J1 June Intensive Revision 2014

# Type I – CSQ Test Question

**China’s Automobile Industry**

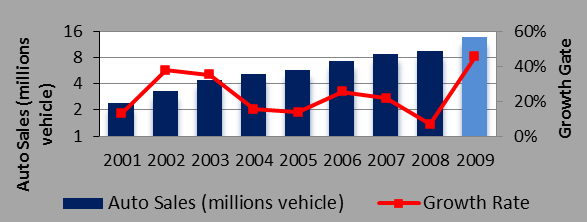
**Extract 1: China’s Fast Developing Automobile Industry**

In 2009, China became the world’s largest auto producer and the world’s largest automotive market. Thanks to China’s sound economic fundamentals and state-oriented preferential policies, the development of the Chinese automobile industry is good and has the potential for further strong development. China has been achieving a remarkable annual GDP growth of 10% over the last two decades. The new rich and middle classes are willing to purchase vehicles as they are largely reflective of high social and economic status. In addition, the government has effectively stimulated domestic vehicle demand by implementing various policies to expand vehicle production, boost domestic consumption and speed up the development of alternative fuel vehicles. The government’s stimulus packages in 2009, such as lower purchase tax on small-engine cars below 1.6 litres and a 5-billion yuandirect subsidies for peasants to purchase minivans and light trucks, have boosted consumers’ spending on new vehicles.

China’s automobile sector is and has been one of the main stays of the Chinese economy. The auto sector has strong linkage with more than 100 upstream and downstream industries, including steel, plastic, aluminium, glass and rubber. Their combined industrial output could amount to around 4 trillion yuan.

Adapted from *Background Brief No. 500, 14 Jan 2010, East Asian Institute, NUS.*

**Figure 1: China’s Auto Sales, 2001 - 2009**

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*Source: China Association of Automotive Manufacturers*

**Extract 2: Mergers and Acquisitions - A Key Development Strategy**

One weakness of the Chinese automobile industry is regional production fragmentation. There are more than 120 vehicle makers, which are almost equal to the combined figures of all auto enterprises in Europe, Japan and the U.S.A. Most of these firms suffer from weak competitiveness and low production capacity. Shanghai Automotive Industry Corporation Group (SAIC), First Automobile Works Co., Ltd (FAW) and Dongfeng Motor Corporation (DFM) are the top three vehicle producers. However, they shared less than 50% of overall auto sales in 2008. The Chinese government is thus pushing for mergers and acquisitions in the automotive industry which will support the emergence of a few leading national companies. The auto sector is an industry that enjoys economies of scale. Mergers and acquisitions can therefore substantially reduce the production cost per vehicle.

Adapted from *Background Brief No. 500, 14 Jan 2010, East Asian Institute, NUS*

**Extract 3: When will China produce a car brand people want to drive?**

Until the late 1970s China was making fewer than 3,000 passenger cars a year. In 1989 it exported just 6 cars. Now, its motor industry supports millions of jobs. Last year they exported almost 900,000 cars. However, this is not a fantastic success when measured against the Chinese government’s ambitions. The Chinese state planners had intended, by 2010, to have “three or four large, globally competitive auto firms” like America and Japan, and for these to have their own successful brands and technology. However, even the most innovative of China’s independent automakers have relied heavily on copying, cost control and public relations to give the appearance of innovation.

Japan and South Korea got their car-making industries going by shutting foreigners out of their domestic markets, giving domestic brands a captive audience to practise on. China let in the foreign carmakers, but on condition that they worked with local partners. The idea was that the Chinese makers would by now have learned the knack of producing world-beating cars, and presumably be in a position to dump their foreign partners. However, this hasn’t quite happened.

Surveys of foreign- and Chinese-branded cars’ mechanical faults show that the local brands are increasingly able to meet the safety standards of the western markets but changing motorists’ perceptions of the inferiority of domestically branded goods will take time. To catch up with their foreign rivals, some of the big Chinese makers are resorting to acquisitions to obtain foreign technology. Shanghai Automotive Industry Corporation Group (SAIC) bought some remnants of Rover, Britain’s former state carmaker, and is using its designers to create promising new models. Geely bought Volvo from Ford, and can now combine its own Chinese market access and strong supply chain with Volvo’s technology and image-making savvy.

However, while Chinese-branded cars may be getting better; but so are foreign ones. The rich world’s carmakers are loading their models with ever fancier navigation, entertainment and safety gear. Meanwhile the global giants’ adoption of standard “platforms”, on which a wide range of models can be built, combined with China’s rising wage bills, mean that Chinese makers’ cost advantages are fading.

Adapted from *The Economist, 5 May 2012*

**Extract 4: China’s support programmes for automobiles and auto parts**

Through a sophisticated web of policies to nurture and support its automotive industry, the Chinese government has played a central role in the growth of China’s automotive industry, and it will continue to do so in the coming years.

Under its national high-technology research and development program, the government invested nearly RMB 5.6 billion (US$872 million) in new energy vehicle technologies from 2002 through 2010. In its 2009 stimulus plan, the government allocated another RMB 10 billion (US$1.5 billion) for the development of key automotive parts and technologies, including but not limited to new-energy vehicles. From 2011 through 2020, the government plans to invest at least RMB 115 billion (US$18 billion) to build up its energy-saving and new-energy automotive industry, nearly half of which will subsidize the development and industrialization of core technologies. New energy vehicles include battery-powered electric cars and plug-in hybrid vehicles. In addition, vehicle and parts makers enjoy access to a broad array of subsidies. The government targets specific automotive components and technologies as encouraged national projects, and producers of products listed in these catalogues enjoy reductions in the corporate income tax rate of 50 percent, subsidized credit from state-owned banks and many other benefits. However, these policies violate China’s international trade obligations as define by the World Trade Organisation.

*http://*[*www.stewardlaw.com*](http://www.stewardlaw.com), January 2012

**Extract 5: Car sales blamed for pollution**

Vehicle exhaust emissions have become the main contributor to worsening air pollution in big Chinese cities as the country undergoes a surge in car sales. In the Ministry of Environmental Protection’s 2010 report on pollution caused by China's vehicle exhaust emissions, the car sales bonanza has been blamed for the devastating air quality in most cities. The report said air pollution problems, ranging from acid rain, haze and photochemical smog, became more frequent in some regions. “All the problems are closely related to vehicle exhaust emissions, including nitrogen oxide and other small particles,” it said.

Adapted from *Wang Qian (China Daily),* 5 Nov 2010

**Questions**

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| (a) | i) With reference to Figure 1, describe the trend of China’s automobile sales during the period 2001 to 2009. | [2] |
|  | ii) Using relevant economic concepts and the data, account for the change in China’s automobile sales in 2009. | [6] |
| (b) | Explain **two** barriers faced by the Chinese automobile manufacturers in penetrating the global automobile market. | [4] |
| (c) | Discuss the effectiveness of mergers and acquisitions by the Chinese automobile manufacturers to increase their share of the global automobile market. | [8] |
| (d) | Examine the arguments for and against the Chinese government’s continued support of the growth of the country’s automobile industry. | [10] |

**Total: 30m**