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China's Rise as Auto-Parts Power Reflects New Manufacturing Edge

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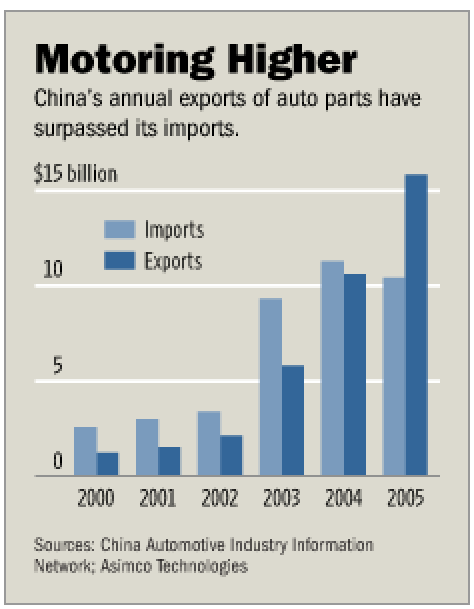
BEIJING -- Raising the bar for competitors around the world, China is shifting its manufacturing resources to increasingly sophisticated goods, as shown by its rapid emergence as a global powerhouse in the auto-parts industry.

Just a few years ago, Chinese-made automotive components were plagued by a reputation for poor quality, and often cost more than U.S. or German parts. Detractors said the precision engineering required for the best parts was beyond the reach of inexperienced Chinese companies and their low-cost workers.

Last year, however, China for the first time exported more parts than its fast-growing auto industry purchased from abroad. Quality has improved so much that major Western auto makers like **Volkswagen** AG and **DaimlerChrysler** AG say they plan in coming years to buy billions of dollars of Chinese-made components -- such as brakes, fuel pumps, wheels and steering systems.



Those gains show how China continues to evolve as a manufacturer, posing new challenges for rivals in the U.S., Europe and Japan. After earning its stripes as a maker of simple consumer goods, such as furniture and textiles, China has branched out, quickly coming to dominate more labor-intensive parts of the consumer-electronics business, such as computer assembly, and moving into a broader range of industries.

The country's production of machinery and transportation equipment has surged, and export of those goods -- which range from auto parts to forklifts to vacuum cleaners -- totaled $352 billion last year, a fourfold increase from 2000.

Meanwhile, motor-vehicle production here has nearly tripled, and China is on pace to overtake Germany as the world's third-biggest auto maker. It has become the world's second-largest car market in terms of sales as millions of Chinese buy cars for the first time. Millions more are expected to do so as their incomes rise and car prices fall.

Now, "China competes in the entire range of products from telecom equipment to textiles," says Hafiz Pasha, director of the United Nations Development Program's Asia bureau.

The transition comes at a sensitive time for the U.S. and Europe, which have been finding it harder to hold on to high-paying manufacturing jobs. Employment in the U.S. auto-parts industry fell to about 644,000 in 2004 from about 721,000 in 2002, according to government figures.

More job losses could be on the way: Some major U.S. parts makers -- including Delphi Corp., which has plants in China -- have sought bankruptcy-court protection. And small and midsize suppliers, which often don't have the resources to set up lower-cost operations abroad, are facing growing pressure.

"In the past two years, Chinese bids for auto-parts orders have driven customer price targets to a level below our costs on some products," said Larry Denton, chairman and chief executive of Rochester Hills, Mich., parts maker **Dura Automotive Systems** Inc., at a recent government hearing in the U.S.

U.S. parts makers have also raised concerns about their access to the huge Chinese market. Earlier this year, the U.S. joined the European Union in asking the World Trade Organization to overturn a Chinese tariff policy that the two trading partners say discourages imports of auto parts.

China says the policy, introduced in 2005, is designed to prevent tariff fraud. It imposes additional tariffs on auto parts that exceed certain thresholds in terms of value or number of components. China says the idea is to discourage anyone who might seek to circumvent its auto tariffs by importing dismantled vehicles at the lower tariff rate that applies to parts and reassembling them in China.

The growth of the Chinese parts industry comes as manufacturers here increasingly grapple with rising wages and higher energy and raw-materials costs. In China's booming coastal areas, where many factories are located, land and labor are no longer as cheap and abundant as they once were, says Lü Tie, a scholar at the Institute of Industrial Economics in Beijing. Those areas "are now pretty close to the level of middle-income countries. Their comparative advantage is changing," he says.

With local wages on the rise, Chinese manufacturers are seeking to improve their efficiency and reduce their reliance on low-cost labor. They are increasingly churning out higher-value products such as auto parts and shifting away from traditional exports such as textiles and toys.

Some Western companies are reaping the benefits of China's quest for greater productivity. **Rockwell Automation** Inc., a Milwaukee maker of high-end equipment and software to run factories, said it has seen its China business grow by more than 30% a year since 2003.

"There is a misperception" about China, says Scott Summerville, Rockwell's president for Asia Pacific. While China still has a lot of labor-intensive manufacturing, he says, "there's a big push right now to make Chinese companies globally competitive. You can't do that just with cheap labor."

Rockwell is part of an influx of foreign money and expertise that has contributed to the improving quality of Chinese-made auto parts and other products. The world's biggest auto companies are also bulking up in China, looking for growth that is increasingly hard to come by in mature markets. They, in turn, often demand that their parts makers be able to supply them directly in China.

In recent months, such major Western auto-parts suppliers as Robert Bosch GmbH, of Stuttgart, Germany, and **ArvinMeritor** Inc., Troy, Mich., have made significant investments in Chinese factories that can make parts for the local market as well as for export.

The higher standards that global companies have introduced, combined with the international growth of local auto-parts makers like Wanxiang Group, has spurred innovation. To gain access to more customers and better technology, Wanxiang has bought several U.S. companies and has expressed interest in buying some assets from Delphi. It says its sales have been growing an average of 26% a year and reached 25.2 billion yuan, or about $3.15 billion, in 2005.

Smaller Chinese companies are also climbing the technology ladder. Huaxiang Group, based in the coastal city of Ningbo, started out in 1982 making plastic caps for medicine bottles. Now it makes molded plastics for auto interiors. Though it has been supplying VW's China operations, about 20% of its 2005 revenue of 2.25 million yuan came from exports, says Xu Peiqi, who runs the office of the board of directors. Huaxiang opened an office in May in VW's hometown of Wolfsburg, Germany.

"The companies are very focused on exports," says Huang Xiaohua, secretary general of the Auto Parts Industry Association of Ningbo. "Products are going up-market," as local manufacturers are increasingly becoming first-tier and second-tier suppliers for the major auto makers, he says.

"When we started exporting in 1997, people argued that you couldn't make" auto parts cheaper in China, says Jack Perkowski, chief executive of Beijing-based parts maker Asimco Technologies Ltd. "People also argued that China would never be a large car market."

Now, he says, "the conventional wisdom is that China can copy but not create. That's going to go too."

--Jason Dean, Gordon Fairclough and Ellen Zhu contributed to this article.

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