the Chinese were used to the old models of domestic brands *Hongqi (Red Flag)* and *Shanghai*. The well-designed VW cars attracted the Chinese people greatly. They read the advertising material and queued up for hours in long lines waiting to catch a glance of the modern cars.³⁹ The Germans had clear awareness that in China the government was the major car consumer and hence their marketing required good relations with the political authorities. They tried to keep a stock of model cars for high-ranking officials from the provinces who came to the auto shows to see the cars.⁴⁰ The small gifts made the influential Chinese pleased and let them favor SVW and their cars more.

On the other hand, VW advised the Chinese executives in SVW to spend a lot of money on TV advertising. Between the late 1980s and the early 1990s, no automakers in China paid attention to TV viewers except SVW.⁴¹ The advertising video, which showed that thanks to SVW's existing service network the Santana was driving around China,⁴² was broadcast to the public via the China Central Television (CCTV) channels. The advertising words – “Yongyou Santana, zoubian tianxia dou bupa” (“If you own a Santana, you won't be afraid of going anywhere”) became a

³⁸ Posth, p. 150.

³⁹ Ibid.

⁴⁰ Posth, p. 151.

⁴¹ Yan Guangming, “Dai Yufang Sheji Santana Guanggao Yu Gushi” (“A Story of How Dai Yufang Designed Santana Advertising Words”), *Qiche Ren (Auto People)* June 1, 2009, p. 2.

⁴² The advertising video is available online:

<http://club.autohome.com.cn/bbs/thread-c-207-4297302-1.html>

popular saying at the time. Besides, the Chinese translation of Volkswagen meant “car of the great masses,” which was used by SVW to express its wish to stay with the Chinese people and serve them. Although there existed a car supply shortage in China until the mid-1990s, and SVW enjoyed a pioneer status in China’s car market without any strong competitor in these days, VW still tried hard in advertising campaigns and to please the customer, because they held little skepticism about China’s near-term potential to develop a mass auto market and was prepared for the coming of the much fierce competition.⁴³

VW’s marketing and service efforts successfully made the Santana together with the Shanghai Volkswagen name well known in China. In 1995, when Citroen held an auto show in Shanghai, the citizens went to visit passionately, because they had mistakenly thought that it was the Santana cars that were on show.⁴⁴ Even the customers from Xinjiang province, China’s remote northwest, admired a Shanghai-made Volkswagen, although they had to travel 4,000 miles around from one end of China to the other to pick up the keys.⁴⁵ Since the late 1980s, SVW has grown to be China’s dominant car manufacturer. As of 1994, SVW’s share of car production in China was about 60 percent of the country’s total output of about 250,000 units.⁴⁶

⁴³ See the interview with Stefan Messmann, deputy managing director of SVW in 1992, in “Business Booms for China’s Carmakers,” *Daily Herald* July 29, 1992.

⁴⁴ Yan, p. 2.

⁴⁵ See Reuters report of “China Keeps Careful Watch on Car Production,” *Daily Herald* January 7, 1994.

⁴⁶ Data came from the report “Volkswagen Sees Its China Auto Production Doubling in 2 Years,” *Mountain Democrat* June 8, 1995.

During the period of the late 1980s and the early 1990s, over 60 percent of all passenger cars sold in China were made by SVW.⁴⁷

It should be noted that the SVW's achievements in market growth also came from the contribution of the Santana's first users – the political authorities, taxi companies and other SOEs. Set aside the fact that since SVW began production in 1985, the governments and SOEs have been its major consumers for over one decade, the Santana, when it was used as the official and business car, easily impressed the Chinese public a lot. In the early 1990s, when the rich individuals entered the car market and purchased the Santana as their own cars, some of them kept in mind that the Santana was the car for the leaders, and to own one would let them have the “face” and show off their success;⁴⁸ others also took the consideration that since the Santana was used by the officials, its safety and quality should be good and reliable.⁴⁹ The taxi drivers who used the Santana most were aware of the car's performance and the working of the after-sale service. They also convinced their families, friends, and even the mass media that the SVW's cars and service were both better than other car producers'.⁵⁰ In one word, the first consumers of SVW not only caught most of the Santana's orders, but also gave a big impact on the growth of

⁴⁷ Yan, p. 2.

⁴⁸ See the interviews with the first private car owners in “Qiche Xiaofei de Heibai Niandai” (“The Black-White Years of Car Consumption”), *Xin Kuai Bao (New Bulletin)* March 31, 2009.

⁴⁹ See a survey cited by “Gongwuche Cheng Jumin Xiaofei Fengxiangbiao” (“Official Cars Became the Vane of Private Car Consumption”), *Zhongguo Chanjing Xinwen Bao (China Industrial News)* August 6, 2009.

⁵⁰ See the interviews with the taxi drivers in Yan Guangming, “Santana: Zhongguo Guomin Diyi Che” (“Santana: The First Car of the Chinese People”), *Qiche Daobao (Automobile Guide)* July 28, 2003.

SVW's private market. This point will be given detailed discussion in the next section.

4.3 Chinese Social Stratification and the Emergence of Private Car Owners in the 1990s

Class is back in China. With the post-1978 reforms, China had the new rich groups and the rich-poor division. This section firstly focuses on the examination of what the new rich groups emerging during the 1980s and the early 1990s were, and then analyzes why they became car owners, and how the social and cultural factors influenced their choices of cars.

Chinese Social Stratification until the mid-1990s

Communist ideology of egalitarianism made China one of the most equalized societies in the world until 1978.⁵¹ When Deng Xiaoping was in power, he criticized his former – Mao Zedong's understanding of "egalitarianism," and pointed out "over the past practice egalitarianism, eating 'big pot' is actually a common backward, a common poverty. We are eating this loss."⁵² Deng indicated, "Poverty is not socialism, and socialism should be the eradication of poverty;"⁵³ "Greatest superiority of socialism is common prosperity, which embodies the nature of

⁵¹ MK. Whyte and WL. Parish, *Urban Life in Contemporary China* (Chicago, IL: University of Chicago Press, 1984), p.44.

⁵² Deng Xiaoping, *Selected Works of Deng Xiaoping* (Volume 3) (Beijing, Renmin Press, 1993). p. 155.

⁵³ *Ibid.*, p. 116.

socialism a thing.”⁵⁴ However, the common prosperity is not equal to synchronize rich, equally wealthy; egalitarianism is not socialism either. He called on the whole nation to concentrate on economic development, and allowed some regions and some people to get rich first, for the purpose of achieving common prosperity faster.⁵⁵

Deng started economic reforms by undertaking a household responsibility system in rural areas in 1978. The collective farming popular throughout the Maoist period was criticized to cause rural economic stagnation due to agricultural collectives’ inherent inability to motivate labor. Recognizing a rural household as the basic unit of production, distribution, and consumption, the household responsibility system transferred property rights to individual families in order to provide a greater incentive to labor.⁵⁶ By 1983, the collective farming became history. As autonomous producers, peasant households had residual income rights over their crops, as well as the rights to specialize in farming.⁵⁷ As a result, in the early 1980s, there emerged some “Wan yuan hu” (peasants with annual household income over RMB10,000) who worked hard on the land and became rich first.⁵⁸ Due to the car supply shortage and the state restriction of private car ownership at the time, these rich peasants mostly bought bicycles and motorcycles as their

⁵⁴ Ibid., p. 364.

⁵⁵ See American reporter Mike Wallace interview with Deng Xiaoping in 1986, cited in Patrick Whiteley, “The Era of Prosperity is Upon Us,” *China Daily* October 19, 2007, p. 7.

⁵⁶ Yanjie Bian, “Social Stratification and Social Mobility,” *Annual Review of Sociology* 28 (2002), p. 94.

⁵⁷ Ibid.

⁵⁸ See reports of Xinhua News Agency on April 18 and November 17, 1980; *People’s Daily* January 20, 1983; Cited in Chen Yu, ed., *Zhongguo Shenghuo Jiyi (Memories of Life In China)*, (Beijing: China Light Industry Press, 2009).

transportation means.⁵⁹ Meanwhile, along with the decollectivization of agricultural production, a host of restrictions were lifted on nonfarm activities. Peasants were given rights to free themselves from land to work locally or elsewhere for higher income from a nonagricultural job,⁶⁰ which caused the township and village enterprises (TVEs), built on commune and brigade enterprises in the pre-reform period, to grow out of rural economic activities and perceptions of spare labor. These enterprises were led often by the former enterprise managers or local leaders who were able to mobilize their fellow villagers and had close contacts with local government agencies and banks.⁶¹ Since under the centrally planned economy, the authorities favored the SOEs and regarded the TVEs as “non-standardized,” the TVEs stayed the margin of the state planning system and enjoyed freer business environment than SOEs.⁶² They obtained all production resources from the market, used independent distribution and supply channels, and were solely responsible for profits and losses.⁶³ Through the 1980s and 1990s, TVEs operated successfully and gradually became the mainstay of the collective sector of the economy. Although most of TVEs were theoretically collectively owned and managers were not owners of the enterprises, many collective TVEs ran as private enterprises in practice, and

⁵⁹ Ibid.

⁶⁰ Bian, p. 94.

⁶¹ David Goodman, “Why China Has No New Middle Class: Cadres, Managers and Entrepreneurs,” in David Goodman, ed., *The New Rich in China: Future Rulers, Present Lives* (NY: Routledge, 2008), p. 28.

⁶² Y. Fan et al, “Chinese Peasant Entrepreneurs: An Examination of Township and Village Enterprises in Rural China,” *Journal of Small Business Management* 34 (1996), p. 71-76.

⁶³ Ibid.

managers behaved economically and socially as if they were owners.⁶⁴ With the success of TVEs, especially during the late 1980s and the early 1990s, the managers became much richer than the peasants who worked on the land. They grew to be one group of the new rich in China and afforded private cars.

Urban reforms were implemented later than rural reforms and formally initiated with the landmark “Decision of the Central Committee of the Chinese Communist Party on Reform of the Economic Structure” issued in October 1984. The “Decision” illustrated the socialist economy as a planned commodity economy based on public ownership, but pointed out that China’s socialist encouraged the common development of various economic forms and management methods,⁶⁵ which ignited the rise of “Ge ti hu” (individual businesses) among the unemployed and poor urbanites. These individual businesses developed from nothing based on an innovative idea or perceived market opportunity.⁶⁶ Although they suffered from the state restrictions and were limited in handicrafts, repair, and other service trades in the early 1980s, some individual business people earned their first RMB10,000 for future investment.⁶⁷ With the decentralization of fiscal system, since the mid-1980s, local governments have been given more financial incentives to develop local economy. Then many individual businesses, thanks to the local government support, developed into private enterprises, and by the early 1990s,

⁶⁴ Christine Wong, “Interpreting Rural Industrial Growth in the Post-Mao Period,” *Modern China* 14(1988), p. 3-30; Goodman, p. 28.

⁶⁵ Chen Yanbing and He Wuxing, ed., *Zhongguo Weihe Ruci Chenggong (Why Is China So Successful)*, (Beijing: Zhongxin Press, 2008), chapter 19.

⁶⁶ Goodman, p. 29.

⁶⁷ Xiaowei Zang, “Market Transition, Wealth, and Status Claims,” in David Goodman, ed., *The New Rich in China: Future Rulers, Present Lives* (NY: Routledge, 2008), p. 62-63.

have been found in all industrial sectors and activities, including mining and heavy industry, as well as light industry, processing, retail and service industries.⁶⁸

Although in general, most private enterprises remained small-scale, the owners became a part of the new rich in China.

What's more, in 1985, the central government allowed some enterprises which had fulfilled their planned production quotas, to sell their surplus output at market prices, while their planned quota production was sold at state-set prices.⁶⁹ This brought about a dual-track price structure in which the same commodities were priced differently between the planned economy and the market. For example, in 1988, one ton of steel sold for RMB700 in the state sector and RMB1,500 in the market.⁷⁰ Under such price structure, many individuals found an efficient way of profit making – to pocket the price differences between the state sector and the market. This business did not require capital or technology, and involved little substantial risks because of the strong demand in the market. The key was the ability to obtain official quotas from the government.⁷¹ Then, during the middle and late 1980s, many individuals operated this lucrative business – it is estimated that about 41 million people participated in business activities related to the dual-track price structure by 1988.⁷² Some of these profiteers were individual business people, some were those well-educated and quitting the job at SOEs, and others even coming from government offices. These officials either had quit their government

⁶⁸ Goodman, p. 29.

⁶⁹ Zang, p. 63.

⁷⁰ Ibid.

⁷¹ Ibid.

⁷² Zang, p. 63-64.

positions for the business or still worked in the offices for the profit, but they all took advantage of their political and social capitals to earn profit for themselves, which caused government corruption to prevail.⁷³ Since the early 1990s, along with China's economic transition to the market system, the dual-track price structure was gradually eliminated. Some profiteers then used their capitals obtained from the price business to set up their enterprises and became rich private entrepreneurs.⁷⁴

China's New Rich and Their Cars

Although the above new rich groups owned much more wealth than the majority of the Chinese, they did not receive a great deal of public esteem for their economic performance through the 1980s and 1990s. It is not always the case that "To get rich is glorious" as Deng Xiaoping proclaimed. The reasons for this are as follows.

For the TVEs, almost all of the employees came from the rural areas. Due to the rigid household registration system (*Hukou*) implemented since the 1950s, the peasants did not receive the same rights as city dwellers. They were completely cut off from many urban privileges – compulsory education, quality schools, health care, public housing, varieties of foodstuffs, etc.⁷⁵ Although both of the central and the local governments have done some Hukou reforms since the mid-1990s and largely relaxed restrictions, Hukou is still limiting the rural people and depriving

⁷³ Zang, p. 64; Bian, p. 96.

⁷⁴ For more information, see <http://baike.baidu.com/view/653911.htm>; Wang Zhigang, *Di Sanzhong Shengcun (The Third Survival)*, (Chengdu: Sichuan Fine Arts Press, 2005).

⁷⁵ Bian, p. 93.

their rights of access to some social benefits and public services.⁷⁶ The unfair Hukou system thus brought about the decades-long urban discrimination against the rural, and the peasants' perception of having a lower status than city dwellers, although some peasant entrepreneurs owned more money than the majority of the urbanites. Besides, Chinese economic structure created a status distinction between state workers and collective workers.⁷⁷ The SOEs, as the mainstay of Chinese economy, enjoyed privileges and social esteem unavailable to the collective sector as well as the private businesses. Compared with the SOEs, private enterprises, same as the TVEs, were marginalized by the state planning system. Although they enjoyed market-orientation in business operation, neither owners nor workers received many SOEs employee's privileges such as career prospects, job security, subsidized housing, and an impressive array of insurance and welfare benefits.⁷⁸ Therefore, in the 1980s and 1990s, state workers as the main contributors to national economy enjoyed a higher status than the collective workers and private entrepreneurs.

Moreover, most of individual businesses were built up by the unemployed urbanites at the time who had poor educational background and humble origins.⁷⁹ Many Chinese pointed out that only those without a better alternative would start an individual business.⁸⁰ These business people often relied on trade speculation to make profits, including the dual-track price business, which was viewed by the public as improper money collection and making an unreasonable profit. The public

⁷⁶ Ran Tao, "Achieving Real Progress in China's Hukou Reform," *East Asia Forum* February 8, 2010.

⁷⁷ Bian, p. 93.

⁷⁸ Zang, p. 62.

⁷⁹ Ibid.

⁸⁰ Ibid.

called the persons undertaking the price business as “Daoye” (profiteers), and the involved officials as “Guandao” (official profiteering), the terms of denigration. The activities of quitting the job in the state sector or the government and participating in the business were called “Xiahai” (jumping into the sea), and often belittled by the public for giving up a high status for economic payoff. So, in one word, the new rich groups emerging in China through the 1980s and 1990s did not feel much glorious, and due to the influence of social and economic factors, they earned money but no public respect, which greatly shaped their car consumption.

Since the 1950s, the Chinese public image of the car was always linked with leadership until the late 1990s when private cars increased quickly. Setting aside the taxi, when the public saw a car, they would instantly have an idea that it must belong to a leader of the government or of the SOE. It was this image that drove the new rich to pursue a car in the days when private cars were scarce in China, because they needed the car to show off their success and make up their social status. In the late 1980s, due to the car supply shortage and the state-planned sales, only a few individual business people bought cars when they had money. But they only afforded some old models such as *Shanghai* sedan and those imported from Russia in the 1970s like Volga and Lada.⁸¹ These cars were sold for about RMB10,000

⁸¹ Zhang Lijuan, “Di Yipi Sijiache zai Anshan” (“The First Private Cars in Anshan”), *Qianshan Wan Bao (Qianshan Evening News)* November 14, 2008; “1986 nian 11 yue Xin Zhongguo Di Yizhang Sijiache Paizhao zai Shanghai Dansheng” (“The First Private Car Plate in Shanghai in November 1986”), available online: <http://www.simsii.org/post/27.html>

compared with the Santana for almost RMB20,000.⁸² Despite old models, the cars already brought big “face” to their owners. As one individual businessman recalled, when he showed his car to his neighbors, some of them admired him and said, “Look, how you are successful! You have a car!”⁸³ He also found the car was helpful for his business because people always mistakenly recognized him as a very important person when he sat in his car. In the early 1990s, with the increase of car production volumes and the relaxation of the state control of private car ownership, there were more rich entrepreneurs becoming consumers in the car market. Meanwhile, during this period, a number of auto JVs and domestic automakers entered the car market and provided more models. For example, Dongfeng signed PSA Peugeot Citroen in May 1992 and began producing *Fukang* sedan; FAW-VW was established in 1991 and offered Jetta A2; and Tianjin Mini Car Factory cooperated with the Japanese Daihatsu Motor to provide Xiali series sedans which were based on the Daihatsu Charades. But not all cars were equal in the eyes of Chinese consumers. The rich entrepreneurs preferred the Santana and the imported cars if they could afford them,⁸⁴ because at the time, about 70 percent of official and

⁸² Yan Guangming, “Dai Yufang Sheji Santana Guanggao Yu Gushi” (“A Story of How Dai Yufang Designed Santana Advertising Words”), *Qiche Ren (Auto People)* June 1, 2009, p. 2.

⁸³ Qu Jiayi, “1986 Shoupi Sijiache Dingzhe Xianmu Shanglu” (“The First Private Cars Were in Admiration in 1986”), *Xin Shang Bao (New Business)* October 29, 2008.

⁸⁴ “Santana zai Zhongguo Chuangzao Qiji” (“Santana Created Brilliance in China”) *Dongbei Wang (Northeastern Net)* September 28, 2009, available online: <http://auto.dbw.cn/system/2009/09/28/052135143.shtml>; Li Anding, “Jianzheng 30 nian: Sijiache 0 dao 1000 wan de Jubian” (“Witness of the Change for 30 Years: Private Cars from 0 to 10,000,000”), *Xinhua News* November 27, 2008.

business cars were the Santana,⁸⁵ and due to the high tariff, only high-ranking leaders and large SOEs could use imported cars.⁸⁶ The new rich, since their fortune was not always appreciated by their neighbors, bought these cars for public respect. One private Ford car owner recalled that every time when he drove his Ford sedan through the downtown, people would yield the car because they thought there must be a big leader in the car.⁸⁷ One private entrepreneur said frankly that his intention of choosing the Santana as his first car was to enjoy the public admiration and esteem the leaders had but he never received. When he sat in his Santana, even the policemen saluted him.⁸⁸ With many rich entrepreneurs owning the Santana cars, the Chinese image of the Santana changed and increasingly was also linked with wealth. In the early 1990s, there was a popular saying: the rich man “drives the Santana, and uses Dageda.”⁸⁹ The image that the Santana was the car serving the leaders and the rich lived on and further affected the private car consumption in the late 1990s and the early 2000s, which will be discussed in the next chapter.

⁸⁵ He Qiuhui, “Shanghai Dazhong Zhongguo Jiaocheng Zhang de Yaolan” (“SVW the Pioneer of China’s Car Industry”), *Tengxun Net* September 8, 2009, available online: <http://auto.qq.com/a/20090908/000165.htm>; also see <http://auto.ifeng.com/roll/20090907/99223.shtml>

⁸⁶ Li Anding, 2008.

⁸⁷ Zhu Xingen, “Songzou Hongse Ford, Gengai Zhongguo Chery” (“Sell the First Red Ford for China-made Chery”), *Dajiang Wan Bao (Dajiang Evening News)* July 14, 2008.

⁸⁸ “Qiche Xiaofei de Heibai Niandai” (“The Black-White Years of Car Consumption”), *Xin Kuai Bao (New Bulletin)* March 31, 2009.

⁸⁹ Dageda is the first generation cell phone in China. In the early 1990s, the phone was sold for about RMB20,000, plus the high service fees, so only the rich people could afford Dageda. See “90 Niandai Zuiniu de Zhuantou: Dageda” (“Dageda, the Most Expensive Brick in the 1990s”), *Dongfang Wang (Eastern Net)* December 2, 2009, available online: <http://auto.eastday.com/auto/08auto/jdzt/wdjd/1991/u1a144244.html>

Summary and Analysis

In the SVW's early marketing story, three actors played important roles: the first is Chinese central government. They firstly influenced mass-production of cars and car ownership by shaping the relevant ideological environment. Because private car ownership was defined by the CCP as violation of total public ownership and symbol of the bourgeois lifestyle, in the pre-reform period, not only was passenger car production very limited compared with truck and other vehicles heavily dominating auto manufacture, but also to own a car was associated with the bourgeoisie signaling separation oneself from the socialist community and thus was prohibited. Since 1978 when economic reforms started and the Open Door policy was adopted, Chinese central government began changing their ideologies for cars and encouraging car production for economic development. In 1994, they issued China's first *Automobile Industrial Policy* which firstly and clearly encouraged the private car ownership to make the car become a legitimate commodity in China. Secondly, they identified and defined the first-generation consumers of SVW. Due to China's central planning system, in the 1980s, sales of SVW's products were state controlled and cars were allocated by the government's agencies to three groups – officials, leaders of SOEs, and taxi drivers. In this way, SVW owned its first-generation consumers easily, and these three actors were enrolled into the SVW network by the government.

The second actor is VW. VW led the SVW's efforts to set up the after-sale service network and advertise its branded cars to the Chinese, which successfully made the Santana together with the Shanghai Volkswagen name well known in

China. This greatly contributed to the enrollment of the potential private consumers into the network.

The third one is VW car – the Santana. Since the Santana’s first main users were the political authorities and the SOEs’ managers, the Santana became the car always linked with the leadership and high social status. When China’s new rich social groups benefiting from the economic reforms began increasingly entering the auto market in the early 1990s, the new rich consumers, due to lack of public respect, pursued the Santana for the purpose of earning “face” and showing off their success. In this case, the Santana played as a nonhuman actor enrolling the new rich individual consumers into the network. But this does not mean that the Santana had an autonomous voice. On the contrary, its voice came from its first main users who made it become the signal of power and privilege and thus attract the new rich to be *willing* to enroll in the network for empowerment. Meanwhile, with the new rich enrollment into the network, Chinese images of the Santana changed, and by the early 1990s, the Santana has become the car associated with the leadership and wealth.

Chapter 5 Volkswagen? : Choose or Not?

This chapter explores how social, political, and cultural factors affected the growth of VW car market and the development of SVW during the period of the late 1990s and early 2000s. Primary attention is given to what roles the Chinese central authorities, VW, and Chinese consumers played in the course of SVW development. This chapter is divided into three parts. The first part looks at the Chinese central government's new strategies and tactics for developing the auto sector in its policies, and the impact of these auto policies on the investment strategies of world-leading automakers in China, which thereby shaped the environment of SVW development. The second part focuses on the coupling between VW cars and their user markets, and provides an analysis of how VW tried to acquire success in highly competitive China's auto market by doing interaction with Chinese users. The last part examines how the political actors, as the biggest car buyers in China, their official car consumption behavior affected the direction of the public consumption, and how the choices of cars by Chinese consumers were shaped by the socio-cultural factors, which thus influenced the SVW's market share.

5.1 The Change of Chinese Auto Policy and the Rapid Development of the Auto Industry

This section firstly draws an analysis of what key political actors were involved in

Chinese auto policy making through the 1990s to show how the Chinese central government controlled the auto industry via policy-making, then presents the new strategies and tactics in the auto policies, and finally provides a description of the big flow of foreign investment and dramatic auto development influenced by the auto policies.

Central Power in Chinese Auto Policy Making

The second and third chapters have offered an account of how the agents of the central government related to the auto sector were engaged in the SVW foundation and early production in the late 1970s and 1980s. Such direct state intervention, however, had to decrease in the 1990s in order to have China achieve a properly functioning market system. But as an engine of growth for the entire economy, the auto industry was still under the control of the central government. With China's auto industry making the transition from central planning and protectionism to increasing market-orientation operations, Chinese central authorities continued exerting their power in this strategic industry via policy making and implementation.

The State Planning Commission (SPC) responsible for formulating and implementing the national economic plan was in charge of drafting and reviewing policies and regulations for development of the pillar industries including the automotive industry, since the national economic plan and economic policy were

closely intertwined in China.¹ The SPC served as the lead unit to bring together representatives from the economic line ministries of the State Council, other state agencies, and Chinese automakers to establish a broad-ranging joint committee for auto policy consultation. By joining this joint committee, the State Council Production Office, the Ministry of Machine Building Industry, the Ministry of Electronics Industry, the Ministry of Finance, the People's Bank of China, and other relevant ministries including the Ministry of Communications (i.e. transportation), Ministry of Public Security, the CNAIC, the large Chinese state-owned auto companies, Customs General Administration, the National Environmental Protection Agency, and the State Office for Inspections all had been involved in the consultation process for the *Automobile Industrial Policy* launched in 1994.² The SPC collected the consensus view of this consultation body on key problems in formulating and implementing auto policies and relevant economic plans, drafting the policy documents, and then presenting them on behalf of the State Council to the National People's Congress (NPC) or its Standing Committee, for official passage into legislation. After approval from the NPC, the State Council transmitted the documents to the sub-central levels, and line ministries for implementation.

The policy consultation process, since including a number of stakeholders whose interests would be affected by the new auto policy, was not easy and smooth. According to a Chinese planner who took part in the policy review in the early

¹ For more information about principal functions of the SPC, see http://baike.baidu.com/view/667626.htm?fromenter=%B9%FA%BC%D2%BC%C6%CE%AF&fr=ala0_1_1

² Gregory Chin, *China's Automotive Modernization: the Party-State and Multinational Corporations* (UK: Palgrave Macmillan, 2010), p. 133-4.

1990s and the drafting of the *Automobile Industrial Policy* in 1994, this process was “a major coordination challenge.” It was “very difficult” to build inter-bureaucratic and central-local consensus, and “strike the balance point” between the competing sector interests of different ministries and departments, on each and every issue.³ But thanks to several senior leaders who provided their support and instructions for the auto policy review and drafting process, the SPC could play a strong leadership of the joint committee, overcome the collective action challenges that could plague horizontal and vertical coordination in the Chinese governance system, and align the views and wishes of the numerous stakeholders to reach consensus. The first leader backing the auto policy group was Zeng Peiyan, then Vice President of the SPC.⁴ Zeng instructed the relevant officials in the SPC to establish the joint committee, and took personal responsibility to lead this group through the policy review process, which culminated the formulation of the *Automobile Industrial Policy* in 1994. He also oversaw the implementation of the auto policy after it was issued. Zeng had nearly 10-years’ work experience in the Electronics and Machinery Ministries, prior to joining the SPC, and academic training in electrical engineering, so he knew well China’s development needs in the automotive sector. As vice president of the SPC, Zeng was involved in the SPC’s review process for large-scale foreign-investment project proposals, and understood how to deal with foreign capital utilization in the

³ Interview with state planners conducted by Gregory Chin in Beijing in January 2006, see Chin, p. 135.

⁴ Zeng Peiyan was appointed as Vice President of the SPC from 1992-1998 and President of the SPC from 1998-2002. He graduated from the Department of Electronics at Qinghua University, and had positions in the Electronics Ministry and the Ministry of Machine Building Industry from 1984-1992. For more biographic information, see http://news.xinhuanet.com/ziliao/2002-03/01/content_295694.htm

auto sector. Zeng became a member of the CCP's powerful Central Financial and Economic Leading Small Group (CFELSG) in 1992, and soon was named Deputy Director of the Office for the CFELSG. The CFELSG composed of the most senior economic leaders in the Party's Politburo and the State Council, usually five to seven members, gave general priorities and guidelines on China's economic problems. Due to his position in the CFELSG, Zeng not only held powerful coordination mandate in the automotive review and policy drafting process, but also had a chance to win the support from China's top leaders, including Jiang Zemin and Zhu Rongji.⁵ Zeng emphasized to achieve more and comprehensive parts and components localization, so his concern was how to play the SPC's functional role in auto policy and economic planning to push the world's large auto companies to "make a strong commitment to help build a modern supply industry in China."⁶

Lu Fuyuan also played an important role in the auto policy group, initially as deputy general manager of the CNAIC, and then Vice Minister of the Ministry of Machine Building Industry (responsible for the auto sector).⁷ He advised Zeng and made sure that the Machine Building Ministry worked in close coordination with the SPC in the sector review and drafting the *Automobile Industrial Policy* in 1994. Lu was a key actor among a group of automotive officials who recognized in the early 1990s that international and domestic conditions in the industry had changed in

⁵ Interview with state planners conducted by Gregory Chin in Beijing in January 2006, see Chin, p. 139.

⁶ Ibid.

⁷ Lu Fuyuan was appointed as deputy general manager of the CNAIC from 1990-1993, and Vice Minister of the Ministry of Machine Building Industry from 1993-1998. He graduated from the Department of Physics at Jilin University, and worked as engineer in FAW in the 1970s and 1980s. For more biographic information, see http://news.xinhuanet.com/ziliao/2003-03/17/content_782308.htm

China's favor, and that foreign automakers had become very interested in China. In the period of the early to middle 1990s, Lu and other officials in the SPC spent significant time analyzing international industry reports and international media coverage better to understand the latest trends in the world auto industry, and advised Zeng that under the conditions that Chinese economic growth, and the potential and real development of the auto market, and production overcapacity in Japan, the U.S. and European markets, China had a unique opportunity to strike some favorable foreign investment deals.⁸

The third backer of the auto policy group was Minister of the Ministry of Foreign Economic Relations and Trade (MOFERT) and later Vice Premier Li Lanqing.⁹ Holding a position in the MOFERT for one decade, Li had a deep reservoir of experience on foreign trade and investment issues, prior to being appointed as Vice Premier in 1993. He also had formal academic training in auto engineering, and maintained an interest in the development of the sector. In the 1950s, he worked for the FAW in Changchun, and visited the Soviet Licha Geoff automobile plant and Gorky automobile plant for further training. In the 1970s, he got a leading position in the Second Auto Works. Li took concern the foreign investment in the auto sector, and participated at different moments in the review and formulation of the *Automobile Industrial Policy* in 1994. According to the SPC planners, Li made

⁸ Interview with the officials and researchers of the SPC conducted by Gregory Chin in Beijing in December 2005, see Chin, p.136-7.

⁹ Li Lanqing had a position in the Ministry of Foreign Economic Relations and Trade (MOFERT) since 1982, and was appointed as Vice Minister of the MOFERT from 1986-1990, and Minister of the MOFERT from 1990-1992. In 1993 he was promoted as Vice Premier. For more biographic information, see http://news.xinhuanet.com/ziliao/2002-01/16/content_240496.htm

sure that the representatives of the different ministries brought into the policy group understood that he gave his strong personal backing to Zeng Peiyan and the SPC.¹⁰

The fourth leader backing the auto policy group was Zou Jiahua, Vice Premier (1991-97) and the SPC President during the early 1990s.¹¹ Zou was a strong advocate of foreign-invested auto projects, and had made a number of visits to SVW, Beijing Jeep, and Guangzhou Peugeot in the 1980s. Zou studied mechanical engineering in China and the Soviet Union, and had auto sector-specific knowledge. He was sent to Germany in 1991 to meet with VW and work out the final details to seal the FAW-VW deal. Zou was known as one of the toughest enforcers of the rules and regulations for foreign investment.¹² As President of the SPC, he supported Zeng and brought his knowledge and experience in foreign capital utilization into the auto policy review process.

While there were tensions and at times major differences of opinions on the key issues among the numerous stakeholders in the auto policy drafting process, these senior leaders made sure the SPC's leadership function and power in settling

¹⁰ Interview with the officials and researchers of the SPC conducted by Gregory Chin in Beijing in December 2005, see Chin, p. 137-8.

¹¹ Zou Jiahua graduated from the Department of Machinery at Moscow Bauman Higher Technical Institute, and in 1988 was appointed as Minister of the new Ministry of Machine Building and Electronics Industry, where he worked closely with Zeng Peiyan. In 1989, he was named as President of the SPC. In April 1991, he was promoted as Vice Premier (while also keeping the SPC President until 1993). For more biographic information, see http://news.xinhuanet.com/ziliao/2002-01/23/content_250695.htm

¹² Interview with former GM senior executive conducted by Gregory Chin in September 2008, see Chin, p. 138.

down the interest conflict across the central ministries, state agencies, as well as between the center and localities. According to one planner:

“The process of drafting the *Automobile Industrial Policy* in 1994 was very difficult. Credit should go to political leadership, especially from Zeng Peiyan, and building a comprehensive consultation process. This was essential to the success of the execution of the policy. With backing from top economic leaders as well, we were able to reach consensus on all of the key issues.”¹³

Meanwhile, the senior leaders also took personal responsibility in leading the auto policy group to identify strategic priorities for foreign capital utilization in moving China’s auto modernization to a higher phase in the 1990s. They set the tone for the auto policy review and drafting process. As one researcher of the SPC recalled:

“These leaders were instrumental in providing a calming influence. They told us that even though the world’s leading automakers were eager to invest in China’s auto industry and approaching us from all directions, we needed to maintain our cool and calm in the automotive policy review exercise and in drafting a new automotive policy.”¹⁴

SVW brought China the foreign advanced auto technologies, and made the Chinese realize that they were lagging far behind in car manufacture. But SVW’s success in localization convinced the Chinese leaders that China’s auto industry could catch up and become modernization via foreign investment and technology

¹³ Interview with the officials and researchers of the SPC conducted by Gregory Chin in Beijing in December 2005, see Chin, p.144.

¹⁴ Ibid., see Chin, p. 139.

transfer. So, through the 1980s and 1990s the Chinese leaders were holding the same stance that to rely strongly on foreign borrowing, and by localization of transferred know-how to strengthen domestic supply and R&D capacities and finally to achieve the goal of building a modern and self-reliant national auto industry, which was reinforced by both of the *Automobile Industrial Policy* in 1994 and the Ninth Five-Year Plan (1996-2000) announced at the end of 1995. But compared with the 1980s, in the 1990s, because Chinese authorities had more than ten-year experiences in cooperation with foreign automakers and management of foreign investment, along with the background that Chinese economic growth, and world market conditions had changed in China's favor, the Chinese leaders reconsidered how to further improve the partnership arrangement on the foreign side. In order to let China's auto industry benefit from the investment of the world's leading automakers and precise use of foreign capital, they adopted the strategy of "go with the best, and go big,"¹⁵ targeting the world's leading auto manufacturers as JV partners to do the desired transfers and to make a contribution to parts localization and domestic R&D capability in the 1990s' policies. The detailed regulations and specifications will be presented below.

Automobile Industrial Policy, the Ninth Five-Year Plan, and the Tenth Five-Year Plan

The *Automobile Industrial Policy* in 1994 placed a focus on attracting more investment from large foreign automakers. It stipulated that when a Chinese automaker was to utilize FDI, it must choose a foreign company which met all of the

¹⁵ Chin, p. 118.

following conditions simultaneously as the partner for joint venture or cooperation.

The foreign company:¹⁶

1. Should have its own product patent and trademark rights;
2. Should own product development and producing technology, and have a product technology index in accordance with current legislation in its own country;
3. Should own its independent international sales network;
4. Should possess superior financing ability.

Above all, no longer would any foreign automaker apply to do cooperation. The possible candidate must have R&D ability, export-ready technology, a global sales network as well as sufficient ability to raise funds. The policy also loosened the one-to-one JV partnership restrictions, and allowed one foreign company to partner with two different Chinese automakers on assembly projects,¹⁷ because the Chinese strategists realized that the one-to-one JV partnership principle inhibited foreign investors from increasing their investment in China.¹⁸ However, the policy still maintained the requirement that in the Sino-foreign JVs producing engines, completed cars, and motorcycles, the Chinese share should not be less than 50 percent,¹⁹ which showed the Chinese leaders' cautious and conservative attitude to

¹⁶ China's State Planning Commission, *Automobile Industrial Policy*, July 1994, Clause No. 28. The full text is available online:

<http://business.sohu.com/2004/06/02/31/article220353167.shtml>; The English translation refers to Chunli Lee, Takahiro Fujimoto, and Jin Chen, "The Impact of Globalisation on the Chinese Automobile Industry: Policy Assessments and Typology of Strategies," *Actes du GERPISA* No. 34, 2003, p. 90.

¹⁷ *Ibid.*, Clause No. 29.

¹⁸ Chin, p. 119.

¹⁹ *Automobile Industrial Policy*, Clause No. 32.

foreign borrowing and their insistence on the “shared equity, shared control” principle.

The policy also highlighted the Chinese authorities’ firm stance on parts localization, and provided even stiffer localization requirements. According to the policy, Chinese automotive manufacturing enterprises must do localization after they introduced foreign technology, and their localization progress was one of the prerequisites for the state approval of their second-stage production.²⁰ No one auto enterprise was allowed to do assembly with the imported completely knocked-down kits (CKDs) and semi-knocked-down kits (SKDs).²¹ Auto JVs had to start production with 40 percent local content, and in doing so, could qualify for 37.5 percent import duties on parts.²² Automakers that reached 60-80 percent local content rates could import parts at 30 and 20 percent duties.²³ These localization requirements got strong backing in the Ninth Five-Year Plan, which emphasized that the new passenger car project should not be inaugurated unless the unit parts (engine & transmission) and the related parts were available before the start of the project, and that the local content rate must be more than 40 percent at the launch of the project.²⁴ The above requirements showed Chinese authorities’ desire to establishing domestic parts and components network and increasing local supply capacity by “forcing” localization.

R&D as a key to fostering an independent auto industry was never ignored by

²⁰ *Automobile Industrial Policy*, Clause No. 42.

²¹ *Automobile Industrial Policy*, Clause No. 43.

²² *Automobile Industrial Policy*, Clause No. 44; Chin, p. 121.

²³ *Ibid.*

²⁴ Chunli Lee et al., p. 91; Chin, p. 121-2.

Chinese auto policies. The *Automobile Industrial Policy* in 1994 clearly expressed the Chinese leaders' requirements for foreign support for technological research and development. It stated that the establishment of a Sino-foreign JV must meet all of the following conditions:²⁵

1. A technological R&D center must be established within the company, and the center must be able to develop new models;
2. It must be able to make products equivalent to the 1990s' international technology standards;
3. It must intend to export its products and achieve foreign currency balance;
4. In selecting parts, Chinese domestic ones should be considered equally.

In one word, China hoped foreign automakers to transfer their "world-class" auto technologies and help Chinese automotive companies to expand their capability in R&D, product design, and advanced manufacturing techniques in order to compete internationally in the car market.

To speed up the development of the auto industry, especially the growth of large-scale Chinese state auto groups, the Ninth Five-Year Plan²⁶ covering 1996 to 2000 followed up the *Automobile Industrial Policy* with state financing policies for the auto sector. According to the Plan, the government would establish an automobile industry trust and an investment company as well as providing funds for the development of the passenger car and parts industry. The National Development Bank specifically would underwrite investment for key auto projects,

²⁵ *Automobile Industrial Policy*, Clause No. 31. The English translation refers to Chunli Lee et al., p. 90.

²⁶ The policies about the auto industry in the Ninth Five-Year Plan refer to Chin, p. 118-9; Chunli Lee et al., p. 91-2.

with RMB5.6 billion in loans. The government also would reduce investment tax and promote introduction of foreign capital to the 25 kinds of auto parts production. For the export-ready automakers, they enjoyed a series of privileges. For example, the National Import and Export Bank would offer export loans to large exporters of automobiles. Once the exporter had achieved the required amount of exports, the added-value tax paid during the domestic distribution process would be immediately refunded in the simplest way. An “International Market Exploring Fund” would be set up to support and encourage the export of Chinese auto products into the international market.

As one strategy to promote the car production as well as to induce the world’s leading foreign automakers into China, the private car ownership at the first time was clearly encouraged in the *Automobile Industrial Policy*²⁷ which announced that the contemporary consumption structure with the governments and SOEs as mainstay should be gradually changed.²⁸ In the Tenth Five-Year Plan (2001-2005) issued in 2001, cars into families was once again clearly encouraged.²⁹ In order to boost family car market, the government set forth the detailed regulations to call for national standards to be developed for car purchase and use by eliminating excessive fees; simplifying the procedure for car purchase, registration, and use; and

²⁷ *Automobile Industrial Policy*, Clause No. 47.

²⁸ *Automobile Industrial Policy*, Clause No. 46.

²⁹ The Fourth Meeting of the Ninth National People's Congress, *The Outline of the Tenth Five-Year Plan for National Economic and Social Development*, March 15, 2001, Chapter 19. The full text is available online:
http://news.xinhuanet.com/zhengfu/2001-10/18/content_51471.htm

increasing the availability of car purchase loans.³⁰ They supported Chinese automakers to develop economy models that had engine displacement of 1.3 liters and that were smaller and priced around RMB80,000 (\$9,600) for the demand of individual consumers.³¹

Same as the 1990s' policies, the Tenth Five-Year Plan backed up the development of large-scale Chinese state auto groups, but it emphasized that in 2005, two or three large auto groups should grow up with sales, distribution, and after-sales service systems commensurate with international standards; their output would supply more than 70 percent of the domestic vehicle market and would include some exports.³² The government also would nurture the formation of 5-10 large supply groups, which would compete in the international market; the largest three companies should enjoy a 70 percent share of the domestic market.³³ These guidelines represented the change of Chinese authorities' strategy for the auto industry – from one industry that heavily relied on technology from outside sources, primarily from the foreign partners in JVs, to one that was closer to being self-standing and independently developing.

Foreign Investment and China's Auto Development

³⁰ China State Economic and Trade Commission, *China's Tenth Five-Year Plan for the Development of the Automobile Industry (2001-2005)*, June 2001. Cited in Chinese Academy of Engineering and National Research Council, *Siren Jiaoche yu Zhongguo (Personal Cars and China)* (Washington, D.C.: National Academies Press, 2003), p. 60.

³¹ *Ibid.*, p. 59.

³² *Ibid.*, p. 58.

³³ *Ibid.*

In the early 1980s when VW decided to invest in China's auto sector and do cooperation with Chinese companies through a JV, other global vehicle manufacturers thought VW was too adventurous. But having witnessed VW's success in China's auto market and its increasing annual profits,³⁴ they started to understand that things were moving in China. With China's economic growth, especially along with the launch of the Chinese auto industrial policies which not only opened a large family car market but also encouraged the world's leading automakers to invest in China and helped China to develop large auto groups, the global players' skepticism about China's near-term potential to develop a mass auto market was gone. They realized the importance of the growing Chinese market, especially amid a global slow-down in the auto sector. For them, gaining access to over 1.3 billion consumers was a great incentive to go to China. As Joe Studwell indicated, "the prospect of adding one quarter of the world's population to a corporation's list of potential clients in a single move, the prospect of a market with statistical potential to become the biggest in the world."³⁵

The biggest US and Japanese companies turning down China's invitations to invest in the late 1970s and early 1980s, in the 1990s, however, they rushed into China and began to negotiate parts manufacturing ventures and lay plans to do assembly operations. As Albert Chambers, then director of corporate communications for Ford Motor Co., said: "We're late, but we're here. We're taking

³⁴ For example, in April 1995, SVW announced that its 1994 after-tax profit doubled to RMB4 billion (\$476 million) compared to the previous year. See "Volkswagen Sees Its China Auto Production Doubling in 2 Years," *Mountain Democrat* June 8, 1995.

³⁵ Joe Studwell, *The China Dream: the Quest for the Last Great Untapped Market on Earth* (NY: Grove/Atlantic, Inc., 2002), p. xi.

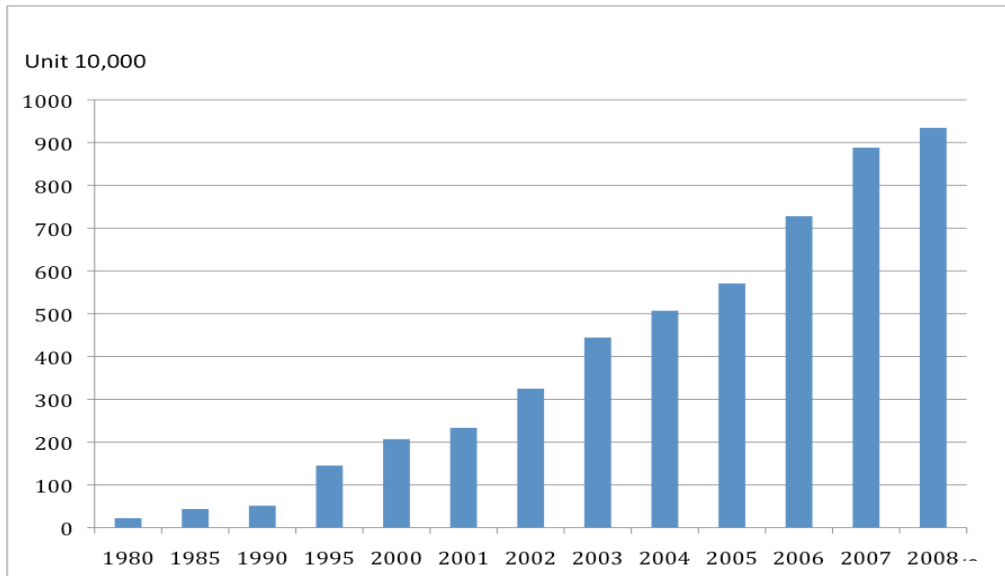
this market very, very seriously.”³⁶ From the mid-1990s to the early 2000s, the top automakers in the world quickly and successfully entered the Chinese market as new investors, including GM, Ford, Honda, Toyota, BMW, and Hyundai, etc. All of them adhered to the guidelines in the Chinese auto industrial policies, and agreed to transfer their leading models to China, as well as the advanced production and soft technology for what would eventually be a full line of modern vehicles, to establish new research development facilities, and to encourage their affiliated parts and components producers to increase their presence in China.

The boom in foreign investment stimulated the development of China’s auto industry. Since the mid-1990s, China’s auto production has got rapid growth (see Figure 5.1). By 2001, more than 600 auto enterprises had been established in China with foreign participation, and foreign investment in the auto sector had reached \$21 billion (RMB174 billion).³⁷

Figure 5.1 Output of Automobile Production in China, 1980-2008

³⁶ Joseph Kahn, “China’s Next Great Leap: The Family Car – Auto Makers Flock to Beijing to Get a Piece of the Market,” *Wall Street Journal* (Eastern edition) June 24, 1994, p. A.5.

³⁷ Chinese Academy of Engineering and National Research Council, p. 12.



Source: National Bureau of Statistics of China³⁸

Meanwhile, the structure of the auto production had also been changed. As private car ownership increased over time, the focus of auto production had been shifted from predominately trucks to passenger cars (see Table 5.1). In 2000, China produced 2.07 million motor vehicles (a 43 percent increase from 1995), 605,000 of which were passenger cars (an 86 percent increase over 1995), and a total export value of RMB20.7 billion (\$2.5 billion).³⁹

Table 5.1 Structural Shift of Automobile Production in China, 1991-2004

³⁸ Data available online: <http://www.stats.gov.cn/tjsj/>

³⁹ Chinese Academy of Engineering and National Research Council, p. 40.

Year	1991	1995	1999	2000	2001	2002	2003	2004
Truck (%)	63.77	49.69	41.32	36.89	34.30	33.57	27.64	29.88
Bus (%)	24.79	27.91	27.79	33.95	35.65	32.84	26.50	24.51
Sedan (%)	11.44	22.40	30.89	29.16	30.05	33.59	45.86	45.61
Total (%)	100	100	100	100	100	100	100	100

Source: *Zhongguo Qiche Gongye Nianjian (China Automotive Industry Yearbook)*,

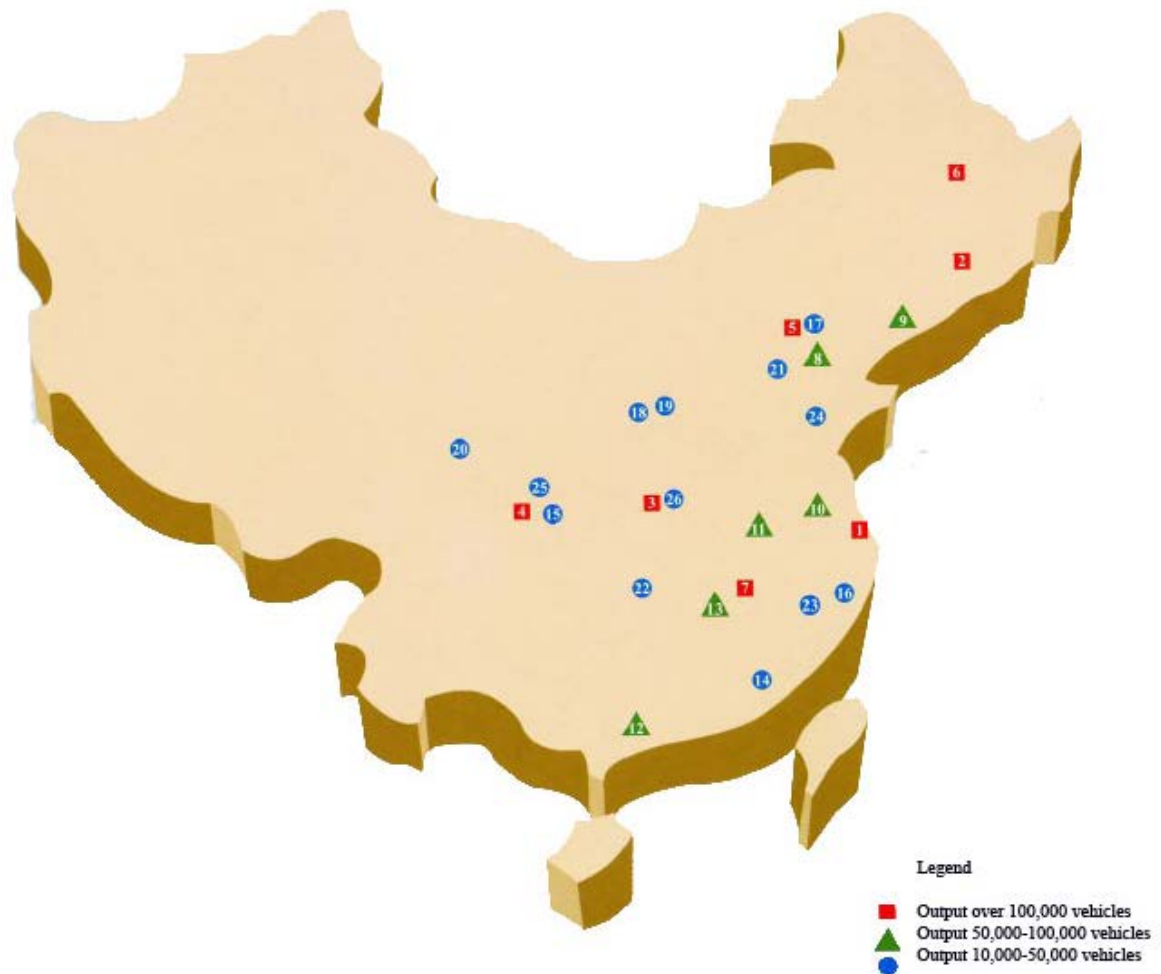
2005⁴⁰

By the end of 2002, China had 7 automobile manufacturers with output over 100,000 vehicles, 6 ones with output between 50,000 and 100,000 vehicles, and 13 ones with output between 10,000 and 50,000 vehicles (see Figure 5.2).⁴¹

Figure 5.2 Locations of Auto Manufacturers with Output over 10,000 Vehicles in China, 2002

⁴⁰ Ministry of Machinery Industry (MMI), *Zhongguo Qiche Gongye Nianjian (China Automotive Industry Yearbook)*, (Tianjin: China Automotive Technology Research Center, 2005).

⁴¹ CAAM (China Association of Automobile Manufacturers), ed., *Zhongguo Qiche Wushi Nian (The 50th Anniversary of Chinese Auto Industry)*(Shanghai: Shanghai Pictorial Publishing House, 2003), p. 188.



Source: CAAM 2003, p. 188.

The foreign partners enriched the Chinese market with a diversity of models meeting contemporary international technology standards, such as Buick GL8, Ford Fiesta, Honda Accord, Nissan Fengshen Bluebird, Hyundai Sonata, etc. They provided Chinese engineers with professional training services and established local R&D organizations. For example, GM helped SAIC to set up the Pan-Asia Technical Automotive Center in Shanghai, an “advanced joint venture technical center and a fully independent engineering joint venture facility,” for the purpose of developing indigenous auto design and assisting any domestic auto company to modernize its

engineering capacities.⁴² Toyota invested \$132 million to establish the Toyota China Technology Center in Tianjin, to train Chinese suppliers, and to build a network of service facilities.⁴³ Moreover, the fact that the world's leading automakers were present in China, along with the state pressure that drove foreign partners to bring their traditional parts suppliers with them into their new ventures in China, lured the auto parts companies in the world to relocate to China. Through the 1990s and early 2000s, AlliedSignal Inc., Robert Bosch GmbH, Cooper, Dana Corp., Delphi Automotive Systems, ITT, Lucas Varity Inc., Rockwell, Siemens, TRW Inc., Tenneco Inc., United Technologies Corp., Valeo, as well as leading Japanese and Korean parts companies, had all invested in parts and components ventures in China.⁴⁴ Delphi alone had established 13 solely funded businesses and JVs, a technology center, and a training center, with a total investment of more than \$400 million by 2002, producing wire harness, electric systems, driveshafts, brake systems, steering gears and columns, generators, and brakes.⁴⁵ The massive amounts of foreign investment not only improved the Chinese auto supply capacity,⁴⁶ but also nurtured China's own brands, Chery, Geely, for example. Rising in the late 1990s, these domestic self-developed brands heavily relied on the local supply capacities and the distribution networks that had been fostered by the big JV assemblers, and started with

⁴² Kelly Gallagher, *China Shifts Gears: Automakers, Oil, Pollution, and Development* (Cambridge, Mass.: MIT Press, 2006), p. 68; Chin, p. 176.

⁴³ Chin, p. 194.

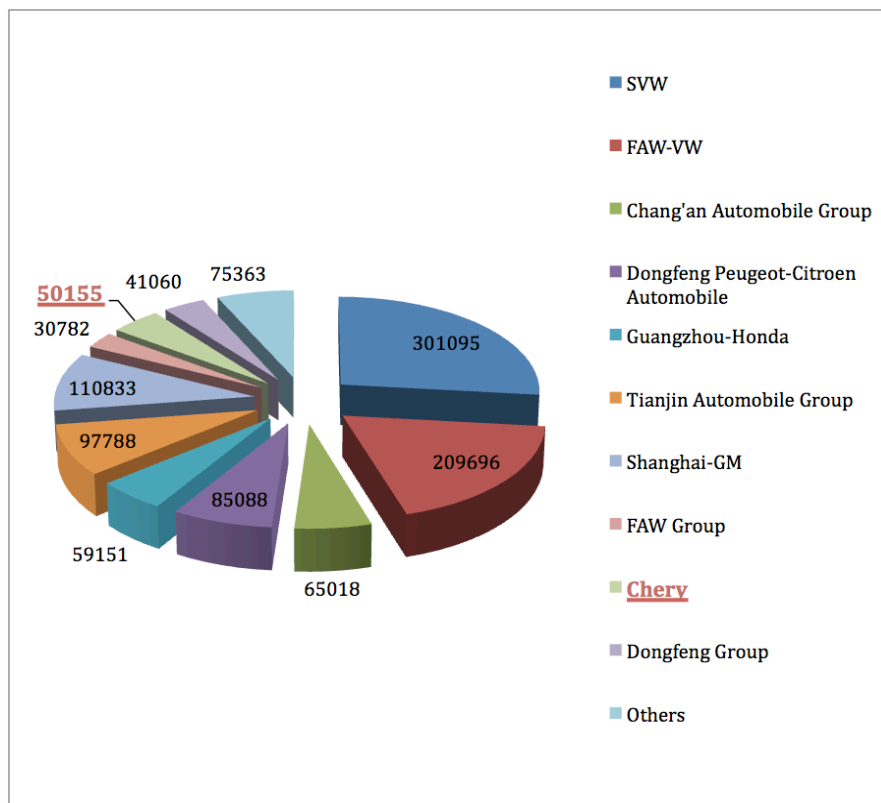
⁴⁴ Wayne Xing, "Shifting Gears," *Chinese Business Review* November 1997, p. 51; Chin, p. 123.

⁴⁵ Chin, p. 123, 229.

⁴⁶ By 2001, local suppliers have provided up to 80 percent of the content of domestically produced vehicles, and they have been exporting 30 percent more parts and components each year. See Chinese Academy of Engineering and National Research Council, p. 12.

production of economy models for the lower income levels of Chinese consumers. They grew up very quickly. Taking Chery as an example,⁴⁷ in March 1997, Chery began building its first factories, and in December 1999, its first car rolled off the assembly line. In 2001, Chery introduced its popular model – “Fengyun” (Wind Cloud), and its sales amounted to 50,155, holding the market share of about 4.5 percent, which was even above that of some large state-owned auto companies (see Figure 5.3). The domestic independent automakers were regarded as the hope of China’s auto industry.

Figure 5.3 Sales of Different Auto Manufacturers in China, 2002



Source: CAAM 2003, p. 192.

⁴⁷ More discussion about Chery will be given in Chapter 6.

5.2 Volkswagen's Localization Efforts in China

Right from its entry in China, VW noticed that their Chinese partners had their own special needs for cars. They used cars to mainly serve the governments and business instead of the family. So, they chose the Santana, the medium-sized car and abandoned the small models VW recommended.⁴⁸ In addition, VW was aware of the peculiarities of the Chinese situation. For example, in contrast to the situation in Europe, Chinese car drivers sounded their horns incessantly – for the reason to warn cyclists who blocked the streets – and always prolonged honking. In the early 1980s China's road condition was poor– the paved road length was about 160,000 kilometers, only 18 percent of the total road length, and there was no highway.⁴⁹ Therefore, since SVW began its production in 1985, the German engineers in Shanghai had modified their models to the Chinese special situation. They introduced the Santana made at SVW no less than 350 changes of technical specifications, which included the horn and chassis. To avoid the horns in the Santana failing, VW upped the lifecycle from the standard cycle of 50,000 actuations to a cycle of 105,000 actuations.⁵⁰ Meanwhile, VW raised the ride height of the

⁴⁸ Carl Hahn, *Meine Jahre mit Volkswagen (40 years at Volkswagen)* (Chinese version) (Shanghai: Shanghai Far Eastern Press, 2007), p. 119, 123.

⁴⁹ “Zhongguo Gonglu Tongche Zonglicheng 60nian Zengzhang 45bei” (“The Total Length of Roads in China Increased 45 Times in 60 Years”), *China Online News* August 17, 2009, available online: http://www.china.com.cn/economic/txt/2009-08/17/content_18347594_2.htm

⁵⁰ Martin Posth, *1000 Days in Shanghai* (Singapore: John Wiley & Sons, 2006), p. 169.

chassis, and adjusted the damping force of the shock absorber for rough ground.⁵¹ Thanks to the VW's modification job, the Santana could ride around China, on both paved and unpaved roads, which attracted the consumers from both the cities and villages.

VW knew that to set up a JV with the Chinese was not only a business but also a social challenge. They were alien to Chinese society and Chinese culture. In order to make their cars alive in China, they must depend on the cooperation of the domestic engineers to improve the cars specific to the Chinese needs, which led them to actively launch a series of programs for Chinese engineering training. Since 1985, VW had chosen Tongji University in Shanghai as their education base in the automobile building sector.⁵² In 1988, Tongji University's newly built program of Automobile Design and Production began recruiting students nationwide. In 1991, the Department of Automobile Engineering was established, which included the programs of engineering machinery, automobile, thermal power, device, and engine. In 1995, the Volkswagen Foundation provided Tongji University with 1,690,000 marks to establish a large modern automobile and engine R&D laboratory. In 1999, VW invested RMB5,000,000 in Tongji University to build the Automobile Marketing

⁵¹ Yan Guangming, "Santana: Zhongguo Guomin Diyi Che" ("Santana: The First Car of the Chinese People"), *Qiche Daobao (Automobile Guide)* July 28, 2003.

⁵² The information about the cooperation between VW and Tongji University comes from the homepage of Tongji University's Automobile College: http://auto.tongji.edu.cn/new/schoolInfo/index_sch.html; interview with Yu Zhuoping, the Dean of Automobile College; Wang Congjun, "Tongzhou Gongji, Pinpai Shuangying" ("Working Together for Win-Win"), *Zhongguo Zhiliang Bao (China Quality News)* October 26, 2009; Wang Xin, "Shanghai Dazhong he Tongji Daxue Hezuo 20nian" ("The 20-year Cooperation between SVW and Tongji University"), *Carfan Net* May 22, 2007, available online: <http://www.carfan.cn/xinwenzixun/quanguoshichang/2010060512025.html>

Management College. In 2002, Tongji University's Center for New-energy Automobile Engineering was set up, and combined with the Department of Automobile Engineering and the Automobile Marketing Management College to become VW-Tongji Automobile College. The students in the College were required to learn the German language, and had internship in SVW. The graduate students and faculty also had opportunities to visit the Technical University of Brunswick in Germany and the company VW AG in Wolfsburg for further training. The College worked together with SVW in many automobile R&D projects, and was called "the second R&D department of SVW." Many graduates from the College have got important positions in SVW and made contributions to the SVW's product and parts localization, such as Liu Jian, the general manager of SVW, with the experience of participating in the work of localizing Passat B5 and Polo models.⁵³

Moreover, VW also sent the Chinese engineers to their German company as well as the overseas companies to join the development of new products for the Chinese market. In 1992, a team of at least ten Chinese engineers was sent to VW's company in Brazil, and began one-year cooperation with German and Brazilian engineers to modify the Spruce 9Z model into the Santana 2000.⁵⁴ Many Chinese particular needs thus were added into the design. For example, because the Chinese preferred using the rear seats to the front one, the engineers not only improved the Santana 2000's rear seat cushion, but also offered more room for the rear area,

⁵³ "Shanghai Dazhong Tongjibang Zhuzheng?" ("Tongjiers in Charge of SVW?"), *Zhongguo Jingying Bao (China Business News)* September 25, 2010.

⁵⁴ Qin Zhongnian and Ding Anping, "Shanghai Santana 2000 Jiaochē Kāfā Zōngshù" ("The Development Procedure of SVW Santana 2000"), *Shanghai Qiche (Shanghai Automobile)* June 1994, p. 2.

which made the passengers feel much comfortable and easier to get off the car.⁵⁵ Compared with that of the Spruce 9Z, the body length of the Santana 2000 was extended by 108mm, which made the car look bigger, plus the more smooth shape, which matched the Chinese aesthetic taste for a car.⁵⁶ Since 1995 when SVW began producing the Santana 2000, the car quickly became the favorite by the government and business people. Even after 2004 when the Santana 2000 was discontinued, the car was still popular in the used car market.⁵⁷ In the late 1990s and 2000s, faced with the fiercely competitive Chinese auto market, VW was more dependent on the cooperation with Chinese engineers in product design. In the development of new models including Passat Lingyu, Santana 3000, and Lavida Langyi, the Chinese engineers played a critical role and designed the cars more “China-ized.” In 2005 when SVW undertook the development of Lavida Langyi – its bestselling car in 2008, their Chinese engineers were responsible for the body and interior design, as well as lights and wheels.⁵⁸ So, in one word, what VW needed was not only the Chinese engineers’ devotion to localization of their European models, but also the Chinese advices and involvement in research and development of new products specific to the China’s market.

⁵⁵ Ibid., p. 4; Teng Bingqu, “Shanghai Santana 2000 Jiaochē Cheshen de Kafa” (“The Development Procedure of the Body of the Santana 2000”), *Shanghai Qiche (Shanghai Automobile)* June 1994, p. 9.

⁵⁶ Ibid., p. 12.

⁵⁷ Wei Zheng, “Shanghai Dazhong Santana 2000 Chengwei Jiuche Shichang de Xinchong” (“SVW’s Santana 2000 Became the Favorite Car in the Used Car Market”), *Beijing Yule Xinbao (Beijing Entertainment News)* March 19, 2004.

⁵⁸ See interview with Cai Qian, the manager of the Center for Automobile Products of SVW: Tang Yu, “Shanghai Dazhong Chexing Sheji Kaolv Guomin Xuqiu” (“SVW’s Car Design Meets the Chinese Needs”), *Qiche Dianping Net (Automobile Comment Net)* April 27, 2010, available online:

<http://auto.cnfol.com/100427/169,1691,7611719,00.shtml>

Meanwhile, VW also paid attention to the voice of Chinese customers and depended critically on information from users in their product design, although they had ever ignored the Chinese users' knowledge of the car. In 2002, VW launched in China its fourth generation of Polo, a new car made with new technologies and of high-quality material. It was an economy car targeting the young middle class. Although it was priced from RMB127,500 to RMB148,000 for different models,⁵⁹ much higher than other economy cars, its fashion body design and reliable quality attracted the Chinese young consumers. In 2003, the sales for Polo Hatchback amounted to over 40,000.⁶⁰ But with more economy models entering the market, consumers found that Polo's internal room design and electronic system were not competitive. Although Polo's parts and components were made of high quality material, which increased the safety of the car, the repair cost became high. So, they preferred paying less money for a more comfortable car. In 2004, the sales for both Polo Hatchback and Polo Notchback combined were 36,000, and in 2005, the sales decreased to 15,400.⁶¹ Polo failure led VW to realize that Chinese consumers were growing up. Compared with those who knew nothing about the car and were passively fed by the automakers in the 1980s, the consumers in the late 1990s and 2000s mostly were well educated and had some knowledge of auto technology although most of them were first buyers. Faced with the diversity of products in the car market, they knew how to use their freedom to exercise choice. VW was aware

⁵⁹ Huang Ying, "Polo of Shanghai VW Priced from 127,500 to 148,000 Yuan," *People's Daily* (English version) March 3, 2002.

⁶⁰ Wang Zheng, "Shanghai Dazhong Gaobie 'Nalai Zhuyi' de Qishi" ("SVW Farewell to 'Bring-ism'"), *People's Daily* July 3, 2006, p. 16.

⁶¹ *Ibid.*

of the importance of Chinese users for their product design, which caused them not only to give more efforts in the localization of models and depend more on their Chinese partner, but also to deepen marketing analysis and extensively collect advice from users for their product development. By 2009, SVW had owned more than 600 4S stores in China. These stores were responsible for sale, spare part, service, and survey. They introduced SVW's new products to consumers, and collected customers' comments, feedback, and advice on the existing products for further improvement by SVW. When SVW started the development of a new model, the 4S stores would conduct the customer survey for the ideas about new product. The survey for the design of Lavid Langyi conducting in 2004 went on for over half a year, for example.⁶² In 2005, SVW launched the "Techcare" service program.⁶³ This program took advantage of SVW's after-sales service network to provide the customers with a full range of services, including purchasing, using, changing, and decorating cars. SVW adhered to their service quality to give customers professional advice and service, and at the same time, the company got paid with the valuable information from customers about what they thought about the cars and what deficiencies and potentialities they had discovered. By this means, SVW acquired the comprehensive understanding of customer needs.

Since the late 1990s, the intense competition among the automakers and the rapid increase of China's private car ownership left VW pressure to introduce more models for different groups of customers in order to uphold its dominance in

⁶² Hu Peng, "Shanghai Dazhong Lavid Langyi Yanfa Dashi Ji" ("The Development Procedure of SVW Lavid Langyi"), *Qiche yu Yundong (Car and Sport)* July 11, 2008.

⁶³ The information about the "Techcare" service program comes from the SVW website, access to: http://www.csvw.com/csvw/dzga/TechCare/tech_brand.shtml

Chinese car market. As of 2004, SVW had owned five series models – VW Santana, Passat, Polo, Gol, Touran.⁶⁴ For every model it offered, SVW always attached an interpretation matching with Chinese culture. For example, Passat Lingyu released in 2005 targeted the contemporary elite groups who were well paid, and had worry-free future. Such groups aged 33-38 years, owned successful career, focused on the family, and respected the traditional Chinese society and values; they were self-confident, believed everything under control, and eager to create new opportunities. According to these customers' aesthetic taste and particular needs, the Passat Lingyu had a wheelbase that was actually 9.1 centimeters longer than the normal Passat, offering more internal room, but without making the car feel as though it was enormous, and the refined interior design, equipped with the leather seats, 3 disc DVD, sunroof, and GPS, looking luxury and fashion, all of which could bring out the owner's success and social status.⁶⁵ SVW named the car "Lingyu," and interpreted as: "Ling" (领) means leading the life, and self-control; and "Yu" (驭) would make people immediately think of driving, but in Chinese, "Yu" also has the same pronunciation as the "域," "御," and "誉," while the three words means "territory," "power," and "reputation" respectively.⁶⁶ So, with this name, the car acquired the meaning of success and self-confidence. SVW's interpretation of Passat

⁶⁴ "5 da Xilie 7 Chexing, Shanghai Dazhong Jinxian Quanaxilie Pinpai Shili" ("5 Series Models and 7 Cars on Show, SVW Was Filling the Full Rang of Brand Strength."), *Sina News* August 23, 2004, available online: <http://news.sina.com.cn/c/2004-08-23/10263468808s.shtml>

⁶⁵ "Passat Lingyu: Shushi Jingzhi de Neibu Kongjian" ("Passat Lingyu: the Comfortable And Refined Interior Design"), *Sina Auto* November 23, 2005.

⁶⁶ "Shanghai Dazhong Xinchu Mingming 'Passat Lingyu' Jihua Niannei Tuichu" ("SVW's New Car Named 'Passat Lingyu' Would Be Launched This Year"), *Sina Auto* October 25, 2005.

Lingyu along with the car design pleased the Chinese customers. In 2006, the sales for Passat Lingyu amounted to over 100,000, and it became one of the bestselling cars in China.⁶⁷

In short, for VW, localization of its products by interacting with the Chinese is of great importance to its eventual success or failure in China's auto market.

5.3 Social Choices: Volkswagen vs. Its Competitors

As Chapter 4 has shown, the choice of cars by Chinese consumers is not only an economic behavior, but shaped by the socio-cultural factors. This section aims to uphold this point by focusing on examination of Chinese car consumption during the period of the late 1990s and 2000s when the mass auto market was growing in China. It firstly explores government car consumption, not only because the government was always a big buyer in the car market, but also due to the influence of official car choice over the private car purchase activities and even the direction of the auto development. Then the car choices by different social classes will be analyzed.

Chinese Political Hierarchical System and Official Car Choices

China's political structure has been described in Chapter 2. The political leaders in China are also ranked as the same hierarchical system (see Table 5.2), and their official car use is classified according to their ranking.

⁶⁷ Zhang Qian, "2006 Xiaoliang Quaxian Piaohong, Zhongguo Qiche Chanye Zaici Jinru Gaofeng" ("In 2006 Sales Up And China's Auto Industry Reached Its Peak"), *Jidian Shangbao (Machinery And Electronics Business News)* February 9, 2007.

Table 5.2 Hierarchical System of Chinese Leaders

Level	Position
State (chief)	President, Premier, Chairman of NPC Standing Committee, Politburo Standing Committee, etc.
State (deputy)	Vice President, the Committee of Politburo, State Councilor, Vice Chairman of NPC, NPC Standing Committee, etc.
Ministry and Province (chief)	Head of ministries, provinces or equivalents
Ministry and Province (deputy)	Deputy Head of ministries, provinces or equivalents
Prefecture or Municipality (chief)	Head of departments of ministries, Head of departments of provinces, Head of prefectures or cities or equivalents
Prefecture or Municipality (deputy)	Deputy Head of departments of ministries, Deputy Head of departments of provinces, Deputy Head of prefectures or cities or equivalents
County (chief)	Head of counties, Head of divisions of

	ministerial departments, Head of divisions of provincial departments, Head of departments of prefectures or cities or equivalents
County (deputy)	Deputy Head of counties, Deputy Head of divisions of ministerial departments, Deputy Head of divisions of provincial departments, Deputy Head of departments of prefectures or cities or equivalents
Township (chief)	Head of towns, Head of departments of counties or equivalents
Township (deputy)	Deputy Head of towns, Deputy Head of departments of counties or equivalents

Source: Civil Service Law of the People's Republic of China, adopted at the Fifteenth Meeting of the Standing Committee of the Tenth National People's Congress, April 27, 2005, clause No. 16.

In China, the official car means the state or collective owned car for serving the government business. During the late 1970s and early 1980s, due to the car supply shortage, only the high-ranking leaders – those at the chief Ministry and Province or higher levels – were offered the special cars which were only used by the leaders themselves. The leaders at the deputy Ministry and Province or lower

levels had no special cars, and had to share the cars for business in the work unit.⁶⁸ Most of the official cars at the time came from Japan. When the SVW project was in negotiation, the Chinese side selected the Santana as the introduced model for the purpose of letting the Santana take place of the imported Japanese cars as the official and business car. So, in the *Provisions on the Car Equipment and Use in the Central Party Government Organs* issued in September 1989,⁶⁹ although still only the high-ranking leaders were eligible to be provided with the special cars, all of the leaders in the central party government organs were required to use the domestically produced cars, and the purchase of the imported cars was prohibited in these units. As a result, the Santana quickly became the typical official car in China. In 1989, VW made the cooperation with FAW and introduced Audi 100 into China's market. This car was equipped with a 2.0 L 4 cylinder engine or a 2.3 L 5 cylinder one, compared with the Santana's 1.8 L engine. As the most luxurious and advanced cars made in China in the early 1990s, Audi 100 became the new favorite by Chinese officials. Meanwhile, despite the central regulation on circumscribing car import, some departments of both the central party and government as well as some local governments still pursued imported luxury cars equipped with bigger engine

⁶⁸ Chinese Communist Party Central Committee and State Council, *Provisions on the Living Conditions of High-ranking Cadres*, November 13, 1979; Central Office of Chinese Communist Party Central Committee and Central office of the State Council, *Provisions on the Living Conditions of the new deputy ministers and deputy governors*, May 21, 1983.

⁶⁹ Central Office of Chinese Communist Party Central Committee and Central office of the State Council, *Provisions on the Car Equipment and Use in the Central Party Government Organs*, September 6, 1989.

displacement.⁷⁰ In order to stop the car import and restrain the officials from pursuing the luxury cars, the central government updated the *Provisions on the Car Equipment and Use in the Central Party Government Organs* in September 1994.⁷¹ They re-emphasized that it was prohibited to violate the provisions to import cars, and stated that the leaders at the deputy Ministry and Province or higher levels must use the homemade cars. The leaders at the chief Ministry and Province level should be equipped with the cars that had engine displacement of less than 3.0 liters (including 3.0 L). Given the great increase of domestic car supply during the early 1990s, the provisions claimed that the leaders at the deputy Ministry and Province level also could be provided with the special cars, and the cars must have engine displacement of less than 2.5 liters. In 1999, the central government set forth more detailed regulations on the car equipment and use in the central party government organs.⁷² Both the car's engine displacement and the purchase price were fixed (see Table 5.3). It was stipulated that the leaders on the chief Ministry and Province level should be equipped with the cars that had engine displacement of less than 3.0 liters (including 3.0 L), and priced below RMB450,000; the leaders at the deputy Ministry and Province level should be equipped with the cars that had engine displacement of less than 3.0 liters (including 3.0 L), and priced below RMB350,000; and other official cars in the departments of the central party and government should be

⁷⁰ Central Office of Chinese Communist Party Central Committee and Central office of the State Council, *Provisions on the Car Equipment and Use in the Central Party Government Organs*, September 5, 1994.

⁷¹ Ibid.

⁷² Central Office of Chinese Communist Party Central Committee and Central office of the State Council, *The Notice on the Adjusted Standard of the Car Equipment and Use in the Central Party Government Organs*, March 3, 1999.

equipped with the engine displacement of less than 2.0 liters (including 2.0 L), and priced below RMB250,000. It reiterated that the official cars must be domestically produced. In June 2002, China's *Government Procurement Law* was launched, and in Article Ten, it was clearly stated that the government should procure domestic goods.⁷³

Table 5.3 Hierarchical System of Chinese Leaders and Their Cars, 1999

Level	Cars
State (chief)	engine displacement of less than 3.0 liters (including 3.0 L), and priced below RMB450,000
State (deputy)	
Ministry and Province (chief)	
Ministry and Province (deputy)	engine displacement of less than 3.0 liters (including 3.0 L), and priced below RMB350,000
Prefecture or Municipality (chief)	engine displacement of less than 2.0 liters (including 2.0 L), and priced below RMB250,000
Prefecture or Municipality (deputy)	
County (chief)	
County (deputy)	
Township (chief)	
Township (deputy)	

Source: The Notice on the Adjusted Standard of the Car Equipment and Use in the Central Party Government Organs, March 3, 1999.

Although the central government kept emphasizing that the official cars should be homemade ones, its definition of “homemade” or “domestic” goods

⁷³ *The Government Procurement Law of the People's Republic of China (Order of the President No.68)*, adopted at the 28th Meeting of the Standing Committee of the Ninth National People's Congress, June 29, 2002, article 10.

broadly referred to all produced inside China, including the cars with foreign brands but produced in JVs as well as China's own brands. Since Chinese carmakers were lagging behind the world's leading companies in auto manufacture, the officials always preferred the choice of foreign brands with high quality, advanced technology, and good reputation as their business cars. According to the Marketing Department of Chang'an Group, in 2004, Chang'an homegrown branded car sales were 580,000 units, of which less than 5800 cars were purchased by the government, only around one percent of the total.⁷⁴ Besides, the regulations on the range of engine displacement and of price, in spite of their original intention of restricting luxury cars in the government, actually provided the officials with a protection umbrella for pursuit of high-class cars. In their procurement budget, the officials always took the upper limit of the range, for example, the cars equipped with 3.0 L engine and priced RMB450,000 for the leaders at the chief Ministry and Province level.⁷⁵ As a result, those low-priced cars (below RMB250,000) with small engine displacement (less than 2.0 liters), of which most were China's own brands, could not enter the government procurement list. The choice of cars by the government not only caused the official budget in car purchase to keep high and increase annually – from RMB50 billion in 2004 to RMB80 billion in 2008,⁷⁶ but also generated a series of car use policies discriminating against cars with small engine

⁷⁴ Zi Qi, "Gongche Caigou de 'Zhongguo Xin'" ("The 'Chinese Heart' in Government Procurement"), *Zhongguo Caijing Bao (China Financial and Economic News)* June 1, 2005.

⁷⁵ "Jujiao Guanche 'Baoma hua' suo Yinfa de Zhengyi" ("The Debate on BMW into the Government Procurement List"), *Lingdao Wencui (Leadership Digest)* December 2009, p. 38-40.

⁷⁶ *Ibid.*, p. 39.

displacement. Although in the Tenth Five-Year Plan (2001-2005) issued in 2001, the central government advocated economy models with 1.3 L engine and priced below RMB80,000, by 2004 there were about 60 large and medium cities, including Beijing and Shanghai, issuing transportation regulations which claimed that the cars equipped with engine displacement of less than 1.0 liters (including 1.0 L) were forbidden from driving through the downtown.⁷⁷ These local regulations stated that because low-emission cars were not environmentally friendly, poor quality, and likely to cause congestion, they should be limited to use. Such explanation, however, was criticized non-reasonable by some Chinese environmentalists, and only for the purpose of benefiting the driving of the official cars.⁷⁸

The government's car preference drove the automakers to avoid providing the models equipped with small engine displacement. Among the series of models launched by SVW as of 2004, the one with the smallest engine displacement was the first-generation Santana with 1.8 L engine. Even Chery that focused on the low end of the market and mainly produced economy models undertook the design of medium-sized car equipped with a 3.0 L 6 cylinder engine since 2003.⁷⁹

What's more, the official choice of cars also influenced the individual consumer's car consumption, which was related to the Chinese public images of the

⁷⁷ "Jin 60ge Chengshi dui 1.0pailiang Xianxing" ("About 60 Cities Limit the Use of Cars with Engine Displacement of 1.0 Liters"), *Xin Jin Bao (Beijing News)* February 2, 2004.

⁷⁸ Shang Yinquan, "Xiaopailiang Jiaochē zai Dachengshi Bei Xianxing de Liyou Bu Chengli" ("The Reason Why Small-displacement Cars Are Prohibited in Big Cities Is Not Reasonable"), *Zhongguo Chanjing Xinwen Bao (China Industrial News)* August 24, 2005.

⁷⁹ See interview with Jin Yibo, the assistant of Chery's general manager, in "Qirui Ruilin G6 Xiangzuo Zhongguo de Gongpuche" ("The Chery's Ruilin G6 Wants To Be the Chinese Official Car"), *Wangyi Auto* March 31, 2009.

officials as well as of official cars. As Chapter 4 discussed, the officials enjoyed high social status in China, which not only was due to the fact that the officials were associated with power, but also resulted from the deep-rooted Confucian thoughts – “Guan Ben Wei” (official rank considered to be the sole criterion of one's value). According to the Confucianism, both of the society and the people should be ruled by man, not by law, so the officials were the people’s rulers, and they were noble and the people were humble; the people should worship and respect the officials, and if they wanted to raise their social status, prove themselves successful, and bring their ancestors and families glory, they had no choice but getting an official position by excellent education, because to be an official was the most glorious and successful career.⁸⁰ Such Confucian thoughts offered the officials not only the high social status, but also the public esteem and admiration, even when the political corruption became rampant after 1978 and was threatening the people’s interests. Since 1978, with the implementation of economic reforms, more official power, including some controls over finance, tax revenues, foreign trade, investment, raw materials, and capital construction, were decentralized to the local level, which not only weakened the central control over the localities, but also provided the local officials with chances to abuse the political and economic privileges and become corrupt. The “Guandao” (official profiteering) emerging in the 1980s and making profits from the dual-track price structure especially caused great public

⁸⁰ See Zhu Xiangdong and Bei Qinghua, “Guan-Ben-Wei de Chengyin Jiexi” (“The Historical Root of ‘Guan-Ben-Wei’”), *Renmin Luntan (People’s Tribune)* vol. 302, 2010, available online: <http://www.rmlt.com.cn/qikan/2010-09-25/9173.html>.

resentment, which resulted in the Tiananmen Square protests in 1989.⁸¹ Although the CCP hastened the ideological education of cadres and party members for the goal of abating corruption and also took a series of anticorruption actions, the number of the officials falling in corruption kept growing.⁸² The trading of power for money became so serious that the mayor of Shanghai publicly acknowledged: "At present, the masses have reacted strongly to the phenomenon of 'no service without money, and poor service with little money.'"⁸³ The communist cadres, in public view, have become privileged groups who pursued power and wealth for themselves, instead of "comrades" who worked only for the people's interests as the CCP always propagated. Although the public angered at the official corruption, the government occupations still held high social prestige in China.⁸⁴ Influenced by the

⁸¹ See the fourth chapter for more information about "Guandao" (official profiteering) and the dual-track price structure.

⁸² Between 1982 and 1986, the CCP's Central Discipline Inspection Commission investigated 230,000 cases in which 148,163 party members were disciplined for bribery and theft, and an average of 22,000 cases of corruption were tried per year. From 1988 to 1993, the Discipline Inspection Committee of the National People's Congress investigated more than 870,000 violations at various levels; 730,000 members were disciplined and 150,000 expelled from the party. Supervisory bodies received nearly 3 million complaints during that period. In the 224,000 cases subsequently investigated, more than 192,000 persons were punished or recommended for punishment. In 1994, the Supreme People's Procuratorate reported that citizen reports of corruption were being received at a rate of about 1.25 million per year by this agency alone. See Michael Johnston and Yufan Hao, "China's Surge of Corruption," *Journal of Democracy* vol. 6, no.4, 1995, p. 86-7.

⁸³ See Shanghai's mayor, Wu Bangguo's words in *FBIS-CHINA*, September 28, 1993, p. 47.

⁸⁴ In recent each year the number of college graduates who applied to official positions is increasing. In 2006 in Jiangsu province, more than 400 persons competed for one position in Jiangsu Statistical Bureau. Many college graduates would rather to look for an official job with low salary than setting up their own business to earn more money. See Wang Yingjing and Hu Hanhui, "The Cultural Path-dependence in the Process of Chinese Entrepreneurs' Growing," *Proceedings of the 2008 IEEE ICMIT*, 2008, p. 815-820.

deep-rooted Confucian thoughts – “Guan Ben Wei,” the people had dual feelings for the corrupt cadres – respected the official position and rank, but hated the malpractices. Therefore, since the late 1980s when the political corruption turned worse, the public image of official cars actually had evolved. Different from the one linked with socialist construction in the pre-reform period, the official car was symbolized power and privilege, as well as high social status, but still receiving public respect. In this case, the cars the government chose and favored thus became the models the public pursued for the purpose of showing their success, social status, or power, and earning people’s respect.

Social Classes and Car Consumption

Just as there are hierarchies of political power and status, so too there are gradations of wealth in China. Three decades of reform since 1978 have brought an astonishingly quick and brutal return to extreme class divisions. While China’s GDP grew up impressively from US\$147.3 billion in 1978 to US\$2.7 trillion in 2007, having in 2005 become the fourth largest economy in the world,⁸⁵ the distribution of wealth has been sharply skewed. Much of the gap that developed among citizens was due to the explosive growth of the private economy from the late 1980s.⁸⁶

⁸⁵ Xu Binglan, “China’s GDP Grows 10.7% in 2006, Fastest in 11 Years,” *China Daily* January 26, 2007.

⁸⁶ In 1987, the Thirteenth Party Congress declared that the private sector should be “permitted to exist,” and in March 1988 the state constitution was revised to legalize the conduct of private business. In 1989, however, following Tiananmen and the subsequent torrent of articles criticizing “privatization,” the number of private enterprises fell 15 percent from 90,581 to 76,581; of these, 8,000 ceased operation and 4,000 declared they were “individual entrepreneurs.” Despite this inauspicious start to the new decade, the private sector soon experienced a boom far exceeding

Especially since the late 1990s, China has been developing into a “three-peaked” society:⁸⁷ there is now a small but fabulously wealthy elite, a middle class of about 80 million, a broad middle of some 800 to 900 million people⁸⁸ who strive to get by and hope for a better future, and at least 200 million bitterly poor.⁸⁹

- the upper class: this top elite is composed of a very few from the top Party

anything it had seen in the 1980s. The turning point was Deng Xiaoping’s Southern tour in 1992 and the subsequent decision of the Fourteenth Party Congress to permit the simultaneous development of different forms of ownership. Between 1991 and 1993, the number of registered private enterprises more than doubled, and the amount of registered capital soared from about RMB12 billion to over RMB68 billion – more than a 5-fold increase. By 1998, there had existed 1,200,978 registered private enterprises, and the registered capital amounted to RMB719.8 billion. In March 2007, the Fifth Meeting of the Tenth National People’s Congress adopted China’s *Property Law* that clearly claimed that the private property should be protected. See Zhang Houyi and Ming Lizhi, ed., *Zhongguo Siying Qiye Fazhan Baogao (Report on the Development of Private Enterprises in China)*, (Beijing: Shehui Kexue Wenxian Chubanshe, 2000), p. 33-9; Joseph Fewsmith, *China since Tiananmen: the Politics of Transition* (UK: Cambridge University Press, 2001), p. 171-3; *Property Law of the People’s Republic of China*, adopted at the Fifth Meeting of the Tenth National People’s Congress, March 16, 2007.

⁸⁷ Peter Edward, “Examining Inequality: Who Really Benefits from Global Growth?” *World Development* vol. 34, no. 10, 2006, p. 1679; Timothy Cheek, *Living with Reform: China since 1989* (NY: Zed Books, 2006), p. 90.

⁸⁸ China’s State Statistical Bureau identified middle stratum families as the households having an annual average income of between RMB60,000 and RMB500,000. According to this official definition, by 2007, about 80 million people joined the middle class. The Asian Development Bank defined the middle class as the people with daily consumption of US\$2-20. According to this standard, the Bank in 2010 reported that there were about 817 million middle class people in China. See “Zhongguo Zhongchan Jieceng Renshu Huoda 800wan” (“The Number of China’s Middle Class People Amounted to 80 Million”), *Shanghai Zhengquan Bao (Shanghai Securities News)* June 18, 2007; “China Has 80 Million Middle Class People: Official,” *Xinhua News Agency* June 18, 2007; “Yahang Baogao Cheng Zhongguo de Zhongchan Jieji Renshu wei 8.17yi” (“The Asian Development Bank Reported China’s Middle Class were 817 Million People”), *Caixin Wang (Financial News)* September 13, 2010, available online:

http://www.hljnews.cn/xw_cjzh/system/2010/09/13/010719617.shtml

⁸⁹ Data comes from the report of the World Bank that claimed that in 2009 there were about 254 million people living under the latest international poverty line in China, in *China Youth Daily* April 8, 2009.

circles, quite often the children of high-ranking officials known as “princelings,” and a every few entrepreneurs who have done well, and often are well connected to leading cadres. While some of them are major beneficiaries of the rapid Internet development in China, such as Zhang Zhaoyang, the founder of Soho.com, most developed their wealth in the real estate market. Among the top 100 super-rich people in China ranked by Forbes in 2002, 47 persons were real estate developers, 5 owned infrastructure enterprises, and other 45 also got involved in the real estate investment to some extent.⁹⁰ In China, the real estate market has a very high barrier to entry since it is capital-intensive and requires access to land. Only those who are high-ranking leaders’ family members, friends, and others related through various kinds of personal ties are able to participate in the land market because the state owns all the banks and land. The cadres can take advantage of their political privileges to help the developers obtain land at give-away prices and low-interest loans from state banks.⁹¹ So, in China, top wealthy elite actually is always closely linked with political power.

- the middle class: although scholars inside and outside China have different definition of the middle class, which causes the number of people identified

⁹⁰ Xing Linchi, “Dichanshang Pinpin Shangbang ‘Forbes’ Tudi Weihe Duochan Fuhao” (“More and More Real Estate Developers Entered the Forbes Rich List”), *Jingji GuanCha Bao (Economic Observer)* November 6, 2002.

⁹¹ It is reported that in Guangdong province, the twelve largest real estate developers are the children of high-ranking officials; in Shanghai, nine out of the ten largest real estate developers are the children of high-ranking officials; in Jiangsu province, all twenty-two of the largest real estate companies and the fifteen largest construction firms are owned by the children of high-ranking officials. See Xiaowei Zang, “Market Transition, Wealth, and Status Claims,” in David Goodman, ed., *The New Rich in China: Future Rulers, Present Lives* (NY: Routledge, 2008), p. 65.

as the middle class varied, both of them agree that the middle class refers to a group of people who are capable of investing in apartments and cars, and who can afford the costs of education and holidays.⁹² This group includes small-scale private entrepreneurs, contract-based managers of state enterprises, professors and senior scientists, senior employees in major banks and other financial institutions, managers and white collar workers of foreign-invested companies and large JVs, media stars, athletes, professional technicians and engineers in various fields, and many other professions that typically require good education, receive high pay, and have some particular consumption habits.⁹³

- the working class: in the 1950s and 1960s the working class was officially and politically recognized as a “leading class.” But the post-1978 reforms, especially after Deng Xiaoping’s tour of Southern China in 1992, eroded this status recognition and differentiated the working class into wage labor in the private sector (12 million as of 1998), unprotected labor who was deprived of welfare benefits and “iron rice bowl” (lifelong employment) in the state sector (70 million), layoff labor wandering in search for a job (30 million), and migrant peasant-labor (60 million).⁹⁴ There were also large numbers of

⁹² Goodman, p. 6-10; Richard Jones, “Conspicuous Consumption,” *Post Magazine* (Hongkong) February 4, 2007, p. 16-20.

⁹³ Chen Xiaoya, “Zhongguo Zhongchan Jieji Fuchu Shuimian” (“The Emergence of a Middle Class in China”), *Juece Tansuo (Policy Research & Exploration)* vol. 2, 2002, p. 32-4; Chen Guanren and Yi Yang, *Zhongguo Zhongchanzhe Diaocha (Investigation of China’s Middle Class)*, (Beijing: Tuanjie Publishing House, 2004), p. 28-9.

⁹⁴ Zhang Wl, “Zhongguo Shehui Jieji Jiecheng Yanjiu Ershinian” (“Twenty Years of Research on Chinese Class and Strata”), *Shehuixue Yanjiu (Sociological Research)* vol. 1, 2000, p. 24-39.

collective-sector labor and retired labor. Although urban workers enjoy the street culture, films, shopping, and other commercial activities, they always save money for living, and cannot afford the luxury goods.

- the poor class: the poverty stratum is emerging from peasants who live on income from agricultural products in inland poor regions. The decentralization reforms of fiscal systems in the 1980s and 1990s, plus the central policy of prioritizing developments of Eastern coastal regions resulted in increasing economic gap between coastal and inland regions. New riches grew in coastal regions, but poverty persisted in inland areas, especially the rural areas. These poor people's average consumption level is estimated (in US\$) as \$0.31 per person per day, under the international poverty line – \$1.25-a-day.⁹⁵

It should be noted that the officials usually are not included the above social strata, due to in China the cadres, especially the leading cadres, as a privileged group whose wage is limited, but income from “gray” and “black” sources not included in paychecks might be high and cannot be clearly estimated.⁹⁶

Sean O'Connell in his studies of the car in British society argued that the car was always identified with different social groups, and consumers had the desire to

⁹⁵ “Shihang Fabu Baogao Cheng Zhongguo Pinkunxian yu Guoji Biaozhun Xiangcha Xunashu” (“The World Bank Reported the Difference between China's Poverty Line and the International Poverty Line”), *China Youth Daily* April 8, 2009.

⁹⁶ The Research Center of the State Council, the Office of the Central Commission for Discipline Inspection, and Chinese Academy of Social Sciences, *Quanguo Difang Dangzheng Bumen, Guojia Jiguan Gongzhi Renyuan Xinchou he Jiating Caichan Diaocha Baogao (A Report on the Income and Family Property of Local Cadres and the Officials in the Party and Government Organs)*, April 2006, available online: http://www.360doc.com/content/09/0130/10/70752_2417875.shtml

choose the “appropriate” cars to express their social status and individuality.⁹⁷ This is also true for most of Chinese car consumers. The top elite generally adopted the imported luxury cars as their cars, such as Rolls-Royce, Ferrari, Volvo, BMW, and Mercedes-Benz.⁹⁸ Taking advantage of their relationship with the government, they could easily get the import quotas for these cars unaffordable for the public but appropriate to their wealth and social status. Some high-class cars chosen by leading cadres, including VW Passat models, and VW Audi A6, were also their favorite. These luxury cars not only symbolized wealth, but also were given the sign of power, even on the road. They always had the right of way, and pedestrians had to yield them. There existed endless stories of pedestrians killed by the drivers of the expensive imported cars like BMWs who either simply raced off or, even if brought to court, got off with minor punishment.⁹⁹ All of the power came from the close relationship between the wealthy elite and leading cadres.

The middle class’s car consumption basically relied on their income levels and savings. Although the Chinese banks have provided car loan services since the early 2000s, the way of financing one’s purchase has not been accepted by most of

⁹⁷ Sean O’Connell, *The Car and British Society: Class, Gender and Motoring, 1896-1939* (Manchester: Manchester University Press, 1998), p. 19-32.

⁹⁸ See “Zhongguo Fuhao Mingren Chebang” (“The Cars of China’s Super Rich”), available online: <http://xk.cn.yahoo.com/articles/080716/1/b3iy.html>

⁹⁹ It is reported that from 2003 to 2009, there happened at least 10 traffic accidents nationwide in which BMWs were involved, and the drivers either raced off, leaving the pedestrian injury or death, including the BMW accidents in Beijing in November 2005 and in April 2007, and one in Shanghai in September 2009, or if brought to court, got minor penalty, such as only two-year jail for killing one person and hurting 12 people in the accident in Harbin in 2003. See “03nian Yulun Huaran de Harbin BMW Zhuangren An” (“The BMW Accident Case in Harbin in 2003”), *Shenghuo Xinbao (Live Daily News)* September 10, 2008; “Jinnian BMW Zhuangren An Bu Wanquan Tongji” (“The Incomplete Statistics of BMW Accident Cases in Recent Years”), available online: http://bbs.qichelian.com/post_4490412_1.html

Chinese consumers. Some people think that to apply for bank loans is a complex and time-costing thing, and they remain unaware of how the deal is transacted. Some people insist that being a car owner means that you really own it, because the car is taken as an indication that your business is successful, and how successful, by the grade of car, while employing the bank loans will hurt this pleasure of possessing the car. More importantly, the Chinese care the interest rate of car loans, although the banks are lowering the rate in recent years.¹⁰⁰ So, in China, consumers are used to buying cars with cash, and if they do not have enough money for cars, they will save up or borrow from parents or relatives until they can pay cash.¹⁰¹ Such cash-paying consumption culture leads the middle class to only purchase the models of which the cost matches money in hand. Thanks to foreign and domestic automakers' contributions to enriching the Chinese market with a diversity of models in different price ranges and specific to different consumer groups, the middle class had more freedom to choose their appropriate cars to express status and individuality. For example, the young women aged 20-35 years enjoyed the fashionable and cute models such as VW Polo Jingqing, Polo Jingqu, Toyota Vios, Corolla, etc.; the businessmen aged 30-40 years were interested in the bigger cars looking luxury and compared to the official cars, including VW Passat Lingyu, GM Buick Regal, and

¹⁰⁰ In a survey nationwide about car consumption undertaken by *Zhongguo Qiche Bao (China Auto News)*, of 3268 participants, 72 percent thought that the process of application for bank auto loan was complex, and 49 percent cared about the interest rate of car loans. See "Baixing Pingshuo Qiche Shichang Xiaofu Xianzhuang" ("The Public Comments on Car Consumption"), *Zhongguo Qiche Bao (China Auto News)* July 4, 2000.

¹⁰¹ According to Ma Xijun, one agent of Shanghai-GM, of 2500 Buick cars he sold in 2009, about 10 percent were purchased by using the bank loans, while 90 percent paid with cash. "Zhongguo Zhongchan Jieji Riyi Zhudao Qiche Shichang Xuqiu" ("The Chinese Middle Class Is Influencing the Auto Market"), *Soho Auto* May 25, 2010.

Buick Excelle; the men who love outdoor sports appreciated the SUV, like Cherokee; the consumers with lower income mostly chose the economy models equipped with 1.6 L engine and priced below RMB150,000 which included the homegrown brands such as Chery, Geely, and BYD.¹⁰²

Influenced by the official choice of cars, the Chinese middle class consumers had the idea that the foreign branded car equipped with big engine displacement much more stood for success than the domestic branded cars and the economy models, and the bigger engine displacement, the more successful. So, if affordable, the government-chosen foreign branded big cars were what they preferred,¹⁰³ which greatly benefited VW, because the Santana, Audi, and Passat had been the mainstay of official cars. Moreover, thanks to SVW's marketing and service efforts as well as the contribution of the users of the Santana in the late 1980s and early 1990s, which was mentioned in the fourth chapter, VW had enjoyed good reputation in China. That the Santana was given the sign of the leadership and wealth in the early 1990s made the Santana become one of the favorite cars by the middle class. Especially after China's entry into the WTO in 2001, faced with the high competition in the Chinese car market, SVW lowered the price of the Santana from about RMB130,000 in 1999 to RMB100,000 in 2002, and to RMB80,000 in 2005,¹⁰⁴ much

¹⁰² "Zhongguo 21 Lei Chezhu Diaocha" ("Survey of China's 21 Kinds of Car Owners"), *Huaer Jie Dianxun (The Wall Street Wire)* February 14, 2006.

¹⁰³ "Gongwuche Cheng Jumin Xiaofei Fengxiangbiao" ("Official Cars Became the Vane of Private Car Consumption"), *Zhongguo Chanjing Xinwen Bao (China Industrial News)* August 6, 2009.

¹⁰⁴ "Shanghai Dazhong Santana, Passat Rengyou Jiangji Kongjian" (SVW Is Reducing the Prices of the Santana and of Passat"), *Zhongguo Qiche Bao (China Auto News)* January 30, 2002; Zhang Yaodong, "Shanghai Dazhong Zuotian Xuanbu Quanmian

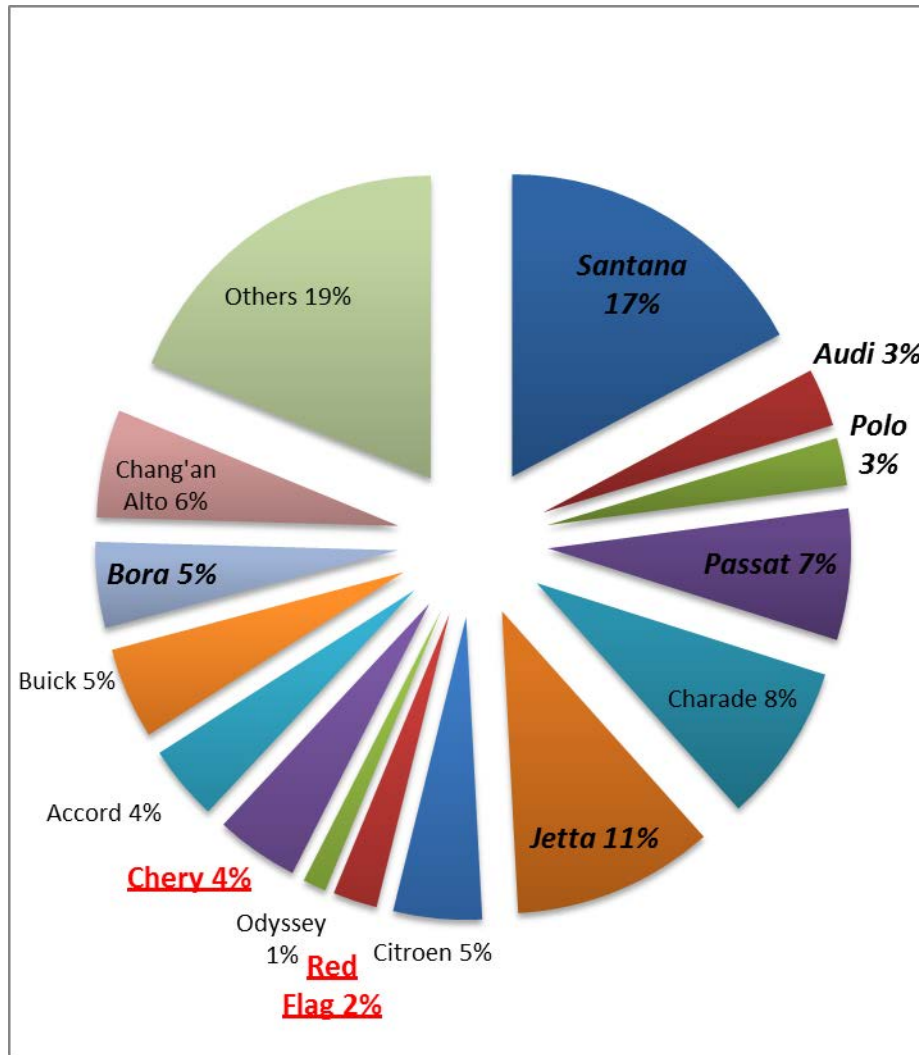
more affordable to the middle class, which stimulated the sales of the Santana. Besides, in China there existed a small group of consumers who pursued the goods admired by the public in order to show off and earn “big face” and public esteem, even when the goods were unaffordable for them and inappropriate to their status.¹⁰⁵ For example, some young people whose income only afforded economy models borrowed money from parents to buy medium-sized cars,¹⁰⁶ which was called in China “Ken Lao” (consumption dependent on parents). Resulting from the above consumption behavior, foreign branded cars, especially the VW cars, dominated the Chinese auto market, while the China’s own brands only captured very limited niches (see Figure 5.4).

Figure 5.4 Market Share of Different Auto Brands in China, 2002

Jiangjia’ (“SVW Announced the Price Reduction Yesterday”), *Beijing Qingnian Bao (Beijing Youth Daily)* August 9, 2005.

¹⁰⁵ In a survey of 700 consumers in Beijing, Shanghai, and Guangzhou conducted by China Economic Monitoring Center, about 14.6 percent of the participants would like to pursue the goods unaffordable for them, for the purpose of showing off and earning “face.” See Wu Xiaoli, “Ni de Xiaofei Daxing Hua Ma?” (“Are You Pursuing the Luxury Consumption?”), *Zhongguo Xiaofeizhe Bao (Chinese Consumer News)* December 6, 2002.

¹⁰⁶ “Zhongguo Zhongchan Jieji Riyi Zhudao Qiche Shichang Xuqiu” (“The Chinese Middle Class Is Influencing the Auto Market”), *Soho Auto* May 25, 2010.



Note: The Santana, Polo, and Passat, are SVW's products, while the Audi, Jetta, and Bora are cars provided by FAW-VW. VW totally had market share of 46 percent in China in 2002. Accord and Odyssey are models by Guangzhou-Honda. Buick comes from Shanghai-GM, Charade from Tianjin Auto, and Citroen from Dongfeng-Citroen. Chery and Red Flag are China's homegrown brands, which had market share of 6 percent in total.

Source: CAAM 2003, p. 193.

Summary and Analysis

Since the mid-1990s, in order to increase market-orientation in China's economic system, the central government controlled the auto sector by policy-making rather than direct engagement. The SPC, thanks to the supports from several senior leaders, exerted its power in the auto policy making process by effectively coordinating different points of view among numerous stakeholders in the Chinese auto sector, including Chinese automakers and the state bureaucracy at both the central and local levels, and pushing through the new auto policies which contained new strategies for using foreign investment to drive China's auto modernization. Through the 1990s and early 2000s, with the issue of these auto policies, a big flow of foreign investment entered China's auto sector. The boom in foreign investment stimulated the development of China's auto industry, but meanwhile generated a number of competitors for SVW, and each competitor was busy with building/expanding its own network in China's auto sector. The increasingly fierce competition in the Chinese auto market forced VW to introduce more models and new designs into China, by which more artifact actors entered the network of SVW (if each model can be regarded as one non-human actor). As one planner of the SPC pointed out:

“For almost ten years, VW had no pressure to transfer more advanced technology to its Shanghai JV. The JV was making huge profits for VW even with the outdated Santana B series technology. Then Shanghai Automotive, VW's Chinese partner, formed another partnership with GM in 1998. After that, VW changed its position. One of the most important outcomes of this new joint venture Shanghai GM,

was production of the Buick luxury car, because it forced VW to decide to produce the Passat at Shanghai VW, after holding off with the outdated Santana for so long.”¹⁰⁷

The central political actors not only controlled the environment of SVW development by policy-making, but also affected the enrollment of Chinese consumers into the SVW network through their official car consumption. It is the political authorities’ official car choices and relevant policies that shaped the Chinese images of the Santana and VW cars. Since the late 1990s when China’s middle class began entering the auto market to choose their private cars, benefiting from inclusion of official car users and the Chinese images of VW cars, the SVW network attracted some Chinese middle class consumers who preferred VW cars to show their success to enroll.

VW also played an important role in enrollment of Chinese consumers by localization its models and interaction with Chinese engineers and users for Chinese specific needs. It introduced a number of new models into the network and defined them with Chinese culture, through which various groups of consumers favoring the models were attracted into the network. Along with the enrollment of numerous human and nonhuman actors, the SVW network was extended largely to dominant the Chinese car market by the early 2000s, even faced with high competition from other auto networks.

¹⁰⁷ Interview with the auto policy researcher of the Academy of Macroeconomic Research of the SPC conducted by Gregory Chin in Beijing in May 2006, see Chin, p. 152-3.

In this case, we can also see although Chinese consumers had freedom to choose their favorite cars, their choice of VW was not only an economic behavior, but shaped by the socio-cultural factors. As Sean O'Connell noted: "Deeply rooted cultural values, which were themselves a product of, and producer of, economic behavior, influenced the development of car ownership."¹⁰⁸

¹⁰⁸ O'Connell, p. 11.

Chapter 6 Driving Forward

On June 20 of 1996, *Economic Daily*, China's most authoritative economic paper, ran a commentator article which argued that the role of foreign investment in China's economy was growing rapidly: imported capital then accounted for about 20 percent of all investment in fixed assets in China, foreign-invested enterprises accounted for 39 percent of China's exports, and foreign trade equaled some 40 percent of domestic production; all this suggested a high degree of dependence. Opening up to the outside world was good, the commentator said, "but pay attention to protecting national industries," which was of great importance for China's economic and even political independence.¹ In an accompanying report on joint ventures in China, one entrepreneur also advocated: "Creating our own labels, developing national industries is our historical mission."² Such nationalist emotions and popular concerns over globalization, sovereignty, and national identity, which had been built up in the course of the 1990s, became stronger with China's entry into the WTO and integration of itself into the world capitalist economic and political system in 2001. They cared about how to develop China's own modern industries, questioned the central government's JV-led modernization strategies and policies in the auto sector, and called for technological independence and innovation.

¹ Commentator, "Dajia Lai Taolun Zhege Zhongda keti – Cong Pijiu Hezi Yinqi de Sikao" ("Let Us Discuss This Important Issue – Joint Ventures in the Beer Industry"), *Economic Daily* June 20, 1996.

² Jiang Po, "'Yanjing' Weishenma Bu Hezi?" ("Why Does 'Yanjing' Not Adopt Joint Venture?"), *Economic Daily* June 20, 1996.

Gabrielle Hecht in her study of nuclear power and national identity in France in the 1950s and 1960s demonstrated how the construction of technology responded to, shaped, and ultimately became inseparable from the postwar reformulation of French national identity. She pointed out: “The relationship between technological change and the meanings of national identity went both ways. Technologies did not merely have symbolic importance; they were themselves the outcomes of cultural processes in which ideas about national identity played an important role.”³ This chapter aims to examine that in the first decade of the twenty-first century, when the SVW network encountered the rising popular nationalism, how such nationalism pushed China’s auto industry to develop forward and influenced the extension of the SVW network in China. Specifically speaking, it concerns how the Chinese consumers, intellectuals, and automakers pursued China’s auto indigenous brands for manifestation of national identity, which at the same time shaped the related auto policy making and VW’ strategies in China for the development of SVW and VW cars. The focus is on the roles that the Chinese consumers, intellectuals, and automakers, the central policymakers, as well as VW played in the mutual shaping process of popular nationalism and SVW network. This chapter is divided into three parts. The first part firstly provides an account of how the popular nationalism affected car consumption, and then explores how Chinese intellectuals and automakers devoted to the development of Chinese cars and identified them truly Chinese. The second part presents that influenced by the rise

³ Gabrielle Hecht, “Technology, Politics and National Identity in France,” in Michael Thad and Gabrielle Hecht, ed., *Technologies of Power: Essays In Honor of Thomas P. Hughes and Aghatha C. Hughes* (Cambridge: MIT press, 2001), p. 254.

of “nationally” branded models, what new changes China’s auto policies have been given by the central authorities. The last part, based on examination of how VW responded to China’s popular nationalism and the change of auto policies, analyzes its strategies and development in China.

6.1 Popular Nationalism and the Rise of Chinese Domestic

Automakers

The popular nationalism growing in the 1990s was identified as “Qiang Guo Meng” (the dream to make China wealthy and strong) or “Zhongguo Jueqi” (China Rising). Different from the state patriotism which built up the bond between the Chinese nation and the CCP-led government, making these two inseparable, and claimed that only under the leadership of the CCP could China be developed into a powerful and wealthy country, the popular nationalists did not refer to the CCP frequently, separated the Party-state from the nation,⁴ and was critical of the Party and its actions. They mainly concerned how to build China into a strong nation through the “Chineseization” (sinification) of modernization.⁵

This section concerns the relationship between the popular nationalism, car consumption, and the indigenous car development. It firstly describes how the popular nationalism rose in the 1990s, and examines how such nationalism influenced car consumption, and then offers an account of how Chinese intellectuals

⁴ Peter Gries, *China’s New Nationalism: Pride, Politics, and Diplomacy* (Berkeley, CA: University of California Press, 2004), p. 133-4.

⁵ Zheng Yongnian, *Discovering Chinese Nationalism in China: Modernization, Identity, and International Relations* (Cambridge, UK: Cambridge University Press, 1999), p. 52-66.

advocated national brands based on their criticism of the official JV strategy and how Chinese automakers developed homegrown brands and models under the banner of nationalism.

Popular Nationalism and Car consumption

In Mao Zedong's era (1949-1976), under the CCP's propaganda, the state patriotism was acceptable by the Chinese. In the Chinese view, the Party and the nation were fused into an inseparable whole.⁶ The people believed that only socialism could save China, and under the leadership of the CCP, they relying on their own efforts could establish a strong and wealthy China. During this period, the Chinese felt honor to love their "socialist motherland," and to contribute to socialist construction. With Deng Xiaoping in power in 1978, however, economic reforms and the open policy were implemented. With China opening the door to the outside, there occurred the identity crisis among the Chinese in the late 1970s, which became worse in the 1980s. Many people, especially young people, began to doubt socialism, as one student wrote:

"So far our generation is concerned, we have been taught, ever since primary school, how good our socialist motherland is and how bitter and hard the lives of the people are in capitalist nation. [Now] we see from television the skyscrapers, modern facilities, parks and cultural centers in foreign countries. Compared with that, our country is backward. How can you expect

⁶ Gries, p. 133-4.

us to turn our thinking around to continue believing in the superiority of socialism?"⁷

When the Chinese were more and more aware that China was well behind the West, and even behind the developing Asian countries of Korea and Singapore, and the ordinary people in the West were not suffering from capitalist exploitation as bitter as what Maoist propaganda described but enjoying the comforts of modern industrial society, they declined their faith in the existing ideology, and went to the opposite extreme: everything was beautiful in the West ("Xifang de Yueliang bi Dongfang de Yuan"). In the mid-1980s, most Chinese showed their strong preference over Western culture. According to a nationwide survey in 1987, 75 percent of Chinese were tolerant of the inflow of Western ideas.⁸ In their view, the West was the symbol of a comfortable material life, a spirit of initiative, rational institutional arrangements, and advanced technologies, and was the model for China to follow. Some intellectuals even advocated developing China through wholesale Westernization.⁹ On the contrary, individuals' loyalty to the socialist state was weakened seriously. In a national survey on the question of whether "love the socialist motherland" was the most important basic morality, the distribution of those who answered "yes" was only 28 percent among people aged 18-30; 38

⁷ See *People's Daily*, May 18, 1979, p. 3; cited in Alan Liu, *How China Is Ruled* (Englewood Cliffs, NJ: Prentice-Hall, Inc., 1986), p. 332.

⁸ Min Qi, *Zhongguo Zhengzhi Wenhua (Political Culture in China)*, (Kunming: Yunnan Renmin Chubanshe, 1989), p. 128.

⁹ In the popular TV series "He Shang" ("River Elegy") produced in 1988, the authors ascribed China's backwardness to Chinese traditional culture, and argued that only through wholesale westernization and the introduction of advanced Western cultures could China develop itself. See Su Xiaokang et al., *He Shang (River Elegy)*, (Beijing: Xiandai Chubanshe, 1988).

percent among those aged 31-45; 46 percent for persons aged 46-60; and 52 percent for those aged 61 and over.¹⁰ So, in one word, through the spread of reforms and the open policy, the old Marxist-Maoist ideology became increasingly ineffective, and the Chinese people tended to favor the West, which resulted in the faith crisis throughout the late 1970s and 1980s.

Although since the late of 1980s, there were some intellectuals standing out to resist China's Westernization, and pointing out that modernization was not Westernization, it was in the 1990s that the popular nationalism rose and increasingly became a dominant ideology in China. Although the major causes varied, economic modernization was a helping factor to the growth of popular nationalism. After Deng Xiaoping's Southern tour in 1992, China's pace of reforms and opening up sped up, which brought rapid economic growth and improved living standards. When the International Monetary Fund (IMF) in 1993 announced that China's economy, when measured in terms of purchasing price parity, was already the third largest economy in the world and would likely become the largest economy in the world by 2025, the Chinese pride swelled.¹¹ Moreover, China's domestic economic achievement led many Chinese to proudly witness that their living conditions were approaching the Western. For example, the car, as one property very popular in Western living, began into the Chinese families. In the 1980s when China was called "bicycle kingdom," many people, especially young

¹⁰ Zheng Yongnian, "Development and Democracy: Are They Compatible in China?" *Political Science Quarterly* 109 (1994), p. 35-59.

¹¹ International Monetary Fund, *World Economic Outlook*, 1993; cited in Joseph Fewsmith, *China Since Tiananmen: the Politics of Transition* (UK: Cambridge University Press, 2001), p.144.

people, admired the Western modern society in which most of the people were driving cars. But since the late 1990s, thanks to the economic growth, the income increase, and the auto development, the car became available and affordable for the rich and middle class. Especially after China's entry into WTO, which caused the fall of the car prices, many urban Chinese and some rich peasants bought their favorite cars. The improved living conditions brought the Chinese their dreamed modern lifestyle, which greatly enhanced the Chinese self-confidence and pride, especially when they found that even the West was surprised at China's rapid development. China's economic success was by the popular mass seen as the rise of China's power, and shaped a more confident national identity.

Meanwhile, the injustices inflicted on China by the international community, especially by the United States, initiated the Chinese anti-Western sentiment. The book *The China That Can Say No*,¹² published in 1996, and written by a group of young journalists and intellectuals, expressed a strong nationalist feeling among young people in China when they experienced attempts by the United States to prevent Beijing winning the bid for the 2000 Olympics; the US block on the application of Beijing to joining the WTO; and the intervention of the US Navy in the Taiwan Strait. The American bombing the Chinese Embassy in Belgrade in 1999 led to a big outburst of popular nationalism – in over 20 Chinese cities popular nationalist movements as well as ordinary Chinese people were protesting.¹³ The

¹² Zhang Zangzang et al., *Zhongguo Keyi Shuo Bu: Lengzhanhou Shidai de Zhengzhi yu Qinggan Jueze (The China That Can Say No: Political and Emotional Choices in the Post Cold-War era)*, (Beijing: Zhonghua Gongshang Lianhe Chubanshe, 1996).

¹³ Jie Chen, "Urban Chinese Perceptions of Threats from the United States and Japan," *The Public Opinion Quarterly*, vol. 65, no. 2 (2001), p. 254-266; Gries, 2004.

Chinese realized that the West did not want China to be strong, which created their intense feelings of hatred towards the West.

The rising anti-Western nationalism was widely spread among ordinary citizens and intellectuals in China, and gradually becoming the dominant ideology when the Chinese society lacked competing ideologies within the society.¹⁴ The popular nationalism was upholding the banner of resisting China's Westernization, which, however, also shaped the Chinese choice of cars. The fifth chapter has shown that the Chinese consumers preferred the foreign branded car, because firstly the government and the rich people all chose foreign brands, which caused the public to feel that driving such cars could make them earn "big face" and show success, and secondly they also believed in the good quality of foreign branded cars. When the Chinese consumers bought foreign branded cars like VW instead of homegrown brands such as Chery and Geely, they did not feel guilty to nationalism, because influenced by the government's definition of "homemade" or "domestic" goods, they thought that all of the cars, including the foreign brands, made in China were domestic goods, and to buy a homemade car was to support national industry. However, with the emergence of the homegrown brands at the end of 1990s and in the early 2000s, the Chinese automakers and some nationalist intellectuals stood out to criticize the shortcoming of such broad definition of "domestic cars." They offered the concept of "Chinese car," and pointed out that only those Chinese-

The event of the American bombing the Chinese Embassy in Belgrade is: in 1999 an American plane on NATO mission mistakenly bombed the Chinese Embassy in Belgrade and three Chinese news-reporters were killed in the blast.

¹⁴ Lucian Pye, "How China's Nationalism Was Shanghaied," in Jonathan Unger, ed., *Chinese Nationalism* (NY: M.E. Shape, Inc., 1996), p. 105.

independently-made cars were truly Chinese cars, such as Chery, Geely, BYD, and Great Wall, while the foreign branded cars produced in the JVs should be called “JV cars.”¹⁵ This definition not only raised the debate on the development path of China’s auto industry among the intellectuals, which will be given details below, but also affected a group of Chinese consumers’ choice of cars. Since most of the homegrown brands focused on the low end of the market and on low-priced cars with small engine displacement, the consumers at the lower income level or with less personal savings would like to buy such cars.¹⁶ Although they admitted that the homegrown brands might not own the high reputation and state-of-the-art technology as the foreign brands did, and had to be faced with the pressure from local government’s regulations discriminating against low-emission cars,¹⁷ they as the owners of the truly Chinese-made cars believed that they made a contribution to the development of national auto industry by buying such cars, which made them feel proud, and also earned them “face.”¹⁸ In other words, the popular nationalism

¹⁵ “Wang Fengying: zai Quanshijie Daxiang “Zhongguoche” Gainian” (“Wang Fengying: Letting the Concept of “Chinese Car” Popular in the World”), *Jinghua Shibao (Beijing Times)* March 11, 2010; Ma Lianhua, “Daxiang “Zhongguoche” Gainian, Zhong Daibiao Zhizhao Zhanye Shengji” (“Making the Concept of “Chinese Car” Popular, Representatives of National People’s Congress Suggested How to Develop the Auto Industry”), *Zhongguo Qingnian Bao (China Youth Daily)* March 11, 2010.

¹⁶ According to a survey about China’s middle class’s car consumption, the consumers whose annual average income of between RMB50,000 and RMB150,000 would prefer the homegrown brands. See Cheng Yuanhui, “Zhongchan Renqun Gou Zuoja, Dexiche, Guochanche Cheng Zuiai” (The Middle Class Buying Cars, German brands and Homegrown Brands Becoming Favorite”), *Meiri Jingji Xinwen (Daily Economic News)* December 21, 2010.

¹⁷ See Chapter 5.

¹⁸ See the online forum “Kai Guochanche Zhaoyang you Mianzi” (“Driving the Homegrown Brand Car Also Earns Face”), access to: http://club.china.com/data/thread/1011/2517/59/16/0_1.html

played an important role in helping the homegrown brands squeeze into the foreign-brand-dominated China's auto market.

The Chineseness of Chinese Cars

Although the popular nationalism attacked against China's Westernization, resisting Westernization does not mean that China's modernization would be slowed down, because in the view of the nationalists, China's modernization and Westernization should be de-linked, and modernization would lead China strong and wealthy. What they concern is how to enhance the "Chineseization" of China's modernization to avoid the misfortune resulting from the westernization that occurred in the former Soviet Union.¹⁹ Since the modernization of the auto industry was regarded as one of the key factors in China's economic development, how to establish China's own internationally competitive auto industry was what the nationalists constantly paid attention to. Although in the 1990s, there appeared the nationalist voices questioning the JV-led auto modernization path and the long-term developmental impact of the Sino-foreign JV strategy, since the rise of the homegrown brands and China's WTO accession, the public criticism of China's major auto JVs and the JV strategy has become intensified. According to Chinese researchers,²⁰ the Chinese

¹⁹ This nationalism is also regarded as a movement of the New Left to be distinguished from the old Left which is mainly referred to CCP ideologues associated with either Marxism or Maoism. See Zheng, 1999, p. 51-3.

²⁰ The following arguments come from Lu Feng and Feng Kaidong, *Fazhan Woguo Zizhu Zhishi Chanquan Qiche Gongye de Zhengce Xuanze (The Policy Choices for Developing China's Auto Industry on the Basis of Independent Intellectual Property)*, (Beijing: Peking University Press, 2005); Zhang Xiaoyu, "Woguo Zhengxiang Qiche Chanye Qianguo Maijin" ("China on the Way to a Strong Automobile Industrial Nation"), *Zhongguo Qiche Bao (China Auto News)* September 16, 2003; Dan Ru,

government's strategy of relying on JVs was aimed at encouraging technology transfers from the leading international automakers, based on the expectation that this would lead to fostering domestic R&D capacities. However, two-decade JV-led auto development path has shown that although China has evolved into a country that has large-scale and modern auto manufacturing capacity inside, it has also become heavily reliant on foreign technology and technical know-how. The Chinese automakers in the large major auto JVs have reaped huge profits from their JVs with the foreign partners, but failed to foster "independent" or "self-reliant" vehicle designs or strong internationally recognized brands. They have continued to rely on foreign automakers to provide product designs, as well as imported tooling, manufacturing equipment, and production expertise. Such overreliance on foreign partners to pursue increased production levels, however, would have the long-term risk of China's auto industry being controlled by foreign partners in the JVs, and thus of denationalizing China's car industry.

Due to the auto industry's critical role in China's economic growth, the dependence on the foreign partners in the auto sector would cause the danger of China's economic dependence, which would undermine China's political independence and national security. Shi Zhong, a nationalist researcher, stated:

"national security is not only about military, but also about a country's economy... Modern industrial technologies can be divided into two types: the

"Zizhu Kaifa Guangyou Reqing hai Bugou" ("Enthusiasm Alone Is Not Enough for Independent Development"), in China Auto News, ed., *Zhongguo Qiche Chuangxin Cankao Ziliao Si Juan (Material on China Automobile Innovation, Volume 4)*, (Beijing: Zhongguo Qiche Baoshe, 2004), p. 61-7; Gregory Chin, *China's Automotive Modernization: the Party-State and Multinational Corporations* (UK: Palgrave Macmillan, 2010), p.204-211.

first type can be used to control others and make others dependent; and the second type functions the opposite, i.e. leading the country to be controlled and to be dependent on others.”²¹

Modern Chinese history shows that dependence eventually leads to the loss of national sovereignty. Before the Opium War (1839-1842), China’s economy was still more developed than most Western countries in many aspects. The West then became more advanced in certain key industrial technologies, such as naval and military, that eventually led to China’s defeat. Therefore, in Shi’s view, only a solid independent industrial system will enable China to become a great power in the international community.²²

Regarding the official definition of “domestic cars” and some intellectuals’ argument that in the era of economic globalization, less attention should be given to the “nationality” of the carmakers as long as they produce inside China and pursue exports,²³ the nationalist observers pointed out²⁴ that the JV-made cars were not

²¹ Shi Zhong, “Buying ba Bijiao Youshi de Luoji Tuixiang Jiduan” (“The Logic of Comparative Advantage Should Not Be Pushed to an Extreme”), *Zhanlue yu Guanli (Strategy and Management)* vol.3, 1995, p. 12.

²² Ibid., p. 11-5.

²³ Chen Qingtai and Lu Zhiqiang, “Zhongguo Qiche Chanye de Fazhan Moshi (shang)” (“Development Model of China’s Automobile Industry (Part 1)”), *Zhongguo Jidian Chanye (China Machinery and Electronics Industry)* vol. 3, 2002, p. 6-9; Chen Qingtai and Lu Zhiqiang, “Zhongguo Qiche Chanye de Fazhan Moshi (xia)” (“Development Model of China’s Automobile Industry (Part 2)”), *Zhongguo Jidian Chanye (China Machinery and Electronics Industry)* vol. 6, 2002, p. 30-1.

²⁴ The following arguments come from Lu Feng and Feng Kaidong; Li Xianjun, “Woguo Qiche Chanye yao Shixian cong Bijiao Youshi xiang Jingzheng Youshi Zhanlue Zhuanbian” (“Our National Auto Industry Needs to Achieve A Strategic Transformation from Comparative Advantage to Competitive Advantage”), *Shanghai Qiche (Shanghai Automobile)*, vol. 9, 2005, p. 2-6; “Yaobuyao Gao Zizhu Pinpai? He Guangyuan Shezhan Long Yongtu” (“Whether to Build National Brands? The Debate

real Chinese cars, because the cars were not designed and produced by the Chinese independently; the foreign automakers, due to their interest in the profitability of the business, would not take the long-term goal of China's auto development important. They saw their Chinese partners as counterparts for manufacturing and not for innovation. Although they appeared to have been cooperative in meeting the R&D transfer requirements contained in the auto policy in 1994, they did not "substantially contribute" to improving Chinese innovation capabilities, which partly caused China's weakness in R&D skills. Therefore, the nationalists emphasized that China should adjust the auto modernization path, including elements of the JV strategy, to put excessive focus on building national brands and models, and developing indigenous R&D capacities. They advocated that more government support should be given to market-competitive medium-sized independents, such as Chery and Geely, and to reduce the emphasis on the large JVs.

The Chinese independent automakers actually were the direct beneficiaries of the JV-led auto modernization process. They took advantage of the modernized local supply capacities and the new supply and distribution networks that had been fostered by the big JV assemblers. Even some of their engineers and R&D staff came from the JVs. Take Chery as an example. Its President, Yin Tongyao, had worked with VW in its joint venture with FAW in Changchun.²⁵ Its major model "Fengyun" (Wind Cloud) was built mainly by assembling together parts from local parts and

between He Guangyuan and Long Yongtu"), *Nanfang Dushi Bao (Southern Metropolis Daily)* September 2, 2005; Chin, p. 211-251.

²⁵ See Yin Tongyao's resume, in *Zhongguo Qiche Bao (China Auto News)* May 9, 2005, p. A4.

components makers that supplied the China operations of VW and GM.²⁶ But different from the JVs, since its birth, Chery was going on the road of producing Chinese own cars. According to Yin, as a Chinese engineer, he was tired of producing the cars with the foreign brands in the JVs; to build a Chinese brand is his dream which drove him to devote to Chery.²⁷ In order to achieve independent development, Chery was attaching great importance to increasing its own R&D capabilities. To make its R&D team strong, Chery shared its dream of developing the Chinese branded cars with the engineers nationwide, and persuaded a number of design and product development engineers and management staff who were working for the large JVs like FAW-VW and Dongfeng to come to work for Chery. Those people who were frustrated by the fact that the large JVs were mainly relying on the foreign partners for product design, and leaving the Chinese engineers only to modify and adapt existing technology for the local Chinese market or left simply doing nothing were inspired by Chery's dream and then left the JVs to join Chery.²⁸ By 2005, there had been more than 20 engineers coming from the large JVs in Chery's R&D center, and they developed the model of "Dongfang Zhizi" (Oriental Son).²⁹ Starting in 2003, Chery held the banner of nationalism to recruit new overseas Chinese graduates as well as Chinese experts from foreign auto companies

²⁶ Chin, p. 185-6; Yao Wei, "Ji Quanguo Laodong Mofan, Qirui Qiche Gongsi Zongjingli Yin Tongyao" ("Interview with Chery's General Manager Yin Tongyao"), *Zhongguo Qiche Bao (China Auto News)* May 9, 2005.

²⁷ Yao Wei; "Qirui Yin Tongyao: Wo de Zhongguo Qiche Meng" ("Chery's Yin Tongyao: My Dream of Chinese Cars"), *Zhongguo Keji Caifu (Chinese Science and Technology Fortune)* April 2, 2010.

²⁸ Yao Wei; "Yin Tongyao de Rencai Zhanlue" ("Yin Tongyao's Strategy of Human Resource"), *Zhongguo Qiche Bao (China Auto News)* May 9, 2005.

²⁹ Ibid.

to join the R&D center.³⁰ This included Xu Min, an oversea Chinese engineer who had extensive work experience in the US at Delphi and Visteon as an engine expert and vice president. Xu returned to head Chery's Automotive Engineering Institute, and was in charge of research and development of Chery's own engine.³¹

As an independent car manufacturer, Chery regarded the self-reliant development of its own engine as a necessary and critical project, because in the eyes of Cheryers, the engine, as a core auto technology, was the "heart" of a car, and without a Chinese "heart" – the engine developed by the Chinese independently – the car could not be a real Chinese car. In 2002, Chery launched its engine R&D project. By cooperation with AVL List GmbH, the Austrian engineering consulting firm that specialized in internal combustion engines, Chery's engineers got the training on the latest technical know-how to design and build the sophisticated engines. Then directed by Xu Min, a team of over 200 researchers focused on engine technologies innovation by themselves and developed the engine with their own intellectual property rights.³² In 2005, the first generation engine named "ACTECO" was born, and began to be equipped into Chery's cars. Compared with the foreign branded engines, ACTECO was powerful, energy saving, and environment-friendly (see Table 6.1). It was outstanding in fuel economy. According to the test data, the

³⁰ Ibid.

³¹ Jia Ke, "Xu Min: Zhongguo Qiche Haigui Xianxingzhe" ("Xu Min: One of the First Returnees in China's Auto Sector"), *Qiche Shangye Pinglun (Auto Business Review)* December 13, 2008; "Qiche Haigui Zhi: Diyifen Chengjidan" ("Automotive Returnees: the First Report"), *Qiche Shangye Pinglun (Auto Business Review)* December 18, 2006; Chin, p. 189.

³² Xu Hengsheng, "Ziji Gan Caineng shang Taijie: Qirui Yang Junwei Tan Fadongji Yanfa" ("Self-reliance: Chery's Yang Junwei Talking about the Engine R&D"), *Xin Cheping Wang (New Auto Review)* August 3, 2010.

fuel consumption of Dongfang Zhizi equipped with ACTECO 1.8 L engine was only 5.04 L per 100 kilometers (46.6 miles per Gallon).³³ By 2008, Chery had owned a series of ACTECO engines with different displacement, including 0.8L, 1.1L, 1.3L, 1.5L, 1.6L, and 1.8L, and produced about 400,000 engines annually.³⁴

Table 6.1 The Comparison of ACTECO 1.6 L Engine and Some Foreign-branded 1.6 L Engines

Model parameters	Chery A5 (ACTECO)	Jetta (VW)	Buick (GM)	Polo (VW)
Displacement (ml)	1598	1595	1598	1593
Maximum Power (kw/rpm)	80/5800	68/5800	78/6000	74/6000
Maximum Torque (nm/rpm)	144/4200	140/3000	142/4000	145/3800

Source: <http://auto.enorth.com.cn/system/2007/06/28/001744369.shtml>

³³ “Zizhu Qiche Xingqi Zaoxin Re, Qirui Qiche Guimo Zuida” (“Independent Automakers Beginning Engine R&D, Chery’s Investment Is the Largest”), *Beifang Wang (E-North)* June 28, 2007, available online:

<http://auto.enorth.com.cn/system/2007/06/28/001744369.shtml>

³⁴ Ibid.

In 2006, Chery signed an agreement with Italy's Fiat to supply more than 100,000 1.6L and 1.8L ACTECO engines per year for Fiat cars assembled in China and abroad.³⁵ Fiat was looking to cut costs in its European operations by importing Chinese-made engines for assembly in Europe. This groundbreaking engine purchase deal, in the view of Chery's President, Yin Tongyao, was "an important step for Chery towards internationalization."³⁶ To build a competitive Chinese brand in international market is Chery's goal. As a Chinese company, Chery aimed to develop into the world's leading car manufacturer like Toyota to make the Chinese brand entitled with high reputation – "our cars are the best" – and to let the world know that the Chinese also can independently design and produce the high quality vehicles.³⁷ Since its birth, Chery has taken "Zou Chu Qu" (going out of China into the world) as one of its development strategies.³⁸ In addition to the increasing export of its cars and auto parts,³⁹ Chery expanded its international operations by establishing JVs in the developing countries. In 2003, Chery signed a JV project with SKT, the leading parts maker in Iran for assembling CKDs of Chery's original

³⁵ Zhou Guangjun, "Feiyate Yaozhuang Qirui Fadongji, Qianxia 10wantai Fadongji Dingdan" ("Fiat Wants Chery's Engine, Signing A 100,000 Engine Purchase Order"), *Beijing Yule Xinbao (Beijing Information Daily)* November 2, 2006.

³⁶ Ibid.

³⁷ See the interview with Qin Lihong, then vice-manager of Chery Sale Co., in Yan Cheng, "Qirui yaozuo Zhongguo de Fengtian" ("Chery Wants to Be China's Toyota"), *Sohu Auto* July 24, 2006.

³⁸ "Yin Tongyue Chuangye Zhichu de Mengxiang: ba Qirui Zuocheng Zhongguo de Mingpian" ("Yin Tongyue's Dream: Building Chery into A World-class Chinese Brand"), *Shangwu Zhoukan (Business Week)* November 16, 2010.

³⁹ In 2001, Chery exported only 10 cars. In 2003, the number of car exported rose to 1200 units. As of 2010, Chery exported its cars to more than 70 countries, and the number of car exported every month was over 10,000 units. See Chen Nan, "Shijie de Qirui" ("The Internationalization of Chery"), *Shangwu Zhoukan (Business Week)* November 5, 2010.

Fengyun sedan.⁴⁰ This project involved building an assembly line in Iran, as well as a new plant for stamping, welding, and painting lines. Total output capacity was 30,000 units per year.⁴¹ In 2006, Chery made the cooperation with Daewoo in Egypt to set up a plant for assembling CKDs of Chery's models of "Qiyun," "Dongfang Zhizi," and "Ruihu."⁴² By 2010, Chery had owned 8 assembly plants distributed in Iran, Egypt, Russia, Ukraine, Malaysia, Indonesia, Brazil, and Uruguay.⁴³ The Chery brand has become a popular one in those countries, and enjoyed good comments.⁴⁴

Chery's as well as other self-reliant automakers'⁴⁵ serious efforts and monumental achievements in building the independent Chinese brands were highly appreciated by the public, and strengthened the Chinese confidence in national auto industry. The formerly skeptical Chinese government was also inspired to growingly give support to the independents. For example, in March 2005, China Export and Import Bank provided Chery with over US\$600 million in export credit for export

⁴⁰ "Zizhu Haiwai Jianchang de Daqushi" ("The Internationalization Drive of Chinese Independents"), *Che Chunqiu (Auto History)*, vol.186, 2007.

⁴¹ *Ibid.*; Chin, p. 191.

⁴² Qian Chanjuan and You Xiaoting, "Jiedao Dayu Shishi "Bentuhua," Qirui Aiji Zuzhuang Shengchan" ("Dependent on Daewoo to Implement "Localization," Chery's Cars Assembled in Egypt"), *Dongfang Zaobao (Oriental Morning Post)* August 3, 2006.

⁴³ Zhu Lei, "Qirui: "Zou Chu Qu" Gengyao "Zuo Jin Qu"" ("Chery: from "Go out of China" to "Go into the Foreign Countries""), *People's Daily* December 17, 2010.

⁴⁴ *Ibid.*

⁴⁵ Other self-reliant Chinese automakers, including Geely, Great Wall, Huachen, and Lifan, have also demonstrated their abilities and efforts to design and produce homegrown brand cars independently. They have joined in the internationalization drive as well. For example, Geely owned assembly plants in Malaysia and Ukraine, Great Wall in Russia, Huachen in South Korea, and Lifan in Vietnam, Egypt, and Russia. See "Zizhu Chuangxin Chengji Xianzhu, Zizhu Pinpai Chengguo Qiche Xunli" ("Remarkable Achievements in Independent Innovation, the Homegrown Brand Car Show"), *Beijing Wanbao (Beijing Evening News)* July 21, 2010; "Zizhu Haiwai Jianchang de Daqushi" ("The Internationalization Drive of Chinese Independents"), *Che Chunqiu (Auto History)*, vol.186, 2007.

promotion and oversea expansion, and the China Development Bank provided a loan of about US\$300 million for Chery to expand its R&D capacities.⁴⁶ The central authorities also made some changes of the relative auto policies for support of the development of Chinese homegrown brands, which will be presented in the following section. What's more, faced with the rise of the Chinese independents, plus the public criticism over large state-owned automakers' overreliance on their foreign partners, and the government's increasing support to homegrown brands, two Chinese major auto groups – SAIC and FAW – began carving out their own path, and putting more efforts to build national branded models. In May 2005, SAIC's CEO Hu Maoyuan pledged to sharpen the company's "core competitive edge" in the coming years by "speeding up the development of SAIC's own brands."⁴⁷ In January 2007, SAIC launched its own branded cars named "Rongwei" (Roewe). By late 2007 SAIC already had the SAIC logo – a curved "S" – appearing on 50,000 vehicles from its Yizheng plant alone. Meanwhile, FAW also drew on its accumulated experience in modern car assembly with VW to move to mass production of its own brand – "Hongqi" (Red Flag). In November 2006, FAW introduced the new HQ3 Red Flag at the Beijing Auto Show. In 2008, FAW announced that it intended to commit over 70 percent of its total investment into developing its "own brand" vehicles in the future.⁴⁸ Although the models offered by SAIC and FAW were pointed out to be

⁴⁶ See *Automotive News* April 22, 2005. Cited in Chin, p. 192.

⁴⁷ Zeng Qinghai, "Automaker Striving to Build Own Brands," *China Daily* May 18, 2005.

⁴⁸ Liu Xiaolin, "Yiqi Jiaocheng Zizhu Pinpai Jukui, Mazda 6 Cheng Weiyi Yingli Chexing" ("FAW's Own Brands Sales Down, Mazda 6 Became Profitable Model"), *Beijing Chenbao (Beijing Morning News)* April 8, 2008.

based on adaptation of technologies purchased from UK and Japan respectively,⁴⁹ the two automakers' successful initiation of "self-owned brands" showed that they intended to separate from their foreign partners and approach the independent development.

6.2 A New Look of Chinese Auto Policy

The nationalists' and Chinese independent automakers' call for development of national auto brands obviously kept in line with the goal of the auto industrial policies. The *Automobile Industrial Policy* in 1994 together with the Ninth Five-Year Plan and the Tenth Five-Year Plan aim to build a modern and self-reliant national auto industry by deploying the foreign capital strategies to ensure transfers of complete car technology and the necessary remaining transfers to build more complete local auto supply networks. However, they failed to introduce market-driven incentives for Chinese auto executives to give priority or dedicate more resources to fostering indigenous product innovation and design capacity in China's large state-owned auto enterprises. Compared with the medium-sized independents' great achievements, the Chinese large automakers were over-reliant over their JV partners, which would make them particularly vulnerable and lack of competitiveness when they were faced with global competition challenges with China's WTO entry. The new Hu-Wen government (2003)⁵⁰ recognized that the

⁴⁹ Chin, p. 192-203.

⁵⁰ The Hu-Wen government refers to the Chinese government headed by General Secretary Hu Jintao and Premier Wen Jiabao who succeeded Jiang Zemin, Li Peng

operating environment for Chinese automakers had changed since 2001. The WTO accession would not only require China to open the various auto-related service sectors to foreign investors, including banking, insurance, as well as retail trade, but also restrict the government's support and protection for the domestic auto production, which would bring tremendous pressure to China's auto firms and market.⁵¹ In order to address the vulnerabilities that remained in the Chinese large automakers in terms of indigenous R&D and innovation capability and to promote the development of national auto industry under the WTO-related challenges, Chinese state planners realized that they must re-align the auto policies and try a different approach to supporting China's auto modernization, by giving more investment support for "Zizhu Kaifa" (independent development) and fostering indigenous brands and technological innovation. According to one planner of the

and Zhu Rongji and were considered the 4th generation Chinese leaders. Their official start date was 2003.

⁵¹ According to the researchers associated with the National Development and Reform Commission (NDRC), the implications of China's WTO accession for the auto industry included: first, trade protection measures had to be significantly reduced by July 2006. Specifically, import tariffs for passenger cars had to be reduced to 25 percent; and to only 9.5 percent tariff duty on imported auto parts. Second, import quotas must be eliminated by 1 January 2006. These two conditions mean that basically free trade would take effect in China's auto sector by July 2006 for all vehicle types, whether domestic or foreign-made. Third, the terms of accession require China to open the various auto-related service sectors to foreign investors, including banking, insurance, and nonbank auto financing, as well as wholesale and retail trade, and their participation could significantly cut into Chinese gains. Fourth, the government's auto parts and components local content requirements must be eliminated to accord with the WTO norms of "nondiscrimination" and "national treatment," that are contained in the agreements on Trade-Related Investment Measures (TRIMs) and Trade-Related Intellectual Property Rights (TRIPs). In brief, China agreed to eliminate the performance requirements which had been imposed on foreign investors for local content, exports, or technology transfer, in agreeing to join the WTO. See interview with the researchers of the Academy of Macroeconomic Research of the NDRC conducted by Gregory Chin in Beijing in December 2005 in Chin, p. 218-9.

National Development and Reform Commission (NDRC)⁵² which was in charge of new auto policy making process: “Our leaders and industry have now reached the consensus that China must have its own stage or arena for development, and develop China’s own brands. At the same time, China cannot close the door, and must continue to have JVs and international cooperation...To properly develop our auto industry, China must ‘walk on two legs’.”⁵³ In other words, China must continue to learn from the leading foreign automakers, and maintain partnerships with them. But in order to become a major player in the global auto industry China cannot depend only on Sino-foreign JVs. China must also focus on developing the independent capabilities of its national auto manufacturers.

In May 2004, the NDRC issued a new Auto Industrial Policy which, although still insisted on the principle of combining technology transfer and indigenous R&D development as the 1994 Auto Industrial Policy stipulated, set forth more details in

⁵² In 2003, the SPC was restructured as the National Development and Reform Commission (NDRC) which then merged with the State Council Office for Restructuring the Economic System (SCORES) and part of the State Economic and Trade Commission (SETC). The reform was implemented in order to emphasize research over resource allocation, *to eradicate a tendency to micro-manage* and to remove significant duplication and overlapping of planning responsibilities. Following restructuring, the NDRC had broader jurisdiction and a greater range of responsibilities, and gained greater power in overseeing the pillar industries including the auto sector. As the government’s main planning body, it had broad authority to formulate policies for long-term *macroeconomic* and social development. The NDRC now has responsibility for: drafting the nation’s annual and five-year plans and submitting them to the National People’s Congress on behalf of the State Council; examining and approving major construction projects; approving foreign investment in specified categories of industries; and creating national policies for power production, energy resource allocation and the management of the nation’s strategic oil reserves. For more functions of the NDRC, see <http://en.ndrc.gov.cn/mfndrc/default.htm>

⁵³ Li Miao, “Hyperdrive: an Industry on the Fast Track,” *China Pictorial*, April 2008, p. 10.

emphasizing independent development, encouraging self-property products, and promoting national brands. It stated that one of the policy objectives was to encourage automotive manufacturers to improve R&D capacities and technological innovation, actively develop products with independent intellectual property rights, and implement the brand management strategy; by 2010, to build up a number of famous automotive brands.⁵⁴ In order to achieve this objective, it noted that enterprises implementing independent innovation would be granted preferential tax treatment.⁵⁵ It also took the protection of intellectual property rights great importance, since to strengthen intellectual property protection would promote domestic enterprises' enthusiasm in independent R&D activities. It called for China's auto companies to increase awareness of product brands, and stipulated that starting from the year 2005, all cars and assembly parts manufactured in China would be required to indicate the registered product trademark of the manufacturer; all cars sold in China will have to display the trademark and name of the manufacturer as well as the place of origin in a prominent position.⁵⁶ It not only renewed the call to support establishment of R&D centers in automotive enterprises for improving indigenous R&D capabilities, but also clearly claimed that the government supported the Chinese enterprises to participate in the state-funded major scientific and technological projects, as well as to do the cooperation with

⁵⁴ China National Development and Reform Commission, *Automobile Industrial Policy*, May 2004, Clause No. 3. The full text is available online:

<http://www.people.com.cn/GB/qiche/1049/2537256.html>

⁵⁵ *Ibid.*, Clause No. 7 and No. 27.

⁵⁶ *Ibid.*, Clause No. 26.

scientific research institutions and universities for R&D projects.⁵⁷ The Chinese automakers were required to master the technologies of the car body, and as soon as possible to gain the capabilities of chassis and engine development. Especially the large-scale auto enterprises should develop the world-class vehicles or parts with independent intellectual property rights.⁵⁸

In terms of management of foreign investment, this policy reiterated the Chinese leaders' conservative attitude to foreign borrowing, and emphasized that the Chinese party in a Sino-foreign joint venture to manufacture complete cars, special purpose vehicles, agricultural transport vehicles and motorcycles was required to hold a majority share; if such manufacturer was a company limited by shares, one of the Chinese parties was required to hold a controlling stake that was bigger than the aggregate of the equity held by all foreign investors.⁵⁹ Moreover, compared with the *Automobile Industrial Policy* in 1994, it highlighted that the establishment of new Sino-foreign JVs in automobile manufacturing required approval by the NDRC and the State Council,⁶⁰ which showed the Chinese government was providing stiffer central control of new JVs' entry into the auto sector.

The Chinese leaders were aware of how rapid economic growth and improved living standards benefited the construction of individual Chinese nationalism, and they also viewed economic modernization imperative in order to provide a solid base for a strong Chinese nation-state and to win people's loyalty to

⁵⁷ Ibid., Clause No. 27 & 29.

⁵⁸ Ibid., Clause No. 28.

⁵⁹ Ibid., Clause No. 48.

⁶⁰ Ibid., Clause No. 44.

the State.⁶¹ So, for the purpose of developing the auto industry into the pillar industry of national economy by 2010, and meeting the growing Chinese demand for automotive products,⁶² the Chinese government held a firm stance on speeding up the development of the auto industry and boosting family car market, although they had realized that the mass motorization would bring China a number of challenges in environment, health, energy, transportation, and urban construction. According to the 2004 Auto Industrial Policy, private car consumption was greatly encouraged. In order to develop a consumer-led auto market, the government would deploy a series of key actions: standardize the administrative fees and charges for vehicle registration and use, and prohibit any excessive fee; support the development of auto financing service, and ask financial institutions to improve their services as well as automobile credit mortgage approach; encourage and regulate the used car trading; improve auto insurance management, and call for the insurance companies to promote diversification of products; and ask the local governments to address local traffic and parking problems, and allow personal investments in construction of parking lots.⁶³ Under the consideration of reducing the effects of rapid motorization on energy and environment, the government supported consumers to purchase and use of the vehicles with low energy

⁶¹ Deng Xiaoping indicated that economic modernization was the foundation of a strong China, and only by establishing economic modernization could China achieve national unity and have power in world politics. See Deng Xiaoping, "The Present Situation and the Tasks before Us," in Deng Xiaoping, *Selected Works of Deng Xiaoping 1975-1982* (Beijing: Foreign Languages Press, 1984), p. 224-258.

⁶² Ibid., Chapter Introduction.

⁶³ Ibid., Clause No. 62-74.

consumption, low-emission, new energy, or new power.⁶⁴ In other words, the economy models with small engine displacement, which most of Chinese independent automakers focused on, would be encouraged.

In order to back up the aim of the Auto Industrial Policy at developing the auto industry and the mass auto market, in March 2009, the NDRC launched the *Automobile Industry Restructuring and Revitalization Plan* covering 2009 to 2011.⁶⁵ In this plan, subject to the existing weaknesses of China's auto industry – irrational industrial structure, low technological innovation and self-development capacity, and imperfect consumption policy, the following strategies were offered:

- Promote the development of large-scale Chinese state auto groups by encouraging FAW, Dongfeng, SAIC, Chang'an and other large auto companies to implement the *nationwide* mergers and acquisitions, and supporting the Beijing Auto, Guangzhou Auto, Chery, and other auto companies to implement the *regional* mergers and acquisitions;
- Support the Chinese auto companies to do independent technological innovation and increase indigenous R&D capacities; require them to master the key technologies including the body, chassis, engine, transmission, exhaust purification, and electronic control system, and to actively develop the new energy vehicles like electric cars or hybrid cars;

⁶⁴ Ibid., Clause No. 61.

⁶⁵ *Automobile Industry Restructuring and Revitalization Plan*, March 20, 2009. The full text is available online: http://www.gov.cn/zwgk/2009-03/20/content_1264324.htm

- Foster the independent Chinese brands by strongly encouraging the Chinese automakers to develop their own brands through independent development, joint development, domestic and international mergers and acquisitions, and other means;
- Stimulate car consumption by adjusting and introducing the policies related to car purchase, use, and update, cancelling any provision unfavorable to the consumption of economy models, and encouraging such consumption through taxes and other economic means.

In order to implement these strategies, according to the plan, the government would take the following actions:

- Formulate and launch the policies on automotive mergers and restructuring, with a focus on such issues as management of surplus staff, transfer of corporate assets, debts disposal, and distribution of tax benefits;
- In the next three years, invest RMB10 billion as a special fund for technological progress and technological innovation to support the auto manufacturers to upgrade products, improve key technology capacities, and develop new energy vehicles and special parts.
- Funded by the central government subsidies, support the large and medium cities to use hybrid vehicles, electric vehicles, and other energy-saving and new energy vehicles.
- From January 20 to December 31, 2009, decrease the vehicle purchase tax for the economy models that have engine displacement of 1.6 liters and below; from March 1 to December 31, 2009, arrange RMB5 billion as

financial subsidies for farmers who buy the passenger vehicles with displacement of 1.3 liters and below; eliminate various of excessive administrative fees and charges for vehicle registration and use by the end of 2009; improve the auto loan system, and formulate the relative regulations; accelerate the construction of urban transit facilities and parking lots.

What's more, this plan clearly announced that the existing policies about government procurement would be revised for support to the Chinese homegrown brands. In December 2009, at the Twelfth meeting of the Eleventh National People's Congress, the State Council made adjustment of the government's budget plan, and claimed that since 2009, of the total vehicles purchased by all levels of government and public institutions, the homegrown brands should not be less than 50 percent,⁶⁶ which showed the government's decision to be a "model" in transforming the Chinese car consumption culture from preferring the foreign brands to preferring the Chinese brands, and from favoring big cars to favoring economy models.

6.3 Volkswagen: Keeps on Being a "Good Corporate Citizen" in China?

This section focuses on the interaction between VW as a foreign automaker in China and the Chinese nationalism. It firstly examines how VW responded to the rise of

⁶⁶ "Peibei Gengxin Gongwu Yongche, Zizhu Pinpai Bude Diyu 50%" ("Updating the Official Cars, the Homegrown Brands No Less Than 50%"), *Xinhua News* December 26, 2009.

popular nationalism and the change of China's auto policies, and then presents some criticism and skepticism over VW's strategies in China.

Volkswagen's Chinese Heart

When VW decided to invest in China in the early 1980s, VW executives pinned their hopes on building a "strong long-term partnership" in China, and on the belief that "the Chinese would have a long memory, and remember their friends."⁶⁷ To reinforce such long-term strategy, VW agreed to transfer their latest model at the time – the Santana – to China, and committed to the localization of the Santana, by which VW gained the trust and confidence of their Chinese partners and of state authorities, and built up a solid relationship with central and local governments. As a pioneer in China's car market, VW led SVW's marketing and service efforts, along with the contribution of the official users and the first generation private consumers, successfully to make the Santana and the Shanghai Volkswagen name well known in China, and to win a high reputation in terms of products and service. These above have been discussed in chapter 3, 4, & 5. What's more, VW was well aware that as a foreign company to do business in China, in order to earn the Chinese friendship, they should make a contribution to the Chinese society and public welfare while collecting their first-entry benefits and profits. Since they entered China, VW not only have funded Tongji University to build and develop the Automobile Engineering program, but also provided scholarships to Jilin University

⁶⁷ Interview with Stefan Messmann, then Deputy General Manager and Commercial Executive of Shanghai Volkswagen, May 2005. Cited in Chin, p. 96.

of Technology, Tsinghua University, and FAW Technical College for professional training,⁶⁸ which with no doubt was VW's strategy of strengthening their own engineering teams in China, but also nurtured the Chinese automotive engineering education. Moreover, as of 2005, VW donated more than RMB50 million to the Red Cross, China's Foundation for Poverty Alleviation, the Chinese Women Development Foundation, China's Hope education projects, as well as the Giant Panda Research Center.⁶⁹ In 2003, when China fought against "SARS," VW donated the Ministry of Health RMB1 million and an advanced Passat ambulance to show their concerns and support to the Chinese people.⁷⁰ VW's such contributions were greatly appreciated by the Chinese, which not only led VW to be entitled with a "good corporate citizen" in China, but also enhanced the VW brands more popular and impressive. According to an online survey conducted by J.D. Power and Sina.com in 2006, among 82 auto brands in China, what impressed the Chinese most were the VW brands (see Table 6.2).

⁶⁸ Wang Xiaoling, "Fang Dazhong Qiche Jituan (Zhongguo) Zhixing Fuzongcai Zhang Suixin" ("Interview with Zhang Suixin, Vice President of Volkswagen Group (China)"), *Shangwu Zhoukan (Business Week)* September 20, 2009, p. 76-7.

⁶⁹ Yuan Deli and Li Tianyu, "Dazhong Qiche Jituan zai Zhongguo" ("Volkswagen Group in China"), *Changchun Ribao (Changchun Daily)* February 20, 2005, p. 8; Wang Qiufeng, "Dazhong Qiche de "Renshang" Fangchengshi" ("Volkswagen's "Benevolence Business" Formula"), *Diyi Caijing Ribao (No. 1 Business News)* October 28, 2010.

⁷⁰ Yuan and Li, p. 8.

Table 6.2 Top Ten Impressive Auto Brands in China, 2006

Rank	Brands
No. 1	FAW-VW
No. 2	SVW
No. 3	Chery
No. 4	Audi
No. 5	Huachen-BMW
No. 6	Dongfeng-Citroen
No. 7	Shanghai-GM
No. 8	Huachen-Zhonghua
No. 9	Beijing-Benz
No. 10	Guangzhou-Honda

Source: <http://auto.sina.com.cn/news/2006-12-02/1309235089.shtml>

However, faced with the nationalists' call for national brands, the rise of Chinese independent automakers, and the central policy being directed to support to independent development, especially when their two Chinese partners – SAIC and FAW – were paying more attention to building their own brands – “Rongwei” and “Hongqi” respectively, VW felt great pressure and believed that they needed do more to acquire the Chinese continuous trust and support. Given the fact that the rapid motorization had raised the Chinese concerns of driving safety and environmental protection, VW decided to invest in these two issues for the benefit of the Chinese people. In terms of driving safety, beginning 2005, VW made

cooperation with Tongji University to jointly do a “Road Traffic Accident Research Project,” which aimed to improve China's unique road traffic environment based on research and analysis of the data on traffic accidents. As a by-product of this project, an education film “Dazhong Anquan Lu” (VW Safety Road) was produced to provide the public with some instructions on driving safety, which has been watched by over 10 million Chinese drivers.⁷¹ With respect to environmental protection, VW not only announced that they would introduce the latest environmental-friendly technologies into China, and was working with the SAIC to develop “new energy” vehicles – compact electric cars – for the Chinese market,⁷² but also invested RMB10 million to cooperate with the Education Center of Environmental Protection Ministry to jointly launch an environmental education program “Dazhong Qiche Changxiang Lvse Weilai” (VW Imagines Green Future) since April 2007. The program, designed to enhance young people's environmental protection awareness, is China's first large-scale and long-term project funded by a corporation, and by 2010 had attracted over 20,000 young persons to join.⁷³

What's more, the 2008 Summer Olympics hosted by Beijing, due to being politicized by the Chinese as a good chance to show the world China's power and

⁷¹ Wang Qiufeng, “Dazhong Qiche de “Renshang” Fangchengshi” (“Volkswagen's “Benevolence Business” Formula”), *Diyi Caijing Ribao (No. 1 Business News)* October 28, 2010.

⁷² Reuters, “China Says Volkswagen to Make EV in Shanghai,” September 27, 2011, available online: <http://www.reuters.com/article/2011/09/28/us-vw-chinaev-idUSTRE78R0DD20110928>

⁷³ Ibid; Chen Yi, “Dazhong Qiche: Zhua Lvse Jingying, Zhong Huanbao Jiaoyu” (“VW: Grasping Green Operation, Focusing on Environmental Protection”), *Jingji Ribao (Economic Daily)* August 7, 2010.

national rise, was embedded with the Chinese nationalism. In order to present their sincerity of backing up the Chinese people and also as a marketing strategy to enhance the Chinese good memory of the VW brands, VW applied for the status as the official vehicle sponsor of the 2008 Summer Olympic Games in Beijing, and dependent on their solid relationship with the Chinese government as well as their contributions to China's auto sector, VW successfully got the status. As a sponsor, VW donated the Olympics \$102 million which included vehicles valued \$20 million provide by SVW and FAW-VW.⁷⁴ VW cars as the official fleet vehicles for the international Olympic Torch Relay traveling from Greece to China were marked with "Beijing 2008" emblem, and linked with the Chinese pride (see Figure 6.1).

Figure 6.1 VW 2008 Olympics Print Ad



Source: <http://www.adcase.org/html/case/quananlei/2009/1217/3183.html>

⁷⁴ Zhu Zhuohua, "Bang Beijing Banhao Lvse Aoyun" ("Help Beijing to Host A Green Olympics"), *Nanfang Dushi Bao (Southern Metropolis Daily)* October 15, 2007.

VW not only shared the Olympic enthusiasm with the Chinese people, but also actively expressed their willing to be with the Chinese even when China was suffering huge losses. The Sichuan earthquake occurring on May 12 of 2008 killed at least 68,000 people, left over 5 million people homeless, and caused millions of livestock and a significant amount of agriculture destroyed,⁷⁵ but it raised nationalistic fervor in China. The public from all over China not only donated money and goods for rescue efforts, but also held a three-day national mourning for the quake victims. People launched various nationalistic slogans, including “Zhongguo Wansui” (Long Live China), “Zhongguo Jiayou” (Go China). VW jointly with SVW and FAW-VW donated the Chinese government more than RMB25 million, and also in less than six months after the earthquake, invested in Sichuan for establishment of a big car production base which would have an annual output capacity of 350,000 cars, and expected total annual sales of RMB400 billion.⁷⁶ VW regarded such investment as a practical action to enhance development of the auto industry in Sichuan, and promote local employment, which meanwhile, also matched the central policy of development of the Western region.⁷⁷

In short, VW's strategy in China has turned to be: stay with the Chinese, and never regard self as a foreign company. As Yang Meihong, the vice president of VW (China), said, “When VW is doing business and committing social responsibility...

⁷⁵ Data comes from Wikipedia, available online:

http://en.wikipedia.org/wiki/2008_Sichuan_earthquake#cite_note-data-7

⁷⁶ Wang Qiufeng, “Dazhong Qiche de “Renshang” Fangchengshi” (“Volkswagen’s “Benevolence Business” Formula”), *Diyi Caijing Ribao (No. 1 Business News)* October 28, 2010.

⁷⁷ Ibid.

always regards self as a Chinese company, and grows with China's auto industry, economy, and society together."⁷⁸ One popular VW's TV advertising video also showed that VW accompanied with the Chinese people to experience over two decades of changes and dreams since the reforms and opening up, and had been dedicating to the Chinese society with loyalty (see Figure 6.2).

Figure 6.2 VW TV Ad with the Subject of Loyalty



Note: The Chinese characters in this video capture means “China’s Road, [with] VW’s Heart.”

⁷⁸ Ibid.

Source: the video available online:

http://v.youku.com/v_show/id_XODIyNDE2MA==.html

The efforts of VW in China successfully strengthened the Chinese good memory of VW, which brought VW sale achievement and increased market share. In 2007, VW sales in China (combination of SVW sales and FAW-VW sales) reached 910,491 cars, increasing by 28 percent over 2006.⁷⁹ From 2007 to 2009, VW kept dominating China's highly competitive car market with market share of about 18 percent.⁸⁰

Criticism and Skepticism over Volkswagen

While VW attempted to show the Chinese their sincerity and willing to contribute to China's auto industry and the Chinese society, some public criticism and skepticism over VW's strategies in China still existed. There were Chinese observers pointing out that as a foreign automaker, VW same as other foreign partners did not have the intention of helping China develop the competitive auto industry; they only saw China as a market to sell vehicles rather than a place to develop vehicles, so could not strongly contribute to improving Chinese innovation capabilities in the auto sector, and would not support their Chinese partners to develop the Chinese

⁷⁹ "Shichang Zhanyoulv Dadao 18%, Zhongguo Cheng Dazhong Qiche Zuida de Shichang" ("Market Share of 18%, China Became VW's Largest Market"), *Xinhua News* January 11, 2008.

⁸⁰ Ibid.; "Dazhong Qiche Jihua Kuoda zai Zhongguo de Shichang Zhanyoulv" ("Volkswagen Plans to Expand Market Share in China"), *Zhongguo Xinwen (China News)* November 17, 2009.

branded models, either.⁸¹ According to these observers, although VW engaged in the localization of the Santana and building up the SVW's local supply network, which indeed benefited China's auto industry by helping the development of local suppliers, VW were never willing to transfer their new technology into China. The prime case was the Santana production at SVW.⁸² Since introduced in the early 1980s, the Santana had become SVW's major model. VW worked on modification of this product in China to try to lengthen its life, rather than introducing new products even when the Santana turned into an outdated model and was discontinued in European market in 1988. VW depended on the Santana to dominate China's car market for over one decade and had less incentive to transfer newer models until GM, Honda, and other foreign automakers entered China and brought their new technologies. Although the Chinese government's protectionist policy at the time created disincentive for VW to do technology upgrades, VW's passive technology transfer doubtlessly discounted the sincerity and friendship VW advertised with the Chinese.

In terms of how VW invested less in strengthening Chinese innovations, the critics placed blame on VW's control of the R&D centers in their JVs without transfer

⁸¹ Zhang Zhiyong, "Dazhong Buliang Gongmin Zhenxiang" ("The Truth of VW Being A Bad Corporate Citizen"), *Caijing Wenzhai (Financial Digest)* November 6, 2007; Cheng Yuan, "Deguo Dazhong Weihe dui Zhongguo Qiche Zizhu huai Diyi" ("Why VW Hostile to China's Auto Independents"), *Zhongguo Qingnian Bao(China Youth Daily)* August 3, 2007; Cheng Yuan, "Weihe Yaoshuo Dazhong Bushi Youxiu Qiye Gongmin" ("Why VW Is Not A Good Corporate Citizen"), *Zhongguo Qingnian Bao(China Youth Daily)* October 18, 2007.

⁸² Ibid.

of any core technology.⁸³ In the view of the critics, VW hired the best and brightest Chinese engineers, and placed them in the R&D centers affiliated to their JVs – SVW and FAW-VW. But the Chinese engineers were left only to modify and adapt existing technology for the local Chinese market, and to do auto body design, but seldom to participate in the research and development of core technologies such as engine and transmission. The VW supported R&D centers actually had focused overwhelmingly on technological improvement on existing products, and localization of these products to suit local needs. There had been little innovation design. In fact, not only the core technologies, but also the key design skills had been kept in VW's home country.

With respect to VW's setting up barriers to stop the Chinese partners from building homegrown brands, the critics recalled that on November 25, 1991, suggested by VW, SAIC, with agreement from the central authorities, terminated further production of its own brand, Shanghai Sedan, and merged the Shanghai Auto Plant into SVW for supporting SVW to expand its production capacity. SAIC's these actions not only meant that SAIC lost its own brand, and had to do full-scale commitment to developing VW's models, but also caused local Chinese parts producers to have to reorient their supply lines to only serving VW at the time.⁸⁴

One more case was, in 2006, SVW launched its concept car – “Ne Zha” (Neeza) – at the Beijing International Auto Show, and announced that they would put this car

⁸³ Ibid.; Lu Feng and Feng Kaidong, *Fazhan Woguo Zizhu Zhishi Chanquan Qiche Gongye de Zhengce Xuanze (The Policy Choices for Developing China's Auto Industry on the Basis of Independent Intellectual Property)*, (Beijing: Peking University Press, 2005); Chin, p. 212-3.

⁸⁴ Cheng Yuan, 2007; Li Miao, “Hyperdrive: An Industry on the Fast Track,” *China Pictorial* April 2008, p. 10.

into production next year. Neeza was designed by SVW Chinese team independently and embedded with Chinese culture, taste, and requirements. Although the car body looked quite good, it lacked of the appropriate engine and chassis, both of which were beyond SVW's R&D capacity and had to be offered by VW. However, it was reported that VW refused to develop the engine and chassis for Neeza, and thus the plan of mass production of SVW's independently developed model had to abort.⁸⁵ Chinese critics also revealed that in 2007, Zhu Yanfeng, the general manager of FAW Group, released a plan that FAW would invest RMB13 billion to build its own brands, and develop 50 models in eight years. But according to the executives of FAW-VW, FAW-VW would not contribute to the development of the 50 FAW's own branded models.⁸⁶

Therefore, the Chinese observers sharply pointed out that it was naïve to believe that VW was a good corporate citizen in China, and willing to contribute to the Chinese auto sector. Since setting up JVs with foreign automakers and introduction of foreign models did not automatically mean a transfer of R&D capability, given that the foreign partners did not want to foster the autonomous capabilities of their Chinese partners, Chinese automakers should take independent development imperative and significant, by which the goal of modernization of China's independent auto industry could be achieved.

⁸⁵ Cheng Yuan, 2007; Yang Kairan and Guan Nan, "Ne Zha, Xin Jieda Taisi Fuzhong? Hezi Gongsì Zao Dazhong Jishu Fengsuo" ("Neeza and New Jetta Aborting? JVs Experience Technological Blockade by VW"), *Jinghua Shibao (Beijing Times)* August 16, 2007.

⁸⁶ Yang and Guan, 2007.

Summary and Analysis

In the first decade of the twenty-first century, the popular nationalism rising since the 1990s was not satisfied with the shortage of Chinese branded cars and large state-owned automakers' over-reliance over their JV partners. Chinese intellectuals and independent automakers defined "Chinese car," translated their visions of China's economic and political independence into technological practices and artifacts, and called for supports to development of Chinese national auto industry, by which they committed to building the Chinese indigenous auto networks. For example, Chery tried to establish and extend its network by materializing nationalism into its cars and engine development. A group of Chinese consumers, especially those at the lower income level or with less personal savings, responded to the nationalist definition of "Chinese car" by choosing the cars produced by Chinese independent automakers. Under the nationalism flag, they were willing to enroll into the indigenous auto networks and stay away from the foreign branded cars.

But the nationalists and their auto networks did not have *significant* influence until Chinese central planners, inspired by the medium-sized independents' great achievements as well as faced with the WTO-related challenges, adjusted its auto policies into supporting independent development and fostering indigenous brands and technological innovation. Although with China's WTO entry in 2001, Beijing's behavior in the auto sector, including providing the domestic auto companies with support and protection via import tariffs and quotas, would be restricted by the WTO regulations and rules, the central planners still maintained

the capacity and power to shape the development of the industry by re-aligning the relevant policies and foreign investment strategies to sustain China's automotive modernization drive. The new auto policies showed Chinese planners were holding preference to the development of indigenous auto networks by giving Chery and other Chinese independents more investment and pushing the large state-owned auto enterprises such as SAIC to devote to Chinese branded cars, while VW still concerned its JV's development and the VW cars in China. This, however, resulted in the divergent viewpoints between the central political actors and VW, and thus destroyed the stability of the SVW network.

As Latour pointed out, "When actors and points of view are aligned, then we enter a stable definition of society that looks like domination." When actors are unstable and their points of view shift, negotiation of their interactions is required to gain alignment and stability.⁸⁷ In order to stabilize the network and keep its dominance in China's car market, VW not only introduced the latest environmental-friendly technologies into the network, but also devoted more to its social responsibilities in China and contributed to the Chinese society, by which it tried to please the nationalism and ensured the Chinese that VW did good to China and China's auto modernization so that acquiring the Chinese government's and consumers' continuous support for the partnership with VW as well as the VW cars.

⁸⁷ Bruno Latour, "Technology Is Society Made Durable," in John Law, ed., *A Sociology of Monsters: Essays on Power, Technology and Domination* (London: Routledge, 1991), p. 129.

Chapter 7 Conclusions: Social Construction of Success

One should try to locate power at the extreme points of its exercise, where it is always less legal in character.¹

---Michel Foucault, 1976

The studies of politics, culture and technology simultaneously can give us insight into how technologies constitute a terrain for transforming, enacting, or protesting power relations within the social fabric.²

--- Gabrielle Hecht, 1998

This case study traces the development of SVW from its foundation to the first decade of the twenty-first century, with a focus on examining that with SVW's progress, what actors (social and technical) were involved in the shaping of the SVW project, how to be involved, and how they interacted with each other and established the heterogeneous associations to constitute the SVW's commercial success in China's car market. In this case, it is obvious that there have been involved a number of heterogeneous actors whose activities played important roles in the SVW development process, including the State Council, SPC, CNAIC, Shanghai municipal government, SAIC, VW, parts suppliers, Chinese engineers, official car users, first VW users, China's middle class consumers, VW cars, etc. Although this study has given its primary attention to only couples of major actors in SVW case, it

¹ Michel Foucault, "Two Lectures," in Colin Gordon, ed., *Power/Knowledge: Selected Interviews and Other Writings, 1972-1977* (NY: Pantheon Books, 1980), p. 97.

² Gabrielle Hecht, *The Radiance of France: Nuclear Power and National Identity after World War II* (Cambridge, MA: MIT Press, 1998), p.10.

has shown that SVW's success stemmed neither from VW cars' perfect function or performance, nor simply from any one actor's operation such as VW's wise business strategies. Rather, what constructs success is a matter of a diverse array of social and material actors and their practices in Chinese political and socio-cultural settings.

Case Study Results and Analysis: Actor-networks of SVW

According to Michel Callon, not only are the networks composed of heterogeneous actors but their relationships are also heterogeneous.³ This case study has investigated key social actors including the Chinese political authorities and institutions (both the central and the local), VW, and Chinese customers, as well as material actors –VW cars, and examined their relationships. It is found that although there exist power relationships (i.e. the central political authorities controlled the localities and automakers), exchange relationships (i.e. the consumers exchanged money for VW cars), cooperation relationships (i.e. VW partnered with the Chinese automakers), and production relationships (i.e. VW designed and offered VW cars), the relationships between the actors are not fixed but may be varied, and an actor may not be involved in the single relationship but had interactions with several entities simultaneously and demonstrated multiple influences upon the SVW network. For example, the SAIC was not only the partner of VW in China but also due to its political agency status controlled by the central institutions and meantime

³ Michel Callon, "Society in the Making: The Study of Technology as a Tool for Sociological Analysis," in Wiebe Bijker, Thomas Hughes, and Trevor Pinch, ed. *The Social Construction of Technological Systems: New Directions in the Sociology and History of Technology* (Cambridge MA/London: MIT Press, 1987), p. 95.

was in charge of the sales of SVW cars in the 1980s. But with the strengthening of market economy and the decrease of the state planning, the SAIC was reformed into a large state-owned enterprise without political functions in 1995, and lost its responsibilities in the price setting and sales of SVW cars. The power relationship between the SAIC and SVW thus disappeared, but the partnership between the SAIC and VW was left, and as a state-owned automaker the SAIC was still controlled by the central institutions. Another example is the central senior planners who controlled VW's investment and supply localization job via power, but at the same time were the biggest consumers of VW cars in China and whose car consumption affected Chinese private car consumers' choices.

In the case of SVW, it can be seen that it is the political actors instead of the technologists in Latour's and Callon's networks who played a pivotal role in the foundation of the network as well as its extension. Taking the function of the SPC as an example, in both of the SVW foundation and early production period, due to China's central planning system, the SPC engaged in the SVW development directly. It is the SPC that launched an auto project, defined the aim of the project, identified the actor status of Shanghai municipal government and Shanghai automakers, and together with other central institutions like the FMMB to begin formulating the network in the late 1970s. It forced VW to contribute to the SVW localization and to enroll Chinese parts and components suppliers. With China's auto industry making the transition from central planning and protectionism to increasing market-orientation operations in the 1990s, the SPC deployed influences over the SVW network via policy making instead of direct intervention. It identified and mobilized

other state agencies, local governments, and Chinese automakers to work for the *Automobile Industrial Policy* in 1994. Although there existed interest conflict and different points of view on the key issues among the numerous entities, the SPC exerted its power to align the views and wishes of the entities to reach consensus and worked out the new policy. Then, with the launch and implementation of the new policy, a big flow of foreign investment entered China's auto sector, which not only stimulated the development of China's auto industry, but also generated a number of competitors for SVW. The increasingly fierce competition in the Chinese car market forced VW to enroll more models and new designs into the network of SVW. In the early 2000s, the SPC (restructured as the NDRC) adjusted foreign investment strategies and issued new auto policies supporting independent development, which mobilized VW to introduce the latest environmental-friendly technologies into the network and devote more to the extension of the network.

The political actors also influenced the enrollment of Chinese private car consumers into the network through changing the Chinese ideologies for cars, eliminating the restriction of private car ownership, as well as choosing VW cars as official cars. To highlight the role of the political actors in the shaping of the network, however, does not mean only the political actors took charge of the SVW development. On the contrary, VW, Chinese private consumers, and even VW cars all played influence over the network as this study has shown. Different from the ANT which gives an autonomous voice to nonhuman actors, this study argues that the VW car like the Santana, as a nonhuman actor enrolling the new rich individual consumers into the network, its voice came from its first main users who made it

become the signal of power and privilege and thus attract the new rich to be *willing* to enroll in the network for empowerment. So, in one word, the development of the SVW network was operated by multiple social actors and practices.

Co-construction of Power and Actor-networks

The ANT regards Interactions between actors as the primary building blocks of actor-networks and their many manifestations are “translations.” As mentioned in the chapter of Introduction, translation is the means by which one actor defines others for enrollment or alignment of the entities in a network. Translation implies definition, but definitions are inscribed in intermediaries which come in many forms. Michel Callon has identified four main types of intermediaries:⁴

- Texts⁵
- Technical artefacts⁶
- Human beings⁷
- Money

In the case of SVW, for example, the SAIC, CNAIC, the Bank of China, and VW became partners of the JV via texts (the JV agreement); VW identified and enrolled local

⁴ Michel Callon, “Techno-economic Networks and Irreversibility,” in John Law, ed., *A Sociology of Monsters: Essays on Power, Technology and Domination* (London: Routledge, 1991), p.135-8.

⁵ Texts, or more generally literary inscriptions, include scientific publications which represent network associations through the citations and references that support the research and also document credit for success in research and investigation, and non-scientific texts such as contracts, internal reports, memos and progress reports.

⁶ Technical artefacts, including scientific instruments, machines, robots and consumer goods, are nonhuman entities which together perform certain tasks.

⁷ Also include the skills, the knowledge and the know-how that human beings incorporate.

suppliers via technical artefacts (the qualified Santana parts and components), the required skills and know-how, money, and even contracts. But this case also has presented that in some situations power/control may be considered as an action intermediary. Due to China's hierarchical political structure and the central planning system, the central political actors strictly controlled the localities and enterprises, and even among the bureaucratic institutions and state agencies, the upper level had administrative power over the lower ones and could align their points of view directly via power/control. For instance, as discussed before, the SPC identified the actor status of Shanghai municipal government and Shanghai automakers and enrolled them in the SVW project via power; although according to the SVW JV agreement, VW had no obligation to hasten the localization process, China's top leaders, including Premier Zhao Ziyang, Vice Premier Li Peng, Vice-president of the SPC, and Zhu Rongji, then Vice-director of the SEC, forced VW to contribute to the SVW localization via power; the dispute on whether to have local parts follow VW's quality standards between VW and Shanghai municipal authorities did not end until Zhu Rongji was appointed as Shanghai's mayor in April 1988 and exerted his political power to align their points of view. Since the mid-1990s, the state intervention in the SVW network took the form of policy making. The auto policies and regulations are also the texts in which power is inscribed. VW, as a foreign automaker, enrolled the Chinese suppliers and engineers into the network, and kept the continuous partnership with the SAIC even when Chinese government began supporting the independent development, because VW had the state-of-the-art

technology and know-how China wanted which was also a kind of power.⁸ As for the SVW individual consumers, they were enrolled and kept faithful to the network because the first and biggest users of the VW cars were the officials, which had the cars embodied with power, and thus made the consumers believe that to purchase and support the VW cars could empower them – earn “face” for them, win the public respect, and show their social status. Hence, what circulated between the individual consumers and the cars included not only technical artefacts and money but also power. To sum up, power/control is an important intermediary that circulated, aligned and defined the SVW network. The multiple levels and degrees of control present in the network contributed to the stability and expansion of the network. According to Bruno Latour, a stable network exhibiting alignment among actors exerts power and domination,⁹ which in this case is materialized into VW’s market share dominant in Chinese car market and its commercial success in China.

⁸ According to Michel Foucault, knowledge is also a kind of power. See Gordon, 1980; Michel Foucault, *Discipline & Punish: The Birth of the Prison* (NY: Random House, 1975).

⁹ Bruno Latour, “Technology Is Society Made Durable,” in John Law, ed., *A Sociology of Monsters: Essays on Power, Technology and Domination* (London: Routledge, 1991), p. 129.

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