

China in the Upcoming Decade¹

Summary

The forthcoming decade will be critical for China's development. In the future, China must maintain balanced growth and simultaneously provide an adequate solution to the problem of income inequality, which necessitates facing myriad challenges and difficulties. Solving these problems will require reform and innovation.

In the past ten years, China's economy quickly caught up with America's economy, quickly reducing the gap. According to our assessment, by 2020, China's nominal GDP will reach 22.9 trillion USD, surpassing America to become the world's largest economy. By 2030, China's nominal GDP will reach 59.4 trillion USD, approximately 1.7 larger than the US economy.

Overcoming the Middle Income Trap

Presently China has already entered the middle income development stage, and faces the challenge of overcoming the middle income trap. "The Middle Income Trap" refers to a state of insufficient force driving economic growth and an imbalance in income distribution brought on because a country's GDP per capita reaches a medium level and cannot continue to smoothly undergo a transformation in the model of economic development. In order to ease the social strain, some countries adopt populist policies with high welfare redistribution, but when the government's financial resources become insufficient to support the system, they excessively print money and simultaneously take on foreign debt, leading to hyperinflation and outflow of capital, and causing the economy to enter long-term stagnation.

In the future, two fundamental factors will restrict China's economic growth: (1) The slowdown in the investment growth over the long term will make the model of economic growth difficult to continue into the future. (2) Negative growth in the labor supply might arise, and the population bonus will disappear. In breaking down the origin of China's previous high speed growth, each factor of production which contributed to high speed growth is implicitly driven by

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the population bonus. Currently China's population bonus has basically disappeared. Simultaneously, the income distribution gap of the society at large has expanded, bringing about exacerbated contradictions in the society. In China, a country that has a tradition of valuing equal wealth distribution, the media of the masses in this rapidly developing society voices intensely for adjusting the income distribution, and this has brought an immense pressure on the government. As soon as income redistribution policies go wrong, it could possibly provoke the swelling of a somewhat extreme tide of thought, creating a serious political economic consequence, and leading the country to sink into a middle income trap that's hard to escape.

To overcome the middle income trap, several challenges and difficulties must be conquered. First, China must in the course of its economic development follow objective principles and from a perfect economic structure find the fountainhead of new economic development. Second, it must preserve social stability as the economy develops while successfully solving the sundry social problems. To accomplish this, there are two problem solving approaches, the first of which is an ineffectual remedy, like trying to stop the pot of water from boiling by skimming water off the top, the second is a fundamental solution, which involves taking drastic measures (i.e. lowering the flame) to address the root cause. In taking the perspective of long-term stability and peace, it's clear that China must choose the second method so as to eliminate problems from the root.

Reforming Income Distribution

The problem of corruption and income distribution is fundamentally a symptom of the incompleteness of reform. China's current income distribution problem was largely caused by an unreasonable initial distribution. A comparatively good solution is to achieve impartiality and efficiency at the time of the initial distribution, using redistribution as the compensation method. To achieve this, the economy must develop according to its comparative advantage along the track of labor-intensive industry so as to create more employment opportunities, which will allow the salaried class to share in the fruits of economic development. This approach to development can gradually lead to a transition from a capital shortage to a capital surplus, abundant labor to a labor shortage. In this process, wages will rapidly rise, capital returns will gradually decline, and the income distribution will fundamentally improve.

Adjusting the economic structure, maintaining balanced economic growth. To overstep the middle income trap, a suitable rate of economic growth must be maintained, new sources of economic growth must be explored, and the latent force of economic development on both supply and demand sides must be found. Solving societal- institutional level problems and adjusting for the imbalances in the economic structure can lead to expanding the production possibilities frontier. On the supply side, China must improve all of the factors of productivity's contribution to economic growth by means of institutional reform and technological innovation. Reform is the first source for increasing the efficiency of all of the factors of production. China must reform to improve the economic structure, unflinching in driving forward and completing the marketization reform. China must adjust the industrial structure and policies, reduce the excessive government intervention, allow privately run enterprises to enter some of the industries originally monopolized by state owned enterprises. It's also imperative to deepen factors of production market reforms and eliminate price distortions. Meanwhile, innovation is the other source of increasing the efficiency of all of the factors of production, including technological innovation and institutional innovation. It's necessary to establish and improve incentive mechanisms to encourage enterprises to independently innovate. Lastly, China must increase

educational investment especially for the children of impoverished families to supply equal educational opportunities in order to create and accumulate human capital.

On the demand side, there is a need to uncover the effective demand by opening up new domestic and overseas markets, adjusting the structure of total demand – consumption, investment, government expenditures and net exports, increasing consumption, increasing investment efficiency, and at the same time appropriately reducing the share of net exports. The primary channel of consumer demand can be expanded through the steady promotion of urbanization and the development of the services sector. Urbanization involves land system reform, household registration reform, housing market reform and public finance and tax reform, which is extremely complicated. It must be carefully designed, be appropriately fair in dealing with the all of the interests, and equally protect public and private property rights. There also must be tax system reform to reasonably sort out central-regional public finance relations, provide local governments a reliable source of revenue and allow them to reduce their dependence on land tax.

Long term growth and the mobility of the social structure. In order to continue long term economic growth, we must protect and cultivate the basic elements of economic growth, place a high importance on capital accumulation, technological progress, and the growth of human capital, and protect property rights. The initiative of human capital investment hinges upon whether or not social mobility can continue. The previous 30 years of reform in China largely depended on liberating the vitality of the society, but in recent years the social structure has in fact begun trending in reverse, with an increase in intergenerational correlations and decrease in social mobility. If this trend continues, there's no way to protect long term economic growth. It's imperative for China to build a better foundation for its long term economic growth.

Economic and Political System Reform

Overcoming the middle income trap requires deep economic and political system reform. In the recent past, political system reform was lagging behind, and so economic system reform lacked the support and coordination with political system reform. This type of system gave prominence to the urgency of political system reform.

The future of political system reform includes the following tasks. First, continue transforming the role of government, and more clearly separate government and enterprise, political affairs, government capital, and society. Second, separate the communist party and government administration. This is the key of political reform, and it's the precondition for the transformation of the role of government and the construction of democratic institutions. For the past few years, the central government has carried out several structural reforms, and the structure of the party hasn't been altered, though this aspect of reform needs to be reinforced. Third, establish a constitutional government. Constitutional government is essentially the condition of limited government under democratically elected representatives. Democratization should be carried out by the plan of a constitutional social order. The core problem of a one party constitutional government system lies in how to handle the relationship between the party and the country. It must occur through a "constitution", "party constitution" or standardized document which stipulates the relationship between the party and country, establishes the authority of the People's Congress, and deals with each aspect of the relationship between the party and NPC, to guarantee all of the rights and freedoms of the citizens. China's democracy must be constitutional government, must clearly write the guiding principles of reform into the constitutional government. Constitutional government should precede democracy. Fourth, create

a democratic mechanism. If the system doesn't create some kind of democratic mechanism, it will be difficult to create long lasting political stability. Grass roots democracy can begin to progressively expand into nationwide democracy. Fifth, build a legal system and institutions. The rule of law and the relative independence and authority of the judiciary must be emphasized. Sixth, rebuild the social order and develop a civil society. There's a need to consider the social layout that will arise as urbanization changes the layout of city and countryside, also the issue of which level of administrative organization will be the fulcrum of the social structure. The deficit in the development of the civil society possibly encouraged a populist sentiment, creating an extreme force attacking the social order. It's necessary to steadily develop the civil society under government control, resolve social conflicts in a manner consistent with civil society. Seventh, discover the core of a genuine Chinese value system. Remodel a value system by returning to China's traditional values and assimilate the outstanding heritage of world cultures. Public finance system reform is the most suitable point of attack for political system reform, as the core of modern democratic politics is budgeting democracy. Democratic politics is an issue of the checks and balances of taxation and government expenditures, it's about limiting the government's authority to levy taxes and expend public finances, subjecting government to the deliberation and restriction of democratic representation.

China's experience of successful reform can be characterized by three principles: (1) Force principle. Any great reform is set in motion by pressure. Only sufficient force can break inertia, and break the barrier of vested interests. Only when there's a crisis can people form a consensus, clearly see the road ahead, and decisively proceed forward. (2) Having confidence in the wisdom of grassroots democracy, respecting the people's choice. (3) Advancing step by step experimenting with trial-by-error reform, crossing the river by feeling the stones, and by means of experimenting, expanding reform "from point to surface", and controlling risk. Looking from the perspective of the driving force, reform can be broken into three types. (1) Conventional reform. This type of reform is often marginal, departmental, and it doesn't involve a challenge of the system's basic framework, so controversy is relatively little. (2) Breakthrough reform. Its characteristic is an expanding on the boundary of the basic system's framework, and it involves a type of breakthrough result. (3) Systematic reform.

The force of conflict is vital to set reform in motion. Currently the possible elements of force include: (1) Maintenance of stability. (2) Corruption. (3) Decrease in the speed of growth. (4) Housing prices as well as the background currency expansion framework. (5) State-owned enterprise reform. (6) Slowing in the speed of growth. (7) New understanding towards issues of the Communist party's history. (8) Degree of consensus in the reform, discrepancy between the call for reform and the actual degree of progress of reform. (9) Aging population's effect on the advancement of population policy reform. (10) The issue of urbanization giving rise to rural land property rights, the enjoyment of the gains of urbanization among peasant farmers and the issue of inner-city poverty and public security. (11) The issue of China's legitimacy internationally. (12) The issue of the party's methods of internal dispute settlement.

International Position

As China's economic mass expands, our country ought to play a more active role in international affairs. "To conceal one's strengths and bide the time" is no longer an appropriate foreign policy for China. The world position of China in the next 10 years will be based on the fundamental notion of multi-polarity. "Uni-polar" indicates only one international order as well as support for the value system of this order; "Multi-polar" indicates an international order and

value system in which several powers or international forces coexist; “joint governance” indicates all the major powers and international forces in a framework of common approval working together to maintain a unipolar international order and value system.

In the future, China will be an important pole of the multipolar world, but China’s goal isn’t to replace the current international order and value system with a new one, but rather to strengthen within the unipolar system, and gradually realize the goal of replacing the US as the dominant power in the second half of this century. China’s interest can be dramatically expanded in the current international order. In the future that can be foreseen, the whole world still cannot produce a country or force that would contend with let alone supersede the US’s leadership. China and the US have an element of antagonism and one of cooperation between them. In a situation of multipolar joint governance, the prospect of cooperation will be even broader. In trade relations, Sino-US interests are complimentary. This is one of the foundations of Sino-US relations. Even if it becomes the world’s largest economic entity, China is still a middle-income country, and its competitive advantage in production still mainly lies in labor-intensive industry. Long into the future, the US’s GDP per capita will be higher than China’s, and its competitive advantage will lie in capital and technology high-intensity production. China’s fast expansion of the market has been of benefit to American corporations. Our foreign policy needs to cleverly utilize the Sino-US economic complementarity. One aspect is the need to strengthen military power, another facet being the creation of a peaceful environment so that America’s large corporations can share in benefits of China’s rapid development. The future of China’s domestic market which will become one of the world’s central markets, its domestic demand will create an enormous potential business opportunity for the corporations of every country. This will require China to advance a step towards open, complete rules of competition in its domestic markets, and strengthen fair trade with foreign enterprises in international economic relations.

At present, the structure of competition among the world’s countries is virtually civilized competition. Today’s rise of China is only a rise in its wealth and power, still not a rise of its civilization, and there isn’t an enduring cultural system in its background. China is a multiethnic country, and in the process of evolving has preserved the unity of a large country. The difference between the traditional empire and the modern national state is that the national state attempts to create a homogeneously integrated interior, but the empires in the interior allow each and every type of diversity. To realize the unification of a civilization’s foundation, different religious cultural traditions need to be recognized, and different political institutions must be allowed to exist to achieve the harmonious coexistence of different ethnic groups. We must absorb the experience from history, and create a multifaceted but united civilization.

1. Review and Outlook

The past 30 years of reform and opening and the historically unprecedented high-speed economic development caused deep changes to take place in China’s politics, economy, and society. China successfully implemented multiple economic and political system reforms, bringing out the market’s fundamental function in resource allocation, stimulating the development potential of enterprises and people, and advancing high-speed economic reform. In the past 10 years, China’s economic construction quickly developed, and the primary energy of the ruling class concentrated on the issues of resolving employment, the three rural issues, and social insurance, etc., to improve people’s livelihood and preserve social stability. In the last ten

years, city and countryside employment has expanded, residents' income and property has steadily grown, the level of basic public services has increased, the city and countryside social security system has been completely established, and health insurance has basically been extended to the entire population. At the same time, it must be observed that the fast paced economic growth has brought a series of structural problems, some related to the sluggish progress of reform, the depth of the reform, and the formidable task of transforming the model of economic development. These problems mainly involve the slowing of economic development, the unreasonable industrial structure, factor allocation disequilibrium, an increase in the city and countryside regional development disparity, growth in social contradictions, and frequent occurrence of government official corruption, etc. These problems propose a new challenge and possible a new direction for the future ten years of reform.

The upcoming ten years will be a pivotal decade for China's development. The recent convening of the CCP 18th Representative Congress proposed two "doubling" goals, to grow GDP and city and countryside household income per capita one fold from their 2010 levels by 2020. In the future, China has the potential to maintain a relatively high rate of growth, but to unearth this potential, several challenges must be confronted, and several difficulties must be overcome. These challenges and difficulties mainly include two aspects; first, China must in the course of its economic development follow objective principles and from a perfect economic structure find the fountainhead of new economic development. Second, it must preserve social stability as the economy develops while successfully solving the sundry social problems. To accomplish this, there are two problem solving approaches, the first of which is an ineffectual remedy, like trying to stop the pot of water from boiling by skimming water off the top, the second is a fundamental solution, and it involves taking drastic measures (i.e. lowering the flame) to address the root cause.

From the perspective of the long term growth of the world economy, the shock created by the 2008 international financial crisis can be seen as a period within a greater long term economic cycle. In the next 20 years, the world economy will experience a long term aftermath, involving a period of decline, slump and recovery. The 50 years from 1980 to 2030 is a complete long term cycle. The first 25 years of this cycle was a period of prosperity, the current 10 years is one of crisis brewing erupting and expanding, and the future 15 year period is one of slump and recovery. In the long term economic cycle, different economic entities will present different development characteristics. Currently the world's developed countries have entered into a "Japanese style stagnation" period, with the following characteristics: first, currency policy cannot be routinely carried out, only through unconventional policies can the economy be stimulated. Second, the national debt issue has emerged. Third, the population aging problem has become serious, and each government force in dealing with this problem has had a difficult time achieving consensus. Fourth, the divide in government has been exacerbated. The bifurcation of domestic politics in Europe, Japan and the USA has intensified, and it's hard to obtain compromise. Developed economic entities are recently in a mid-period of a long cycle, and the entirety of financial innovation is marching towards a slowdown. In emerging markets, the entirety of growth is moving towards a slowing in comparison with the previous 20 years, structural adjustment is approaching acceleration, the middle income trap problem has become increasingly pronounced, and technology manufacturing transfer is in an unstable state. The global economy is evolving such that the elements of uncertainty are increasing, and each country's policy coordination is becoming more important by the day. In this kind of macro-level

international economic context, emerging economic entities should speed up structural transformation development models.

In the past 10 years, China's economy, according to the comparative price calculation, maintained double digit growth, 2011 GDP nominal amount reached 46.6 trillion Renminbi, or 7.21 trillion US dollars. In 2010, China's economy according to nominal Renminbi and nominal US dollars calculation has already surpassed Japan to become the world's second largest economy.² In 2011, the US total GDP was 2.1 times that of China. Table 1 displays China's catch up with the US during the period 2000 to 2011. In the valuation of the US dollar, during these 10 years, China's nominal catch-up rate reached 14.1%, which signifies that in each 5 year interval, China's GDP gap relative to the US decreased roughly by one half.

Table 1 China's Economic Catch-up Relative to the USA: 2000-2011, %

	China		USA		China-USA	
	Cumulative	Annual Avg	Cumulative	Annual Avg	Cumulative	Annual Avg
GDP Real Growth	114.2	10.4%	17.3	1.6%	96.9	8.8%
GDP Deflator	52.0	4.8%	25.3	2.3%	27.7	2.5%
GDP Nominal Growth	167.2	15.2%	42.6	3.9%	124.5	11.3%
Exchange rate (direct quotation)	-24.1	-2.2%	100.0	0.0%	-24.1	-2.2%
GDP Growth Measured in USD	197.2	17.9%	42.6	3.9%	154.6	14.1%

Note: 2000 is the base year. China/USA cumulative represents the balance of the annual growth rate, annual average represents the difference of annual growth rates. RMB adopted direct quotation method, negative indicates RMB appreciation.

Date Source: 1978-2011 China GDP data comes from "China Statistical Yearbook 2012". USA GDP data comes from the US Department of Commerce Bureau of Economic Analysis. RMB-USD Exchange Rate 1981-2011 data comes from the "China Statistical Yearbook 2012".

Suppose in the period 2012-2020 the Chinese economy, calculated at comparable prices, maintains an annual growth rate of 7.5%, and in 2021-2030 an annual growth of 6%, and the U.S. economy, also calculated at comparable prices, maintains 2.5% growth; also suppose that the U.S. annual inflation rate is 2%; China's 2012-2020 annual inflation rate is 4.5%, and 2021-2030 annual inflation rate is 4%. Also suppose 2012-2020 nominal appreciation of the RMB against the U.S. dollar is 1.5% per year, 2021-2030 rates remain unchanged, and the Chinese yuan-denominated nominal growth rate is 12.0% per annum in 2012-2020, and is 10% per annum during 2021-2030, and annual nominal growth denominated in U.S. dollars is 13.5% in 2012-2020, and 10% annually during 2021-2030.

² In comparing China US total GDP, this report mainly used nominal GDP, and didn't use the purchasing power parity calculation of "real GDP". Real GDP reflects the standard of living of a country's residents, but doesn't reflect the comparative purchasing power of the two countries, and nominal GDP does reflect this. For example, when the Renminbi compared with the US dollar appreciates 10%, China's real GDP doesn't change, but, the purchasing power of China's residents holding Renminbi in purchasing American products or services actually increases by 10%. Due to this, when ascertaining the relative position and overall economic size between country-to-country, nominal GDP is a better index than real GDP.

U.S. nominal growth 2012-2030 is forecast as 4.5% per annum. Table 2 shows the 2020 and 2030 China and US nominal GDP forecast. According to the forecasts in Table 2, by 2020, China's GDP will reach \$ 22.9 trillion, surpassing the United States to become the world's largest economy.³ By 2030, China's GDP will reach \$ 59.4 trillion, 1.7 times the US GDP. During this time, the RMB to U.S. dollar exchange rate in 2020 will rise to 5.64 yuan per dollar.

Table 2 China and USA Total Economy Forecasts

Year	USA (Trillion USD)	China (Trillion Yuan)	China (Trillion USD)	China/USA (Multiple)	Exchange Rate (RMB/USD)
2020	22.40	129.23	22.91	1.02	5.64
2030	34.79	335.18	59.43	1.71	5.64

Assuming the world economy in the next decade will grow at an average annual nominal growth rate of 7%, by 2020, the Chinese economy will account for 17.9% as a proportion of the world economy from 10.4% in 2011, while the U.S. economy will account for 17.4%, from the current 21.6%. The 2011 Chinese population was about 1.31 billion, and had a U.S. dollar per capita income of about one tenth the U.S. By 2020, China's population will grow to 1.37 billion, with a per capita income of about \$16,700. According to the above-mentioned forecast whereby China's total size will surpass the United States after ten years, China's per capita income indicators are expected to improve from the current low-middle income country level to medium-high income levels, but at that time China's per capita income will still be less than 30% of the forecasted U.S. per capita income.

In the long term, growth dependent on traditional, unlimited supply of cheap labor and large capital investment will gradually reduce in its contribution to growth, and potential production capacity will slowly decline. In the next decade it will be necessary to change the existing style of growth, through resolving the structural imbalances accumulated from the past, unfair distribution and other issues, so as to unleash the economy's potential to achieve sustainable and stable development, and simultaneously maintain a moderate growth rate. Accelerating the deepening of the market orientation and elimination of the economy's various distortions is the most critical drastic approach to achieving steady and rapid economic development and social and political stability. This way, there will be more sustained and healthy economic development, on the other hand there will be a more equitable income distribution, and the social order will be more stable.

2. Overcoming the Middle Income Trap

According to international standards, China has entered the middle-income stage of development. In the next decade, China faces the task of maintaining economic growth

³ Economists from each country have made their predictions of the timing of China's GDP surpassing the US GDP based on different assumptions. IMF2011 April "World Economic Outlook" forecasts, according to purchasing power parity, that China will surpass the United States in 2016. Arvind Subramanian of The Peterson Institute for International Economics believes that in purchasing power parity terms, China already surpassed the United States in 2010.

momentum to overcome the problems arising from the development process, to succeed in the challenge of overcoming the middle-income trap.

The Meaning of the Middle Income Trap

"Middle income trap" refers to when a country's per capita income reaches moderate levels, but due to not successfully achieving economic changes in the development pattern, the driver of economic growth becomes insufficient, culminating in a state of economic stagnation.

The World Bank's "East Asian Economic Development Report (2006)" proposed the "Middle Income Trap" concept, which basically means: few middle-income economies successfully rise to become high-income countries, and they more often fall into a period of stagnation of economic growth, neither being able to compete in wages with low-income countries, nor able to compete with wealthy nations in cutting-edge technology. In the process by which a middle-income economy advances to high-income, it can neither repeat nor break away from the development models of former countries that transitioned from low-income to middle-income. So, its economic growth is prone to stagnation and wavering. As it enters this period, the tensions accumulated from the rapid economic development become concentrated and erupt. The original growth mechanism and mode of development cannot effectively deal with the systemic risk thus formed, and economic growth is prone to significant fluctuations or stagnation, and either becomes delayed or cannot enter the ranks of high-income countries.

According to the World Development Index of the World Bank statistics, which includes 214 countries and regions, at the end of 2011 there were more than 98 countries with a GDP per capita of more than \$4,000 (in 2011 dollars), accounting for 46% of the nations. Among the 98 countries, there were 53 whose level of GDP per capita surpassed \$12,000, which indicates entering the high income country stage. The 53 countries spanning from middle-income to high-income level spend an average of 12.4 years. Due to obvious scale advantages, countries with a population size over 10 million in rising from middle-income to high-income only spent an average of 11.9 years.

At present there are 45 countries with a GDP per capita between \$4,000- \$12,000. Some have entered a middle stage of development, but due to the accumulation of political, cultural, economic, religious, and military conflicts, they've stagnated at the middle-income stage for a long period, a situation which is called, the "middle income trap". At this stage of development, the economic structure severely changed. In the face of change, some countries exhibit "blindness" when dealing with the relationship between economic growth and income distribution. Some Latin American countries adopted development models characterized by import substitution and large monopolistic enterprises, and ignored the small and medium sized enterprises and the interests of the people, which led to polarization of the social structure. To alleviate the social pressures, the governments of these countries implemented populist policies with high welfare distribution. When the government's public financial resources were insufficient to support the welfare distribution policy, the excessively printed money and took on foreign debt, causing hyperinflation and capital flight, which lead the economy to experience long-term stagnation.

Because the absolute level of income is in a constant state of change, when measuring the middle income trap, it's more suitable to use relative income, which basically involves measuring a country's income as a proportion with the income levels of the most developed countries in the world. Using the relative income measurement, and letting Japan at the time of the Meiji Restoration be the low income country, its GDP per capita was roughly 20% that of the

richest countries, and following the gradual rise in its income ratio, it reached 95% of US income levels by 2011. For China, to judge whether or not it has overcome the middle income trap, one would need to observe that its income relative to developed countries has risen.

From the perspective of economics, the meaning of the middle income trap can be explained by borrowing from the theoretical framework of economic growth, in which the capital stock per capita and income per capita converge to a particular steady state. In steady state equilibrium, the economy grows at a constant rate. If the stable equilibrium point is less than \$12,000, there exists a middle-income trap. If the stable equilibrium point is less than \$4,000, it has fallen into a poverty trap. In this situation a strong force is required to push the economy forward to break it away from the trap. Since each country has a different production and savings function, the steady state will likely be different for each country's economy, and some countries either fall into middle income or low income traps. To overcome the middle income trap an economy must break through the cycle of low efficiency. At the political and social level, if reform cannot deepen in a timely way, and if social tensions cannot be alleviated, reform might enter into a gridlock, and the country can become enveloped in a serious political and societal crisis in which it is attacked by radicalism from two opposing directions. We must be alert to this possibility.

China Faces the Danger of the Middle Trap

China is currently facing the danger of the middle trap. On the one hand, after 30 years of rapid growth, China's economic growth slowed down. On the other hand, the income distribution gap has been increasing, and the calls for the adjustment of the whole societal income distribution have become louder.

There are two fundamental elements restricting China's future growth. First, the future investment growth rate is slowing down. China's investment led growth is difficult to continue in the long-term. The development model dependent on cheap labor, cheap land and at the expense of the natural environment is unsustainable. There is a need to prevent excessive investment-driven growth and to improve the investment structure, which is currently over-reliant on real estate. At the same time, following the financial deepening, returns on capital have declined, and this will reduce the future investment growth rate, which will produce an unfavorable impact on economic growth.

Second, the labor supply may exhibit negative growth. First of all, China's demographic dividend has gradually disappeared. Over the past few decades, the age of the working population has continued to increase. In China's opening to the world, in which it had an abundant labor force, in a high savings environment, there hadn't been a trend of reducing returns to capital, and so the population bonus became one of the sources of China's rapid economic growth which was unprecedented in the past 30 years. In decomposing the past 30 years of China's rapid economic growth, the contribution of labor represented about 8%, and the education level of the labor force and human capital contributed about 4%. The demographic dividend (population bonus), narrowly defined as a decrease in the population ratio, contributed 7%. In addition, half of the improvement in the total factors of productivity came from improved resource allocation. A large number of surplus labor flowed from low productivity sectors to high productivity sectors, realizing a reallocation of resources.⁴ The demographic dividend lies in

⁴ Cai Fang, "How Can China Avoid the Middle Income Trap", statement from the "China in the Upcoming Decade" discussion at the Peking University National School of Development.

the shadow of each type of factor of production's contribution to China's rapid growth. If the demographic dividend were to disappear, it would directly reduce the economic growth. In 2010, during the sixth census, the 15-59 year old labor force population began to decline, so by 2010 China's demographic dividend disappeared.⁵

When it's traditionally difficult to continue economic growth, the income distribution gap of the entire society simultaneously expands further. The widening of the income disparity creates an exacerbation of societal tension and brings on community-wide incidences. In China, a country that has a tradition of valuing equal wealth distribution, the rapidly developing mainstream media in this modern society voices intensely for adjusting the income distribution, and this has brought immense political pressure. As soon as income redistribution policies go wrong, it could possibly provoke the swelling of a somewhat extreme tide of thought from the left and right, creating serious political economic consequences, which would sink the country into a middle income trap from which it would be hard to break away.

How to Cross the Middle Income Trap

For China to successfully cross over the middle income trap, maintain economic stability and sustainable growth, mine its growth potential, and reasonably solve the problem of income distribution, it must overcome many challenges and difficulties. These challenges and difficulties mainly include two aspects; first, China must in the course of its economic development follow objective principles and from a perfect economic structure find the fountainhead of new economic development. Second, it must preserve social stability as the economy develops while successfully solving the numerous social problems. At present, the main factors that undermine social stability are corruption and discontent among citizens. To accomplish this, there are two problem solving approaches, the first of which is an ineffectual remedy, trying to stop the pot of water from boiling by skimming water off the top, the second is a fundamental solution (i.e. lowering the flame) to address the root cause. The redistribution of the resources to solve the problem of income inequality is an ineffectual remedy. But from the perspective of long term stability, the most important is still to employ a fundamental solution to eliminate the source of the problem. For example, for the problem of corruption, if there's rent to be earned it will breed corruption, and only when the rent is removed will corruption reduce.

Improving income distribution. The distribution of income includes the initial distribution and redistribution. At present, the problem of income distribution in China is largely rooted in an unreasonable initial distribution. Improving the initial distribution can effectively alleviate the problem of unequal distribution of income. A new idea proposed in the 18th Congress Report is that by adjusting two proportions, the first one is the proportion of household income as a percentage of the national income, and the second is the proportion of labor income in the initial distribution. The initial distribution and redistribution need to consider both fairness and efficiency, though redistribution mostly emphasizes fairness. To solve the problem of income distribution it's better to achieve fairness and efficiency in the initial distribution, and use redistribution only as a supplementary means.

For the initial distribution to achieve fairness and efficiency, the economy must develop in accordance with its comparative advantage. This is because developing the economy according to its comparative advantage will make it the most competitive and the most efficient. At the same time, if the economy develops according to its comparative advantage, in

⁵ Same as above.

labor-intensive industries or in the labor intensive sectors of capital intensive industries, the economy can create more jobs, which will allow the average wage earners to gain more employment opportunities and enjoy a greater share of the fruits of development. More importantly, this development model makes the economy very competitive, creating substantial surplus and increasing the capital accumulation. China can thereby gradually transition from a relative shortage of capital to a relative abundance of capital, and it can change from a relative abundance of labor into a relative shortage. In this process, wages will quickly rise, and the return on capital will gradually decline. Low income workers would become more and more valuable and the high-income earners would be relatively less valuable, it would fundamentally improve income distribution. For other East Asian countries and regions in this stage of rapid development, income distribution gradually improved, and it was due to the change in the structure of the factors of production during the process of economic development, which led them to exhibit changes in the relative prices of production factors.

After the reform and opening, labor-intensive industry, which is alignment with comparative advantage, developed very quickly, but why did income distribution become worse and worse? At the same time that rapid development occurred, many social problems appeared, including corruption and income distribution problems. All of these problems are related to the lack of completion of the marketization reform. Financial repression, unreasonable resource prices and monopoly problems influenced unreasonable income distribution; this created monopoly rents, breeding corruption. Therefore, the problem of income distribution and corruption were fundamentally caused by the reform not being fully in place.

In the next ten years, if China actually wants to achieve the two “double” goals, it should adjust the “two proportions”, and the initial allocation of funds must simultaneously place importance on equity and efficiency. It must deepen the reform, complete the transition of the dual-track system to perfect a socialist market economic system. If this is done, the economy will not only develop according to its competitive advantage, but it will also develop faster, and income distribution should continue to improve, rather than growing the gap.

At present, the reform of income distribution in China is not only necessary, but China also has met the prerequisite conditions to reform. In the early stage of reform and opening up, China's per capita income was extremely low, capital was of extreme shortage, and some industries did not accord with comparative advantage, and because there was a lack of viability, it needed to continue to rely on subsidies to survive. At present, China's per capita income has reached \$6,000, there is no shortage of funds, and the industries possess the ability survive on their own, so there is no need to subsidize them. If the income distribution reform is implemented in a timely fashion, “two double” goal of the 18th Party Congress can be reached.

Adjusting the economic structure, maintaining balanced economic growth. In the next ten years, in the process of economic development, it's necessary to follow the objective laws intrinsic to economic development, and through the adjustment of the economic structure, maintain a suitable rate of economic growth. To cross the middle income trap, bypass the low income level equilibrium state, moderate growth must be maintained. To maintain moderate growth, new sources and starting points of economic growth must be excavated, looking for drivers of growth potential from both supply and demand sides. By solving problems at the social-institutional level, adjusting the imbalances in the economic structure, sources of economic growth can be mined, expanding the production possibility frontier.

On the supply side, China needs to increase the TFP contribution to economic growth through reform and technological innovation. Reform is the way to improve the first factor of

productivity. Through the reform of its economic structure, China can excavate the potential production capacity of each factor of production, but must be unwavering in advancing the complete marketization reform. China's monopolized state owned enterprises currently lack an adequate mechanism for entry and exit and in some areas, the government doesn't allow other creative enterprises to enter, causing the total factor of productivity to lose its vitality, and this has brought an enormous economic loss.

Research shows that developed countries have increased their total factor productivity by one third to one half by providing a mechanism that allows enterprises' free entry and exit. Another study showed that the productivity disparity between firms in China was substantially greater than those between firms in the United States. If the China's productivity gap between its firms were on par with the gap between firms in the U.S., China could increase its TFP by 30-50%.⁶ There is a need to adjust the industrial structure and industrial policies, with an emphasis on policies which reduce the government's excessive intervention. Due to China's excessive involvement in industrial policy, regional industrial development is imbalanced. The capital-labor ratio of the central and western regions is evidently higher than that of coastal regions, and this industrial structure has deviated from the resource structure, and is contrary to the competitive advantage. To correct the distorted industrial structure, there needs to be a deepening in the reform of production factor markets, an elimination of all kinds of distortions in production factor pricing, a renewed reasonable allocation of resources, and the present comparative advantage in relatively cheap labor needs to be fully utilized. At the same time, there is a need for deepening financial reform, the steady implementation of the marketization of interest rates, and excessive investment needs to be curbed.

Another boost to the source of the total factor productivity is innovation. Innovation includes technical innovation and system innovation. Through technological innovation, China must narrow the technology gap with developed countries, establish and improve the incentive mechanisms, and encourage independent innovation of enterprises. The state and society need to provide increased support for technological innovation. Innovation comes from the accumulation of human capital, so increasing investment in education is needed, and the idea of equal educational opportunities must be realized. When the national public finances improve significantly, more funds need to be invested in education, and for families of different backgrounds and income levels, especially for the children of poor families, we need to provide equal educational opportunity, and this will lead to the creation and accumulation of human capital.

On the issue of innovation, the relationship between the government and the market must be dealt with. It should be realized that the market cannot solely be the mechanism for the allocation of resources; the government needs to play a role. The government and the market each have their own room for development and function, and in the process of industrial transformation, it's imperative to explore and differentiate their respective roles. The key of industrial upgrading is innovation, and innovation can occur through different channels. Industry only needs to conduct its own R&D when it has met the world's technology frontier. If the enterprises don't have subsidies for implementing innovation, they might not be able to survive in the market, while subsidy means the government is intervening in the market, and doing so would violate the requirements of the market economy.

On the demand side, the effective demand must be further explored, so it's necessary to break new ground in domestic and foreign markets, adjusting the structure of consumption,

⁶ Cai Fang. Same Annotation.

investment, government spending and net exports in the total demand, strengthen the role of consumption in driving economic growth, increase the efficiency and improve the structure of investment, and at the same time appropriately reduce the share of net exports in total consumption. The main way to expand consumer demand is through the steady development of urbanization and the services sector, the exploration of domestic markets, and the development of the middle class. Urbanization is an important channel for expanding the domestic market, and so urbanization must be resolutely advanced. At the same time, we must acknowledge that urbanization touches on the reform of the rural land system, the household registration system, the city housing markets, and government reform of the fiscal and taxation systems, which is an extremely complex task of system engineering with a high degree of difficulty. It requires careful design, meticulous implementation, and proper and fair consideration of the interests of all parties, and equal protection of public and private property rights. Successful city reform also requires straightening out the central-local fiscal relations through a reform of the tax system, with a clear delineation of central and local government responsibilities and source of income, so local governments can obtain a reliable source of income with reduced dependence on land revenue and the ability to provide adequate public services.

Long term growth and the mobility of the social structure. In order to continue long term economic growth, we must protect and cultivate the basic elements of economic growth, place a high importance on capital accumulation, technological progress, and the growth of human capital, and protect property rights. To achieve this, property rights must be protected. Only when property is protected will people be willing to invest, accumulate capital, and create technology. Among the three factors of production, physical capital, human capital and technological progress, human capital investment hardly ever receives enough attention. Willingness to invest in human capital depends on the context of the social structure. People are willing to invest in their human capital, to receive education, improve their skills, and change their destiny through their own efforts only when the society provides conditions such that they can see the hope that their investment may provide a return. So the willingness to invest in human capital return depends on whether or not the social structure can maintain a favorable mobility, which is a type of social flexibility or a vertical unimpeded upwards social ladder. If a society can achieve this, young people, no matter their station of birth or family background, can see the hope of their future, and they will be willing to engage in human capital investment. Only this type of society has dynamism, and only this society can ensure its long term economic development. China in the past 30 years, especially in the first period of over twenty years, opened originally completely rigidified social channels by liberating the social vitality. China in this aspect has experienced success from this development, however recently a reversing trend has emerged in the social structure. This type of reversing trend is related to the economic system and the competitive environment, government policy, and is related to the high concentration of the society's resources.

Relatively speaking, the advantaged class can easily utilize these opportunities to expand its interests, and the interests of the non-dominant class are put under a squeeze. No matter whether looking at data or from observing phenomena, intergenerational correlations are increasing and social mobility is decreasing. Trends solidifying in the Chinese society are very dangerous. If this trend were to continue, no matter whether through structural or policy adjustments, the vitality of long term economic growth wouldn't be guaranteed. We hope the new leadership will not only focus on the economic growth during when they are in office, but

also lay a solid foundation for long term vision economic growth. Beginning from now, we hope they carry out structural social reforms, can really create a vibrant society, and maintain China's long-term continuous economic progress. In discussing overcoming the middle income trap, we must integrate with the changes in the entire international market. Because of the large size of the Chinese economy, its economic growth rate will affect the pace of growth in the world economy. The development of international rules will have a great influence on China's competitive advantage in the future. To cross over the middle income trap, we must overcome the limitations of vested interest groups, and advance the coherence of the consensus towards reform. Cultivating the emerging interest groups can also put pressure on the vested interested groups, and giving a shock to the monopoly of vested interest groups can promote the marketization reform.

3. Economic and Political System Reform

Overcoming the middle income trap requires deep economic and political system reform. In the recent past, political system reform was lagging behind, and so economic system reform lacked the support and coordination with political system reform. This type of system gave prominence to the urgency of political system reform.

Although in some respects political reform has lagged behind, it's actually always been continually progressing. Those who perceive China as having only implemented economic reforms but not political reforms are one-sided. Without political reform there wouldn't have been any economic development. Following the 1950s due to historical reasons and the reality of that time, China built a totalitarian political and social system. The structure is based on the Danwei system as the building block and a set of horizontal relationships, and a highly centralized system of government. From the central to the local units, it was a homogeneous system that integrated the political, economic, and social structure. And it was extremely effective for social mobilization and integration. After 1978, Deng Xiaoping put emphasis on economic development, making the economic construction the center, and following that the marketization reform. The construction the market economy first required a set of rules and following it a standard of conduct in accordance with the market rules. So the reform after 1978 made the transformation of the government's function as the core agenda, and this reform process ended the totalitarian political and social system. From the perspective of government, through five large scale reforms of the central government's administration and management institutions, it transformed from a government which comprehensively managed the society to a service-based authoritarian government which provisioned public goods. Only from this change was the role of the market economy established.

Political System Reform

In general it is said that the reform mainly contained three aspects, the first concerned the relationship between the state and society, and the state and the individual, the second dealt with the source of the state's authority and the ways it exercised it, and the third set the rules of behavior for the state, society, and individuals. Since 1978, the first aspect of government reform, for which Deng Xiaoping had put forth a thorough discourse, was solidly instituted. The 1982 "constitution" specified that the party must govern within the framework of the constitution,

renounce class conflict as the guiding principle, and give up the concept of people, which it renamed as “citizenry”. This is of great significance in the history of China. **In the process of reform, the political resources of an all-powerful state was turned into a tool of societal mobilization and for the societal integration with the advancement of reform and development, making, “strong nation—weak society” the characteristic of an authoritarian political system.** This system has a higher administrative performance and ability to mobilize, but the social system’s degree of autonomy is relatively low, and it’s relatively weak in organizing the society to solve social problems. Since after the mid-1990s, government’s power once again gradually expanded. On one hand, the government began to pay attention to social stability, and it began to pay attention to fairness, justice and social welfare. On the other hand, the expansion of government power to a certain extent also strangled the vitality of the market. Monopolistic state-owned enterprises traded power for money, and formed the monopoly interest groups, which exacerbated the discrepancy between the two ends of the income distribution. In recent years, a frequent occurrence of official corruption and social community incidences demonstrated the urgency of the reform of political system.

The future of political system reform includes the following tasks. First, continue the transformation of the role of government, and more clearly separate government and enterprise, political affairs, government capital, and society. Specify the function of each level of government, optimize the allocation of functions between them, transfer out functions that the government shouldn’t be managing and properly administer the functions that government should manage. At the institutional level, do a better job of bringing out the market’s fundamental role in resource allocation, bringing out the public and social organization’s role in the management of public affairs, and improving the effectiveness in providing public goods.

Second, separating the communist party and government administration. This is a very important idea during the Deng Xiaoping period, in the description of political system reform in the Thirteenth National Party Congress report, the first idea is the separation of the party and administration. The key reform of the political system is first and foremost the separation of the party and the government’s function. Separation of party and government is mainly a functional separation. Without this separation, a series of separations are difficult to practically implement. From this, a modern constitutional government, a highly effective public service oriented government can be realized. In recent years, the central government has repeatedly implemented organizational level reform, but the organization of the party never reformed, and so this aspect of reform needs to be strengthened. This is a precondition for the transformation of the role of government and the construction of democratic institutions. With regard to the realistic situation in China, the relation between Party and government is a grave problem that must be addressed. How to achieve leadership in the party and in government carry out principles of modern governance is a difficult challenge. To solve this problem requires the great wisdom of the Communist Party, and also requires the active participation of the whole society.

Third, establishing a constitutional government. Constitutional government is essentially the condition of limited government under democratically elected representatives. Democratization should be carried out by the plan of a constitutional social order. The core issue of a one party constitutional government system lies in how to handle the relationship between the party and the country, which Deng Xiaoping proposed in the 1980s, but it never was resolved. This must occur through the “constitution”, “party constitution” or standard documents which stipulate the relationship between the party and country, establish the authority of the NPC, deal with each aspect of the relationship between the party and NPC, and deal with violations of the constitution.

The standard for evaluating a constitution is the degree to which it guarantees the rights and freedoms of its citizens. In 1978, Deng Xiaoping put forward that class struggle would no longer be the guiding principle and in 1982 changed the wording to protecting the interests of particular classes' interests. According to the constitution, it must protect workers, teachers, farmers, the rights of all of the citizens and the equality of everyone's rights. China's democracy must be a constitutional government, it must construct constitutional socialism to serve as the country's primary reform goal, and it must clearly write the guiding principles of reform into the constitutional government. The relationship between constitutional government and democracy should be that constitutional government precede democracy. One must realize that that in the history of many nations, the early stages of constitutional government was not democratic.

Fourth, creating a democratic mechanism. If the system doesn't create some kind of democratic mechanism, it will be difficult to create long lasting political stability. In order to realize democracy, the transformation of government functions is very important, as the separation of party and government is the basic premise of democracy. The Deng Xiaoping era had developed a conception of democracy which would begin at the grassroots level and gradually expand to nationwide democracy. There could be direct elections at the county level, then representatives that come out of county and above levels can partake in indirect elections for the first tier provincial officials, and provincial officials indirectly become elected to be central government first tier officials. In the era of universal internet usage, more work must be done with regard to democratic mechanisms; otherwise it will have an adverse effect on China's long term stability and the party's ability to reflect the will of the people.

Fifth, the construction of the legal system. The construction of the legal system over the past twenty years can be divided into two stages. The first stage involved learning the Western modern legal system, but it was seriously disconnected with China's society and culture. The second stage was a return to the essence of the legal system, which put forward the idea of people-oriented legal system, but it didn't emphasize enough the rule according to law, and so it didn't balance the people-oriented system with rule according to the law, causing social instability. The next step must emphasize the importance of rule of law, and stress the relative independence and authority of judicial law.

Sixth, rebuilding the social order and developing a civic society. There's a need to consider the social layout that will arise as urbanization changes the layout of city and countryside, as well as the issue of which level of administrative organization will be the fulcrum of the social structure upon which to construct social order. This issue involves deciding under the constraints of the modern economy and transportation costs whether to develop large cities, mid-sized cities or county-level cities as the future fulcrum of urbanization; this must be further investigated. The deficit in civic society results in a lack among the people of the power to self-organize. Authoritarian politics views social conflict as a threat to the safety of the system, and so it increases control, which makes social conflict difficult to immediately resolve, makes it difficult to develop a civic society, and possibly encourages a populist sentiment, which then creates an extreme force that attacks the social order. To solve this problem, it's necessary to steadily develop the civic society under government control, use civic society to implement democratic training for the people, and resolve social conflicts through civic society.

Seventh, discovering the core of a genuine Chinese value system. A country that doesn't have a belief system or a concept of right and wrong is a country with no hope. In the past, these aspects were explored, but it basically was unsuccessful. At present, there is chaos in the social order, and a reason for the collapse of moral values is that a core value system was not

established. Remodeling a value system requires returning to China's traditional values and assimilating the outstanding heritage of world cultures. A genuine core value system involves identifying the inherent qualities in Chinese culture of its people. The Chinese people have been a civilization for 5000 years which has exhibited continuity at the levels of physical implements, organization, and core values, and the Confucian culture has for those 5000 years been the unchanging core ethical value. It has taken various forms in different times in history, but its essential meaning is unchanged. This unchanging culture permeates through the genes of each and every Chinese person, so its development has a fundamental basis. We must be genuinely willing to face this and accept it.

Public finance system reform may be the breakthrough point for political system reform, as the core of modern democratic politics lies in budgetary democracy. Democratic politics is an issue of the checks and balances of taxation and government expenditures, it's about limiting the government's authority to levy taxes and expend public finances, subjecting government to the deliberation and restriction of democratic representation. Budgetary democracy is for the levier of taxes to obtain consent of the taxpayer, it requires that expenditures must be known to the taxpayer, and government expenditure behavior is restricted by the people's representatives. The essence of democratic constitutionalism is to limit the government's power to tax and it's an issue of budgetary democracy, not just an issue of people's universal suffrage and voter's direct "voting authority". If China's political system does not have a clear constitutional goal, and is merely a future political democratization process conceived as the adoption of only the format of the universal suffrage which is prevalent in some Western countries, not only will China not be able to preserve social stability and long-term economic growth, but it may cause a "Cultural Revolution" kind of "free expression of views" style of "Great Democracy", and could even become a "democratic violence" or "tyranny" of the majority. The institutional reform of the government requires making the NPC and CPPCC pragmatic, expanding the NPC Standing Committee, professionalizing it, establishing a finance committee, budget working committee, etc. organizational structures which have real power, such that the budget must be approved and signed by the NPC in order to be implemented, and only the government branch can channel public funds.

The next ten years will be the key period for the reform of the political system; China has very good conditions to pursue political reform, but it also faces enormous challenges. If political reform is successful, the following economic reform and development will move the economy past the middle-income trap, and the Chinese people can move towards a society with stability and political robustness. If in the future ten years the political front cannot get creative in its development, it will affect the achievement of economic development and even long-term political stability.

Force and Experimentation

One of the advantages of China's system in implementing policy is that it can conduct large-scale national experiments, gain experience from them, and then expand. China's experience of successful reform includes: (1) Force principle. Any great reform is set in motion by pressure. Only sufficient force can break inertia, and break the barrier of vested interests. Only when there's a crisis can people form a consensus, clearly see the road ahead, and decisively proceed forward. The Household Responsibility System, the accession to the WTO, and the introduction of foreign capital forced the typical crisis-induced reform in the state owned enterprises. (2) Having confidence in the wisdom of grassroots, respecting the people's choice.

The top tier plan must come from pressure from the bottom tier. (3) Advancing step-by-step experimenting with trial-by-error reform, crossing the river by feeling the stones, and by means of experimenting, expand reform “from point to surface”, control risk, and engage in reform of a great cause through the whole society doing the countless trial by error activities and gaining achievements from them.

Analyzing from the perspective of the driving force, reform can be broken into three types. The first type is conventional reform. This type of reform is often marginal, departmental, and it doesn't normally involve a challenge of the system's basic framework, so controversy is relatively little. This kind of reform is also likely to be effective, but from the perspective of driving force of the institutional reform, its influence is relatively small. In the past ten years there has been a lot of this type of reform, for example, the reduction and exemption of agricultural taxes in the “three rural” issues. The second type of reform is breakthrough reform. Its most important feature is the expanding on the boundary of the basic system's framework, and it has a breakthrough effect. For example, in the 1990s, after the Southern Tour Speeches and the big four establishments of the socialist market economics system, there was the implementation the first macro-level tax and exchange rate series of reform, and in the later part of the 90s, there was the reform of state-owned enterprises and the “double entry” reform. These reforms each have of various degree breakthroughs and expansion of the system's boundary. But they aren't necessarily Pareto improvements, and often are exchanges of benefits, and the controversy is relatively big. The third type is systematic reform. It touches upon economic strategy, political philosophy, including in 1982 the issue of how the constitution determines the course of political reform. It can be said, the institutional model that took shape in China's reform process was to a large degree not the result of prior rational planning, but rather was the result of countless peoples' collective experience.

The force of conflict is vital to set reform in motion, and many reforms in history came out of force. Currently the possible elements of force include:

(1) Maintenance of stability. With frequent community incidences, the maintenance of stability day by day increasingly becomes an important factor of consideration for each level of government. The backdrop of each kind of social contradiction is the maintenance of stability, for example the unfair exercise of administrative power. The young generation's awareness of the defense of legal rights, and the strengthening of civic awareness increased the urgency of solving this type of problem. Only from fundamentally solving these social conflicts through reform can political and social stability be realized.

(2) The problem of corruption. Corruption of the government and corrosion of the social body, if not effectively curbed, might lead to the destruction of the Communist Party and the nation. The public pays very much attention to the problem of corruption, and the high-level administration also absolutely views it as important. Strengthening the power of the supervision and restriction of the government's power is the only way to fundamentally solve the problem of corruption.

(3) The problem of income distribution. In recent years, the gap in income distribution has widened, the causes of which include the insufficient degree of the marketization reform and problems brought on by the market economy itself. The excessive gap in income distribution has given rise to a serious social conflict, and needs to be dealt with as soon as possible.

(4) Prices. The high prices, which are caused by the excessive monetary expansion and land transfer problem, give rise to resentment among urban residents. Housing price problems cannot simply depend on the administrative price limits to control it; it's necessary to solve a series of institutional problems in the backdrop.

(5) The reform of state owned enterprises. Over the years there are two factors in the force of state-owned enterprise reform. Reform of the state-owned enterprises. Over the years there are two factors which will force the reform of state-owned enterprises, the first of which is the public's opinion towards the position of the "eldest son" of the state-owned enterprise and the gap in his actual performance. The second is the problem of the exchange of personnel appointments among the senior state-owned enterprise managers and senior government personnel. These problems have attracted widespread attention and criticism from the public.

(6) Slowing in the speed of growth's impact on the pressure for reform.

(7) The effect of the intellectual class on a new understanding of the Communist Party's history, on the different evaluations of the historical figures, and reflections of the disaster of the Cultural Revolution, are likely to become turning points for political system reform.

(8) Current degree of consensus regarding reform, the expressed demand for reform, and the discrepancy between the hope and expectations among the populace for reform and the actual degree of progress in reform may become a driving force for reform.

(9) The population aging problem may advance population policy reform.

(10) Urbanization that has given rise to the rural land property right reform problem, the problem of farmers sharing in the fruits of urbanization and the new poverty and public security problems in inner cities. These problems could possibly become factors driving the steady advancement of urbanization.

(11) International recognition of the origin of one country regime legitimacy is a very important force mechanism.

(12) The problem of how the party will internally settle disputes is an important factor in advancing the standardization of inner party life.

China's most important reforms were all related to pressures, only under pressure can inertia be broken, only under pressure can the barrier of vested interests be broken. Crisis induces reform, since when crises occur, they lead people to make clear distinctions between right and wrong, and choose a feasible path. The Household Responsibility System and accession to the WTO are typical crisis induced reforms. In the process of reform, there needs to be belief in the people's wisdom and respect for the main agents' economic activity selection. To implement gradual experimental reform, only by crossing the river by feeling the stones, expanding reform "from point to surface", is it possible to control risk, and make a sensible choice.

In recent years, with the development of the economy, the resources controlled by all levels government have increased, and fiscal revenue has grown rapidly. However, as the fiscal revenue increased, government employees' drive to reform decreased, vested interests caused a slowing of reform. We must find new forces to advance reform. In the next 5-10 years, China will launch many reforms. Among these there will certainly be conventional reform, and healthcare and social security reform will thereafter become routine.

At the same time, opportunities for breakthrough reform will be greatly enhanced. Problems including the population, interest and exchange rates, which over the past 10 years were very controversial, will all see reform opportunities. In institutional change, the reform process sometimes requires that we wait a long time, and at times problems which have accumulated over a long time will erupt within a short period, in which case may lead to breakthrough change. According to several types of analysis, the current window for breakthrough reform in China is related to institutional reform and economic problems. These issues are at the intersection of economic reform and political and social reform, for example, urbanization, rural land property rights reform and fiscal budgeting reform. On the other hand, these are economic problems, as they relate to economic growth and people's livelihood, and they are fully necessary and feasible for reform. On the other hand, if corresponding political and social reforms are not implemented, these reforms cannot be carried out. These reforms provide reasons and a basis for the corresponding political and social reform, and create conditions for further reform.

4. China's Global Position in a New Historical Era

China's rise and its impact on the global governance structure has been among most the influential and impactful world historical events since the conclusion of last century's Cold War. In terms of current U.S. dollars, China will overtake the U.S. within about eight years to become the world's largest economy. In the modern history of the world, there have been seven times when emerging powers overtook the traditional powers, which have led to six tragic confrontations or major warfare. In the process of China's rise, is it possible to avoid violent international conflicts and possibly even war? We believe that war is not inevitable.

The Basic Principle of China's Global Position

Under the backdrop of the rapid expansion of China's economy, a variety of domestic and foreign factors require China to play a more active role in international affairs. "Keeping a low profile and bid one's time" is no longer applicable to our foreign policy. China's positioning in the world during next decade should be "Multi-Polarity Unipolar Joint Governance" as the basic principle. "Unipolar" refers to the international order and a single value system supporting it; "multi-polar" means the co-existence of multiple large or international forces and value systems within the international order; "joint governance" refers to all the major powers and international forces in a common recognition of the international framework, a vested interest in working together in the maintenance of this international order and unipolar value system.

China will become an important pole within the future multi-polar world, but China's goal is not to start a new value system or world order to replace the existing one, but further development and self-strengthening under the existing unipolar system and achieve in the latter

half of this century completion of the transition as the preeminent global power from the United States and other powers.

International affairs are full of variables and risks, and require strong and stable forces to maintain the world's peace and order, such is the unipolar order. Why does one need unipolar order? First of all, unipolar order eliminates a variety of competition between the international forces for global dominance, thus saving resources for more productive uses. Secondly, unipolar order is conducive to saving transaction costs in trade between countries. International order is an inter-state system, the system of unipolarity provides a certainty of protection in the relations between countries, and when a country knows how another country in a particular case will act, while at the same time also knows that the country knows the rules of this world order, it becomes easier to form a stable equilibrium. Third, unipolar order benefits a developing country's economic development. International order is always dominated and maintained by the developed countries that have developed earlier, and as long as developing countries do not challenge this order, they will easily receive recognition and approval from the developed nations, and thus will have more space and opportunities to develop their economies. Fourth, a consistent value system maintained under the framework of the unipolar order helps eliminate ideological competition, thereby greatly reducing the probability of international conflict.

The future of the unipolar world order requires multipolar joint governance in order to be achieved. First, multipolar governance is a self-made requirement by the relative decline in position and status of the United States. After the break-up of the Soviet Union, the United States alone dominated the world, but the events of "911" and the War on Terror, especially the financial crisis and the debt crisis followed, caused the United States to feel increasingly unable to assert power to the degree it wants. In this case, it is perfectly logical that the United States asked China to bear a part of the international political and military responsibilities. Secondly, other countries also have the desire to participate in global governance. Third, a multi-polar world does not necessitate multi-polar governance, for unipolar order is better than multipolar order. As long as participating national countries have sufficiently broad shared interests, a multi-polar world will be able to achieve joint governance. Fourth, from China's own perspective, participating in a multi-polar world of global governance is better than going at it alone or starting all over again. Starting over from scratch would be a direct challenge to the current international order, something the US-led Western world would not tolerate. Further, China's interests can be greatly enhanced under the existing international order. In most international agencies, the allocation of voting rights and decision-making ability is proportional to a country's GDP relative to its share of world GDP, and with China's continued economic growth, China's share of voting rights and decision-making ability will improve accordingly. Change in the relative position of the United States does not mean the decline of America. In the foreseeable future, the world still cannot produce a nation or coalition of forces to overtake or even compete with the United States' leadership. America's biggest advantage is that it possesses self-regulation mechanisms to deal with various challenges and crises. In the future system of global governance the United States will no longer enjoy absolute authority of a hegemon, but it will remain the only major power with a dominant position.

Does participation in a unipolar multi-polarity system mean that China will lose independence in international affairs? The essence of this problem is at the core of how to handle China-US relations. In this regard, we must see there is both a confrontational aspect and a cooperative aspect between China and the U.S. Under unipolar multi-polarity governance, prospects for cooperation may be broader. The confrontational aspect manifests in the struggle

and competition of interests between an existing power and a rising one; this is followed by the issue of the two countries with different social systems, with mutually rejecting social values; third is on the Taiwan issue, where China is determined to defend its sovereignty and unity, while the United States will always include of Taiwan in its Asian strategic plan, thus resulting in the fact there will always exist the possibility of military conflict between the two sides. Confrontation and conflict between the two countries is determined by a number of fundamental factors that is impossible to resolve in the short term, but relations between the two countries will not become a completely hostile one. Because of the interdependence between the two countries has formed highly shared interests, one can use more a rational, pragmatic and wise attitude and way of looking at both sides of the system and the difference in values, handling the divergence and contradictions to defuse any potential crisis.

The Economic and Political Basis of China-US Relations

In economic and trade relations, the interests of the China and United States are complementary. This is one of the key foundations of future Sino-US relations. Even if it becomes the world's largest economy, China's per capita income will still remain far below that of the United States, and China's comparative advantage still mainly lies in labor-intensive industries. For a very long time into the future, the United States will have a higher per capita income than China, and its comparative advantage lies in capital and technological-intensive industries. U.S. companies hope to find rapidly expanding markets, and China is such a market. China's rapid development is beneficial for large U.S. companies. Our foreign policy must make clever use of the complementary nature of Sino-US economic relations. On one hand, China must strengthen its military power, but on the other hand, for China, for the United States, and for global development, the best choice is to create a peaceful environment. To create a peaceful environment, one must enable U.S. companies to share in the benefits of China's rapid development. In a future Chinese market fueled by internal demand, China will become one of the key centers of world markets, and China's domestic demand for foreign enterprises will create huge business potential for global businesses. To turn business opportunities into economic reality would require China to continue to open up the market in the future, improve and complete domestic market competition rules, and to further strengthen the international economic and trade relations with foreign firms on fair trade. Even if one day China's per capita income level rises to be par with the United States and competition between the two countries intensifies, if we are open and also economically specialized, Sino-U.S. economic and trade relations will remain beneficial for U.S. companies. Therefore, we should continue to strengthen reforms and the opening up of our economy to the outside world.

There exist many conflicts and differences between China and the U.S., but there are also many things in common. China after reform and opening up, especially after joining the WTO, experienced unprecedented development in U.S. trade and economic cooperation. Although there is some degree of trade imbalances and trade friction, with the RMB exchange rate issue never ceasing, economic interdependence of the two sides has only strengthened. After the 2007-2009 financial crisis, the global economic recovery and rebalancing required the United States and China to join forces and guide the rest of the world, with economic interdependence constituting the foundation of Sino-US relations. In the area of security, facing the threat of terrorism and nuclear proliferation crises, the two sides are united in collaboration under common interests.

In the unipolar multi-polarity system of governance, China and the United States must find the lowest common denominator, the core of which is to provide public goods for global

governance, including the maintenance of world peace and establishing fairness and justice in order to promote world economic growth and social progress, respond to challenges facing humanity such as poverty, nuclear proliferation, terrorism threats, environmental deterioration and climate, food and energy security, improvement of education and health, natural disaster prevention, appropriate use of resources, and so on. China and the U.S. account for a large proportion of the total global economy, with great influences in politics, military, and culture. Not only is the provision of global public goods an obligation, it is also in line with their own best interests.

Cooperation with the United States does not mean giving up China's own interests. Pertaining to core interests (such as territorial integrity), China must show determination to defend its own interests; regarding unreasonable aspects in composition of the international order, China should actively promote reform. However, from a strategic consideration, changing unreasonable aspects of international order is not directly challenging the U.S. position, but engaging in incremental reforms. In other words, China's participation in a unipolar multipolarity joint governance should be more of a collaborator but also a constructive innovator.

In terms of global development trends, we are faced with uncertainty, structural imbalances and an assortment of difficult problems, but there are many aspects that are certain. First, relations between major powers are basically set and the institutional order determined after the Cold War will no longer easily experience major upheaval. Secondly, the BRIC countries developed. The global political landscape has also undergone profound changes, such as online media, the Arab Spring, the Islamic revolution, and these problems may pose more hazards than the traditional large country issues. Finally, properly addressing internal conflicts is also a very important issue in handling international relations.

Renaissance of China's Civilization

China's future development prospects must be placed in a global scope to properly examine. The competitive landscape of today's world appears to manifest in conflicts between nations, but if examined from a deeper perspective of civilizations, inter-state conflict is essentially a conflict of competing civilizations. Today the world is divided into three major powers, the United States, the EU, and the newly risen China, each with civilization as a factor in the background. In addition to dominating the world via economic, technological and military strength, there is also a very important aspect, the competition between civilized discourse and the systems and institutions of different civilizations.

The United States as a Christian Protestant new civilization is able to continue to absorb and internalize other civilizations, maintaining a very strong competitive vitality. And Germany, one of the better developed nations in the EU, is also a Protestant nation, maintaining Protestant work ethics and spirit of competition. The reason for the relative decline in Europe today is partly due to the negative impact of Latin culture, stemming from a laid-back Latin culture and its aversion to competitive forces. France and Italy today also possess this problem, as behind the stagnation of economic and social development of each lie the presence of civilization defects.

Turning to China, the current rise is just a rise in wealth. In a sense, Chinese people today are more like nineteenth century Europeans than contemporary Europeans themselves, since we have a never-ending adventurous enterprising spirit. The secrets of China's rise can be explained from a civilizational perspective. However, China today is still only focused the rise in wealth, not the rise of a civilization, and behind that rise does not yet exist a sustainable cultural system, lacking a new Chinese Civilization Version 2.0. China today lacks initiative in world speaking

rights, the context behind "receiving criticism" from the international community is because we do not have civilizational discourse, nor do we have rule-making authority. Since reform and opening up, China has been focused on its own domestic problems, and is foreign to the rules of international affairs, possessing a wide gulf in the universal discourse of civilizations and international rules formed on the basis of international law.

China's current self-positioning involves two unique historical factors: first, China is a 9.6 million square kilometers unified yet multi-ethnic country, and that its evolution as a large nation from the nineteenth century to the present day has always maintained unity is not a simple fact of nature. Traditional empires and modern nation-states differ in that the nation-state attempts to build an integrated homogeneous society, while the empire allows a wide variety of societal differences and internal diversity. Today China's internal affairs is very complex, with issues such as "One country, two systems" and ethnic autonomy, it is clear one cannot simply use recognition and integration to advance this civilization. So how do you recognize the different religious and cultural traditions, allow for the existence of different political systems, achieve harmony of different ethnic minorities in frontier regions, even the coexistence of various institutional structures in different provinces, and achieve unified governance in a civilized manner? This problem requires us to change our way of thinking, examine what kind of civilized values in the end we want for China, and reflect on what kind of political system and kind of nation we want to be in the future, the exact type of questions that will be answered with Chinese civilization version 2.0. Today, with the exception of Russia post-Soviet Union disintegration that still partly plays the role of 20th century empire, China is almost the only nation in the world remaining that has basically retained the geographical coverage and population of the pre-existing 20th century historical empire. Thus, simply abandoning the political history of the previous two thousand years would be detrimental to China's development. Secondly, China is a socialist country. As the primary piece in the worldwide disintegration of socialism, China did not fall, but also quickly became the world's second largest economy. It is meaningful to stand on these two premises when discussing China's political position. And in fact, these two premises are experiencing enormous challenges, the first of which is the so-called multi-polar unified China, because although Chinese territory has not been fully unified, the basic system being multi-polar is a basic premise for discussing of China's position. The second challenge is the socialist political structure, with a party-state as its basic framework. Regardless of whether or not people like it, historical precedence in these premises must be used as our discussion for future changes.

China's democratic issue is very important and very complex, but its ethnic question is even more complex and this issue needs to be addressed of today. Chinese civilization is capable of assimilating ordinary ethnic minorities who do not possess advanced religions and civilizations, but finds it difficult to assimilate ethnic groups who have similarly advanced religions and historically rich civilizations on par with us. Therefore, the reconstruction of Chinese civilization is not a simple question of Confucian Renaissance. If we wish to integrate different parts within a civilization, we need to learn from historical experience. China historically has not been a monotheistic country. According to this experience, we can devise a method to merge Confucianism, Taoism, Buddhism, and Tibetan Buddhism teachings, creating multi-polar unified civilization.

At present, China is actually entering the international political and economic order, not only South-South relations, but also North-South relations and North-North relations, as China faces dialogue in all three of these dimensions. China needs to have more understanding and

knowledge of non-Western regions. In relations with Non-Western regions, repeating the path taken by European will cause new conflicts for China, and possibly even lead to changes in the international geopolitical order. Therefore, future China faces enormous challenges in traditional and diverse regional relations, as well as internal relations and other aspects. These issues require careful consideration when positioning ourselves in the future.

"Keeping a low profile and biding one's time" has been the principle China adhered to in foreign relations for the past 30 years, and it has helped China acquire valuable geopolitical space and time for development in the international arena. However, with China's rapid economic expansion, China's economic growth has already made a tremendous impact on other countries and the international community requires China to take on more global responsibilities. Our overseas interests continue to expand, and such expansion also requires our government to take a more proactive stance to partake in international affairs and to provide additional protection for the benefit of our businesses and individuals. In this context, we need to place "unipolar multi-polarity joint governance" as the China's new position on the international stage during next decade, for we have to be constructive reformers to the existing international order rather than overthrow the existing order or create our own order and value system that compete with the existing one. In order to achieve these objectives, we need to plan ahead, clearly state to the world our strategic goals, and share with the United States the governance responsibilities of the world's political, military and economic affairs, achieving a peaceful transition of power between the two major nations.