

# Contractionary Investment Policies in China 1988/89: Accounting for the Implementation Difficulties and Successes\*

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In the past twenty years the People's Republic of China has undergone four marked periods of overheating as measured by output and price rises. While the 1980 bout of inflation was primarily a result of planned price increases, inflation in 1985/86, 1988/89, and 1993–95 increasingly reflected underlying market imbalances as prices had been liberalized and production decisions decentralized. Inflation was experienced as most severe in the 1988/89 period when the inflation rate climbed rapidly to levels – since the early years of the PRC unprecedented – above 20 per cent in mid-1988. Panic purchases in summer 1988 because of expected further price rises spread to several cities and inflation became tantamount to “social instability.” The Chinese Communist Party Central Committee strongly voiced its concern about the “stable and healthy economic development” in a communiqué on 30 September 1988: “At present, our overall economic situation is good, but the difficulties and problems are numerous, the most prominent being the excessively large commodity price rises.” Party and central government in 1988 felt compelled to stop economic overheating in order to prevent further panic purchases and rises in the inflation rate which would endanger social stability.

According to Chinese economists, the development of the inflation rate is intricately linked to the extent of investment in fixed assets.<sup>1</sup> One link between excessive investment in fixed assets and the inflation rate is established through the competing demands of the producer goods sector and the consumer goods sector for materials and intermediate products. As investment grows rapidly, materials and intermediate products become scarce and their prices rise, leading in turn to increases in both producer and consumer goods prices. A second link is established through the wage payments in the excessively expanding producer goods sector; an

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1. For a general exposition of the relationship between investment in fixed assets and inflation see Li Yining, *Zhongguo jingji wang hechu qu* (Where is the Chinese Economy Heading?) (Hong Kong: Shangwu yinshuguan, 1989), ch. 5. For a broader view of China's macroeconomy, including the relationship between investment in fixed assets and inflation, see Zhang Shouyi and Ge Xinquan, *Zhongguo hongguan jingji: lilun, moxing, yuce* (China's Macroeconomy: Theory, Models and Predictions) (Beijing: Shehui kexue wenxian chubanshe, 1995), Part 1. Liu Yingqiu, *Zongxue qiu biandong guilü yu hongguan zhengce xuanze* (Pattern of Change in Demand and the Choice of Macroeconomic Policies) (Xi'an: Shaanxi renmin chubanshe, 1993) offers a more detailed view of demand and supply relationships.

increase in the overall wage bill leads to increased spending on consumer goods and thereby also to rising consumer goods prices. The Chinese leadership believes that these theoretical links between investment in fixed assets and inflation hold.<sup>2</sup>

Consequently, the central government in 1988/89 exerted strong efforts to control investment in fixed assets. Beginning in March 1988 certain projects under construction were to be cut. Later in 1988 the State Council broadened the range of projects to be cleaned up and temporarily prohibited the start of new projects. By 1989 quotas on cutting investment in fixed assets were issued and the overall investment limit for 1989 was frozen at the 1988 level. But the contractionary investment policies were not immediately successful; up to the end of 1988 the central government's efforts were largely in vain.

The literature on macroeconomic cycles in China documents the progress of the cycles and analyses their causes.<sup>3</sup> It identifies the macroeconomic measures taken to restrain economic growth and inflation, such as investment and credit controls. However, it offers few insights into the actual mechanisms employed in the implementation of contractionary macroeconomic policies. Poor policy implementation results are stated but frequently not further explored. The abundant Chinese-language literature on the topic tends to neglect the question of policy implementation altogether.

Poor implementation results are explicitly dealt with in the literature on central-local relations and on the appropriate tools of macroeconomic

2. For example, the State Council in an instruction of 24 September 1988 on cleaning up fixed assets investment projects under construction and on reducing the investment volume and adjusting the investment structure, states: "In the past few years overall investment in fixed assets has risen rapidly, exceeding the total financial and material supply possibilities. This is one of the most important reasons for inflation." Similar statements can be found in the government's work report of, for example, 1989 (see *Shaanxi ribao* (*Shaanxi Daily*), 21 March 1989). A lead article in *Renmin ribao* (*People's Daily*) on 2 September 1988 explicitly states the two links and claims that approximately half of China's annual steel output is used for the production of producer goods – with the producer goods sector therefore influencing the quantity and price of steel supplied to the consumer goods sector. Regarding the second link, almost 40% of capital construction funds end up being expended on consumer goods. Statistical significance tests on leading and lagged correlation coefficients using quarterly data from *Zhongguo tongji yuebao* (*China Statistics Monthly Report*), *China Statistics Monthly* and *China Monthly Statistics* covering the third quarter of 1984 to the third quarter of 1996 in fact allow for (i) investment in fixed assets and real Gross Output Value of Industry (GOVI) to cause inflation, and for (ii) investment in fixed assets and real GOVI to move closely together (all at the .1% significance level).

3. See, for example, Barry Naughton, "Monetary control and China's most recent macroeconomic cycle," *China Economic Review*, Vol. 4, No. 2 (1993), pp. 231–34; Hoe Ee Khor, "China – macroeconomic cycles in the 1980s," *China Economic Review*, Vol. 3, No. 2 (1992), pp. 173–194; Zou Heng-fu, "Socialist economic growth and political investment cycles," Policy, Research, and External Affairs, Working Papers, Public Economics, Country Economics Department, The World Bank WPS 615 (March 1991); Hiroyuki Imai, "China's endogenous investment cycle," *Journal of Comparative Economics*, Vol. 19, No. 2 (Oct. 1994), pp. 188–216. The literature published in China includes numerous books, such as Xu Nuojin, *Jingji bodong yu tonghuo pengzhang de jiegouxing fenxi* (*A Structural Analysis of Economic Cycles and Inflation*) (Beijing: Zhongguo jinrong chubanshe, 1995), Zhang Sai, *Zhongguo jingji bodong yanjiu* (*A Study of Economic Cycles in China*) (Beijing: Zhongguo jinrong chubanshe, 1995), or Liu Yingqiu, *Pattern of Change*, as well as journal articles (in, for example, *Jingji yanjiu* (*Economic Research*)).

policy. From the point of view of central–local relations, contractionary investment policies may experience implementation difficulties as they run counter to local interests.<sup>4</sup> The process of reform in as far as it meant decentralization may have weakened the power of the centre vis-à-vis the provinces. For example, Zhao Suisheng finds that “by the late 1970s, although the central authorities still talked in ideological terms about coordinating the national economy like one big chessboard, local governments in pursuit of parochial interests had already divided up the board. The power of ideology was no longer sufficient to carry out recentralization programs and to override parochial interests in favor of central control over economic resources or financial targets.”<sup>5</sup> Huang Yasheng, on the other hand, argues that economic decentralization has been accompanied by a strengthening of China’s unitary political system. In the case of administrative control over investment in fixed assets he views central–provincial relations as a problem of asymmetric information, adverse selection and moral hazard which is overcome through personnel allocation.<sup>6</sup>

In the presence of divergent interests of centre and locality the question of appropriate tools for the conduct of macroeconomic policy arises. Shaun Gerard Breslin finds that “whilst reforms weakened the old lines of command of central planning, new macro-economic control mechanisms were slow in emerging.”<sup>7</sup> For the case of central government control over investment in fixed assets, Barry Naughton, after remarking on weak supervision and the need for central pressure through personnel

4. Jae Ho Chung, “Studies of central–provincial relations in the People’s Republic of China: a mid-term appraisal,” *The China Quarterly*, No. 142 (June 1995), pp. 487–508, presents an extensive overview of the literature on central–local relations in China. More recent work includes Shaun Gerard Breslin, *China in the 1980s: Centre–Province Relations in a Reforming Socialist State* (London: MacMillan Press, 1996); Hong Yinxing and Cao Yong, “Jingji tizhi zhuanxing shiqi de difang zhengfu gongneng” (“Functions of the local government during economic transition”), *Jingji yanjiu*, No. 5 (May 1996), pp. 22–28; Hu Angang, *Zhongguo xia yi bu (China’s Next Step)* (Chengdu: Sichuan renmin chubanshe, 1995); Xin Xiangyang, *Daguo zhuhou: Zhongguo zhongyang yu difang guanxi zhijie (Emperor and Princes: Central–Local Relations in China)* (Beijing: Zhongguo shehui chubanshe, 1995); and Wu Guoguang and Zheng Yongnian, *Lun zhongyang–difang guanxi: Zhongguo zhidu zhuanxing zhong de yi ge zhouxin wenti (Central–Local Relations: The Crucial Question in China’s Systemic Transformation)* (Hong Kong: Oxford University Press, 1995).

5. See Zhao Suisheng, “China’s central–local relationship: a historical perspective,” in Jia Hao and Lin Zhimin (eds.), *Changing Central–Local Relations in China: Reform and State Capacity* (Boulder: Westview Press, 1994), p. 30.

6. See Huang Yasheng, “The strategic behavior of Chinese local governments during the reform era,” *China Economic Review*, Vol. 6, No. 1 (1995), pp. 169–186; “Central–local relations in China during the reform era: the economic and institutional dimensions,” *World Development*, Vol. 24, No. 4 (April 1996), pp. 655–672; *Inflation and Investment Controls in China: The Political Economy of Central–Local Relations During the Reform Era* (Cambridge: Cambridge University Press, 1996). Similarly, Barry Naughton argues that “it is simply not the case that the Chinese central government is a feeble state, bereft of effective instruments of macroeconomic control and doomed to a process of economic disintegration.” See Barry Naughton, “China’s macroeconomy in transition,” in Andrew G. Walder (ed.), *China’s Transitional Economy* (Oxford: Oxford University Press, Studies on Contemporary China, 1996), p. 122.

7. See Shaun Gerard Breslin, *China in the 1980s: Centre–Province Relations in a Reforming Socialist State* (London: MacMillan Press, 1996), p. 7.

channels and campaign strategies, concludes that "the center simply does not possess adequate tools to directly control local investment. Within the economic management system, neither financial supervision nor administrative planning directives offer central planners the option of effective control of local investment."<sup>8</sup>

This article, focusing on one particular element of macroeconomic policy – the contractionary investment policies of 1988/89 – departs from the earlier research in two respects. First, it focuses on the actual process of implementation, rather than on results only. Secondly, to do so it traces policies and their effects across time and across all tiers of the state hierarchy down to the county level, rather than analysing macroeconomic aggregates on the national and provincial tier or establishing cross-sectional and longitudinal correlation based on provincial observations.<sup>9</sup>

The earlier findings on the existence and effect of provincial obstructionism are confirmed. Central administrative control over investment in fixed assets during the 1988/89 contractionary macroeconomic policy period did encounter implementation problems on the provincial tier. However, a focus on central–provincial relations misses out on the role of central ministries during contractionary macroeconomic policy periods as well as on the role of the subprovincial tiers.<sup>10</sup> Central ministries account for almost half of all investment by state-owned enterprises and resist implementation of contractionary investment policies even more successfully than provinces. On subprovincial tiers investment by collective- and

8. See Barry Naughton, "The decline of central control over investment in post-Mao China," in David M. Lampton (ed.), *Policy Implementation in Post-Mao China* (Berkeley: University of California Press, 1987), p. 76.

9. "State hierarchy" is defined as the central government (the Standing Committee and/or the Plenum of the State Council); local governments on all tiers (the Standing Committee and/or the Plenum of a local government); and ministries and other subgovernmental organs on all tiers (the "bureaucracy"). The distinction between these three types of institutions is somewhat inexact in that some ministers are part of the standing committee of the government of that tier (and all ministers are part of the government plenum of that tier). The distinction occurs below primarily in the context of the institution issuing instructions. Government instructions are clearly distinguishable from ministerial instructions. "Instructions" denote all formal documents issued by the state hierarchy, ranging from "regulations" (*tiaoli*) to "circulars" (*tongzhi*). "Lower-level tiers" denotes subcentral tier governments and the bureaucracy (including central ministries).

10. Jae Ho Chung, "Central–provincial relations" finds very little literature on central–local relations that would not be limited to *central–provincial relations*, and restricts his discussion to the literature on central–provincial relations. An exception is Dorothy J. Solinger, "Despite decentralization: disadvantages, dependence and ongoing central power in the inland—the case of Wuhan," *The China Quarterly*, No. 145 (March 1996), pp. 1–34, who examines the relationship between centre, province, and the extra-plan (*jihua danlie*) city Wuhan. Thomas P. Lyons, *Poverty and Growth in a South China County: Anxi, Fujian, 1949–1992* (Ithaca, NY: Cornell University East Asia Program, Cornell East Asia Series No. 72, 1994) covers the top four tiers of the state hierarchy in his analysis of poverty and growth in one county. The central–local literature is limited not only by its focus on the relationship between centre and province but also by its almost systematic exclusion of investment control (often in favour of fiscal issues). None of the comprehensive treatments of several aspects of central–local relations, such as Breslin, *Centre–Province Relations*, Jia Hao and Lin Zhimin (eds.), *Changing Central–Local Relations in China: Reform and State Capacity* (Boulder: Westview Press, 1994), Xin Xiangyang, *Emperor and Princes*, or Bo Guili, *Zhongyang yu difang guanxi yanjiu* (*A Study of Central–Local Relations*) (Jilin: Jilin daxue chubanshe, 1991) offer any chapter on investment control.

individual-owned units occurs largely outside direct administrative control.

A focus on central-provincial relations also ignores the very particular constellation of interests in the case of contractionary investment policies. Suppose it were true that price stability can be achieved by placing appropriate limits on the growth of investment in fixed assets. Then any one unit within the Chinese economy which can avoid these limits, while they are obeyed by all other units, will enjoy the fruits of a low growth rate of investment in fixed assets, namely a low inflation rate and social stability. At the same time it will itself experience rapid economic growth because of its high investment growth rate. The dilemma that inflation control requires concerted action, with shirking being immediately rewarded through more rapid economic growth, means that no part of the state hierarchy has any incentive to limit its investment unless deviations are severely punished.

A distinction between macroeconomic and microeconomic decisions allows further insights. The decision to commence a contraction is a macroeconomic one. How it is reached is of minor interest; it suffices that such a decision will invariably be taken at some point. For if it is accepted wisdom that excessive investment in fixed assets is the major cause of inflation then once a given inflation rate is viewed as too high (and there is some scope for diverging views), the decision to reduce investment levels is a routine one; the necessary consensus will arise as price stability deteriorates.<sup>11</sup> One administrative channel through which to reduce investment in fixed assets is the cutting of investment projects under construction. Such cuts require a large number of decisions to be made by lower-level tiers on individual investment projects. These are the microeconomic decisions. Given the constellation of interest, lower-level tiers have no incentive to make these microeconomic decisions. During the 1988/89 contractionary macroeconomic policy period, implementation of contractionary investment policies became primarily a matter of having lower-level tiers make clearly delineated microeconomic decisions following ever more narrowly and explicitly set central government guidelines, and then of enforcing them. The need for microeconomic decisions rather than simply enforcement is at the core of the implementation problem. This suggests that it is not the tool per se that matters for

11. Disputes within the central leadership may in fact have accounted for the timid start of the contractionary investment policies in 1988. Throughout early and mid-1988 the centre was torn by discussions on price reform with Party General Secretary Zhao Ziyang setting the economic reform agenda pressing for rapid price reform, while SPC head Yao Yilin and Premier Li Peng opted for a slower pace of reform. Only at the Tenth Politburo session on 15–17 September 1988 was the conflict resolved in favour of the latter two who were assigned primary responsibility for handling the economy. On the differing opinions within the central leadership regarding the pace of reform and the need for contractionary measures see, for example, *Zhonggong nianbao* (*Chinese Communist Party Annual Report*) (Taipei: CCP Research Magazine Publishing House, 1989), pp. II-1 to II-5, Lowell Dittmer, "China in 1988: the continuing dilemma of socialist reform," *Asian Survey*, Vol. 29, No. 1 (January 1989), pp. 12–28, or Joseph Fewsmith, *Dilemmas of Reform in China: Political Conflict and Economic Debate* (Armonk, NY: M.E. Sharpe, 1994).

implementation but the extent of microeconomic decisions required to achieve policy targets.

In order to trace implementation of the central government contractionary investment policies across all tiers of the state hierarchy – central, provincial, municipal (or prefectural, likewise below) and county – this article focuses on one province, Shaanxi. A number of factors render Shaanxi province a suitable case. First, a large share of total investment in fixed assets in Shaanxi province occurred in the state-owned sector, the prime target of the contractionary investment policies. Secondly, it had a roughly balanced budget in 1989. If it had received large central government subsidies, it might have had incentives to follow central government instructions; if it had run a large surplus this could have implied more authority to ignore central government instructions. Thirdly, in 1989 it was not among the poorest provinces in China, a status that could have served as excuse for not implementing central government policies. Fourthly, foreign investment in Shaanxi province, that is, the type of investment exempted from the contractionary investment policies, accounted for only a small share of its investment.<sup>12</sup> Finally, Shaanxi province has a reputation as a “conservative” province that does not take the lead in reform;<sup>13</sup> adherence to traditional planning principles should have helped implementation of contractionary investment policies. Various information on both behaviour and outcome in other provinces and their subprovincial units confirms that Shaanxi province is not an outlier.

For the central and provincial tier numerous government and ministerial instructions on investment in fixed assets during the years 1988 and 1989 are available; municipal-level documents are scarcer. Interviews with government officials (in particular planning commission officials) on all tiers within Shaanxi province served to fill the gaps.<sup>14</sup> The 1988/89 contractionary investment policies were in the beginning widely publicized. Newspapers for 1988 and 1989 are available on the national and the provincial tier as well as for two out of the ten municipalities/prefectures in Shaanxi province, Yulin and Yan'an municipality. (None existed on the county tier.) In addition, various statistical and general yearbooks covering provincial, municipal and county tiers were used.

The article is organized as follows. The next three sections

12. Shaanxi province in 1989 ranked 15th among all 30 provinces in the share of total investment in fixed assets accounted for by state-owned enterprises, seventh in the relative local budget surplus, 21st in GDP per capita, and 11th in the ratio of foreign funds to investment in fixed assets. See *1990 Zhongguo tongji nianjian* (China Statistical Yearbook 1990) (Beijing: Zhongguo tongji chubanshe, 1991), pp. 38, 91, 155 and 655; and *Quanguo ge sheng, zizhi, zhixishi lishi tongji ziliao huibian (1949–1989)* (Provincial Historical Statistical Material 1949–1989) (Beijing: Zhongguo tongji chubanshe, 1990), various pages.

13. See also Kevin P. Lane, “One step behind: Shaanxi in reform, 1978–1995,” in Peter T.Y. Cheung, Jae Ho Chung and Zhimin Lin (eds.), *Provincial Strategies of Economic Reform in Post-Mao China: Leadership, Politics, and Implementation* (Armonk, NY: M.E. Sharpe, 1998), pp. 212–250.

14. On subprovincial tier interviews were conducted in various counties in two municipalities (*shi*) and one prefecture (*diqu*). Interviews, newspaper reports and numerical data all attest that there is no need to distinguish between municipalities and prefectures. In the following, “municipality” captures both entities.

introduce the contractionary investment policies of 1988/89, evaluate their success or failure, and analyse the central government's strategies. In the two sections thereafter the concept of a central-provincial dichotomy is reviewed and the issue of "appropriate tools" refined through the distinction between macroeconomic and microeconomic decisions.

### *The Contractionary Investment Policies*

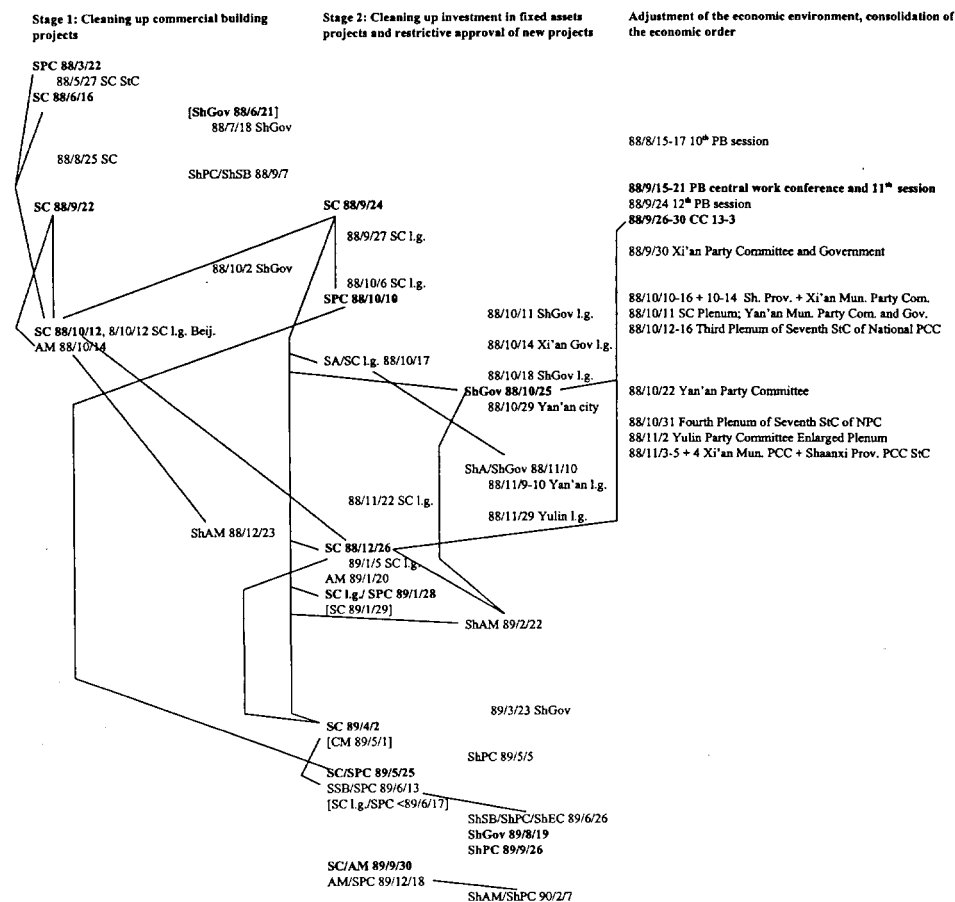
The 1988/89 contractionary investment policies evolved in two stages over two years. The first stage began with a State Planning Commission circular in March 1988 (SPC 88/3/22) on cleaning up "office and conference building, assembly hall and guest house investment projects" (in the following abbreviated "commercial building projects"), and ended in autumn 1988 with a temporary State Council regulation on commercial building projects (SC 88/9/22) and detailed instructions on cleaning up such investment (SC 88/10/12).<sup>15</sup> At the second stage, starting in late September 1988, the scope of measures became much broader with the "cutting" (stopping or delaying) of all investment projects under construction (SC 88/9/24). The cleaning up of commercial building projects was incorporated in this circular as was a prohibition on approving new investment projects for the rest of the year. Central government activities slowed down after the issuing of quotas on 2 April 1989 on how much investment to cut before the end of June 1989.

Cleaning up investment in fixed assets at the second stage was paralleled by a larger effort to "adjust the economic environment and consolidate the economic order, while deepening the economic reforms." The objective of limiting or reducing investment in fixed assets in order to rein in inflation became the major objective in a massive attempt at reasserting central control over the economy. At the core of the adjustment effort was the communiqué by the Third Plenum of the 13th Central Committee (CC 88/9/30, in the following abbreviated CC 13-3). This offered no detailed instructions but served as a guideline, the "spirit" (*jingshen*) of which was to be translated into concrete actions by state organs. Implementation of the "CC 13-3 spirit" spread from the Party centre to state and Party organizations on all tiers.

Figure 1 in the first two columns, referring to the two stages of contractionary investment policies, lists government documents as well as events which yielded informal instructions. A distinction between centre

15. For a more extensive list of instructions and events, including short descriptions, as well as for a list of instruction titles and concise sources please contact the author. All instructions are from State Planning Commission, *Zhonghua renmin gongheguo jihua fagui huibian 1988-1990 (PRC Compendium of Planning Laws and Regulations)* (Beijing: Zhongguo fazhi chubanshe, 1991); *Zhonghua renmin gongheguo falü quanshu (PRC Laws)* (Changchun: Jilin renmin chubanshe, 1989); *Renmin ribao*; Shaanxi Province Planning Commission, *Shaanxi sheng guding zichan touzi guanli wenjian xuanbian (Shaanxi Province Selected Documents on Investment in Fixed Assets)* (Shaanxi, 1993); *Shaanxi ribao*; *Shanxi zhengbao (Shaanxi Province Bulletin)*; *Yulin bao (Yulin News)*; and *Yan'an bao (Yan'an News)*. In the following, instructions are referred to by an abbreviation for the institution issuing the instruction and the date of issuing (year/month/day).

up commercial building	Stage 2: Cleaning up investment in fixed assets projects and restrictive approval of new projects	Adjustment of the economic environment, consolidation of the economic order
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AM: Auditing Ministry  
CC: Central Committee  
CM: Construction Ministry  
l.g.: leading group  
NPC: National People's Congress  
PB: Politburo  
PCC: People's Consultative Conference  
SA: State Archives

SC: State Council  
ShA: Shaanxi Province Archives  
ShAM: Shaanxi Province Auditing Ministry  
ShEC: Shaanxi Province Economic Commission  
ShGov: Shaanxi Province Government

ShPC: Shaanxi Province  
Planning Commission  
ShSB: Shaanxi Province  
Statistical Bureau  
SPC: State Planning  
Commission  
SSB: State Statistical Bureau  
StC: Standing Committee

A square bracket indicates that neither text nor summary of the regulation is available.

Major instructions and events are in bold.

At each of the two stages central and subcentral instructions and events are listed in separate columns.

*Sources:*

As given in n. 15.



and localities is made at each of the two stages (see two sub-columns at each stage). The third column lists selected Party events. Lines denote explicit mentioning of an earlier document in a later document. Later documents, especially on lower-level tiers, frequently adopt central government instructions for local use, such as requesting the dispatch of inspection teams by the subordinate tier government. Absence of a line connecting a central government document with a lower-level tier government document does not imply that the central government document has not been passed on to subprovincial tiers; it does, however, suggest that lower-level tiers did not issue local adaptations. Cross references to and between Party events because of their large number are not documented except for the case of the CC 13-3 communiqué. Figure 1 will be further interpreted below.

### *Success or Failure of the Contractionary Investment Policies?*

Given this sequence of instructions by governments and government departments on all tiers, were the contractionary investment policies successful? Were projects under construction cut and no new projects started? Both the outcome of the contractionary investment policies and compliance by lower-level tiers during implementation with procedures laid out in the policy itself suggest that in the first year there was only very gradual success. Nevertheless, by the end of 1989 the ultimate objective of a reduction in the inflation rate had been achieved.

*Outcome of cutting investment and prohibiting the start of new projects.* There is no evidence that cleaning up commercial building projects as requested by SPC 88/3/22 led to any cutting of investment in fixed assets projects. In Shaanxi province no independent document was issued adapting SPC 88/3/22 for provincial implementation. It was only after the State Council reminder of 88/6/16 that first results on the central and provincial tier trickled in, and only after SC 88/9/24 six months later, extending the cleaning up efforts to all investment projects, that the cutting started in earnest on all tiers (see Table 1).

Nation-wide the volume of investment in fixed assets cut by November 1988 amounted to no more than 7.4 per cent of the realized 1988 (nominal) investment. *Renmin ribao* on 6 January 1989 claimed that in provinces in which much investment has been cut, the cut nevertheless amounted "up to now" to no more than 6 per cent and in less successful provinces to only 1 per cent; according to *Renmin ribao* of 23 January 1989 the nation-wide average "up to now" was about 3 per cent. Shaanxi province in mid-1988 reported a cut equal to more than 20 per cent of annual investment; the year-end figure later published was 6.1 per cent. On the municipal tier, cuts ranged from 0.9 to 68.6 per cent. The largest cuts occurred in Xi'an and Xianyang municipalities which had been singled out in a State Council instruction (SC 88/10/12) for a first round of cuts. The available county-level data on cuts varies from 1 to 342 per cent of investment by state-owned units.

Table 1: Construction Projects Stopped or Delayed in 1988/89

<i>Up to</i>	<i>Tier and location</i>	<i>No. of projects</i>	<i>Investment volume (m.yuan)</i>	<i>Construction area (1000 sq.m.)</i>	<i>Overall investment volume 1987/1988 (m.yuan)</i>	<i>Stops/ delays as % of 1988 investment</i>	<i>Source of information and comments</i>
mid-July 1988	Nation-wide	104	4,000	2,870	364,086/449,654	0.9	Shaanxi ribao 88/7/24
< end-Nov. 1988	Nation-wide	10,220	33,400	-	364,086/449,654	7.4	Shaanxi ribao 88/12/20, Renmin ribao 88/12/20
< 89/3/13	Nation-wide	17,000	> 50,000	-	364,086/449,654	11.1	Renmin ribao 89/3/13
< 89/4/2	Nation-wide	18,000	> 64,700	-	364,086/449,654	14.4	SC 89/4/2
< end-Nov. 1988	Central min.	627	3,570	-	-	-	Renmin ribao 88/12/30; all commercial building projects
88/7/18	Shaanxi province	18	> 2,000	680	8,089/9,472	> 21.1	Shaanxi ribao 88/7/21, 88/10/12; first round
88/10/11	Shaanxi province	9	61.03	247.5	8,089/9,472	0.6	Shaanxi ribao 88/10/12; second round (also cut US\$176 m)
< 88/12/13	Shaanxi province	69	-	-	8,089/9,472	-	Renmin ribao 88/12/13; commercial building projects
< 88/12/13	Shaanxi province	172	390	260	8,089/9,472	1.8	Renmin ribao 88/12/13; cap. con. and techn. upd. and tr.
end-88	Shaanxi province	286	580	-	8,089/9,472	6.1	SXNJ 1989, 126
< 88/11/8	Shaanxi traffic bureau	12	13.79	329	-	-	Shaanxi ribao 88/11/8

end-88	Baoji mun.	114	166	–	635/883	18.8	SXNJ 1989, 390
88/8/18	Xi'an mun.	–	2,000	700	2,315/2,443	81.9	XASKMZFWJXB 88/II, 589; "cancellation," not stop or delay
<88/10/15	Xi'an mun.	6	–	–	2,315/2,443	–	Renmin ribao 88/10/15, Shaanxi ribao 88/10/16
end-88	Xi'an mun.	53	1,400	548.7	2,315/2,443	57.3	SXNJ 1989, 382
~88/10/25	Shangluo mun.	16	6.5	37.97	199/185	3.5	Shaanxi ribao 88/10/27
<88/11/18	Yulin mun.	3	4.29	5.93	283/351	1.2	Shaanxi ribao 88/11/18, Yulin bao 88/11/29
end-88	Weinan mun.	37	57	76	536/572	10.0	SXNJ 1989, 406
end-88	Yan'an mun.	17	11.47	–	247/354	3.2	SXNJ 1989, 412
end-88	Xianyang mun.	122	458	–	538/668	68.6	SXNJ 1989, 395
end-88	Tongchuan mun.	6	2,585	–	262/289	0.9	SXNJ 1989, 402
<88/10/29	Yan'an city	36	–	–	>33.4/51.2	–	Shaanxi ribao 88/10/29; six projects were outside the plan
<88/11/18	Chenggu county	10	9.25	–	>10.8/32.3	28.6*	Shaanxi ribao 88/11/18
<88/11/18	Sanyuan county	26	60.2	–	>25.5/17.6	342.0*	Shaanxi ribao 88/11/18
88/11/18	Dengcheng county	4	1.02	5.928	>62.9/87.8	1.2*	Shaanxi ribao 88/11/18
<88/12/6	Yulin city	10	2,9189	15.481	>66.6/50.9	5.7*	Yulin bao 88/12/6

## Notes:

Since the figures for the overall investment volume in 1987/88 on the county level are not available, those for investment by state-owned units only are reported. The percentage figure for projects stopped or delayed thus is biased upwards.

## Sources:

Figures for overall investment in 1987 and 1988 are from *Zhongguo tongji nianjian*, *Shaanxi tongji nianjian* (Shaanxi Province Statistical Yearbook) (Beijing: Zhongguo tongji chubanshe), and *Shaanxi sheng dishixian: lishi tongji ziliao huibian 1949–1990* (Shaanxi Province Municipal and County Collection of Historical Statistics 1949–1990) (Beijing: Zhongguo tongji chubanshe, 1991). XASKMZFWJXB = Xi'an shi renmin zhengfu wenjian xuanbian (Xi'an Municipality Government Document Selection) (Xi'an: Xi'an shi renmin zhengfu bangongting); SXNJ = Shaanxi nianjian.

After all the efforts to cut investment, the actual cuts reported appear small. However, with most taking place in the last two months of 1988, did they perhaps have a major impact in these two months? Capital construction both on the provincial and national level decreased between June and August 1988 (see Table 2), but it also did so nation-wide in previous years. A special reason for the marked decline in mid-1988 in Shaanxi province could be that efforts in the first stage of cleaning up commercial building projects only now showed results. In November 1988 capital construction in Shaanxi province exhibited an unusual although small dent, which could be in response to the second stage cleaning-up efforts. National data appear unperturbed throughout September to December 1988. Only in the first half of 1989 did capital construction slow down. Technological updating and transformation showed little restraint in late 1988 on either the provincial or national level. Perhaps technological updating and transformation was not cut enthusiastically, or capital construction projects were in part reclassified as technological updating and transformation. Only in 1989 did technological updating and transformation decrease significantly, with some delay in Shaanxi province, although investment was picking up again by December 1989.<sup>16</sup>

SC 88/9/24 and later regulations requested strict control over the start of new projects. Nation-wide, the number of newly started capital construction projects dropped from 42,764 in 1988 to 29,320 in 1989.<sup>17</sup> The share of the investment volume of newly started projects in total annual capital construction fell from 19.9 per cent in 1988 to 14.6 per cent in 1989.<sup>18</sup> In all of Shaanxi province the 62 per cent reduction claimed in newly started projects by state-owned units in 1989 over 1988 indicates a very substantial cut. The reduction was larger in provincial and subprovincial projects than in central projects. On the municipal tier reductions in newly started projects reported in Xi'an, Hanzhong and Ankang municipalities ranged from 16.7 to 43.6 per cent.<sup>19</sup>

Monthly data on capital construction and technological updating and transformation projects newly started nation-wide and in Shaanxi province show little change in the 1988 pattern over that in 1987 (see Table 2). Shaanxi province, in strong violation of the policy, experienced an almost threefold rise in the number of newly started capital construction

16. For investment by collective-owned units and individual-owned units (including private-owned units) monthly data are not available.

17. See Yan Chuchu, "Guanyu zaijian touzi guimo de jianyi" ("Proposals on the volume of investment under construction"), *Jingji yanjiu cankao*, No. 28 (March 1993), pp. 39–43, who also offers data on newly started capital construction projects for the years 1985 to 1987 (56,361; 44,112; 43,291) but not for the years after 1989.

18. See *Zhongguo tongji nianjian 1992 (China Statistical Yearbook 1992)* (Beijing: Zhongguo tongji chubanshe), p. 153. The shares for the years 1987–91 are 21.3, 19.9, 14.6, 16.5 and 23.2%.

19. For the provincial and municipal data see *Shaanxi nianjian 1990 (Shaanxi Province Yearbook)* (Xi'an: Shaanxi renmin chubanshe), pp. 101, 203, 352, 445 and 456. Data on the investment volume of newly started projects on provincial and municipal tier are not available.

Table 2: Capital Construction and Technological Updating and Transformation

Month	Capital construction (b.yuan)										Capital construction projects newly started				
	China (nation-wide)					Shaanxi province					China (nation-wide)				
	1987	1988	1989	1990	1987	1988	1989	1990	1987	1988	1989	1987	1988	1989	1989
1	2,746	2,976	2,811	2,826	-	0.043	0.014	0.031	-	-	-	-	-	-	-
2	2,746	2,976	2,810	2,826	-	0.042	0.014	0.031	-	-	-	-	-	-	-
3	6,248	7,054	7,463	8,276	-	0.170	0.249	0.171	8,454	7,890	-	-	297	-	-
4	7,113	8,306	8,275	8,276	-	0.195	0.150	0.216	4,396	5,420	5,804	-	302	217	217
5	9,394	10,851	9,312	10,272	-	0.275	0.183	0.299	5,783	6,429	4,492	-	139	189	189
6	11,908	13,439	11,551	14,154	-	0.260	0.281	0.438	7,532	7,199	-	-	207	-	-
7	9,818	11,439	12,011	12,351	0.211	0.255	0.276	0.256	4,093	4,212	-	83	119	-	-
8	9,093	10,943	10,793	11,894	0.234	0.198	0.236	0.276	3,515	3,839	2,906	159	109	123	123
9	12,210	13,688	12,405	14,371	0.262	0.316	0.269	0.381	4,740	4,142	2,760	-	120	70	70
10	10,960	13,841	12,680	14,382	0.256	0.332	0.353	0.406	4,158	5,937	-	-	202	-	-
11	12,588	15,154	15,267	15,595	0.344	0.294	0.394	0.387	3,038	4,296	-	180	81	-	-
12	37,586	43,662	48,421	55,037	1.074	1.137	1.426	1.025	18,758	18,910	-	462	1153	-	-

Table 2: *Continued*

Month	Technological updating and transformation (b.yuan)						Technological updating and transformation projects newly started					
	China (nation-wide)			Shaanxi province			China (nation-wide)			Shaanxi province		
	1987	1988	1989	1987	1988	1989	1987	1988	1989	1987	1988	1989
1	1,048	1,142	1,151	-	0,012	0,022	-	-	-	-	-	-
2	1,048	1,142	1,151	-	0,013	0,023	-	-	-	-	-	-
3	3,256	3,739	3,019	-	0,063	0,098	-	7,405	-	-	184	-
4	3,553	4,230	3,748	-	0,107	0,109	-	5,065	3,138	-	178	95
5	4,389	5,096	4,417	-	0,153	0,157	-	5,239	2,640	-	167	94
6	5,928	6,883	5,811	-	0,138	0,092	-	6,688	-	-	140	-
7	5,667	6,081	5,069	0,129	0,179	0,145	-	3,624	-	32	65	-
8	4,648	6,366	5,101	0,139	0,148	0,110	-	4,772	2,008	109	91	47
9	5,909	7,408	5,446	0,130	0,209	0,129	-	3,146	2,545	84	71	40
10	5,557	8,861	5,962	0,140	0,205	0,129	-	3,558	-	54	70	-
11	6,329	9,701	6,499	0,186	0,216	0,189	-	4,163	-	61	62	-
12	27,291	34,802	30,621	0,725	0,915	0,912	-	26,872	24,303	732	621	-

*Notes:*

January investment data are not available. The cumulative February figure was therefore distributed equally across the first two months of the year. The monthly data on newly started projects are derived from the time series on "cumulative number of projects under construction" as "cumulative number of projects under construction at time t minus cumulative number of projects under construction at time t-1."

*Sources:*

Calculated from *Zhongguo tongji yuebao* and *China Statistics Monthly*.

projects in December 1988 over the same period in 1987 compared to a very modest rise nation-wide. The number of technological updating and transformation projects newly started in December 1988 was slightly down over the same period in the previous year both nation-wide and in Shaanxi province. The few data points available for 1989 suggest that the number of newly started projects finally decreased in 1989, especially in Shaanxi province, independent of the type of project.

In the absence of target figures on how much to cut investment in fixed assets in 1988 it is impossible to give a precise answer as to whether the contractionary policy was successful in 1988. The data reveal only very minor cuts, but perhaps the success of the contractionary policy lay precisely in avoiding large increases in investment in fixed assets in the second half of 1988. (The State Council did issue control figures for cutting investment in fixed assets in 1989; however, these figures were not publicized.) Compared to the previous year, investment in fixed assets decreased significantly in 1989, and the restrictive approval practice for new projects was effective for the state-owned sector both nation-wide and in Shaanxi province. Actual lower-level tier compliance with central government instructions, analysed below, supplements these conclusions based on the outcome.

*Compliance with central government instructions.* The sequence of instructions and events on the central and provincial tiers suggests a high degree of formal compliance with central government instructions on the provincial tier during the implementation of contractionary investment policies. For example, the Shaanxi province government responded to SC 88/6/16 with an almost identical circular of its own on 21 June 1988 (for the transmission of this and other instructions see Figure 1). The transmission of higher-level tier instructions was formally correct; there was no systematic distortion of higher-level tier intentions.<sup>20</sup> But lower-level tiers were clearly not enthusiastic about the contractionary investment policies. The policies would have come to a premature end after SPC 88/3/22 had not the State Council intervened (SC 88/6/16). Even then, according to *Renmin ribao* of 17 July 1988, by the deadline only three provinces had reported back to the centre and less than 20 of about 50 central ministries; of those provinces and central ministries which had reported back about ten claimed that the check showed there was no need to cut any projects. Subprovincial tiers were not stirred into action until the Party stepped in on 26–30 September 1988.

Delays in passing on higher-level tier instructions were common. For example, SC 88/9/24 was not transmitted by the provincial tier to the subprovincial tiers until one month later on 25 October 1988 – despite the fact that the standing committee of the Shaanxi province government met

20. Lower-level tier instructions frequently copied major passages of the higher-level tier instruction if they did not pass on the higher-level tier instruction in full. Lower-level tier additions never thwarted the intention of higher-level tier instruction.

**Table 3: Characteristics of Projects Cut and Audited in Shaanxi Province**

<i>Type of project</i>	<i>Number of projects</i>	<i>Share in total investment volume audited (%)</i>
Commercial building projects	73	89.3
Capital construction projects	134	8.2
Technological updating and transformation projects	19	0.9
Township and collective-owned projects	53	1.6
Total	279	100.0

*Source:*

ShGov 89/8/19.

every Monday morning. Deadlines had to be extended repeatedly. For example, the original deadline for cleaning up commercial building projects of 30 June 1988 (in SC 88/6/16) turned into an end of November deadline for cleaning up all investment projects under construction (in SC 88/9/24), which was then extended to 10 January 1989 (in SC 88/12/26), and finally to April and May 1989 (in SC 89/4/2). The cut-off date for the start of new projects receded further into the future the lower the tier on which the prohibition was to be implemented. While the State Council prohibited the start of new projects for the rest of 1988 on 24 September 1988, the Shaanxi province government chose a cut-off date of 1 October 1988 – but formally publicized this date only on 25 October 1988 (in ShGov 88/10/25). The deputy head of the Yulin Municipality Government at the Enlarged Plenum of the Yulin Municipality Party Committee on 2 November 1988 announced a retroactive cut-off date of 20 October 1988, one month after the State Council had requested that no new projects be started nation-wide.

The formal success in transmitting central government instructions is furthermore called into question by a provincial as well as a central auditing report. According to the provincial auditing ministry's report on stopped and delayed projects on provincial and subprovincial tiers, between January and June 1989 the provincial auditing bureau audited 279 of the 407 projects which it says had been cut by the end of April 1989<sup>21</sup> (see Table 3). By far the largest share of cuts in terms of volume occurred in commercial building projects while capital construction projects in general (which in this auditing report did not include commercial building projects) did not even account for 10 per cent, although the main thrust of SC 88/9/24 was directed against exactly these projects. The

21. Information on the audit in Shaanxi province is from ShGov 89/8/19.



cutting of technological updating and transformation projects and of township and (other) collective-owned projects played a negligible role.<sup>22</sup>

Of the 226 state-owned projects cut and audited (the first three items in Table 3), 139 in fact had never been started. These 139 accounted for 94.3 per cent of the total investment by the 226 state-owned projects, or for 92.8 per cent of the investment volume of all 279 projects cut and audited. In other words, if the 279 projects are representative of all 407 projects cut in Shaanxi province by the end of April 1989, then only 7.2 per cent of all proclaimed investment cuts in Shaanxi province constituted a reduction in investment already started (the type of cutting requested by SC 88/9/24). In newspapers and on television some localities and central ministries simply announced the cutting of projects which never existed. In other cases, projects were included which would not have been able to start construction anyway, for various reasons such as the lack of a final agreement with foreign investors, cancellation by the investing unit, lack of support by a superordinate ministry, lack of funds and successful inclusion in the plan of part of the project only.

Of the audited projects only 42 had already expended any money (equal to 0.81 per cent of the total investment volume which was cut); of these, three had not yet started cleaning up but were waiting for an opportunity to continue construction, two had already been completed, and four were simply continuing construction. Of the 53 projects undertaken by townships and collective-owned units, 15 were outside the plan and only 20 had already been started; the report argued that since the damage in case of enforcement of a construction stop or delay would have been great, the 20 projects were in effect not cut and still continuing construction.

SC 89/9/30, reporting on the nation-wide situation, covered very similar ground. Construction continued despite orders to stop or delay the project; if projects were stopped, their inclusion in the plan was not cancelled and investors only waited for a chance to continue construction; some provincial governments and central ministries reported to the State Council leading group that certain projects had been cut but the construction unit had not received any order to stop or delay construction; most projects had never been started; projects cut usually already had some other problems which prevented their construction. *Shaanxi ribao* on 5 December 1988, reporting on the National Planning Conference, found

22. Although SC 88/9/24 required cuts in projects independent of ownership, the municipal tier appears to have focused solely on capital construction projects (i.e., one category of state-owned projects), and within this category mainly on commercial building projects. (See, for example, *Yan'an bao*, 29 October 1988, or *Yulin bao*, 5 November 1988). It was not until 1989 that technological updating and transformation projects received some attention, and not until 1990 that investment by townships, collective- and individual-owned units became regulated in Shaanxi province (ShPC 90/2/19, ShPC 90/2/10); these categories thus constituted temporary havens for endangered capital construction projects. (According to SC 88/10/12 the central ministries were responsible for investigating the spurious use of the name "collective-owned" by commercial building projects in which central ministries were involved.)

that in some places construction was suddenly accelerated once the required degree of completion for continuation of commercial building projects was made public. Investing units also flagrantly dodged inspections of their project (*Renmin ribao*, 4 April 1989) and did not deposit their investment funds at the People's Construction Bank of China for supervision as required (*Renmin ribao*, 30 December 1988 and 27 January 1989). Local governments furthermore claimed exemptions from the contractionary investment policies for various reasons.<sup>23</sup>

In sum, the strategies employed by lower-level tiers and projects to counter the central government's contractionary policy fall into three categories. First, transmission of higher-level tier instructions was delayed, and cut-off dates were announced retroactively only. Secondly, rather than cutting actual investment, in practice most cuts occurred in projects which had not yet been started, at times not even included in the plan. Thirdly, projects "cut" frequently awaited an opportune moment to continue construction, while projects under construction and in danger of being cut were quickly finished ahead of time. The avoidance of actual cuts in investment as well as the stream of renewed central government instructions and the postponement of deadlines suggest that lower-level tier compliance with the purpose of the central government instructions was far from perfect.

*Overall performance.* While the contractionary investment policies on cutting investment projects under construction had little success and the temporary prohibition to start new projects did not show results until 1989, overall investment clearly levelled off by 1989. As Table 4 shows, overall growth in investment in fixed assets was still strong in 1988, in particular in the collective-owned and the individual- (and private-) owned sector of the economy. But in 1989 investment growth stagnated in Shaanxi province and even turned negative nation-wide, suggesting that the contractionary investment policies were successful. By the end of 1989 the central government's ultimate objective, a reduction in retail prices, had been achieved.

The contractionary investment policies were even more successful if investment in fixed assets is adjusted for inflation. Using the ex-factory price index of industrial goods or its sub-indicator for means of production as deflator (see Table 4),<sup>24</sup> real investment in fixed assets had

23. For example, the head of Yulin municipality at the Enlarged Yulin Municipality Party Committee meeting on 2 November 1988 claimed: "The provincial Party Committee and government are very concerned about us old revolutionary bases in Northern Shaanxi Province. At the past provincial meeting [Enlarged Second Plenum of the Seventh Party Committee] the leaders of the provincial Party Committee and government said that some liberation projects in our poor region are basically guaranteed. The subsidized projects determined by the provincial finance bureau will also not change. The old revolutionary base construction funds and the poverty funds will also not change ... Therefore, despite the present situation of controlling credit and investment, the economy in our region will still be able to develop normally" (*Yulin bao*, 5 November 1988). In contrast, the broad coverage of the Enlarged Second Plenum of the Seventh Party Committee in the press did not include any passage on special exemptions for Yulin municipality (or any other locality).

24. A deflator for investment in fixed assets is not available for the years covered here.

Table 4: Investment According to Project Ownership

	Share in total (in %)				Growth over previous year (in %)				
	1986	1987	1988	1989	1990	1987	1988	1989	1990
Nation-wide investment	100.00	100.00	100.00	100.00	100.00	20.57	23.50	-7.98	7.53
State-owned units	65.52	63.12	61.44	61.28	65.60	16.15	20.23	-8.23	15.11
Capital construction	38.95	36.89	35.01	37.50	38.29	14.20	17.21	-1.43	9.80
Technological updating and transform.	20.51	20.84	21.81	19.06	18.66	22.51	29.26	-19.56	5.25
Collective-owned units	12.97	15.02	15.83	13.78	11.90	39.64	30.11	-19.91	-7.11
Urban	4.85	4.98	5.67	4.49	3.67	23.85	40.63	-27.20	-11.99
Rural	8.13	10.04	10.16	9.29	8.23	49.06	24.89	-15.85	-4.75
Individual-owned units	21.51	21.86	22.73	24.95	22.50	22.56	28.42	1.00	-3.01
Urban	2.47	2.76	3.49	3.39	2.80	34.80	56.05	-10.60	-11.07
Rural	19.04	19.10	19.24	21.56	19.70	20.97	24.43	3.10	-1.74
Investment in Shaanxi province	100.00	100.00	100.00	100.00	100.00	27.33	17.10	0.48	8.97
State-owned units	74.37	71.84	70.82	70.53	71.21	22.98	15.44	0.08	10.01
Capital construction	45.76	42.48	41.49	42.18	41.23	18.20	14.38	2.14	6.53
Centre	24.04	21.41	21.72	23.91	24.18	13.43	18.76	10.62	10.22
All sub-central	21.72	21.07	19.77	18.27	17.05	23.48	9.92	-7.17	1.70

Table 4: *Continued*

	Share in total (in %)				Growth over previous year (in %)				
	1986	1987	1988	1989	1990	1987	1988	1989	1990
Technological updating and transform.	25.75	25.60	25.44	23.34	22.36	26.59	16.37	- 7.83	4.42
Centre	8.67	8.01	9.22	9.69	8.99	17.60	34.72	5.66	1.10
All sub-central	17.08	17.59	16.23	13.65	13.37	31.15	8.01	- 15.49	6.78
Collective-owned units	6.67	9.16	8.64	6.38	6.71	74.76	10.39	- 25.72	14.62
Individual-owned units	18.95	19.00	20.54	23.08	22.08	27.66	26.61	12.89	4.23
Nationwide price indices									
Retail price index	-	-	-	-	-	7.3	18.5	17.8	2.1
Ex-factory price index of industrial goods	-	-	-	-	-	7.9	15.0	18.6	4.1
Price index for means of production	-	-	-	-	-	-	13.7	18.9	4.4

*Notes:*

Absolute nation-wide investment in 1986 to 1990 was 301.962, 364.086, 449.654, 413.773 and 444.929 b. yuan. Absolute investment in Shaanxi province in 1986 to 1990 was 6.353, 8.089, 9.472, 9.518 and 10.372 b. yuan.

*Sources:*

Calculated from *Zhongguo tongji nianjian* 1991, p. 143; *Zhongguo tongji nianjian* 1997, p. 267; *Shaanxi tongji nianjian* 1990, pp. 92, 97; *Shaanxi tongji nianjian* 1991, pp. 205, 214, 231; *Shaanxi sishi nian* (Shaanxi Province Forty Years) (Beijing: Zhongguo tongji chubanshe, 1989), pp. 217, 261, 275; *Zhongguo shichang tongji nianjian* 1994 (China Market Statistics Yearbook 1994) (Beijing: Zhongguo tongji chubanshe, 1995), pp. 615, 617.

already begun to slow down in 1988 and dropped by as much as 20 per cent in 1989.

The success was not uniform. The prime target of the contractionary investment policies, capital construction, was one of the sectors least affected in 1989. In contrast, the second category of investment in fixed assets by state-owned units, technological updating and transformation, experienced a sharp fall in 1989. Investment in the collective-owned sector, although not the prime target of the contractionary investment policies, likewise fell sharply in 1989 both nation-wide and in Shaanxi province. (But due to the small share of this sector in all investment, especially in Shaanxi province, the contribution to the overall growth rate remained small.) Investment in fixed assets by individual-owned units (including private-owned units, likewise below) showed continued, albeit slow, growth in 1989. The reasons for these differences are explored below after the government's implementation strategies have been clarified.

### *Central Government Implementation Strategies*

In response to the poor outcome of the efforts to cut investment in fixed assets the central government adopted a number of strategies. Central government investment policies evolved in a logical progression of target expansion, increasing specification of requirements and the issuing of quotas, a pattern altogether highly reminiscent of the Maoist era. Responsibility for implementation of the contractionary investment policies was increasingly assigned to individuals, and the CC 13-3 communiqué ensured that this responsibility was not taken lightly. The administrative engagement in the contractionary investment policies was adjusted with measures such as the creation of leading groups and a strengthening of the supervision, auditing and monitoring process. A publicity drive attempted to raise public awareness and thus pressure localities into action.

*Central government policy evolution.* Central government policy evolved with the response of lower-level tiers to previous instructions. The original State Planning Commission instruction starting the first stage of contractionary investment policies (SPC 88/3/22) asked in very general terms for a broad type of behaviour to be applied to a very narrow range of objects: the "cleaning up of commercial building projects." Such a vague behavioural requirement ("cleaning up") very much limited in scope (to commercial building projects) allows lower-level tiers to make their own decisions as to which project merits continuation and which project should be cut. There was no lower-level tier response. Even the issuing of a severe admonishment in June 1988 by the State Council as higher-level authority (SC 88/6/16) did not yield more than a formal response.

A stricter approach was needed and came at the end of September when the contractionary investment policies entered the second stage

(with SC 88/9/24). On the one hand the scope of projects was broadened to cover all projects, regardless of ownership and, in the case of state-owned projects, regardless of type of investment (capital construction or technological updating and transformation). On the other hand, the required lower-level tier behaviour was unambiguously specified as cutting projects under construction. The freedom of lower-level tiers now became limited to identifying the individual projects and then deciding whether to stop or to delay. A list of investment categories on projects to be definitely cut was appended to the instruction. An additional central government instruction issued two weeks later (SC 88/10/12) subordinated the cleaning up of commercial building projects to this second stage and laid down exact numerical criteria on the degree of project completion required for a commercial building project to escape stopping or delaying.

In late December the central government finally moved to prevent lower-level tiers from dragging their feet by requiring that all projects which fell into one of the categories specified in September be immediately discontinued and only then be cleaned up (SC 88/12/26). Consideration of whether to stop permanently or to delay a project, and arguments on whether the project should after all be identified as falling into one of the categories listed by the central government, could take place only once the project had been discontinued.<sup>25</sup>

Parallel to the efforts to cut investment in fixed assets projects under construction the State Council categorically prohibited the start of new projects for the rest of the year (SC 88/9/24). In contrast to the efforts to cut investment in fixed assets projects under construction, lower-level tiers were not required to act in a specified manner but were simply informed that they had lost the authority to start new projects. In January 1989 the blanket prohibition was extended until August 1989 (SC/SPC 89/1/28).<sup>26</sup>

The final step in restraining the decision-making scope of lower-level tiers was the annual planning procedure. In April 1989 the State Council issued strict quotas on reducing investment in fixed assets as part of the annual investment plan (SC 89/4/2). The issuing of quotas had two implications. First, while cutting investment in fixed assets constituted a request by the centre to the provinces and central ministries to reach microeconomic decisions contrary to lower-level tier interests, the annual plan, on the other hand, constituted a request by provinces and central ministries that the central government approve their intended investment in fixed assets. The momentum now rested with the State Council. Secondly, the State Council set the priorities for investment in the coming year and then felt comfortable to cut everything else "with one knife."

25. This instruction also somewhat rescinded the extension to "all" investment projects independent of size and ownership first included in SC 89/9/24 and more realistically specified as target all projects of state-owned and collective-owned units.

26. Exemptions from both the requirement to cut projects and the blanket prohibition to start new projects were possible but narrow in scope and required approval within a much centralized structure. For details see SC 88/12/26 and SC/SPC 89/1/21.

Lower-level tiers could no longer affect the overall investment volume by delaying the identification of individual investment in fixed assets projects to be cut, and they did not openly violate the central government's investment plan once it had been established. By mid-1989 the State Council had thus switched from requests for certain lower-level tier behaviour to direct results-oriented commands through the blanket prohibition on the start of new projects and a restrictive 1989 investment plan including quotas on investment to cut.

*Assignment of responsibility.* The central government increasingly assigned responsibility for cleaning up investment in fixed assets to clearly defined institutions and persons. While the State Planning Commission in March 1988 assigned responsibility for cleaning up commercial building projects only to local governments and central ministries in general (SPC 88/3/22), the State Council itself three months later explicitly assigned responsibility to provincial leaders (SC 88/6/16),<sup>27</sup> which prodded them into – at least formal – action. Five days after the State Council's instruction, the Shaanxi province government issued an instruction on cleaning up commercial building projects on 21 June 1988. In this instruction it furthermore assigned responsibility to the heads of municipalities and provincial bureaus.

In September the State Council continued the unambiguous assignment of responsibility into the second stage of contractionary investment policies (SC 88/9/24). It requested provincial governors to set up leading groups, and Shaanxi province reacted promptly with a first meeting of the provincial leading group on 11 October 1988. The same pattern holds for the subprovincial tiers in response to ShGov 88/10/25.

The assignment of responsibility to individuals was backed by the explicit Party support for the contractionary investment policies expressed in the CC 13-3 communiqué. Party involvement raised the level of urgency associated with the contractionary investment policies. For provincial governors as well as all members of the provincial leading group it meant an exhortation issued by the organization which had appointed them or had accepted their appointment.<sup>28</sup>

27. The full text of SC 88/6/16 is not available; central ministries were not mentioned in the newspaper article summarizing the instruction.

28. It is impossible to find evidence on individual instances of direct Party pressure on lower-level tier government personnel in response to CC 13-3. Huang Yasheng, *Inflation and Investment Controls*, ch. 8, resorts to correlation and regression coefficients to establish that provincial tier personnel changes are an instrument used by the centre to achieve compliance with contractionary investment policies. The central Organization Department of the Chinese Communist Party appoints provincial governors and deputy governors; appointment decisions on the heads of provincial bureaus and their deputies while being made by the local Party Committee must be reported to the central Organization Department. The Party centre thus has direct influence if not control over personnel decisions regarding the staff in charge of implementing the contractionary investment policies on the provincial tier, including all members of the provincial leading group who are personally responsible for the cleaning up of investment in fixed assets projects under construction. For more details on the distribution of appointment authority see John P. Burns, "Strengthening central CCP control of leadership selection: the 1990 nomenklatura," *The China Quarterly*, No. 138 (June 1994), pp. 458–491, and Huang Yasheng, *Inflation and Investment Controls*, ch. 4.

The CC 13-3 communiqué also mattered because of its signalling effect. While the central government issued detailed instructions on cutting investment projects under construction and on prohibiting the start of new projects, the CC 13-3 communiqué signalled to lower-level tiers that the central government instructions on controlling investment in fixed assets would be enforced. It would not be the case that the locality which obeyed central government instructions would suffer from cutting investment in fixed assets projects *and* from a high inflation rate caused by other localities ignoring central government instructions. For lower-level tiers the only remaining question then was the extent of action required. Each locality took one small step in cutting investment in fixed assets, then stopped to check how far the other localities had gone before taking another step. This incremental process of project cuts continued as long as the "CC 13-3 spirit" prevailed and the central government continued to issue instructions reinforcing or raising its requirements.

*Administrative adjustments.* After the initial policy implementation failure the central government bypassed the regular chain of command for controlling investment in fixed assets projects. It created a special task force for decision-making and enforcement in the form of a leading group, and asked provinces and central ministries to do likewise. The leading group took over all aspects of controlling investment in fixed assets. At the central tier it issued instructions either in the name of the State Council or in co-operation with the State Planning Commission, dispatched inspection teams, approved (if not suggested) projects for cutting and projects to be exempted from the cutting requirement, and co-ordinated the actual implementation of the project cancellations (SC 88/12/26).

This suprastructure mattered in that the potential for a higher-level tier versus lower-level tier dichotomy was vastly reduced. Within the leading group suprastructure there was little scope for delays and irregular exemptions. There was a clearly defined overall objective. Members consisted of local leaders and representatives of ministries whose mission was related to macroeconomic stability.<sup>29</sup> All members of the leading group were identified as individuals, personally responsible for decisions and implementation.

The State Council furthermore enhanced the control function of a number of ministries represented in the leading groups. In 1988 the auditing ministry became increasingly active in the regular administration

29. *Shaanxi ribao* on 12 October 1988 listed the members of the provincial leading group by name, position within the leading group and position within the regular state hierarchy. Among the various institutions represented in the leading group, the People's Bank of China, People's Construction Bank of China, supervision bureau, statistical bureau, auditing bureau and Industrial and Commercial Bank of China all have a strong vertical relationship with the corresponding units on the central (and the municipal) tier. The central government thus brings together not only institutions which are likely to be concerned about the macroeconomic balance but those which furthermore may be attentive to central government instructions due to their degree of vertical leadership.



of investment projects as well as in checking projects supposedly cut.<sup>30</sup> According to the 1988 auditing regulations (SC 88/11/30), the auditing ministry has the authority to issue binding constraints to individual state-owned projects on the use of funds; it also has the right to order the finance ministry and banks to stop disbursing funds, and to order banks to pay fines imposed on particular units from those units' accounts.<sup>31</sup>

In 1988/89 the auditing departments in fact ordered projects which were illegally continuing construction to stop, although these commands were not always successful (ShGov 89/8/19, SC/AM 89/9/30). The central auditing report recommended that auditing departments on all tiers impose economic penalties, confiscate projects of the relevant government, and, if necessary, report to the supervision ministry for imposition of administrative penalties. Supervision departments on all tiers had begun to set up telephone lines and mailboxes for public reporting on investment in fixed assets projects after the issuing of SC 88/9/24. In case of violation of one of the various instructions, penalties were to be meted out, ranging from economic and administrative penalties to legal prosecution and the confiscation of projects by the government of the relevant tier.<sup>32</sup>

Nevertheless, the strengthening of auditing and supervision departments could not guarantee full compliance. The authority of the auditing ministry as part of the government remained weak on all tiers. A lead article in *Renmin ribao* on 29 November 1988 deplored the fact that the supervisory functions of the auditing ministry had not been fully developed; some local leaders were said to interfere with the supervisory work or to block it. There is no evidence that penalties were meted out in Shaanxi province for non-compliance with the contractionary investment policies.

Reporting duties became more stringent as the central government requested ever more detailed information on the actual state of investment and the degree of compliance with its instructions. SPC 88/3/22 on cleaning up commercial building projects only asked for a summary report on the results to be submitted to the State Council via the State Planning Commission before 30 June 1988. SC 88/6/16 tightened this requirement by explicitly requesting a written report. In addition, all stopped or delayed commercial building projects now had to be reported in the press. SC 88/9/24 on cleaning up all investment in fixed assets

30. Both central and provincial tiers during this period issued detailed instructions on the regular auditing of investment projects before construction. (See AM 88/10/14 and ShAM 88/12/23, AM/SPC 89/12/18 and ShAM/ShPC 90/2/7.)

31. While the objects of the auditing ministries' attention were supposedly state-owned capital construction projects and collective- or individual-owned investment projects in which a state-owned unit participated (ShAM 89/2/22), the provincial auditing report on cut projects (ShGov 89/8/19) included short references to collective- and individual-owned projects without stating explicitly that state-owned units had participated in these projects. ShAM 89/2/22 gave each municipality the right to decide whether to include technological updating and transformation projects in the auditing work.

32. *Shaanxi nianjian* 1989, pp. 50 and 73, reports on the work of the provincial supervision bureau; a few individual cases are named but none refers to misbehaviour with respect to cleaning up investment in fixed assets projects.

projects under construction set out further, strict reporting requirements. Provinces and central ministries had to report on the progress of their efforts (rather than on the results only) to the State Council office of the leading group on cleaning up investment in fixed assets projects under construction, and they had to do so in fixed time intervals (every ten days). ShGov 88/10/25 bound the next lower-level tier into this reporting system. In addition, the Shaanxi Party Committee on 10–16 October 1988 asked all municipal and provincial bureaus to report in December to the provincial Party Committee and the provincial government on investment adjustment and consolidation; important matters were to be reported immediately.<sup>33</sup>

In order to keep track of actual policy implementation on lower-level tiers the central government not only relied on reports received from these tiers but repeatedly dispatched inspection teams. SC 88/9/24 (and then again SC 89/4/2) required the State Council and all provinces and central ministries to dispatch work groups to investigate as soon as possible. Ten inspection teams were sent out by the central government for several rounds of one-month inspections to “prod and assist” provinces and central ministries, and to “remove the obstacles in some cadres’ ideological awareness” (*Renmin ribao*, 20 December 1988). They reported back to Premier Li Peng and Deputy-Premier (and also head of the State Planning Commission) Yao Yilin. Lower-level tier governments and Party in Shaanxi province dispatched their own inspection teams with some delay. But the inspection teams had little, if any, authority regarding the inspected unit. The ten central inspection teams were each led by a vice-minister,<sup>34</sup> that is, by a person whose rank does not exceed the rank of the provincial governor. The purpose of dispatching inspection teams thus was primarily to provide the higher-level tier with a reliable picture of the cleaning up investment in fixed assets efforts. This may then have led to further instructions by the higher-level tier.

*Publicity drive.* The central government early in 1988 set two much publicized examples for lower-level tiers to imitate. On 27 May the State Council Standing Committee decided to cut a number of commercial building projects in Beijing. On 25 August the State Council organized the cleaning up of commercial building projects in Beidaihe and Xingcheng; the results were later incorporated into requirements for the provinces and central ministries in SC 88/10/12. Only projects which were already to at least 50 per cent finished were permitted to continue construction; overall, the construction area was reported to have been

33. Additional regulations were issued in 1989. SC 89/4/2 maintained the public reporting duties by asking the statistical bureaus on all tiers to report to the public on the reduction of investment in fixed assets in quarterly intervals. SSB/SPC 89/6/13 and ShSB/PC/ShEC 89/6/26 further clarified the reporting duties and extended and specified the coverage. For example, starting in the third quarter of 1989, provinces had to report on investment by collective-owned units and individuals.

34. See SPC investment research institute and SSB investment statistics office (eds.), *Zhongguo touzi baogao 1991 (China Investment Report 1991)* (Beijing: Zhongguo jihua chubanshe, 1991).

reduced by 61.1 per cent (SC 88/10/12). By imposing severe cuts on construction in the top leaders' seaside resort, Beidaihe, the State Council set a clear precedent; it would be better for the lower-level tiers if forthcoming cuts were substantial rather than trifling.

*Renmin ribao* up to early 1989 reported provincial exemplary successes in cutting investment in weekly or biweekly intervals (see Table 1). Throughout 1988 it consistently passed on all central tier instructions on investment matters. It carried almost a dozen pertinent lead articles. For instance, it criticized the insufficient implementation of central policies by central ministries (*Renmin ribao*, 30 December 1988) and revealed the poor quality of supervision and in general low level of policy implementation (*Renmin ribao*, 17 July, 24 and 29 November 1988). On 7 October 1988 it published two telephone numbers of the State Council leading group encouraging public involvement in the cleaning up process.

At the provincial level press reporting was much more restrictive. Central government inspection teams visiting Shaanxi province remained unmentioned on the provincial and subprovincial tiers. The provincial and the municipal press did not carry a single lead article on investment in fixed assets. *Shaanxi ribao* summarized some of the central government instructions but almost never reported provincial tier instructions. The municipal tier ignored provincial and municipal instructions altogether and only very rarely referred to central instructions. *Shaanxi ribao* and the municipal newspapers published no more than the names of the projects cut, if at all, with an occasional overall figure for the area under construction or the investment volume cut.<sup>35</sup> The small number of reports on local events in *Shaanxi ribao* consisted almost exclusively of short notices on results of the local efforts to cut investment projects. At the municipal level, press reporting on investment in fixed assets was negligible.

Provincial and municipal tiers thus made no effort to use press reporting as a means to pressure the next lower-level tier into action. Since central government measures were publicized through the national press and television, the local press could not avoid giving the issues some coverage, but no criticism of any local authority was ever carried. For example, SC 88/10/12 explicitly listed Xi'an municipality and Xianyang municipality as two of the 60 nation-wide cities which were to start a first round of fully cleaning up commercial building projects, but the corresponding report in *Xi'an wanbao*,<sup>36</sup> while mentioning that some cities had been chosen for the first round, did not mention that Xi'an municipality itself was one of them.

35. Contrary to the instructions, the name of the approving unit was never made publicly known on any tier. SC 88/6/16 asked for the results of the cleaning up of commercial building projects to be reported in the provincial press as well as in *Renmin ribao*. The report was to include project name, approving unit, and construction area. ShGov 88/6/24 required publication of projects by its bureaus and by the municipal tier. SC 88/9/24 asked for the results of the cleaning up of all investment in fixed assets projects to be published but did not give any further details.

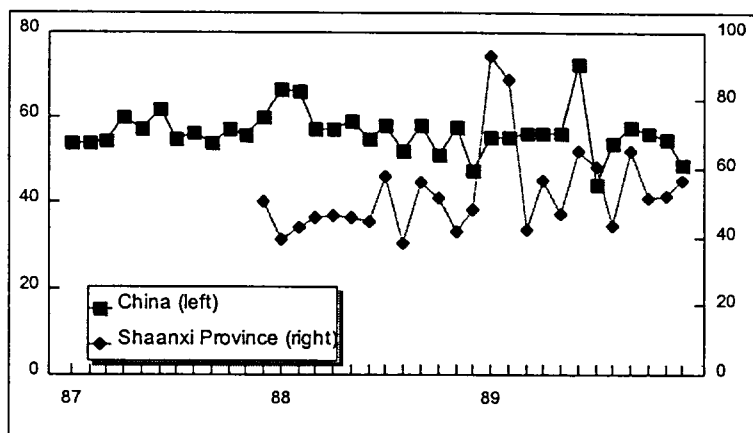
36. See *Xi'an wanbao* (*Xi'an Evening News*), 21 October 1988.

*Limited Explanatory Power of Central-Provincial Dichotomy*

Given the constellation of interests particular to the case of contractionary investment policies, Shaanxi province, as all other provinces, had large incentives to avoid cutting investment projects and to continue initiating new projects. However, compared to central ministries, Shaanxi province performed rather well. In addition, investment in fixed assets by the provincial tier accounted for only a small share of all investment in fixed assets in Shaanxi province; the behaviour of subprovincial tiers clearly mattered.<sup>37</sup>

*Lack of compliance by central ministries.* Capital construction projects of central ministries in Shaanxi province accounted for 40–60 per cent of all monthly capital construction in the province in 1988. But in January and February 1989 this central share rose to more than 80 per cent and remained above the 1988 level for the rest of 1989 (see Figure 2, right-hand scale). Provincial and subprovincial tiers in Shaanxi province thus responded much more favourably to central government instructions

Figure 2: **Share of Central Ministries in Capital Construction 1987–89**  
(in %)



Sources:

*Zhongguo tongji yuebao, China Statistics Monthly.*

37. The findings here, while derived mainly for the case of Shaanxi province, equally apply to other localities. Data on cuts in other localities as well as data on actual investment and on projects newly started suggest that state-owned units in Shaanxi province may have complied better with central government instructions than the nation-wide average state-owned unit. On the other hand, the central auditing report at one point singled out Shaanxi province (as it did other provinces at other times) for reporting cuts in investment projects which had never been started. Neither the central auditing report, nor central documents, nor newspaper reports indicate that Shaanxi province complied in significantly different fashion with central government instructions from other provinces.

than central ministries.<sup>38</sup> The response to SPC 88/3/22 described above confirms that it is not only the provincial tier which was dragging its feet during implementation of contractionary investment policies but also, and possibly even more so, the central ministries; few of the central ministries acted before the deadline. *Renmin ribao* on 30 December 1988 – far into the second stage of contractionary investment policies – complained that “until today there are still [central] ministries which have not yet placed the cleaning up of projects on the agenda of important matters.”

The central government went as far as playing off provincial governments against central ministries in an attempt to cut central ministerial investment. For example, SC 88/12/26 stated that central ministries had to inform those of their projects chosen to be stopped promptly. If the central ministry were not to inform the project, the provincial government was to report up immediately. There is no evidence that this measure had any impact. It is clearly not in the interest of a province to reveal violations of the central government's instructions by central ministries with which the province wants to maintain good relations for future co-operation; the province may earlier have lobbied the central ministry extensively for the investment project. It may even be in a province's interest to cut local investment to an extent that satisfies the central government in order to preserve central projects from which it can benefit.

Central industrial ministries and central investment companies are in a stronger position than provinces to refuse implementation of contractionary investment policies. As Barry Naughton has pointed out,<sup>39</sup> up to three-quarters of all investment in fixed assets by central ministries may occur in infrastructure and thus be deemed more valuable by the central government than other investment – although the central government did not spare the central ministries in its instructions on cutting investment in fixed assets projects. But even if in 1989 three-quarters of central investment had been deemed worth continuing by all tiers concerned, this would have left for cutting in non-essential sectors approximately one-quarter of investment in fixed assets by central ministries, or 8 per cent of total investment in China. Given an overall rate of project cuts in total investment of approximately 3 per cent by January 1989 as reported in *Renmin ribao* of 23 January 1989, cutting only half of the central ministries' non-essential investment projects (4 per cent of total investment in China) would have made a big difference.

It is also to the advantage of the central ministries that the State Planning Commission is particularly concerned about central investment in fixed assets since investment and overall production planning on the

38. Using annual data, for the average province the subcentral share in capital construction did not decrease from 1988 to 1989; the subcentral share in technological updating and transformation, however, did decrease. (Monthly tier-specific data on technological updating and transformation is not available.) Shaanxi province thus for the case of capital construction projects complied comparatively well with central government instructions.

39. See Naughton, *Decline of Central Control*, pp. 64ff, and *China's Macroeconomy*, pp. 131f.

central tier is one of its core tasks. The primarily large and medium-sized projects of central ministries are major determinants of employment and long-term production plans. The plan figures for 1989 reflect this central bias. While planned investment nation-wide in 1989 was kept at its 1988 level, the plan target for provincial investment was reduced by, in the case of Shaanxi province, 19 per cent.<sup>40</sup>

*Lack of central administrative investment control beyond provincial tier.* The provincial tier matters for central government contractionary investment policies both as investor and as transmitter of central government instructions to subprovincial tiers. The provincial role as investor is minor; in Shaanxi province capital construction and technological updating and transformation by the provincial tier made up barely 13 per cent of total investment in fixed assets in 1989.<sup>41</sup>

With central government instructions addressing only central ministries and provincial governments, but provincial government instructions in turn covering municipalities and counties, the provincial tier appears crucial in passing instructions on to the tiers below for implementation. As documented above, the provincial tier was not enthusiastic about the contractionary investment policies. While in the end it passed on and adapted central government instructions, it did not start any on its own initiative to reduce investment in fixed assets. Neither did it make any particular use of enforcement mechanisms beyond what was required by the central government, such as the establishment of leading groups and the dispatch of inspection teams.

The central government must have been well aware of this dilemma as it finally extended its direct influence beyond the provincial tier. Within the planning system it directly addresses the extra-plan cities and extra-plan conglomerates as it does provinces. In SC 88/10/12, however, the central government listed 60 cities to clean up investment in fixed assets projects under construction in a first round without justifying this infringement into provincial territory. These included in Shaanxi province, Xi'an municipality, an extra-plan city, but also Xianyang municipality, which is a regular municipality and not an extra-plan city. By including the major municipalities in its sphere of influence, the central government in Shaanxi province reached almost half of all municipal state-owned investment. State-owned investment by all other municipalities and counties, that is, that out of direct reach of the central government, in 1989, the first year for which these data are available, then accounted for only approximately 18 per cent of total state-owned investment in Shaanxi province. For state-owned units thus by the end of 1988 there was little need to rely on the provincial tier to transmit the contractionary investment policies.

Collective and individual-owned units, which in Shaanxi province

40. See the provincial economic and social development plan in *Shaanxi ribao* of 9 May 1989.

41. See *Shaanxi tongji nianjian 1990*, pp. 92, 97 and 116; comparable data for earlier years are not available.

accounted for 6.38 and 23.08 per cent of total investment in 1989 respectively, largely escaped the direct investment control measures. SC 88/9/24 alluded to cleaning up investment by collective-owned units, but offered details only for capital construction and technological updating and transformation projects; later instructions such as SC 88/12/26 continued to focus on investment by state-owned units. Overall limits on investment in fixed assets by the collective- and individual-owned sectors of the economy included in the investment plan starting in 1988 were abandoned again in the early 1990s.

The reach of the state hierarchy did not fully extend to these enterprises as small-scale investment did not require planning commission approval in 1988/89.<sup>42</sup> The half-a-dozen staff in the county planning commission investment department would furthermore have been insufficient to stop or delay small-scale investment activities throughout the county. Since new investment projects need land, collective- and individual-owned investment projects were supposedly supervised by the county land management department; however, in practice this department was equally ill-equipped to fulfil the task. Furthermore, township enterprises are subordinate to the township government's township enterprise department which receives business guidance from the county township enterprise department. Village enterprises are subordinate to the village committee and have no direct link to the county level. Contractionary investment policies for these enterprises would have had to be formulated by an unenthusiastic county government. Implementation would have required transmission through township governments and their township enterprise departments as well as through a large number of village committees. This extended chain of transmission, the adverse interest of all institutions involved and the near impossibility of monitoring because of the large number of projects and their small size meant that in practice the contractionary investment policies did not reach township and village enterprises through these administrative channels.

It is thus not astonishing that investment in fixed assets by collective- and individual-owned units continued to grow in 1988 at rates exceeding those of state-owned enterprises (see Table 4). A lead article in *Renmin ribao* on 4 April 1989 stated that investment by collective- and individual-owned units on township level and below was "basically out of control." What is astonishing, however, is the big reduction in investment in fixed assets by collective-owned units in 1989, a reduction far exceeding that in state-owned and individual-owned units, both nation-wide and in Shaanxi province. Although collective-owned units in 1989 accounted for no more than 6.38 per cent of total investment in Shaanxi province, the fact that central government contractionary investment policies appear successful for just this category of investment appears paradoxical given

42. The Shaanxi Province Planning Commission only on 10 February 1990 issued a circular establishing a regulatory framework for investment in fixed assets by collective- and individual-owned units; on 19 February 1990 it issued an additional regulation on investment by township enterprises (ShPC 90/2/10 and 90/2/19). The central government had not explicitly requested such regulations.

the lack of investment planning control on the county tier. To resolve the issue requires a look beyond the administrative investment control measures.

### *Macroeconomic Policies Versus Microeconomic Decisions*

The particular constellation of interests in the case of contractionary investment policies suggests a step beyond the central-provincial dichotomy to explain the outcome of contractionary investment policies, focusing instead on the mechanics of implementation. The central government is unable itself to evaluate the approximately 100,000 investment projects under construction throughout the country and to decide which projects to cut. In 1988 for good economic reasons it was unwilling to issue precise instructions on what to cut without individual evaluation. All the central government could therefore do was determine general categories of investment projects to be cleaned up and to urge localities to act. The 1988/89 contractionary investment policies were thus characterized by the need not so much for the execution of precisely formulated instructions but for lower-level tier decisions to cut a particular project. As the experience in Shaanxi province shows, the concentration of decision-making power – rather than only executive powers – on lower-level tiers opened up numerous opportunities for evasion.

The issue of lower-level tier decision-making authority in reducing investment in fixed assets was resolved only through the annual planning procedure when each lower-level tier had to provide a consistent local investment plan that stayed within the centrally imposed limits. The temporary prohibition on starting new investment projects likewise worked well because it was generic and did not require lower-level tier decisions; starting a new investment project without special permission by the State Planning Commission or the State Council immediately constituted a violation of the central government instruction and could have triggered punishment. As the auditing reports attest, the problem was never primarily one of execution, but of vacuous decision-making cutting projects supposedly under construction but in fact not yet started.

The mechanics of implementation were different for collective- and individual-owned units. Such investment was of little importance to the central government and therefore it was willing to clamp down indiscriminately. However, since the county (and urban district) tier was in no position to exert control over the large number of collective- and individual-owned enterprises, particularly those spread across the countryside, the central government switched tools. It adopted a tool which in this particular case would allow avoidance of both the need for transmission of its instructions through the state hierarchy and the need for microeconomic decisions by individuals whose interests ran contrary to those of the central government. The central government clamped down on credit to collective- and individual-owned units. This proved successful because credit was extended exclusively through the centralized banking system including the rural credit co-operatives under control of the Agricultural Bank of China. As Table 5 shows, bank loans financed 36.27 per cent of



Table 5: Sources of Investment Financing Nation-wide

	Share in total investment financing (in %)										Growth over previous year (in %)					
	State-owned units			Collective-owned units			IOUs			Total	State-owned units			Collective-owned units		
	Total	Cap. con.	Techn. upd.	Total	Urban	Rural	Total	Urban	Rural		Total	Cap. con.	Techn. upd.	Total	Urban	Rural
1987 Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	20.57	16.15	14.20	22.51	39.64	23.85	49.06
Budgetary funds	13.06	20.55	32.65	4.26	1.87	0.00	0.00	0.00	0.00	1.04	0.77	-1.99	57.19	58.41	58.41	
Domestic loans	22.96	24.56	19.02	40.37	45.23	38.03	6.34	30.96	25.43	30.96	25.43	27.65	22.90	48.52	25.36	66.68
Foreign funds	4.82	7.33	10.35	2.30	3.87	0.00	0.00	0.00	0.00	71.71	71.33	74.83	109.35	81.40	81.40	
Own funds	47.93	38.20	28.50	48.30	42.81	37.31	82.08	17.24	15.47	11.06	15.36	15.50	19.13	13.54	20.33	
Other funds	11.23	9.37	9.48	4.77	18.54	6.21	24.66	11.57	27.76	6.85	21.96	53.91	96.82	14.78	116.10	37.51
1988 Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	22.13	18.05	13.60	29.12	30.11	40.63	28.42
Budgetary funds	9.06	14.67	24.24	2.76	0.68	1.89	0.00	0.00	-15.32	-15.73	-15.65	-16.57	41.89	41.89		
Domestic loans	20.57	24.20	18.08	38.62	43.77	32.09	0.00	9.41	16.31	8.00	23.54	16.77	36.07	5.39	-100.00	
Foreign funds	5.72	8.96	13.87	2.65	1.59	4.44	0.00	45.13	44.45	52.20	48.80	61.40	61.40			
Own funds	54.35	40.49	31.05	51.11	41.64	42.66	41.07	100.00	38.49	25.13	23.75	36.65	38.44	40.15	37.46	56.46
Other funds	10.30	11.68	12.76	4.86	19.82	7.24	26.84	0.00	12.00	47.17	52.93	31.49	39.06	64.03	35.94	-100.00
1989 Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	-6.95	-6.54	1.70	-19.47	-19.91	-27.20	1.00
Budgetary funds	8.26	13.36	20.84	1.79	0.51	1.57	0.00	0.00	-15.16	-14.87	-12.59	-47.57	-39.50	-39.50		
Domestic loans	17.31	20.85	18.88	29.57	26.71	32.75	23.79	3.43	-21.67	-19.46	6.20	-38.36	-41.03	-45.51	-37.61	

Table 5: *Continued*

	Share in total investment financing (in %)						Growth over previous year (in %)									
	Total	State-owned units			Collective-owned units			IOUs	Total	State-owned units			Collective-owned units			IOUs
		Total	Cap. con.	Techn. upd.	Total	Urban	Rural			Total	Cap. con.	Techn. upd.	Total	Urban	Rural	
Foreign funds	6.63	10.15	14.27	3.39	2.94	0.00	0.00	7.72	5.85	4.66	2.89	47.75	47.75			
Own funds	56.93	42.80	31.90	55.87	47.97	46.91	96.57	-2.54	-1.21	4.51	-11.98	-7.73	-19.95	-0.65	-2.47	
Other funds	10.88	12.84	14.11	9.38	21.87	9.75	27.72	-1.70	2.72	12.42	55.59	-11.63	-2.00	-13.08		
1990 Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	7.53	15.11	9.80	5.25	-7.11	-11.99	-4.75	-3.01	
Budgetary funds	8.71	13.21	21.34	2.12	0.42	1.36	0.00	13.47	13.79	12.45	24.10	-23.37	-23.37			
Domestic loans	19.57	23.62	22.22	32.47	27.50	35.15	24.09	21.57	30.42	29.22	15.58	-4.36	-5.56	-3.56	0.99	
Foreign funds	6.25	9.11	13.15	4.08	2.32	7.50	0.00	1.50	3.34	1.17	26.64	-26.76	-26.76			
Own funds	52.36	42.15	31.10	54.85	47.66	48.31	47.37	-1.10	13.35	7.05	3.33	-7.71	-9.35	-6.94	-15.03	
Other funds	13.10	11.91	12.19	6.49	22.10	7.68	28.54	29.53	6.82	-5.16	-27.20	-6.12	-30.72	-1.94		
Total investment	Absolute data (b.yuan)						Growth over previous year (in %)									
1987	364.09	229.80	134.31	75.86	54.70	18.13	36.57	79.59	20.57	16.15	14.20	22.51	39.64	23.85	49.06	22.56
1988	444.66	271.28	152.58	97.95	71.17	25.50	45.67	102.21	22.13	18.05	13.60	29.12	30.11	40.63	24.89	28.42
1989	413.77	253.55	155.17	78.88	57.00	18.56	38.44	103.23	-6.95	-6.54	1.70	-19.47	-19.91	-27.20	-15.85	1.00
1990	444.93	291.86	170.38	83.02	52.95	16.34	36.61	100.12	7.53	15.11	9.80	5.25	-7.11	-11.99	-4.75	-3.01

Notes:

IOUs denotes individual-owned units. Cap. con. denotes capital construction. Techn. upd. denotes technological updating and transformation.

Sources:

Calculated from *Zhongguo tongji nianjian* 1987, p. 468; 1988, p. 560; 1989, p. 478; 1990, p. 154; 1991, p. 144.

all investment in fixed assets by collective-owned units in 1988, but only 26.71 per cent in 1989. Bank loans for investment in fixed assets by collective-owned units already in 1988 grew by only 16.77 per cent, compared to a growth rate of 48.52 per cent in 1987, and fell by 41.03 per cent in 1989, and by another 4.36 per cent in 1990. Loans for investment in fixed assets by state-owned units, in contrast, grew by 16.31 per cent in 1988, fell by only 19.46 per cent in 1989 and increased again by 30.42 per cent in 1990.

For precisely collective-owned units bank lending mattered as it financed almost 40 per cent of their investment in fixed assets throughout the mid-1980s, a share approximately twice as high as in the case of investment in fixed assets by state-owned units. Changes in no other financing source had such an impact on the availability of funds for investment in fixed assets by township- and village-run enterprises. On the other hand, while loans to individual-owned units were likewise severely cut back already in 1988, this reduction had only a very minor impact on investment in fixed assets by individual-owned units since loans had accounted for barely 6 per cent of their financing sources in 1987 (see Table 5). In 1988 and 1989 individual-owned units, accounting for almost one-quarter of total investment in fixed assets nation-wide as well as in Shaanxi province, remained least affected by the contractionary investment policies (see Table 4).<sup>43</sup>

Bank lending behaviour may also explain why the volume of capital construction projects in 1989 fell far less than that of technological updating and transformation. While lending to capital construction projects was up by 6.20 per cent in 1989, lending for technological updating and transformation fell by 38.36 per cent in 1989 (see Table 5); this reduction is likely to have had a large impact since bank lending financed 36.27 per cent of all technological updating and transformation in 1988 and 26.71 per cent in 1989 (versus only 18.08 and 18.88 per cent in the case of capital construction). Lending for capital construction projects is largely determined by the planning commission on all tiers and earmarked in the credit plan as designated to a particular project. In cutting capital construction projects under construction, the initiative on deciding whether to cut a project rested with the leading group of which the banking system was part, rather than solely with the banks.

Relatively small-scale, short-term lending for technological updating and transformation, on the other hand, is usually not earmarked in the credit plan. Each tier receives a total limit up to which it can lend throughout the year. Since banks had no incentive not to lend up to the lending limit and enterprises were keen on cheap bank funds, the reduction in lending for technological updating and transformation suggests that the central government found it convenient to cut aggregate lending

43. The slight reduction in investment nation-wide in 1990 could be due to political reasons in the aftermath of 4 June 1989.

limits on non-earmarked lending, while not affecting individual long-term capital construction projects already well under construction.<sup>44</sup>

In bank lending policies as in direct administrative contractionary investment policies, it is thus the ability to avoid administrative microeconomic decisions on individual projects which makes for successful policy implementation. The availability of different macroeconomic tools matters only in as far as alternative tools require microeconomic decisions to a different extent.

### *Conclusions*

Prior to 1988/89 the predominance of government-determined fixed prices prevented macroeconomic imbalances from translating into significant open inflation. By 1988/89, however, a sufficient range of prices had been freed for unprecedented rises in the inflation rate to occur. The central government resorted to its traditional measure to address imbalances between the producer and consumer goods sector: adjusting the volume and structure of investment. But lower-level tiers failed to comply promptly.

Despite numerous central government instructions, the extent of investment cuts throughout 1988 was minor. Lower-level tiers delayed transmission of higher-level tier instructions, cut projects which had never been started, and finished endangered projects ahead of time. Only in 1989, when unambiguous control figures for cutting investment in fixed assets, a new annual investment plan and a strict prohibition to start new investment projects were in place, did investment in fixed assets drop significantly as compared to the previous year.

Both the focus on central-provincial relations and the focus on the question of the appropriate macroeconomic policy tool can shed only partial light on the implementation process and outcome of the contractionary investment policies in 1988/89. Central ministries resisted implementation of contractionary investment policies even more successfully than provinces; on subprovincial tiers investment by collective- and individual-owned units occurred largely outside direct administrative investment control.

In the 1988/89 contractionary investment policy period the central government in the end succeeded in reining in investment in fixed assets. From a central-provincial perspective thus, the centre is in control. But a focus on central-provincial relations as analytical perspective not only neglects other tiers of the economy, it also appears lacking in scope in the case of contractionary investment policies. The central-provincial dichotomy in the case of contractionary investment policies does not reflect the bargaining of two parties for their shares of the pie in a zero-sum game. Rather, it reflects one aspect of a free-rider problem in which

44. A similar argument applies held for the budget appropriations to capital construction projects and technological updating and transformation (see Table 5).

everyone loses if free riding is pervasive. Once the decision to conduct contractionary macroeconomic policies has been taken, the central government is no more than an enforcement agency. State-owned units, subordinate to any of the four top tiers of the state hierarchy, as well as collective- and individual-owned units, were scrambling for a free ride in 1988/89. The provincial tier was in a special position only in so far as it could try to shelter 18 per cent of investment in fixed assets by state-owned units in Shaanxi province in 1989 by virtue of its transmitter role, and by not establishing a regulatory framework on investment in fixed assets by collective- and individual-owned enterprises before 1990.

A more rewarding analytical view is perhaps a focus on the degree to which implementation requires microeconomic decisions rather than simply lower-level tier execution. For this appears the crux of the 1988/89 implementation issue. Execution of unambiguous instructions which leave no scope for lower-level tier choices was very successful in 1989, except that these instructions came late since the government was reluctant to attach such priority to its contractionary investment policies as to overrule all concern about the efficient application of its contractionary measures. The central government could have "cut with one knife" early on (such as requiring all projects under construction to be stopped immediately), but at what price to the economy? It was the scope for lower-level tier choices in the implementation process that opened up the possibility for lower-level tiers to delay if not avoid full implementation of central government instructions throughout 1988.

Little has changed since 1988/89. The next contractionary macroeconomic policy period of 1993 to 1995 was again characterized by the need to reach microeconomic decisions in order to cool the overheated economy. The switch in contractionary tools from direct administrative decisions on investment projects to financial measures did not imply a switch to targeting macroeconomic aggregates, such as the money supply. Rather, since lending decisions for capital construction projects of state-owned units were also reached by the planning apparatus – individual projects receiving earmarked loans within the plan – contractionary macroeconomic policies translated primarily into restrictive microeconomic lending decisions.

The highly discretionary implementation process in 1988/89 conducted the old-fashioned, campaign-style way proved costly as well as time-consuming. The central government had repeatedly to issue instructions stating ever more specifically the targets of the contractionary investment policies and the requested lower-level tier behaviour. Responsibility for lower-level tier actions was assigned to specific individuals and leading groups were set up. The Party explicitly supported the contractionary investment policies. Auditing and supervision hierarchies were strengthened, examples were set, publicity generated, and inspection teams dispatched. By 1993–95 the reduction of credit limits and adjustment to credit quotas may have proved less costly than the direct administrative investment control measures in 1988/89. But since the "soft landing" was

still implemented with many administrative lending decisions reached on a case-by-case basis, the policies took almost two years to succeed.

The 1988/89 period of contractionary investment policies is evidence that the central government is fully able to ensure the prevalence of nation-wide objectives in the medium to long term. However, the mechanisms on which it relies to achieve these objectives are still those of the centrally planned economy. This reliance on microeconomic decisions to be reached by all tiers of the state hierarchy and on the annual planning procedure with its plan targets and limits contrasts sharply with the need for quick and efficient macroeconomic policy in an increasingly market-based economy. China lacks true macroeconomic policy tools, that is those that do not first need to be translated into microeconomic measures by the administrative apparatus.

The challenge of the future thus lies in a switch to macroeconomic policy tools that do not rely on microeconomic decisions, tools such as money supply or interest rate targeting that show quick effects, are cheap to implement and allow fine-tuning ahead of time to prevent the recurrent slide into periods of severe inflation before measures begin to show effect. Such macroeconomic policy would deny China's state hierarchy much of its present microeconomic decision-making role in the economy. China's economic decision-making elite cannot have both, direct control over enterprises and investment projects, as well as efficient macroeconomic management.