Why Has Economic Development Often Failed to Deliver Common Prosperity?

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8 September 2021

From Confucius' saying that the worry is "not about underpopulation but about uneven distribution" (see Note 1) or the quote by Aristotle that "the worst form of inequality is to try to make unequal things equal", to the failure of "trickle-down economics" explored in American society in recent years, and the recent review in China of the progress of "common prosperity" since the national reform and opening-up policy "letting some people get rich first", wealth disparity has since ancient times been a popular issue. Here I would like to give an overview of the global wealth-gap problem, with a focus on the serious situation in Hong Kong. Hopefully this will stimulate more in-depth discussion and thinking.

Wealth inequality under globalization

Over the intervening two decades plus of hyper-globalization from the mid 1980s onwards, some more-populous developing countries (e.g. China, India, Brazil, South Africa, etc.) have achieved rapid growth within a short time through economic reform and opening up. On the one hand, this has narrowed the economic differences across countries. On the other hand, hyper-globalization has brought unforeseeable impact on developed nations and their manufacturing industries in particular. Multinationals having moved large numbers of labour-intensive jobs to low-pay labour markets has led to problems of massive industrial unemployment and wage stagnation, thus widening the income gap among these countries. Not only has the fact that international trade often gives rise to winners and losers long been within the expectations of the traditional international trade theory but it has also been found in the data analysis of many countries in recent years. Given the further yawning of the global wealth gap during the hyper-globalization era, coupled with the incitement by politicians and the media, recent years have seen the formation of a common view around the world that economic globalization is the main cause of the worsening wealth gap. As a result, such ideologies as anti-globalization, populism, nationalism, and anti-elitism have gradually emerged.

However, the interaction between technological development and globalization – also a factor in widening the wealth gap – has not received systematic quantitative analysis in economics literature. In fact, it is evident from some research studies that compared with international trade, automated and smart manufacturing is more effective in replacing large numbers of jobs on a long-term basis, especially those that can be regularized and digitized, e.g. parts assembly or data analysis and text analytics. Not just low-paid employees but middle- to high-income positions, such as clerks, accountants, and lawyers, have also been gradually affected. David Autor, a labour economist at Massachusetts Institute of Technology, has found in his years of studies that both average wage growth and employment growth in middle-income occupations have been far lower than those at either the upper or lower reaches of the income distribution in Western advanced countries since the 1990s. This consequence was characterized by him as the "hollowing out of the middle class" (see Note 2). With the continued advancement of production technology and application of artificial intelligence, many jobs are expected to vanish soon. As emphasised by the famous historian Yuval Harari in his book, *21 Lessons for the 21st Century*, apart from climate change and nuclear war, the biggest challenge to human beings in future will be the questioning of self value when labour input is no longer required for most jobs.

Meanwhile, two other economic phenomena derived from globalization and technological development have also intensified the disparity between the rich and the poor. First, industrial productivity growth driven by technology development persistently surpassing that of the service sector, coupled with the fact that companies are now more able to find labour replacement around the world, has caused many manufacturing workers to switch jobs to service industries with lower average pay and productivity growth. More often than not, both retraining potential and upward mobility in the service sector are far lower in comparison with traditional industries. Apart from reducing economic productivity on the whole, "deindustrialization" found in different parts of the world including Hong Kong and in recent years, the Mainland, has exacerbated income inequality.

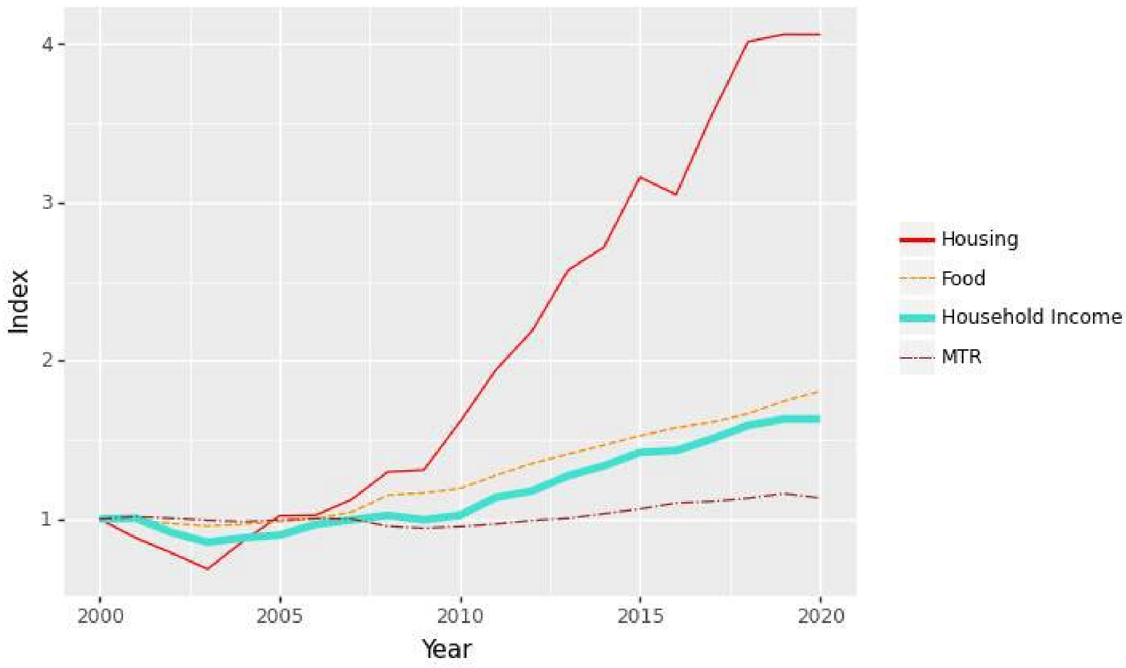
In addition, technology and trade have enabled companies with a competitive edge to further seal their leadership or even monopoly position in the market through the benefit of economy of scale and by lobbying the government. This has strengthened both their pricing power as well as their bargaining position vis-à-vis suppliers and workers. The anti-monopoly laws and cases recently seen worldwide have been in place exactly to remedy market injustice resulting from monopolization by enterprises.

In terms of intensity, wealth inequality is even more serious than inequality in labour income. In the wake of the 2008 financial crisis, many central banks, not least the US Federal Reserve, have maintained years of the quantitative easing (QE) policy to create a low-interest environment. They have also bought huge amounts of stocks and other high-risk and high-return investment products, directly pushing up asset market prices, including property prices. As pointed out by Thomas Piketty in his classic book *Capital in the 21st Century*, a review of Western countries' experience of the past centuries points to the fact that in case of average asset returns higher than economic growth rates, wealth inequality within the generation concerned or even across generations will deteriorate.

Since the outbreak of the coronavirus epidemic in early 2020, numerous central banks have increased a total of trillions of US dollars worth of money supply and have strengthened QE. Rebounding after hitting rock bottom in late April the same year, stock markets around the world went on to make new record highs one after another, being out of touch with the real economy. Low-wage jobs were particularly hard hit by the pandemic while global inflation has gradually emerged. If history is any indication, these are worrying developments. Should wealth inequality be left unchecked, it will not only trigger economic crises but will also cause more social problems and will aggravate political risks around the world.

Wealth disparity worsening in Hong Kong

Figure 1: Hong Kong's Median Income and Costs of Living



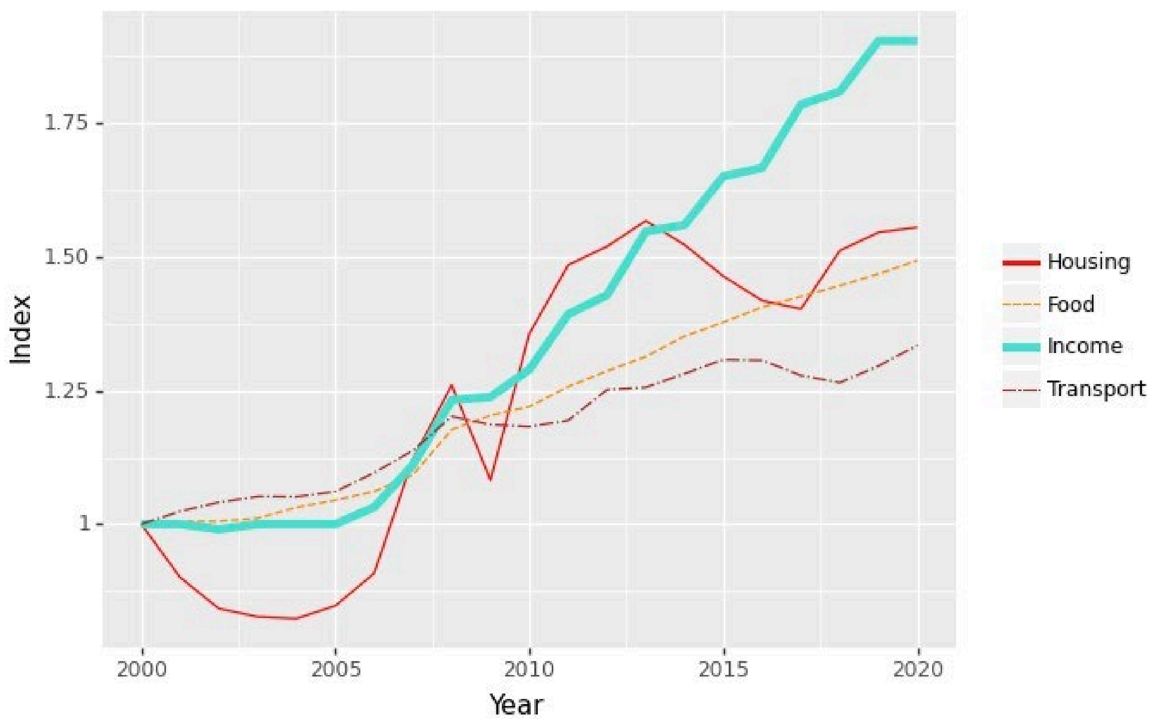
Source: Census and Statistics Department and Rating and Valuation Department, Hong Kong SAR Government; author's calculations

Note: Data for food CPI is from Hong Kong's Census and Statistics Department. The definition is the weighted average of food prices including meals bought outside home. Data on MTR and household income is from the Census and Statistics Department. Data on housing cost is from the Rating and Valuation Department. The definition is the average housing price of class B private residential flat per square feet. All data series are normalized to 1 for the base year 2000.

As is widely known, the wealth-inequality problem in the Hong Kong SAR is considered one of the worst internationally. The above-mentioned factors leading to wealth inequality in Western countries have long taken roots in Hong Kong, a small open and developed economy. Over the years, ever-rising property prices have been the primary reason for disparity between the rich and the poor. The catchphrase "Success calls for a hard-working father" is the root cause of the "lying flat" mentality of many. As shown in Figure 1, the growth of as high as 89% in GDP per capita from

2000 to 2020 may paint a rosy picture of the overall economy. Yet during the same period, the increase in median household income stood at merely 63% paled while the housing expenditure of a four-person family living in private accommodation shot up 306%. Even those with no intention to be homeowners were inevitably made to feel the pressure of food prices which had surged by over 80%. In the same two decades, Singapore, a constant competitor, saw a sharp spike of 90% in its median household income as well as increase in average housing and food prices at 52% and 50% respectively (see Figure 2). No wonder most people in Hong Kong not just feel little improvement in standard of living but are also beginning to feel the pinch. Housing is of course the most severe problem in the SAR, which has been widely discussed together with policy analysis conducted in the community. I therefore will not go into detail here.

Figure 2: Singapore's Median Income and Costs of Living

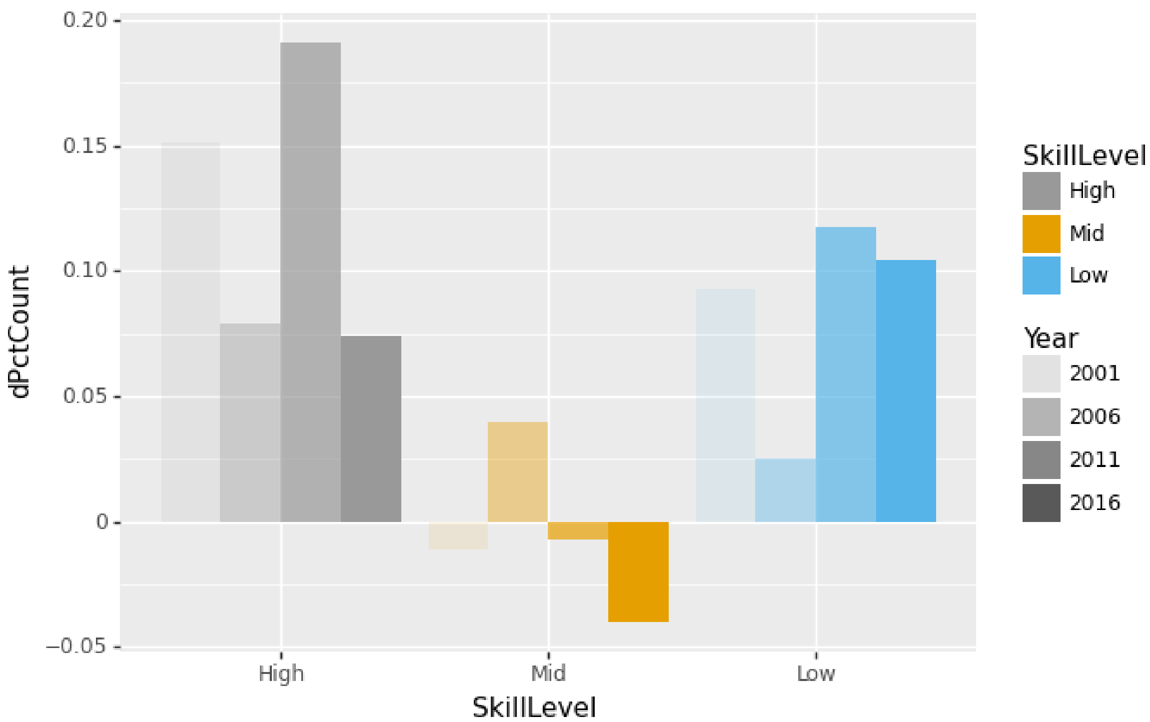


Source: Department of Statistics, Ministry of Manpower, and Urban Redevelopment Authority, Singapore; author's calculations

Note: Data for food CPI is from the Department of Statistics. The definition is the weighted average of food prices including food serving services. Data on transportation, defined as the weighted average of public transport prices, is from the Department of Statistics. Data on household income, defined as the nominal gross median monthly income of employed persons, is from the Ministry of Manpower. Data on housing cost is from the Urban Redevelopment Authority. The definition is the average price of urban private residential apartment per square metre. All data series are normalized to 1 for the base year 2000.

The reasons for the yearly-growing trend of income inequality are varied. As mentioned in my analysis in the "Hong Kong Economic Policy Green Paper" published by the HKU Business School in 2021, the total contribution of the four pillar industries accounts for approximately 60% of the local GDP. With the exception of financial services, employment in the other three pillar industries, i.e. tourism, trading and logistics, and professional services, nevertheless has been on the decline year on year. The two service sectors that feature lower wages (trading and logistics as well as tourism) have been shrinking since 2010 and 2013 respectively.

Figure 3: Changes in the Share of Employment by 3 Skill Levels



Source: Census and Statistics Department, Hong Kong SAR Government; author's calculations

Note: The "high-skilled" group includes employment in the occupations of managers, professionals, technicians; The "mid-skilled" group employment in the occupations of administrators, production workers, and sales; The "low-skilled" group includes employment in the occupations of personal, cleaning, security, operators, labourers. The classification follows closely that of Autor (2019).

The diminishing employment of the three pillar industries has not been taken up by high-tech knowledge-intensive sectors, which Hong Kong, as an advanced economy, should have specialised in. Instead, just like the situation in various Western countries, more low-income service jobs, particularly in retail and personal services, have been created. As illustrated in Figure 3 below, similar to what David Autor has found in the West, Hong Kong's job market has become increasingly polarized, with increasing shares of both high-income positions (e.g. managers, professionals, and technicians) and low-income ones (e.g. personal-service workers, cleaners, security guards, operators, and labourers) displacing middle-income jobs, including administrators, production workers, and sales professionals. According to the latest data from Hong Kong's population census, the share of low-income jobs in total employment grew even faster than that of high-income jobs between 2011 and 2016. Amid the global trends of de-globalization and de-intermediation, the shares of trading and logistics and related service industries in the overall labour market will likely continue to decrease. As for the tourism sector, which has been ravaged by the COVID-19 pandemic, it will probably take years to recover to its pre-pandemic level.

There is a social consensus that housing should be the starting place to tackle the wealth-inequality problem in Hong Kong. That said, the issues of the future development and transformation of Hong Kong's economy have received less discussion in the community. As I have emphasized time and again in my newspaper articles, any service-oriented economy after industrial transformation should focus on driving sustainable economic growth and creating diversified jobs as its economic policy goals. The keys to sustainable growth lie in alleviating the wealth disparity on the one hand and generating job opportunities conducive to upward social mobility on the other hand, in addition to enabling self-sustainability among natural and economic ecosystems.

While hurdles abound to implementing specific policies, national governments have created incentives and set out parameters to drive sustainable development by attempting various policies. Both the Chinese and US governments have recently proposed redistribution policies, such as tax reform. However, in my opinion, the more difficult task is how governments can reposition themselves to strike a balance with the market economy so as to boost sustainable economic development.

Despite the different views of scholars and policymakers from diverse backgrounds on the effectiveness of the market economy, in the final analysis, for long-term solutions to economic issues, the poverty problem in particular, welfare policies are only a stopgap while the root cause lies in economic development. To achieve a fresh start for Hong Kong's economy after COVID-19 and amid the ongoing China-US struggle, collective thinking across all sectors is essential. I have elaborated through different media on the importance of high-end industries to Hong Kong's sustainable economic growth, the solution of shortcomings in the industry-academia-research ecosystem, the promotion of innovation and technology development, marketization of scientific research, and industrial diversification. As for which industries should be prioritized for development, given the word limit of this column, watch this space later on for more discussion.

Note 1: Confucius, *The Analects*, trans. D.C Lau, (London: Penguin Books, 1979)

Note 2: David Autor, "Work of the Past, Work of the Future", Richard T. Ely Lecture, American Economic Association: Papers and Proceeding, May 2019, 109 (5): pp. 1–32