Executive Summary

By any standard, China's economic performance over the last three decades has been impressive. GDP growth averaged 10 percent a year, and over 500 million people were lifted out of poverty. China is now the world's largest exporter and manufacturer, and its second largest economy.

Even if growth moderates, China is likely to become a high-income economy and the world's largest economy before 2030, notwithstanding the fact that its per capita income would still be a fraction of the average in advanced economies.

But two questions arise. Can China's growth rate still be among the highest in the world even if it slows from its current pace? And can it maintain this rapid growth with little disruption to the world, the environment, and the fabric of its own society?

This report answers both questions in the affirmative, without downplaying the risks. By 2030, China has the potential to be a modern, harmonious, and creative high-income society. But achieving this objective will not be easy. To seize its opportunities, meet its many challenges, and realize its development vision for 2030, China needs to implement a new development strategy in its next phase of development. The reforms that launched China on its current growth trajectory were inspired by Deng Xiaoping who played an important role in building consensus for a fundamental shift in the country's strategy. After more than 30 years of rapid growth, China has reached another turning point in its development path when a second strategic, and no less fundamental, shift is called for. The 12th Five Year Plan provides an excellent start. This report combines its key elements to design a longer-term strategy that extends to 2030. More importantly, it focuses on the "how," not just the "what." Six important messages emerge from the analysis:

First, implement structural reforms to strengthen the foundations for a market-based economy by redefining the role of government, reforming and restructuring state enterprises and banks, developing the private sector, promoting competition, and deepening reforms in the land, labor, and financial markets. As an economy approaches the technology frontier and exhausts the potential for acquiring and applying technology from abroad, the role of the government and its relationship to markets and the private sector need to change fundamentally. While providing relatively fewer "tangible" public goods and services directly, the government will need to provide more intangible public goods and services like systems, rules, and policies, which increase production efficiency, promote competition, facilitate specialization, enhance the efficiency of resource allocation, protect the environment, and reduce risks and uncertainties.

In the enterprise sector, the focus will need to be further reforms of state enterprises (including measures to recalibrate the role of public resources, introduce modern corporate governance practices including separating ownership from management, and implement gradual ownership diversification where necessary), private sector development and fewer barriers to entry and exit, and increased competition in all sectors, including in strategic and pillar industries. In the financial sector, it would require commercializing the banking system, gradually allowing interest rates to be set by market forces, deepening the capital market, and developing the legal and supervisory infrastructure to ensure financial stability and build the credible foundations for the internationalization of China's financial sector. In the labor market, China needs to accelerate phased reforms of the *hukou* system to ensure that by 2030 Chinese workers can move in response to market signals. It also needs to introduce measures to increase labor force participation rates, rethink wage policy, and use social security instruments (pensions, health, and unemployment insurance) that are portable nationwide. Finally, rural land markets need to be overhauled to protect farmer rights and increase efficiency of land use, and policies for acquisition of rural land for urban use must be thoroughly overhauled to prevent urban sprawl, reduce local government dependency on land-related revenues, and address a frequent cause of complaint from farmers.

Second, accelerate the pace of innovation and create an open innovation system in which competitive pressures encourage Chinese firms to engage in product and process innovation not only through their own research and development but also by participating in global research and development networks. China has already introduced a range of initiatives in establishing a research and development infrastructure and is far ahead of most other developing countries. Its priority going forward is to increase the quality of research and development, rather than just quantity. To achieve this, policy makers will need to focus on: increasing the technical and cognitive skills of university graduates and building a few world-class research universities with strong links to industry; fostering "innovative cities" that bring together high-quality talent, knowledge networks, dynamic firms, and learning institutions, and allow them to interact without restriction; and increasing the availability of patient risk capital for startup private firms.

Third, seize the opportunity to "go green" through a mix of market incentives, regulations, public investments, industrial policy, and institutional development. Encouraging green development and increased efficiency of resource use is expected to not only improve the level of well-being and sustain rapid growth, but also address China's manifold environmental challenges. The intention is to encourage new investments in a range of low-pollution, energy- and resource-efficient industries that would lead to greener development, spur investments in related upstream and downstream manufacturing and services, and build international competitive advantage in a global sunrise industry. These policies have the potential to succeed, given China's many advantages—its large market size that will allow rapid scaling up of successful technologies to achieve economies of scale and reduced unit costs, a high investment rate that will permit rapid replacement of old, inefficient, and environmentally damaging capital stock; its growing and dynamic private sector that will respond to new signals from government, provided it gets access to adequate levels of finance; and a relatively well-developed research and development infrastructure that can be harnessed to reach and then expand the "green" technology frontier.

Fourth, expand opportunities and promote social security for all by facilitating equal access to jobs, finance, quality social services, and portable social security. These policies will be critical in reversing rising inequality, helping households manage employment-, health-, and age-related risks, and increasing labor mobility. China's relatively high social and economic inequality (some dimensions of which have been increasing) stems in large part from large rural-urban differences in access to jobs, key public services, and social protection. Reversing this trend requires three coordinated actions: delivering more and better quality public services to underserved rural areas and migrant populations from early childhood to tertiary education institutions and from primary health care to care for the aged; restructuring social security systems to ensure secure social safety nets; and mobilizing all segments of society—public and private, government and social organizations—to share responsibilities in financing, delivering and monitoring the delivery of social services.

Fifth, strengthen the fiscal system by mobilizing additional revenues and ensuring local governments have adequate financing to meet heavy and rising expenditure responsibilities. Many of the reforms proposed in this development strategy—enterprise and financial sector reforms, green development, equality of opportunity for all—have implications for the level and allocation of public expenditures. Over the next two decades, the agenda for strengthening the fiscal system will involve three key dimensions: mobilizing additional fiscal resources to meet rising budgetary demands; reallocating spending toward social and environmental objectives; and ensuring that budgetary resources available at different levels of government (central, provincial, prefectural, county, township, village) are commensurate with expenditure responsibilities. Without appropriate fiscal reforms, many of the other reform elements of the new development strategy would be difficult to move forward.

Sixth, seek mutually beneficial relations with the world by becoming a pro-active stakeholder in the global economy, actively using multilateral institutions and frameworks, and shaping the global governance agenda. China's integration with the global economy served it well over the past three decades. By continuing to intensify its trade, investment, and financial links with the global economy over the next two decades, China will be able to benefit from further specialization, increased investment opportunities and higher returns to capital, and mutually beneficial flow of ideas and knowledge. As a key stakeholder in the global economy, China must remain pro-active in resuscitating the stalled Doha multilateral trade negotiations, advocate "open regionalism" as a feature of regional trading arrangements, and support a multilateral agreement on investment flows. Integrating the Chinese financial sector with the global financial system, which will involve opening the capital account (among other things), will need to be undertaken steadily and with considerable care, but it will be a key step toward internationalizing the renminbi as a global reserve currency. Finally, China must play a central role in engaging with its partners in multilateral settings to shape the global governance agenda and address pressing global economic issues such as climate change, global financial stability, and a more effective international aid architecture that serves the cause of development in poor nations less fortunate than China.

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These six priority reform areas lay out objectives for the short, medium, and long term, and policy makers need to sequence the reforms within and across these areas appropriately to ensure smooth implementation and to reach desired outcomes. A successful outcome will require strong leadership and commitment, steady implementation with a determined will, coordination across ministries and agencies, and sensitive yet effective management of a consultation process that will ensure public support and participation in the design, implementation, and oversight of the reform process. And since the global economy is entering a dangerous phase and China itself will be transitioning from middle-income to high-income status, the government will need to respond to a variety of risks, shocks, and vulnerabilities as they arise; in doing so, it must hold fast to the principle that policy responses to short-term problems should uphold, not undermine, long-term reform priorities.