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Introduction

In February 2009, China surpassed a slumping United States to become the largest automotive market and producer in the world. This is the latest sign that China has joined the world's great powers after three decades of unparalleled economic growth. China's ascent has depended on growth and exports in a range of industries, from electronics to footwear and apparel; however, its continued rise is tied to strategic industries such as automobiles, steel, petrochemicals, telecommunications, and energy. The auto industry has grown rapidly in China over the past three decades, undergoing a thorough industrial transformation.

Since its inception in the early 1900s, the auto industry has been dominated by the Big Three US firms (General Motors, Ford, and Chrysler), and more recently by Japanese and European automakers. In China, it was designated a pillar industry in the mid 1980s, and then an engine of growth for the entire national economy in the early 1990s. China's auto industry experienced a decade-long boom starting in the mid 1990s as waves of foreign investment poured into the sector. By 2003–4, two Chinese automotive companies had joined *Fortune* magazine's list of the world's 500 largest companies (China First Automotive Works and Shanghai Automotive Industrial Corporation). In 2003, Chery Automotive Company, one of the smaller independents, started exporting passenger cars, a first in China's automotive history. Chery has made export growth a central priority for future development.

China's booming auto industry surprised many when it surpassed Japan as the second largest auto producer in the world in 2006.[1] Its continued rise to the world's number one ranking has generated broader attention. The fact that it has coincided with the US auto

industry entering into its worst crisis ever has generated concern in certain national capitals. However, the groundwork for the tectonic shifts was actually laid in the 1980s, and key developments that took place from the early to mid 1990s – long before the concern over China's global rise.

This book addresses two themes in political economy – the role of the state in industrial development and multinational corporations (MNCs) in developing countries – in the context of the world's fastest rising economic power. It examines the Chinese state's leadership role in pushing foreign automakers to transfer large amounts of investment capital and advanced automotive technology to China. The international transfers have been crucial for remaking a once backward auto industry into one that has modern large-scale assembly capacity, comprehensive local supply networks, current car models, and more recently, a new generation of Chinese car brands and models. The focus here is on how the Chinese Party-state has affected developmental outcomes in this strategic industry, especially how Chinese officials intervened with the 1994 Automotive Industrial Policy to force sophisticated and complete transfers of car technology, and to push the national industry from a preliminary phase of auto modernization in the 1980s to a more advanced stage of modernization in the 1990s. The automobile sector is an optimal sector for examining the two aforementioned themes given that the Chinese state has relied heavily on external sources for investment capital, technology, managerial expertise and technical know-how, and related services, to remake the sector into one that is internationally competitive.[2] The intent here is to understand how contingent (world and domestic) market factors and conscious state mediation were brought together to achieve industrial modernization objectives in China's automotive sector. Chinese Communist Party, government, and corporate representatives made the most of changing international market conditions and China's own growing market potential to draw in more sophisticated and higher value-added segments of the automotive supply chain to China. However, despite China's success in acquiring modern manufacturing capacity, the path taken has also resulted in an auto industry that is characterized by enduring vulnerabilities.

This book responds to two questions: first, do states, and the Chinese state in particular, have the capacity to carry out industrial policy, especially to leverage effectively foreign investment from MNCs for national developmental purposes; second, does the resulting industrial policy change the behavior of MNCs. For question one, we analyze

two competing hypotheses: one is the fragmented authoritarianism and decentralized weak state model; the other is China as a unified and strong state. In Part II of the book, we will show that in China's auto development, especially from the early 1990s onwards, there was much more centralized leadership and coordination than acknowledged in the weak state model. This observation challenges the prevailing wisdom in China studies, which has given a lot of attention to the view of a fragmented, decentralized, and weakened Chinese state. Question one is a question of Chinese political studies. Question two comes from ongoing debates in international and comparative political economy, and here we apply it to the China country case. The tendency of both the proponents and critics of MNCs has been to present the multinationals as somehow beyond state regulatory controls.

This study builds on an established literature on how differing national institutional arrangements mediate challenges of international economic integration through institutional structures and norms, patterns of industrial policy and policy networks.[3] It draws conceptual inspiration from a more recent and select literature in international–comparative political economy that has rethought the link between global–local politics in relations between states and MNCs.[4] Doremus, Keller, Pauly, and Reich have developed an analytical framework for examining how system-level arrangements of power are combined with political forces at the domestic level to exert influence on multinational businesses. They examine how states, understood as institutional structures and polities, can influence and even determine the basic institutional structure of MNCs. Whereas Doremus et al. analyze how domestic political structures in the original home states of MNCs leave a long-term effect on the core structures and strategies of multinational firms, we will examine how the "belief-systems" of modern international corporations have been partially reshaped by the influence of the domestic ideational and normative structures, the collective understandings of strong host states, such as China. We will see how leading MNCs partially internalize the national institutional norms of the powerful new host nations to which they have relocated. This approach gives attention to how the strategies and structures of corporations can and do change as they operate internationally. The goal of this study is to integrate conceptual reconsideration and original research on China's automotive modernization and industrial policy, and to offer a more balanced assessment of the role of the Chinese state, and internal and external factors in China's industrial modernization.

Automotive modernization: distinct phases and critical junctures

We can begin by establishing whether China's auto industry has, in fact, undergone "modernization". What are the main indicators? In 1985, when the first model joint ventures opened in China, the country produced only a total of 5200 passenger cars.[5] By 1993, the total had increased to 220,000 cars, and by 2004, had jumped to 2.3 million units produced.[6] Sales of passenger vehicles increased nearly fivefold between 1998 and 2004, from 484,000 cars to 2.3 million. The main purchasers of automobiles have shifted from government and enterprise purchases to private consumers. From 1978 to 2002, China saw major increases in output, shifts in product structure from truck production toward car production, expansion in the range of products, improvements in product quality, enhanced product development skills, progress in human resource development, increased industry consolidation, and more recently, growing potential for exports of parts and entire vehicles, and Chinese outward investment in overseas auto markets.[7]

The role of MNCs and FDI in China's automotive modernization has been especially striking. Between 1994 and 2003, foreign firms invested approximately US$12 billion in China, and by early 2005, the total had surged to US$20 billion. FDI contributed significantly to economic gains in China's automobile industry in several other ways. First, investment from the foreign partners in joint venture automotive firms facilitated new job creation, especially desirable and stable jobs for a large new segment of Chinese workers in the joint ventures.[8] Second, foreign investment in the auto industry benefited the wider Chinese economy as Sino-foreign joint ventures generated strong demand inside China for raw materials, related inputs, and automotive parts and components. By the mid 1990s, 5–6 percent of steel production, 80–90 percent of petroleum products, 14–16 percent of machine-tool production, 50 percent of tempered glass production, 45 percent of tire production, 15 percent of engineered-plastics production, and 15 percent of paint production were the result of demand from the Chinese auto industry.[9]

According to a report (2001) published by the China Automotive Technology and Research Center (CATARC), a top Chinese automotive research center: "Before the reform and opening up to the outside world, the Chinese auto industry was 30 to 40 years behind that of the developed countries, whereas nowadays the level as a whole is

10 to 15 years ... behind that of the advanced countries."[10] Despite the significant developmental gains that have been made, China's leading auto assemblers remain, small in comparison to global leaders, lagging behind global leaders in terms of R&D expenditure, and in marketing and in brand development.[11]

In addressing the gains that have been made over the past three decades, qualitative indicators of automotive modernization can be drawn from groundbreaking research on the auto parts producers in China and India, and their integration into global auto supply chains. In a detailed study for the World Bank, the economist John Sutton provides data on China's auto parts industry that shows that by 2000–1 the manufacturing capacities of Chinese domestic suppliers in the lower to middle value-added segments of the parts and components chain have been brought up to international standards in terms of quality and productivity.[12] Sutton's case study research has focused on car seats and mufflers. He finds that, for China and India specifically, international transfers of technology, managerial, and other forms of know-how – stimulated by domestic content requirements – have led to a "successful outcome" in these segments, meaning that an "infant [supply] industry" has been "successfully nurtured".[13] The modernization of China's auto industry is correlated with, and arguably caused by, the integration of the domestic industry into global supply chains – the internationalization of China's auto industry.

Another dimension in the shift to a higher level of automotive modernization from the mid 1990s onwards relates to the issue of international standards. A key element of auto modernization is that manufacturing capacities have been raised to a level that is either comparable or much closer to international standards. By 2002, over 1000 Chinese auto enterprises had received ISO 9000 certification, the international standard for quality management, and another 100 had received QS 9000 certification, by then the world's most demanding automotive quality standard system.[14] The 1990s also saw China making significant progress in establishing its own modern product quality certification systems, such as the China National Accreditation Council for Registrars, China National Accreditation Committee for Product Certification Bodies, China Registration Board for Auditors, and China National Accreditation Committee for Laboratories.[15] By the end of 1999, the Chinese auto industry had developed 56 mandatory standards, marking progress on standardizing vehicle performance

and safety. Engine emission of all domestic-made cars could meet the Euro-I standard, and some newer vehicles could even meet Euro-II and Euro-III standards.[16]

Gallagher suggests that "without the technology transfer from foreign firms, it is virtually impossible that the Chinese firms would have been able to achieve" the gains they made.[17] She writes: technology transfer from foreign companies enabled a complete transformation of China's automobile industry during the 1980s and 1990s. Thun is more circumspect, viewing the contributions of the foreign partners as confined mainly to the assembly plant rather than the development of the entire supply network.[18] Nonetheless, he concedes that some of the foreign partners did transfer technology to the joint venture and taught their Chinese counterparts how to run a modern assembly plant. He acknowledges that foreign investment has been central to auto sector development, and that differences in the "identity, role and strength of the foreign partner" may have some impact on the variation in outcomes of automotive development in the different Chinese regions that he examines.[19]

Chinese researchers have highlighted that the most significant gains in local parts production capacity were from the mid 1990s onwards, which allowed China to make the leap to modern manufacturing of complete cars by the late 1990s.[20] Despite importing close to 200 sets of technology during the 1980s, the Chinese auto industry had not achieved economies of scale in auto production by the early 1990s (except around Shanghai VW), and had only mastered production techniques common to the first stage of indigenizing imported auto technology.[21] This car technology was 10–15 years behind in the product cycle. The domestic industry was still dependent on joint production with foreign automakers for passenger cars, even though the domestic industry had achieved independent manufacturing capacity for trucks, buses, and motorcycles. By the early 1990s, China was still far from having the capability to develop key parts such as the gearbox, engine, and vehicle body, let alone manufacture and design new models of vehicles to a reasonably high standard.

While the domestic auto industry could manufacture and renovate the parts and technology for a range of vehicle types by the early 1990s, including trucks, buses and motorcycles, Chinese producers had not acquired the capacity to build complete cars.[22] This only came in the 1990s, with the relocation of key parts and component producers to China around the mid 1990s. Through the joint ventures and wholly foreign owned enterprises that large foreign parts makers established

in China, the more value-added segments of the auto production chain were extended to the country. By the end of the 1990s, more than 300 Chinese automotive enterprises had undergone technological renovation using foreign investment, and the domestic industry had introduced over 300 "foreign techniques". Among them were 26 for whole automobiles, 25 for generators, gearboxes, and the integration of main parts, 153 for parts, and 79 for process and R&D.[23] These initiatives explain how a number of Chinese parts and component suppliers, especially in the higher value-added segments, significantly improved their capacities from the mid 1990s onwards. Although the cars produced inside China were still about 5–10 years behind the leading foreign models by the late 1990s, the country had built up significant modern parts-making capacity, reengineered its production systems, and acquired sophisticated assembly capabilities for complete cars. Between 1992 and 1998, the domestic industry saw major increases in unit output levels, and the 2.348 million units produced in 1998 meant that the country could meet the rising domestic demand for cars through domestic supply.[24] By the early 2000s, Chinese parts producers in the lower to middle value-added segments of the parts chain had achieved international market competitiveness. These changes embodied the qualitative shift that China made in automotive modernization, from a lower phase of modernization in the 1980s to a higher phase in the 1990s.

The understanding of automotive modernization in China that guides this book is international and comparative. It distinguishes between differing phases of modernization, and highlights the role of state mediation in bringing about qualitative and quantitative shifts in a two-decade process of auto modernization, that started in the mid 1980s onwards, and transitioned to a more advanced stage from the mid 1990s onwards. It examines the "critical juncture" of the early to mid 1990s, and describes the catalytic role of state intervention in shaping the path of auto development in China.[25] In using the term "modernization", the author is aware that it has been heavily contested in development studies, comparative politics, and international and comparative political economy. "Modernization" here is intended to be descriptive, and not meant to convey preference or support for all aspects of China's reindustrialization, or all aspects of China's complex modernity. There have been downsides to China's pursuit of automotive modernization, foremost being the environmental repercussions of not seeking a transportation strategy that is more balanced between public and private means of

transportation, and a lack of emphasis on environmentally friendly technology.[26]

The argument in brief

Endogenous factors cast a long shadow over the study of China's automotive development. Eric Thun shows that local institutions, state actors, and firms played crucial roles in sustaining China's auto modernization drive.[27] What is not adequately examined are the key roles that central state authorities and foreign automakers have played, in coordination with local factors, in the modernization process, and especially in initiating transformational processes.

The central argument of this book is that the Chinese state has effectively mediated relations between the world's leading automakers and domestic automotive groups to push foreign automakers to transfer large amounts of investment capital, and advanced technologies, to China. The Chinese Party-state has intervened to influence the content and direct the flows of foreign investment into this strategic industry, resulting in the transformation of a once backward auto industry into one that has modern large-scale assembly and supply capacity, current car models, and more recently, a new generation of homegrown Chinese models. Chinese government officials intervened with the 1994 Automotive Industrial Policy (hereafter the '94 AIP), to ensure effective execution of the AIP and the related measures in the Ninth Five-Year Plan (1996–2000). In essence they forced increasingly complete transfers of auto production technology and know-how to China. In exchange for the transfers, Chinese officials provided assurances that the state would build the necessary infrastructure to facilitate the growth of a passenger car market, and meet the operational needs of a high quality modern supply network, functioning according to just-in-time and lean production methods.

Chinese government and corporate representatives made the most of fortuitous world and domestic market conditions in the early to mid 1990s to extract optimal transfers of capital, modern technology and technical know-how from the most capable MNCs and their affiliated parts producers. The Chinese state played an indispensable role in pushing the country to a higher phase of automotive modernization, using a package of policy and regulatory controls on foreign investment to draw the leading foreign assemblers and their key components suppliers into the country. From the mid to late 1990s, foreign

automakers extended the more sophisticated and higher value-added segments of the auto production chain to China. These developments resulted in the transfer of complete car manufacturing capability, and provided for the eventual birth of a new generation of Chinese passenger cars from 2002 onwards.

The '94 AIP was a watershed policy. It is important to clarify that the causal importance of the AIP was not its effect on the total volume of FDI flows into China auto sector per se. The counterfactual argument could be that the fast-growing Chinese market induced the MNCs to go into China, and gave the Chinese state more leverage – rather than any specific policy instruments or adjustments, or any unique features of the state. Skeptics of state intervention could argue that, rather than state stimulus, the massive inflows of FDI into China's auto sector in the mid and late 1990s were merely the result of the attraction of a sizeable Chinese domestic car market by the late 1990s. Or that the MNCs brought their latest models to China in the late 1990s and early 2000s only because the market was becoming very competitive and it was no longer possible to compete without bringing more modern car models. The counterfactual argument would be that it was mainly market competition that drove MNC behavior not state policy.

While not denying that growing market competition was part of the story, it was only part of the explanation. The significance of the '94 AIP to China's auto development lay not in the increased amounts of FDI that poured into China after 1994 per se, but more precisely in its role as a policy tool for Chinese representatives to force more *complete transfers* of automotive manufacturing capability to China in the 1990s in the final push to large-scale, modernized production.[28] The more limited capital transfers and technology of the 1980s only provided a preliminary foundation for a modern auto supply network in China, and mainly in the Shanghai area. The initial gains were the result of the combined efforts of the Shanghai Automotive Industrial Corporation (SAIC) and Volkswagen, and Shanghai parts suppliers to build a local supply network to feed Shanghai VW with locally sourced parts; to reach the 40 percent local content requirements demanded by Chinese authorities. The Shanghai GM negotiations initiated the transition to a higher stage of auto modernization. The landmark Shanghai GM deal resulted in the introduction of an entirely new range of modern car and truck models, and the accompanying technology and assembly processes. These negotiations also induced most of the world's leading auto parts and components

producers to relocate to China, starting in the early and mid 1990s. Both Delphi and Visteon, the main parts suppliers to GM and Ford, established a substantial manufacturing presence inside China in this period. Other parts and component makers came in anticipation of the finalization of the Shanghai JV deal.

Interviews with key participant-observers on the Chinese side and former senior GM representatives indicate that the higher value-added transfers would likely not have happened without the '94 AIP, and the personal interventions of state officials, such as Zeng Peiyan, to push for more robust transfers. Zeng, Vice Chair of the State Planning Commission, was especially important at the central level, and Lu Jian, CEO of the SAIC and Director of the Automotive Localization Office under the Shanghai mayor, played a crucial role at the Shanghai level. In the hands of these professionally competent and politically effective Chinese representatives, the '94 AIP became a strategic lever to pressure MNCs for more comprehensive investment transfers in the service of the country's auto modernization drive.

The effectiveness of state mediation in executing the '94 AIP, and especially the foreign investment strategy, was preceded by important shifts in the Chinese governance structure in the early 1990s, especially the recentralization of decision making and regulatory authority over industrial planning and policy related to the strategic industries. This recentralization of state power enabled the Chinese state to be more effective in its execution of industrial policy in the 1990s, specifically in wresting concessions from MNCs. This recentralization of centralized state leadership and coordination was aided in the China context by the particular nature of the Chinese Party-state. Selective Leninist means – institutional norms and organizational structure – were reasserted from the early 1990s onwards to provide greater coherence for the modernization drive. Norms of "unified and centralized Party leadership", "democratic centralism", and the "correct line", were combined with the CCP's senior cadre management system to ensure disciplined formulation and coherent implementation of the auto industrial policy. This extended to the coordination of domestic resources and contributions to match the transfers of capital, technology, and technical capability from foreign investors.

Although China has made dramatic gains in automotive modernization, the particular path taken has resulted in a national auto industry that is both modern *and* vulnerable. The domestic industry is characterized by modern manufacturing capabilities, but enduring vulnerabilities, in that national automakers continue to lack product innovation and

design skills, systems integration capabilities, and global brand power. China's entry into the WTO has spurred further growth in the auto sector. At the same time, the requirements of accession could exacerbate existing weaknesses. Chinese authorities, and the auto companies themselves, are now focused on devising measures to strengthen the indigenous capabilities of Chinese automakers, and to transition once again to an even higher stage of automotive modernization. This time beyond the catch-up mode.

Multinationals and the state in developing countries

Is it actually possible to lever MNCs for national developmental objectives, and if so, how to do so? This book builds on a literature which has examined how, and under what certain conditions, states in developing countries might successfully regulate MNCs and channel foreign investment to support national development objectives.[29] This theme follows the tradition in political economy which compares different state institutional approaches to promoting industrial development, through mediating international economic integration.[30] Research that has focused on the constraints which MNCs and foreign investment exert over developing countries has generated some rich empirical and political insights.[31] However, this line of thinking diverts attention away from analysis of the differing conditions that lead states to assume the "political will" to engage with MNCs, or the range of policies or precise detail on the development strategy that states have actually produced to try to regulate the interaction between their countries and MNCs. Nor does the constraints literature give adequate attention to the domestic institutional variables which have played an influential role in shaping developmental outcomes, in both positive and negative cases.

Critics of MNCs have suggested that the state has limited ability to control the behavior and impact of multinationals on the host country, and that MNCs tend to contribute to wage stagnation, inequality, and unemployment. Others are concerned about the "inappropriateness" of the production technology or product mix that multinationals transfer to recipient countries, the role of MNCs in "surplus extraction" through transfer pricing and excessive royalty payments, predatory behavior and manipulation of consumer preferences. The common image of the MNC is of "rootless, massive commercial hierarchies, whose far-flung activities appear to constitute the very sinews of a global economy".[32]

MNC supporters argue for their role as an extra source of capital in conditions of scarcity, and for providing needed skills, technology transfer, managerial know-how, and complementary services.[33] They point to MNCs as contributing to a healthy fiscal and external balance, to their "rationalizing" effect on particular sectors and industries, even over governments which may have to rationalize their administrative structures and institutions and reorient their functions, to support the operations of MNCs. MNCs are seen as the vehicles of increased efficiency, productivity, engines of sustained growth and even sustainable development, generating new employment and effective competition. Proponents further suggest that recent trends in globalization have helped eliminate conflicts of interest that may have existed between profit-oriented MNCs seeking to rationalize global activities within particular industries, and host governments that plan on a national cross-industry basis, and regulate to promote the public good.[34]

From the standpoint of the host government in developing countries, the issue is not whether the MNCs are inherently "good" or "bad", but whether they are useful to the developing country for acquiring scarce inputs and complementary services, e.g. export marketing, from external sources on the best possible terms. The challenge is exploring the possibility for achieving desired developmental outcomes through alternative means of interacting with the present world, including with MNCs. As Helleiner has asked: Can less be paid for that which is useful which MNCs provide? [35] Can the detrimental effects of MNC activities be controlled?

The post-Mao Chinese leadership also saw the policy challenge as whether and how China could use MNCs and FDI to modernize its auto industry, *yet* ensure that 'the Chinese side' did not lose control. Chinese authorities were concerned about the potential denationalization of the national auto industry that could result from the increased role for multinationals and foreign investment. The Party elite put its faith in new state rules and policies on foreign investment, and the regulatory influence they could exert by controlling foreign investment approvals, starting with joint ventures and Special Economic Zones, and later across many sectors of the economy. These measures were specially tailored to China's political situation, and enabled Chinese authorities to contain the economic vulnerabilities resulting from increased exposure and engagement with "foreign capital", while simultaneously allowing the country to benefit from increased international linkages.[36]

China's foreign investment laws for the period in question (1980s and 1990s) required strict joint ownership arrangements, with the foreign side only allowed a minority share, in order to dilute the degree of control which foreign partners could hold inside their Chinese subsidiaries. The state introduced a set of trade, exchange rate, and pricing policies, and a combination of general and sector-specific, and negative and positive incentives to push content localization above the required levels. Investment commissions in developing countries have also wielded significant discretionary powers in the administrative management of FDI.[37] It is useful to go beyond legal or policy statutes, to examine the role of domestic state organizations and institutional norms in shaping FDI flows.

To back up the laws and regulations, Chinese authorities ensured that approvals for foreign invested projects went through three government bodies, starting with the line ministry responsible for foreign investment and trade, which during the 1980s was called the Ministry of Foreign Economic Relations and Trade (and renamed the Ministry of Foreign Trade and Economic Relations in 1992), the State Planning Commission (later renamed the State Development and Planning Commission in 1998), and ultimately at the executive level, the State Council. The key institutional filter in this approval process was the State Planning Commission (SPC). The interlinking of the economic agenda and priorities of the Party and government leadership was secured through the SPC, while the relevant line ministries and the Customs General Administration were assigned the task of following up to make sure that investment is taking place as promised. [38]

The Chinese state: fragmented, weak, and decentralized?

Given the magnitude of change that has occurred in China in the post-Mao period, including in the auto sector, it is not surprising that there has been intense debate in the study of Chinese politics over how best to characterize China's political system. The fall of Leninist regimes around the world, and the radical transformations that have followed in their wake have led to a "paradigm gap". The reforms in China in the economy, politics, and society over the past three decades suggest that the political–economic order is fundamentally changing.[39] Baum and Shevchenko have noted that with no ready-made theoretical or conceptual models available to fill the void left by the apparent demise

of the old Leninist order, "more and more scholars have entered the paradigm sweepstakes".[40]

One concept that appears to have endured, especially for those researching policy making in Chinese economic development, is "fragmented authoritarianism".[41] This is the idea that, in China, governmental structures are fragmented vertically along functional lines, and coordination can only be achieved across different ministries if a coordinating organ has sufficient power. Bureaucratic organs of equal rank bargain intensely and continuously over scarce resources, and in many instances decisions can only be reached and compliance ensured through the intervention of higher authorities. A related body of research, that also presents state power in China as diffused, focuses on the rise of the local state and local institutions. This literature examines decentralization as a central feature of China's economic reform process. It suggests that the decision-making authority of local governments and enterprises has increased significantly in the post-Mao period.[42] The cumulative effects are that localities have great incentives to promote local development, sometimes even by enacting policies that ignore national objectives. The corollary to decentralized authority is weakened national state capacity.[43]

Adam Segal and Eric Thun draw on the fragmented authoritarianism and decentralization hypotheses, and a growing number of studies that reorient the study of political economy to the local level, to argue for focusing on local institutions as developmental tools and local institutional variation in determining "success" in the specific sectors of information technology and automotive.[44] They suggest that local governments do not simply try to reproduce and catch up with development efforts initiated by the central government, but are often the actual architects of growth, designing and implementing development policies which are conducive to local institutional frameworks and specific development needs. They emphasize that it is important to understand that national economies are made up of disparate regional economies, and that recent studies on subnational units in advanced economies have focused on the manner in which micro-agents of capitalist systems, including companies, customers, employees, owners of capital, organize their relationships within a framework of incentives or "rules of the game" set by a range of market-related institutions. The heterogeneity of local development efforts and different regional groups of industrial actors will invariably conceptualize and organize industrial activity in ways that reflect their own pasts and local characteristics. The economic reforms in China have produced a similar "mosaic effect", and

promoted regional variation.[45] The central government expanded both the decision-making authority of local governments and enterprises and their ability to retain the revenue earned within their respective jurisdictions. The result is a system that encourages localities to promote local development, resulting sometimes in local industrial policies that ignore national objectives. Even on issues officially controlled by the center, a local government's interpretation or the degree of compliance with central dictates is often the more important determinant of policy.[46]

Thun applies the fragmented authoritarianism and "local variation within a national whole" approaches to describing China's auto sector development. He suggests: "in the auto industry, this problem of fragmented authority was particularly vexing because investment capital was extremely scarce and the widespread linkages of the industry drew a large number of government offices into the policymaking process. Bureaucratic infighting was more common than coordinated development."[47] He says that, in the auto sector, sufficient coordination across the usually fragmented political system was only possible at the local level, and only seen in Shanghai, which created the Automotive Industry Leading Small Group (in 1987).

While not rejecting the significance of local variation, the view of China's auto development presented here differs from the fragmented, weakened, and constrained central-state and nationally diffused model of industrial development, especially for China's auto policy process from the early 1990s onwards. While "fragmented authority" is an accurate depiction of the structure of decision making and administration in the auto sector in the 1980s, an important policy shift occurred in the 1990s, in which the SPC intervened to restore a greater degree of centralized coordination to China's auto development process, especially in utilizing foreign investment. A more complete understanding of the role of the state in China's auto modernization – especially from the early 1990s onwards – requires returning to an approach that analyzes how a restrengthened SPC, under the leadership of Vice Chair Zeng Peiyan, reached across the rival state agencies, to enforce a significant measure of centralized political and regulatory direction and policy coordination in the country's auto modernization process. This view calls for returning to the concept of a nationally integrated Chinese state, anchored on the concept of the "Party-state". It also calls for once again analyzing how different national institutional structures respond to challenges of industrial modernization, which are often the result of pressures from international economic integration. It places emphasis again on

comparing differences in state structures in industrial intervention in national entities – even while being mindful of local variation within national units – as the most prescient comparisons for understanding China's auto sector development.[48]

The Chinese Communist Party is seen as having various means for maintaining a productive tension between economic decentralization and political coherence in the state structure.[49] Even if some traditional Communist institutions of control have been weakened because of the devolution of centralized authorities, Party and government leaders nonetheless continue to have a range of Leninist means at their disposal for ensuring centralized control, including the economic planning organs through which the Party can exercise economic leadership, specifically the SPC, as well as internalized Leninist norms of "unified and centralized leadership", "democratic centralism" and the "correct line", and Leninist senior cadre management systems such as the *nomenklatura*, for ensuring effective execution of political and economic directives. The Leninist institutional legacies provide the Chinese government with a unique "reserve capacity" for coordinating industrial development, and have been brought to bear on the strategic industries. The Chinese government has means at its disposal for dealing with policy deficiencies that are very different from other developing countries, or authoritarian systems.

The traditional concept of the Party-state continues to hold relevancy for capturing important aspects of China's evolving system of governance and economy. Not only has the CCP not disappeared along with other Leninist regimes around the world, it continues to be the predominant political force in Chinese state and society. White's view of the essential character of the Communist state in China still applies: the key institution is the Party.[50] The state is understood here as a complex of interlocking institutions and power relationships that perform vital ideological, political, administrative, economic, and coercive functions. The Party is not above or outside 'the state' – it is the essential dynamic component, exercising political leadership: decision making, socialization, social coordination, mobilization and control, and conflict management. The Party is the main ideological agent within the state, charged with the task of controlling the bureaucratic and coercive organs of power; and its power extends through the state to society at large.[51] In the regulation of China's strategic industries, especially those with large-scale foreign invested projects, the roles of the Party and the state bureaucracy continue to be tightly interlinked.[52]

This is not to deny the fact that there is "fragmented authority"[53] in China, or that power inside China appears as a "honeycomb pattern" with a "highly localized, highly segmented, cell-like pattern",[54] or that decentralization has unleashed influential new actors[55] and empowered local actors with a greater degree of autonomy in some sectors and locales, sometimes even at the expense of central coordination and direction.[56] This study shows, however, that there is more than fragmented authority and decentralized power in the "People's Republic", and especially in strategic industries. Powerful forces of systemic integration and coordination are at work inside the pillar industries, although their role is not trumpeted, and they usually function behind closed doors. The Party's role in influencing economic outcomes continues to stretch from finance to industrial policy, and to trade and exchange rate policy.[57] The reassertion of the primacy of the Party in the affairs of the state, at all levels, has been especially pronounced in the period since the early 1990s. Overemphasis of coordination problems results in missing the important coordination that has taken place in China's industrial redevelopment during the reform period. Zeng Peiyan and the SPC used the centralized institutional structures of the Chinese Party-state to bring together a broad-ranging group of domestic stakeholders to formulate and execute the '94 AIP. At the same time, Zeng, his auto policy network, guided by the AIP, also brought about profound changes in China's auto industry in the 1990s, including making more strategic and targeted use of foreign investment than in the previous decade, and forcing foreign investors to transfer more complete car technology. The issue here is the adaptability of Leninist controls to a changing economic environment, to new forms of international investment partnership, and to growing market dynamics.[58]

In the auto sector, the organs of the Party-state were not passive institutions, buffeted by new market pressures from above and below. They actively intervened to shape incentives and constrain powerful market actors, to influence the content and direct foreign investment flows to desired national objectives. The unique institutional factors of the Chinese Party-state exerted a powerful coordination effect on developmental outcomes in China's auto modernization drive, especially from the early 1990s onwards. The institutions provided coherence across a fragmented environment of rival state agencies and central–local tensions in the execution of the foreign investment strategy in the AIP. At the same time, Leninist means were not conducive to inducing Chinese state auto executives to make sure that

their companies developed automotive design and innovation skills, and systems integration capacity.

The automotive sector may be an exceptional case study in terms of the degree of reliance on foreign investment; it is the one sector where every major project involves foreign investment and Chinese–foreign corporate partnership. However, this same feature makes it a useful focal point for examining whether and how the Chinese Party-state has been effective in utilizing MNCs and foreign investment for realizing the country's national development goals. It is the sector in which the Party-state has put the most concerted effort into developing and implementing a comprehensive and coordinated strategy for "utilizing foreign capital".

Outline of the book

This introductory chapter has outlined the theoretical and conceptual foundation for the book. Chapter 2 provides a comparative and international perspective on the character and role of the Chinese state in terms of its purposive intervention in industrial modernization. Part I describes the first or lower phase of China's automotive modernization process. Chapter 3 examines the contextual background for China's automotive sector development in the 1980s and 1990s. It discusses the global and domestic context in which the Chinese Party-state began to facilitate the modernization of the national automotive industry, its initial mediation efforts between the domestic automotive enterprises and foreign MNCs in the late 1970s and early 1980s. The focus is on how world economic conditions, external factors, constrained the effectiveness of the strategy of using foreign investment and expertise for rebuilding China's auto industry. The main inhibiting factor was that only weak MNCs were willing to invest in China's auto sector during the 1980s. However, domestic coordination failure in this period also contributed to the unsatisfactory developmental results at this stage.

Part II examines the transition and evolution of China's automotive sector development as it shifted to a higher phase in the 1990s. Chapter 4 describes how the Chinese Party-state directed Volkswagen toward investing in China in ways that would achieve national developmental objectives. The focus will be on the role of central state authorities in prodding this key MNC to contribute beyond its contractual obligations, and play a direct role in building modern local parts manufacturing capabilities to supply the Shanghai VW

joint venture. Yet Volkswagen also distinguished itself from its two foreign rivals in this period, AMC/Chrysler and Peugeot, by taking on a substantial role, working together with local actors and institutions to build a modern local parts supply network in the Shanghai area. Chapter 5 analyzes the details of the 1994 Auto Industrial Policy, reconsidering its aims and its medium-term relevancy. In outlining a more expansive, yet systematic and targeted foreign investment utilization strategy, the '94 AIP represented a major advance on the more general industrial restructuring plan of the previous 1987 AIP; a more precise and coherent state mediation strategy that pushed the country to a more advanced stage of auto modernization. Chapter 6 examines the political institutional factors that enabled the Party-state effectively to coordinate the implementation of foreign investment strategies in the auto sector. We describe how Leninist arrangements and specific actors in the Chinese Party-state affected the formulation and execution of the '94 AIP, specifically the organizational role of the SPC as the interlocutor of Party and bureaucratic leadership, the senior personnel management system, and the organizational norms of "unified and centralized leadership", "democratic centralism", and "the correct line". These distinctive Leninist features enabled the Chinese state to steer foreign investors toward advanced auto modernization objectives in a coordinated manner, securing transfers of technology required for building complete modern cars in China. Chapter 7 discusses how two previously irreconcilable forces – world leading auto firms and strong state regulation – were brought together to rebuild China's auto industry. Attention is focused on the bargaining dynamics among the main actors in the bidding for the second joint venture assembly partnership with Shanghai Automotive (SAIC). Professionally qualified Chinese authorities and corporate representatives used the '94 AIP effectively to leverage the key foreign auto firms to invest in China. We also learn how General Motors, when facing a strong state with demonstrated ability to cajole international automakers into investment concessions, took bold proactive steps to win the JV bid and push for special investment allowances that gave it decided competitive advantages over its foreign rivals.

Part III examines the cumulative impact of the particular path that China has taken to redevelop its automotive industry over the past three decades. Chapter 8 describes how Chery, FAW, and SAIC built on the bargaining and reindustrialization gains of the 1980s and 1990s, the international transfers of increasingly sophisticated and complete technology and technical know-how, to further advance

China's auto reindustrialization agenda. The efforts of the previous decades, in developing modern auto assembly capacity, building up comprehensive local supply capacity for parts and components, and sophisticated distribution networks, culminated in a new generation of Chinese homegrown brands and vehicle models. Each of these three Chinese auto groups have taken different strategic approaches to "integrative innovation", to creatively integrate international and domestic resources into newly adapted car designs. Chapter 9 reflects on the impact of China's MNC-reliant auto development strategy from the standpoint of limits and vulnerabilities. The main finding is that although China has been turned into a large-scale producer of modern vehicles, a major source of low-cost auto parts, and new "nationally" branded models, the domestic auto industry also displays significant limits in indigenous car design and innovation capability. The massive waves of FDI that poured into China over the past three decades have not led to a full range of technological learning on the Chinese side, which is considered to include technology application, adaptation, design and innovation capacities. While manufacturing skills for the production of complete cars were successfully transferred by the late 1990s, China's domestic automakers have not experienced significant improvements in design and innovation capabilities for car models or production systems. China is still heavily reliant on foreign MNCs for leading-edge automotive design and innovation, and the accompanying design for systems integration. Chinese auto companies have seen limited gains in these crucial areas of corporate competitiveness, in this capital- and technology-intensive industry. In short, China's domestic automobile industry is more modern, yet also vulnerable. The chapter furthermore finds that the terms and conditions of the country's accession to the World Trade Organization could intensify the existing developmental limits in its domestic auto sector.

The concluding chapter returns to the main themes of the book, summarizing the lessons learned that can be drawn from the Chinese case for other developing states, and states in the global economy more broadly. The most important lesson is that the Chinese experience is not repeatable. Similar to Johnson's view on the Japanese developmental state, the main message in this book is that China's experience of automotive modernization would be hard to emulate, if for no reason other than China's industrial redevelopment success has depended on a world automotive industry with cash-flush MNCs. For more than two decades, the world's leading automakers had excess capital to invest in new growth markets, but now the global economy is mired in a downturn

and finance is constrained. Also difficult to replicate would be the situation of a Chinese Communist Party-state which has secured three decades of historically unprecedented market growth, in a country of 1.3 billion people. Nonetheless, some measured developmental lessons can be drawn from China's experience of automotive reindustrialization. We will return to these at the end of the discussion.

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