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## Development of wage dispersion: A case study of Hong Kong

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# Development of wage dispersion: A case study of Hong Kong

Ho Ching Florence Yuen

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# **DEVELOPMENT OF WAGE DISPERSION: A CASE STUDY OF HONG KONG**

**Ho Ching Florence Yuen**

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## ABSTRACT

In recent decades, economic performance of Hong Kong has been remarkable and currently its per capita income is amongst the highest in the world. Meanwhile, its income distribution is highly uneven compare to the major advanced economies. As employment income remains the largest constituent of household market income in Hong Kong, it is expected that the development of its earning inequality may have contributed to the high income inequality.

This paper aims to study how wage dispersion has been developed in Hong Kong since 1980s and to identify the reasons behind such development. It also intends to outline policies that can be implemented to reduce the wage dispersion in Hong Kong. Examination on relevant statistics reveals that wage inequality in Hong Kong has been rising since 1980s. Though market factors were definitely in play, growing wage gap was largely a result of insufficient labour market institutions to protect workers from employment practices aiming to enhance wage flexibility. While large scale institutional reform has low feasibility, initiatives to fine-tune the current institutional setting are essential to restore the balance of power between workers and employers in wage determination. Reforms on tax and social security system may also relief the impact of wage dispersion on growth and employment.



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## 1. INTRODUCTION

Economic development concerns typically on the increase in income of an economy. However, whether these gains are distributed in a way such that most people within the economy can benefit also matters. This aspect is usually reflected in the distribution of income. Income inequality is influenced by a number of factors, and among them, earning dispersion has been identified as a major driver of the growing disposable income gap in developed economies in the recent decades. Apart from equity issue, there was also concern over the adverse impact of wage dispersion on output and employment. Higher wage inequality that leads to a more uneven market income distribution would result in a lower level of consumption and eventually reduces growth and employment (Herr and Ruoff, 2014).

Hong Kong has a per capita income among the highest in the world. Meanwhile, its income distribution is highly uneven compare to the major advanced economies. Examining one of the key factors influencing the income distribution in developed economies, changes in wage dispersion, in the context of Hong Kong's development is therefore essential to understand the distributional issues within the small-open economy. This paper attempts to study how wage dispersion has been evolved in Hong Kong since 1980s, a period during which Hong Kong has experienced major economic and political transformation against a turbulent external environment. It also aims to detect the market and institutional factors contributed to such development. With respect to these factors, the paper intends to identify actions that can be undertaken to moderate the impact wage dispersion on Hong Kong's economy.

Analysis in this paper shows that wage dispersion in Hong Kong has been growing since 1980s. It argues that such phenomenon is a result of changing supply-demand conditions in the labour market under neoliberal labour market institutions, which failed to safeguard workers' interest and allowed wage inequality to grow. To reduce wage dispersion in the small-open economy practicing free market capitalism, this paper proposes measures to fine-tune labour market policies and reform pro-business institutions so as to rebalance the power between workers and employers. Alternative ex-post policies, including reform on tax and social security systems, are also recommended to mitigate the impact of wage dispersion on employment and growth.

This paper is organized as follows. A literature review on the theoretical explanations of wage dispersion, which covers market, social and institutional determinants, will be conducted in Section 2. After an overview on Hong Kong's economic development and income inequality, the development of wage dispersion in Hong Kong since 1980s will be discussed in Section 3. Factors contributing to the development observed in Section 3 will be investigated in Section 4. With regard to these factors, Section 5 will outline the policy directions

and propose measures to narrow the wage gap in Hong Kong. The final section concludes.

## 2. THEORETICAL EXPLANATION FOR WAGE DISPERSION

### 2.1 Neoclassical Explanation

From the neoclassical point of view, wages are determined according to worker's contribution within the framework of supply-demand interaction in the labour market (Atkinson, 2015). The fundamental explanation of wage inequality under this paradigm is the difference in human capital and productivity. As workers possess heterogeneous human capital contribute to output differently, corresponding pay received by each worker would not be the same if wages are awarded according to productivity. As a result, workers receive real wage that reflects the marginal product of the last unit of worker employed (Herr, 2002).

Apart from that, skill-biased technological change also emerged as one of the mainstream theories to explain the rising wage inequality as technology advances, particularly the wage gap between the skilled and unskilled workers. It hypothesizes that the improvement in communication and information technology is on one hand complementary to the productivity of skilled workers, and on the other hand competitive to that of unskilled workers, which widen productivity gap between the two groups (Borjas, 2013). In essence, it lifted the relative demand for and placed a wage premium on skilled labour.

Another driving force behind the growing wage gap between skilled and unskilled workers is considered to be trade globalization. Global division of labour, facilitated by technological improvement, relocated unskilled jobs from the industrialized economies to the South, where wages of unskilled workers are lower. As developed economies shifts towards sectors require higher skills, changes in relative demand for workers enabled skilled workers to enjoy wage premium (Atkinson, 2015). Sectoral shift driven by trade globalization increase employment share in tertiary industries which also contributed to rising wage inequality, as dispersion of wages within the service sector is generally greater owing to heterogeneous job nature and skills requirement (Wolff, 2000). Distortion of wage structure is further intensified by changing demand for imports and exports. Growing demand for imports produced by low-skilled workers and exports produced by skilled workers enlarged the wage difference between domestic skilled and unskilled workers in developed economies (Borjas, 2013).

Lastly, demographic change, mostly in the form of migration, is regarded as an alternative neoclassical explanations for growing wage dispersion in the era with increased geographical mobility of workers. The simple supply-demand logic behind provides that immigration of low-skilled workers would increase its supply which causes downward pressure on their relative wages (Wolff, 2000).

The other side of the story is the shortage of skilled workers created by emigration lifted relative wages of those remained (Herr and Ruoff, 2014). Either of these circumstances, or sometimes both, would intensify wage inequality.

## 2.2 Institutions and Social Determinants

Apart from neoclassical explanations, institutional and social factors also play a decisive role in determining the wage structure. Degree of wage dispersion, according to Atkinson (2015), depends on two elements: supply-demand condition, which set out the range of possible wage, and social conventions, which determine the exact pay within the given range. In other words, wage structure depend on social determinants which include the motives, preferences and power of various economic actors under given market conditions.

The level of unionization, coordination of collective bargaining as well as mechanisms to extent negotiation results to non-unionized segments have crucial impact on wage dispersion in this line of argument. If collective bargaining is decentralized, characterized by weak unions, firm-level coordination and insufficient extension mechanism, overall wage dispersion is likely to be higher. On contrary, wage dispersion is expected to be lower if unions are strong, sectoral or national level coordination is present and universal extension mechanism exist (Herr & Ruoff, 2014). For instance, increasing wage dispersion in recent decades are often associated with the observed diminishing role of trade unions and collective bargaining owing to a rise in contingent to cope with the unstable global economy (Herr & Ruoff, 2014).

Another key institutional trend to explain growing wage gap is the falling real value of minimum wage. Minimum wages can alter the wage structure in favour of low-wage earners by reducing inequality in the bottom part of earning distribution (Belser & Rani, 2015). The recent trend in wage dispersion is likely a result of keeping minimum wage low in order to lower wage cost so as to increasing labour market flexibility and employment (Herr & Ruoff, 2014). Apart from falling real minimum wage level, ill design of other labour market policies, including poor unemployment protection and insufficient active labour market policies also undermines the bargaining power of workers, giving rise to a more unequal earning distribution.

The shareholder-value corporate governance system, which gain prominence since 1980s, also exerted negative impacts on wages inequality. Under such system, incentive structure to maximize earnings result in disproportionately high wages for management and professionals. On the other hand, the desire to safeguard shareholders' interest urges firms to increase wage flexibility. The adoption of these wage payment principles has consequently polarized the distribution of earnings in the labour market.

## 2.3 Other Explanation

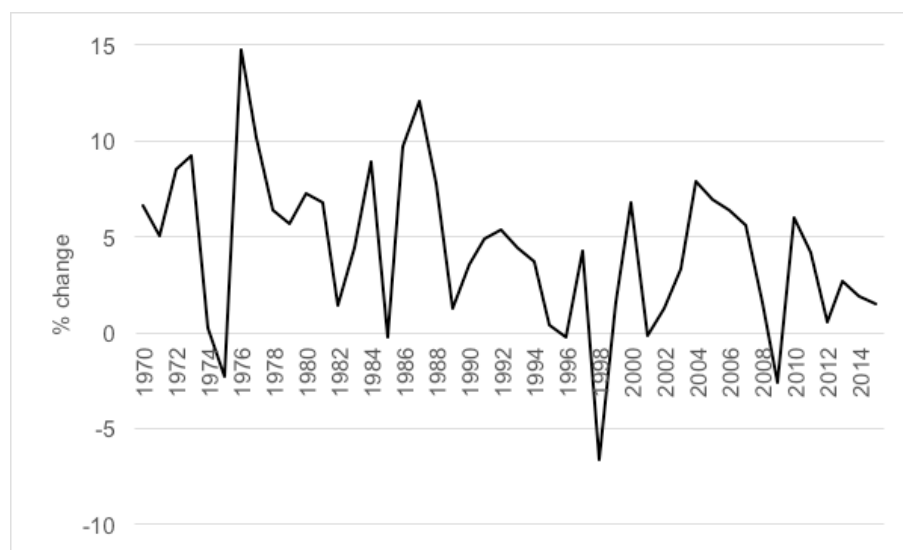
A major explanation for the development of high wage sector is known as the “superstar phenomenon”. The explanation is developed on the basis that individual workers are unique in terms of capacities and talents that no perfect substitutes are available. As a result, *“top performer in a field is able to extract a rent that is related to the extent of the market served; those unable to afford to see the top performer go to the next best performer; and so on”* (Atkinson, 2007, P.57). In other words, the earnings of the “next best performer” depend on the extent of market which the top performer in the industry can serve, which has been extended greatly by technological advancement and trade in the recent decade. Consequently, the top performer is able to extract extra rent at the expense of the earnings of inferior performers in the expanded market, which facilitated the development of a segment in which individuals’ earnings are exceptionally high (Borja, 2013).

Empirical analysis offer no evidence that any of the aforementioned factors dominates the development of wage dispersion in recent decades. Although market forces are definitely in play, significance of institutional factors should not be overlooked. How wage structure changes under prevailing market forces depends very much on labour market institutions, power relations and government policies.

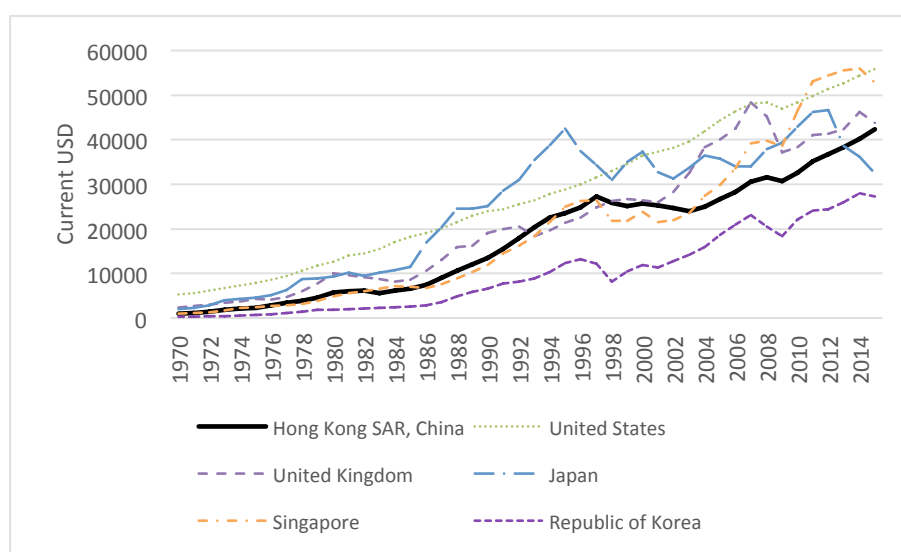
# 3. WAGE DISPERSION IN HONG KONG

## 3.1 Economic Development and Income Inequality in Hong Kong since 1980s

Hong Kong has been undergoing major political and economic changes since 1980s. During this period, its sovereignty returned from Britain to China under the principle of ‘One Country, Two Systems’. Significant economic restructuring also took place. Its major industries changed from export-oriented manufacturing to service industries, and eventually it evolved into an international financial center. Despite hardly hit by several economic crises, the small open economy was able to maintain a considerable average growth rate throughout the years, especially during the 1980s (Figure 3.1). Its ability to catch up with major economies (Figure 3.2) is often attributed to its practice of free-market capitalism. During the course of its development, state intervention in the market has been kept to a minimum in Hong Kong. High degree of economic freedom, with absence of capital control and minimal trade barrier, made it one of the most popular destinations for foreign investment. The economic system also lent flexibility for Hong Kong to recover quickly subsequent to major crises, which explains why Hong Kong has been able to maintain economic growth throughout the years despite having considerable economic and political changes.

**Figure 3.1: GDP per Capita Growth in Hong Kong, 1970 to 2015**

Source: World Bank (2016); author's representation

**Figure 3.2: GDP per Capita in Selected Economies, 1970 to 2015**

Source: World Bank (2016); author's representation

### Development of Income Inequality in Hong Kong

Although Hong Kong has been experiencing substantial economic growth in the past decades, it is in doubt whether the citizens are enjoying a fair share of the fruits of economic success. Unlike the hypothesis made by Kuznets (1955), the dispersion of income in Hong Kong did not stabilize with its economic progress. On contrary, income inequality has been growing constantly in the recent decades (Table 3.1).

**Table 3.1: Gini Coefficient of Hong Kong, 1981-2011**

	1981	1986	1991	1996	2001	2006	2011
Household market income	0.451	0.453	0.476	0.518	0.525	0.533	0.537
Household disposable income	*	*	*	0.466	0.470	0.475	0.475

Note: Gini coefficient of household disposable income prior to 1996 is unavailable.

Sources: Census and Statistics Department, HKSAR (2007, 2012), Lui (2013); author's calculation

During the 30-year period, there has been a constant increase in income inequality in Hong Kong measured in terms of household market income. Income redistribution appeared to be insufficient, as the post-tax post-social transfer Gini coefficient is still among the highest in advanced economies (Table 3.2).

**Table 3.2: Gini Coefficient of Household Disposable Income, Selected Economies, 2011-2014**

	Hong Kong	US	UK	Germany	Canada	Japan	Republic of Korea
Gini coefficient	0.475	0.394	0.358	0.292	0.322	0.33	0.302
Year	2011	2014	2013	2013	2013	2012	2014

Note: Latest data of each economy during the period has been selected for comparison.

Sources: Census and Statistics Department, HKSAR (2012), OECD (2016)

Different explanations were suggested for the growing income inequality in Hong Kong. Regardless of the underlying cause, it is highly probable that the development of wage dispersion has exert a significant influence on the income gap, since employment income<sup>1</sup> still accounted for over 85% of household market income in Hong Kong despite rising capital share (Table 3.3).

**Table 3.3: Proportion of Employment Income to Household Market Income in Hong Kong, 2001-2011**

	Hong Kong	US	UK	Germany	Canada	Japan	Republic of Korea
Gini coefficient	0.475	0.394	0.358	0.292	0.322	0.33	0.302
Year	2011	2014	2013	2013	2013	2012	2014

Source: Census and Statistics Department, HKSAR (2012)

<sup>1</sup> 'Employment income' in this paper refers to the monthly income from main employment. For employees, this is the total amount earned from their main employment including salary or wage, bonus, commission, overtime, housing allowance, tips and other cash allowances. New Year bonus

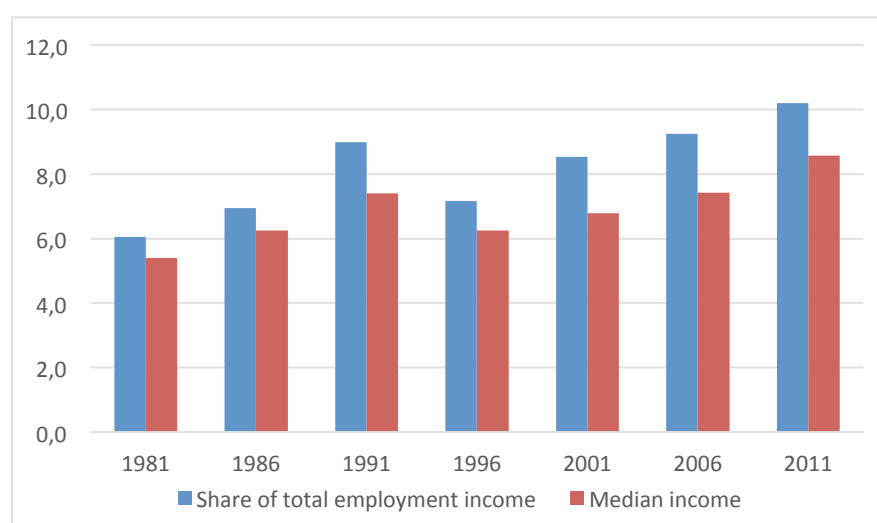
### 3.2 Development of Wage Dispersion since 1980s

Various measurements of wage inequality are adopted in this section to reflect the development of wage inequality in Hong Kong. The first indicator is decile ratios, which include i) D9/D1 ratio, ii) D5/D1 ratio and iii) D9/D5 ratio. These ratios are calculated based on two different values, a) median employment income and b) share of total employment income of the decile groups involved, which are extracted from data collected by the Census and Statistics Department in various Population Census and By-census<sup>2</sup>.

The ratio between the second highest 10% and the lowest 10% of wage earners (D9/D1 ratio) had been increasing between 1981 and 2011, with an exception for the period between 1991 and 1996 (Figure 3.3). The ratio of median wage in D9 and D1 increased from 5.4 in 1981 to 8.6 in 2011, while that of the share of total employment income increased from 6.0 in 1981 to 10.2 in 2011.

Figure 3.4 shows the ratios of earnings between the middle and low wage earners. The ratios between the two groups exhibit a similar trend as the D9/D1 ratio, except with a much smaller overall increase during the period. The rise in ratios has been more significant in the 1980s, while subsequent growth has become much milder since 1996. The overall increase of the ratio for median wage was only 0.2, while for the share of total employment income was 0.6.

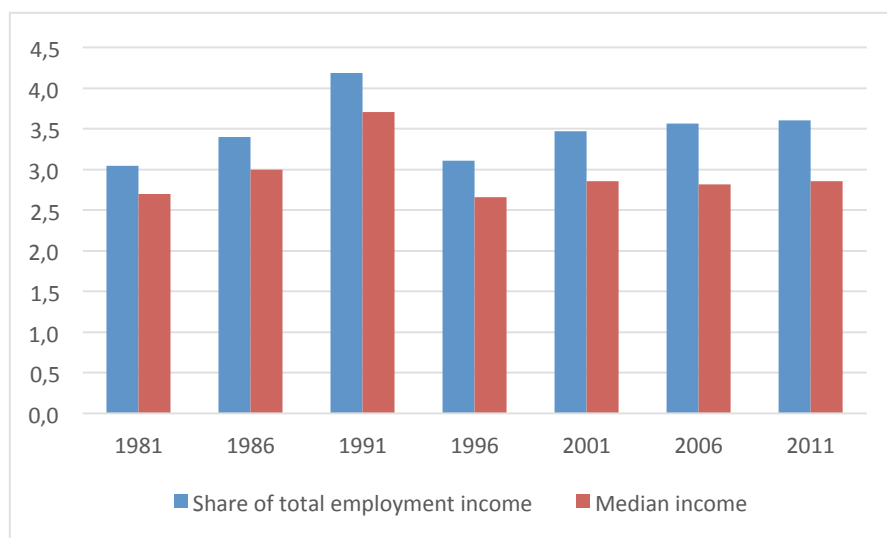
**Figure 3.3: D9/D1 Ratio of Employment Income in Hong Kong, 1981-2011**



Source: Census and Statistics Department, HKSAR (2007a, 2012a); author's calculation based on unpublished census data

<sup>2</sup> In this paper, the corresponding values of the second highest decile group (D9) rather than the highest decile group (D10) are used for computing decile ratios. This is to make the earnings ratios more comparable as the number of deciles groups between D5 and D9 would then be the same as the number between D1 and D5. Employment income data of the highest decile group will be taken into account through other measurements in the later part of this section.



**Figure 3.4: D5/D1 Ratio of Employment Income in Hong Kong, 1981-2011**

Source: Census and Statistics Department, HKSAR (2007a, 2012a); author's calculation based on unpublished census data

Dispersion of wages between the top and middle earners display a slightly different movement. The D9/D5 ratios shows a steady and an uninterrupted upward trend (Figure 3.5). The ratio for median wage increased from 2.0 in 1981 to 3.0 in 2011, while for share of total employment income increased from 2.0 in 1981 to 2.8 in 2011.

Even though all three decile ratios, measured both in terms of median employment income and share of employment income, has been rising, the extent of changes is different (Table 3.4). The D9/D1 ratios experienced the highest percentage growth during the period, followed by the D9/D5 ratios, which also experienced a significant increase. Meanwhile, the D5/D1 ratios experienced a much smaller change. This shows that higher wage inequality in the upper part of the distribution was the major cause of increased wage inequality.

**Figure 3.5: D9/D5 Ratio of Employment Income in Hong Kong, 1981-2011**

Source: Census and Statistics Department, HKSAR (2007a, 2012a); author's calculation based on unpublished census data

**Table 3.4: Percentage Change in Decile Ratios between 1981 and 2011**

	D9/D1	D5/D1	D9/D5
Share of total employment income	68.78%	18.29%	42.69%
Median income	58.73%	5.82%	50.00%

Source: Census and Statistics Department, HKSAR (2007a, 2012a); author's calculation based on unpublished census data

The data presented above shows a growing dispersion of wage among various groups. Instead of a polarization of employment earnings between the top and bottom wage earners, middle and low wage earners both lost in comparison with the high wage earners. This deduction can be further supported by the statistics shown in Table 3.5. Despite the fact that both the low and middle wage earners lost in 2011 compare with 1981, the percentage reduction in wage share was the most significant for the bottom deciles. On the other hand, high wage earners were clearly the winners during the course of development, as they were able to extract even larger share of employment income. In particular, the rise in earnings of D10 outpaced the other top earners of the distribution.

The development of wage dispersion in Hong Kong can also be captured by the Gini coefficient of individual employment income estimate by using the share of total of employment income of various decile groups (Table 3.6). The result obtained is largely consistent with the trend displayed in the previous two measurements (decile ratios and share of total employment income of decile groups): the overall wage distribution is becoming more uneven. Yet, unlike the development displayed by the D9/D1 and D5/D1 ratios, the Gini coefficient does

not indicate a temporary improvement of wage inequality from 1991 to 1996. Closer examination of decile data revealed that the fall in D9/D1 and D5/D1 ratio in 1996 was caused by an increase in employment income share in D1, together with a fall in employment income share in D5 and D9, as well as a surge in employment income share in D10<sup>3</sup>.

**Table 3.5: Share of Total Employment Income of Decile Groups, 1981 and 2011**

	1981	2011	Percentage change of income share over the period
D1	2.3%	1.5%	-35%
D2	4.4%	2.7%	-39%
D3	5.2%	3.9%	-25%
D4	6.1%	4.7%	-23%
D5	7.0%	5.4%	-23%
D6	7.8%	6.6%	-15%
D7	9.3%	8.2%	-12%
D8	10.6%	10.6%	0%
D9	13.9%	15.3%	10%
D10	33.4%	41.2%	23%

Source: Census and Statistics Department, HKSAR (2007a, 2012a); author's calculation based on unpublished census data

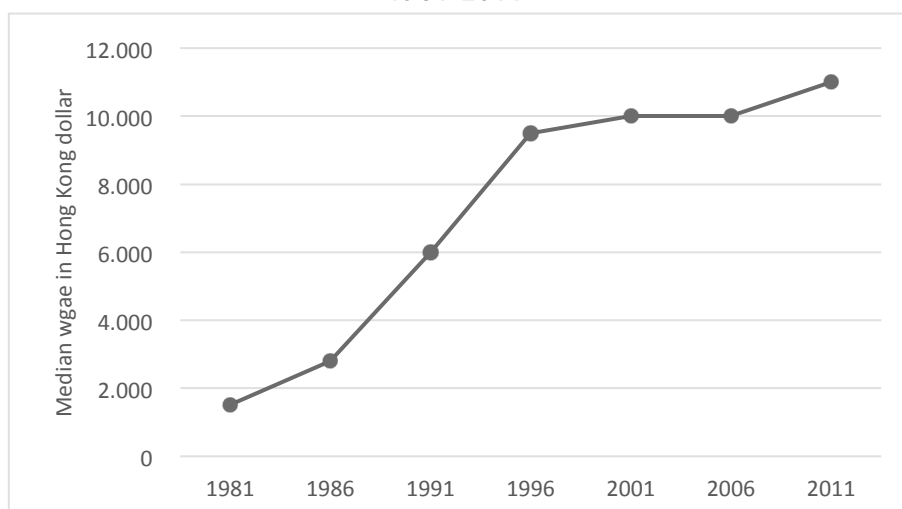
**Table 3.6: Gini Coefficient of Individual Employment Income in Hong Kong, 1981-2011**

	1981	1986	1991	1996	2001	2006	2011
Gini coefficient	0.384	0.403	0.418	0.464	0.468	0.483	0.490

Source: Census and Statistics Department, HKSAR (2007a, 2012a); author's calculation based on unpublished census data

During the same period, median monthly employment income in Hong Kong has been rising, sharply prior to 1996 and mildly thereafter (Figure 3.6). Nonetheless, the increase in median wage by no means reflect an improvement in distribution of employment income, as revealed in the above analysis.

<sup>3</sup> The observation was mainly based on unpublished census data. The fall in D9/D1 ratio and D5/D1 ratio between 1991 and 1996 were possibly due to the massive return of emigrants during early 1990s owing to economic reasons. However, details of the return of migrants will not be covered in this paper. The discussion in the following sections will mainly focus on the overall trend in wage dispersion.

**Figure 3.6: D9/D5 Ratio of Employment Income in Hong Kong, 1981-2011**

Source: Census and Statistics Department, HKSAR (2007a, 2012a) and unpublished census data; author's representation

As for the gender pay gap, median monthly employment income of the male and female wage earners in Hong Kong between 1985 and 2011 were shown in Table 3.7. The ratio of median monthly employment income between male and female workers were also presented in the same table. As reflected by the data below, fluctuations in gender pay gap were observed, without a clear trend showing the pay gap has been either narrowing or widening. Yet, the median wage of male workers in all surveyed years were higher.

**Table 3.7: Median Monthly Employment Income by Sex (in Hong Kong dollar), 1986-2011\***

	1986	1991	1996	2001	2006	2011
Male	3,000	6,000	10,000	12,000	11,500	13,000
Female	2,000	4,500	8,000	8,800	8,000	9,300
Male to female median monthly employment income ratio	1.50	1.33	1.25	1.36	1.44	1.40

Note: Median monthly employment income prior to 1986 is unavailable.

Source: Census and Statistics Department, HKSAR (2017b); author's calculation

To conclude, Hong Kong's wage dispersion has been growing between 1981 and 2011. The data also shows the share of employment income has been increasing in the top deciles, while that of the middle and bottom deciles have declined. Such development is possibly caused by the development of high wage sector or the erosion of relative wages in the middle and low wage sectors, or both occur concurrently. Also, there is a small tendency of the "fanning-out" of the top decile in the upper part of the distribution. Meanwhile, there is has been no clear sign of

narrowing or widening of gender pay gap, even though the median wage of male workers remained higher throughout the years.

## 4. FACTORS CONTRIBUTING TO THE DEVELOPMENT OF WAGE DISPERSION IN HONG KONG

### 4.1 Market Factors

#### (i) Economic Restructuring

As discussed earlier, Hong Kong has experienced a major structural change since 1980s. Relocation of factories from Hong Kong to the mainland China to take advantage of lower rent and labour cost has led to a massive shrinkage of manufacturing sector since 1980s. Development of service industries was promoted in order to sustain economic growth. As a result, valued-added and employment share of the service sector surged during since 1980s.

Table 4.1 and 4.2 shows the change in sectoral contribution to GDP and employment share by industries in Hong Kong since 1980s. The declining importance of manufacturing sector is implied in the falling share of contribution to GDP as well as employment share in secondary production. Conversely, significance of service industries increased over the years, which was reflected by its rising contribution to GDP and employment. The data shows a massive shift in employment from manufacturing to service sector has been occurred in Hong Kong since 1980s.

**Table 4.1: Share of Contribution to GDP by Broad Economic Sector in Hong Kong, Selected Years**

	Share of Contribution (%)		
	Primary Production	Secondary Production	Tertiary Production
1980	1.0	31.6	67.5
1990	0.3	25.3	74.5
2000	0.1	14.3	85.6
2010	0.1	7.3	92.6
2015	0.1	7.4	92.6

Note: The totals may not add up to 100% due to the effect of rounding.

Sources: Lui (2013); Census and Statistics Department, HKSAR (2016b)

**Table 4.2: Employment Share by Industry in Hong Kong, 1981-2011**

	1981	1986	1991	1996	2001	2006	2011
Manufacturing	41.3	35.8	28.2	18.9	12.3	9.7	4.8
Construction	7.7	6.2	6.9	8.1	7.6	6.8	7.8
Wholesale and retail trade, restaurants and hotels	19.2	22.3	22.5	24.9	26.2	27.2	30.1
Transport, storage and communication	7.5	8.0	9.8	10.9	11.3	11.6	10.6
Financing, insurance, real estate and business service	4.8	6.4	10.6	13.4	16.1	17.0	17.5
Community, social and personal service	15.6	18.4	19.9	22.3	25.5	26.9	28.6
Other	3.9	2.9	2.1	1.5	1.0	0.8	0.7

Sources: Lui (2013); Census and Statistics Department, HKSAR (2007a, 2012a)

Economic restructuring and employment shift has possibly fueled the growth of wage dispersion through two possible means. First, destruction of manufacturing jobs led to an excess supply of low-skilled workers, which result in downward pressure of wages in low-skilled jobs. While service sectors were able to absorb part of these workers, mismatch in skills requirements leave them weaker power to demand for decent wages. Prevailing supply-demand condition in the labour market forces these workers to accept lower wage.

Second, employment shifted towards sectors with more heterogeneous skill requirements and thus higher within-sector wage dispersion was resulted. Between 1981 and 2011, three industries experienced the highest growth in terms of employment share: (i) financing, insurance, real estate and business service; (ii) community, social and personal service; and (iii) wholesale and retail trade, restaurants and hotels (Table 4.2). These are also the sectors with relatively large within-sector wage dispersion (Table 4.3) owing to their heterogeneous job requirements. Overall earning distribution became more uneven, as the employment share of these sectors grew.

**Table 4.3: Gini Coefficient of Employment Income by Industry in Hong Kong, 1981-2011**

	1981	1986	1991	1996	2001	2006	2011
Manufacturing	0.335	0.359	0.389	0.414	0.409	0.428	0.438
Construction	0.331	0.357	0.352	0.361	0.338	0.347	0.364
Wholesale and retail trade, restaurants and hotels	0.391	0.403	0.378	0.396	0.403	0.423	0.423
Transport, storage and communication	0.301	0.315	0.331	0.357	0.373	0.383	0.382
Financing, insurance, real estate and business services	0.476	0.474	0.467	0.481	0.470	0.478	0.480
Community, social and personal service	0.415	0.429	0.448	0.480	0.509	0.515	0.520
Others	0.427	0.451	0.433	0.457	0.471	0.473	0.425

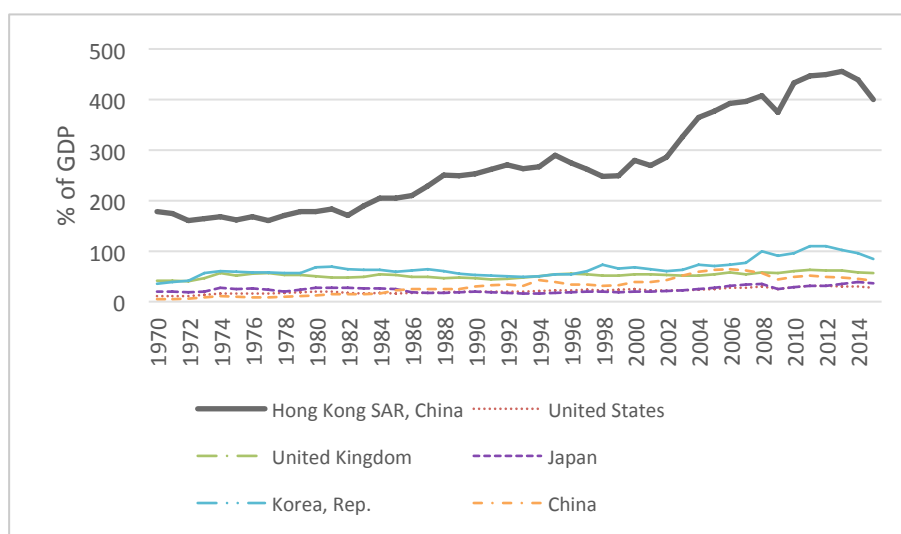
Note: "Others" include agriculture and fishing, mining and quarrying, electricity gas and water and other miscellaneous industries.

Source: Lui (2013)

#### **(ii) Vulnerability to the Change in External Conditions**

Hong Kong is an outwardly-oriented economy and its economic activities depend greatly on the external environment. Compared to other advanced economies, Hong Kong has a much higher trade to GDP ratio, and the ratio was increasing more rapidly than the others since 1980s (Figure 4.1).

Hong Kong's exceptionally high level of trading activities explains why it is much more sensitive to the change in global economic environment. The laissez-faire approach it has been adopting, with nearly absence of policies to control trade and capital flow, make it even more vulnerable to external crisis. In addition, over-reliance on mainland China in terms of trade increases Hong Kong's proneness to economic recession. Economic integration between mainland China and Hong Kong has been catalyzed since the handover in 1997. Trade with mainland China alone accounted for over 50% of Hong Kong's total trade in 2015 (Trade and Industry Department, HKSAR, 2016a). Consequently, the slowdown in economic growth and change in value of Renminbi against Hong Kong Dollar have significant impact on the businesses in Hong Kong.

**Figure 4.1: Trade as a Percentage of GDP of Selected Economies, 1970-2015**

Source: World Bank (2016); author's representation

Vulnerability to external economic shocks in particular those related to mainland China means measures have to be taken to hedge against market risks. Experiencing frequent crises with huge impact since 1997, sentiments of employer changed and they demanded greater flexibility to cope with shocks. One of the most commonly used strategy is to increase wage flexibility, including the practice of subcontracting and nonstandard employment. This means regular employment is replaced by jobs with lower wages, poorer benefits and reduced job security. Change in employment practices left workers smaller power to bargain for better wages, especially for those in the low- and middle-wage segments of the earning distribution.

### (iii) Rising Operation Cost of SMEs

In addition to the need for cushioning external crises, employers also seek to increase wage flexibility to offset rising cost pressure. In Hong Kong, majority of the business establishments are Small and Medium Enterprises<sup>4</sup> (SME). They employ a considerable portion of the labour force and traditionally served as a major source of employment for unskilled and inexperienced workers<sup>5</sup>. In order to survive, SMEs has to be responsive to cope with changing business environment and reduce risk through maintaining cost flexibility. Rent, cost of materials and supplies as well as wages are the three major categories of expense for most SMEs. Small firms have been facing escalating cost pressure from the former two types of costs in the recent decades due to various reasons.

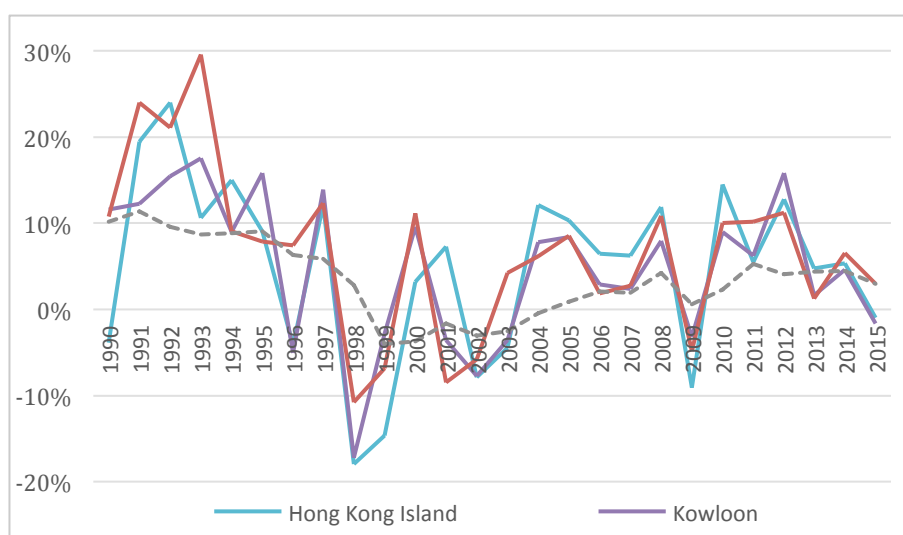
<sup>4</sup> In Hong Kong, business establishments are considered to be SMEs if they are engaging in the manufacturing sector with less than 100 employees or in the non-manufacturing sector with less than 50 employees.

<sup>5</sup> The most recent statistics shows that over 98% of the businesses establishment in Hong Kong are SMEs which employed around 50% of the labour force (Trade and Industry Department, HKSAR, 2016b).



Hong Kong's property price is ever-rising and amongst the highest in the world. Besides exceptionally high housing prices, shop and office rent are also becoming unaffordable for small businesses. Since 1990, shop rent has been fluctuating much more widely than the inflation rate, and in most years, the extent of increase is greater than the change in price level (Figure 4.2). Several reasons can explain the high and constantly rising shop rental price in Hong Kong. First, there are only a few property developers in the market and they exercised market power to push up rental prices directly and indirectly. Second, since the adoption of Individual Visit Scheme<sup>6</sup> in 2003, demand for pharmaceutical and luxury products from mainland Chinese tourists increased greatly. Derived demand for retail shops constantly bids up shop rent. Third, unregulated speculative activities has also driven up rental prices.

**Figure 4.2: Change in Private Retail Average Rent, by District, 1990-2015**

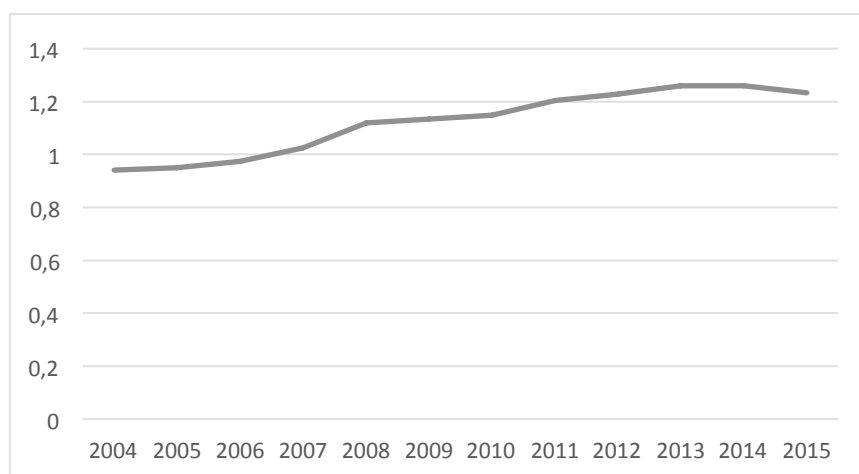


Source: Rating and Valuation Department, HKSAR (2016), World Bank (2016); author's calculation

Another source of cost pressure comes from materials and supplies. Many SMEs rely on import supplies from mainland China for their businesses and the appreciation of Renminbi against Hong Kong dollar since the currency reform in mainland China in 2004 greatly increased their cost of operation over the past ten years (Figure 4.3).

<sup>6</sup> Under this scheme, citizen of designated cities in mainland China can visit Hong Kong on an individual basis, in contrary to business visa and group visit prior to its implementation.

**Figure 4.3: Chinese Yuan to Hong Kong Dollar Exchange Rate, Yearly Average, 2004-2015**



Source: Canadian Foreign Exchange Services (2016)

As limited action can be taken for the small businesses to get around rising rent and appreciation of Renminbi, the remaining way to deal with the cost pressure is to reduce wage cost. Therefore, SMEs increase wage flexibility through nonstandard employment and performance-related pay so as to share business risk with their employees. This created downward pressure on wages in the low and medium wage sector which eventually led to greater wage inequality.

#### **(iv) Constant Influx of Low-skilled Migrants**

Since 1950s, there has been a constant influx of immigrants from mainland China to Hong Kong. Prior to 1980s, many of them who entered Hong Kong illegally became the major source of cheap and low-skilled labour to support the early development of labour-intensive manufacturing industries in Hong Kong (Turner et al., 1991). Nevertheless, the situation change since 1980s. Despite flow of illegal immigrants was largely curbed due to policy change (Lam and Liu, 1998), there was still constant streams of legal immigrants from mainland China under the One-way Permit Scheme for the major purpose of family reunion<sup>7</sup>. Between 1986 and 2015, over 1.1 million migrants arrived Hong Kong under this scheme, the amount was huge compared to a total population of 7.3 million in Hong Kong as at the end of 2015 (Census and Statistics Department, HKSAR, 2017a). For most years, over 60% of these migrants are at working age, which contributed to a considerable increase in the labour supply in Hong Kong. For instance, between 1996 and 2011, nearly 800,000 immigrants moved from mainland China and among them around 520,000 were at working age<sup>8</sup>.

<sup>7</sup> The daily quota under this scheme was agreed by the Chinese and Hong Kong government at 75 in the early 1980s, which then increased to 105 in 1993 and further revised to 150 since 1995 (Bacon-Shone et al., 2008).

<sup>8</sup> These figures were calculated by the author based on the data from Census and Statistics Department, HKSAR (2002, 2007b, 2012b, 2016c) and Home Affairs Department, HKSAR (2016).

Labour force participation rates of persons from the mainland having resided in Hong Kong for less than 7 years (PMR) are shown in Table 4.4. Even though the labour force participation rate of these new migrants was lower than the average rate of the whole population, in all surveyed years at least 40% of new migrants participate in the workforce. New immigrants from mainland China could possibly have accounted for a significant proportion of increase in labour force. If a conservative estimation of a labour force participation rate at 45% is applied, new migrants arrived between 1996 and 2011 alone could have possibly account for as much as over 30% of the increase in the entire labour force during the same period<sup>9</sup>.

**Table 4.4: Labour Force Participation Rates of PMR, 1991-2011**

	1991	1996	2001	2006	2011
Labour Force Participation Rate	60.9	54.3	44.2	45.7	47.8

Source: Census and Statistics Department, HKSAR (2002, 2007b, 2012b)

Statistics also showed that academic attainment of these working age migrant are relatively low. Even in 2011, majority of the migrants have not completed upper secondary education, though improvement has been observed throughout the years (Table 4.5). Also, compare with the entire Hong Kong population, the proportion of new migrants with upper secondary education or above is significantly lower (Figure 4.4). The education level of these migrants determines the types of employment they could participate in. Majority of the new migrants are engaging in low-skilled to semi-skilled occupations (Table 4.6). While workers taking up professional or managerial position increased to nearly 40% in the entire Hong Kong population, the corresponding proportion for PMR is still below 20% in 2011(Figure 4.5).

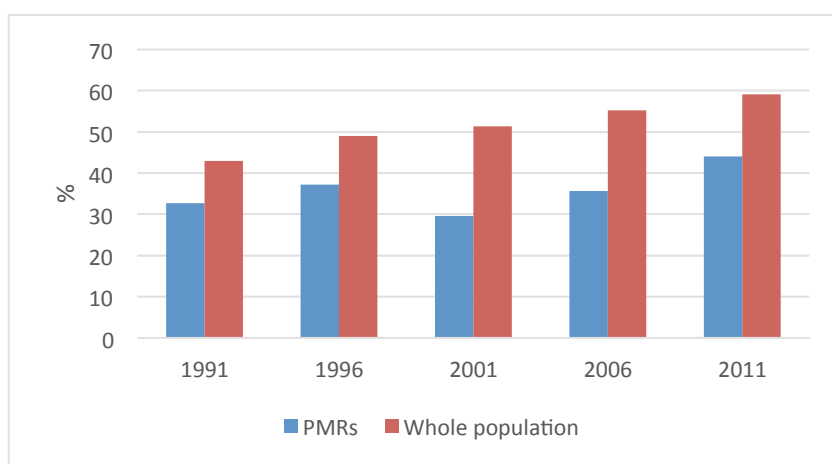
The influx of mainland Chinese migrants with comparatively lower education and skill level than the general population is not a recent phenomenon in Hong Kong. However, it has only contributed to the growing wage dispersion in Hong Kong since 1980s. Prior to economic restructuring, the negative impact of immigration on the labour market was much more trivial since there were abundant low-skilled factory jobs (Lam and Liu, 1998). Persistent and increasing inflow of low-skilled migrants since 1980s, when employment in the manufacturing sector is constantly declining, created market pressure that reduced the wage of low-skilled jobs. As such, the wage gap between the low-wage and high-wage sectors increased.

<sup>9</sup> Estimation was made by the author based on the data from Census and Statistics Department, HKSAR (2002, 2007b, 2012b).

**Table 4.5: Highest Education Attainment of PMR Aged 15 or above, 1991-2011**

	1991	1996	2001	2006	2011
No schooling/ Kindergarten	10.3%	6.4%	6.7%	4.3%	1.8%
Primary	24.2%	23.7%	25.3%	18.6%	13.2%
Lower Secondary	32.8%	32.6%	38.4%	41.4%	41%
Upper Secondary/Matriculation	24.9%	26.6%	23.9%	27.8%	28%
Tertiary	7.8%	10.7%	5.7%	7.9%	16%

Source: Census and Statistics Department, HKSAR (2002, 2007b, 2012b)

**Figure 4.4: Percentage of PMR with Upper Secondary Education or above, 1991-2011**

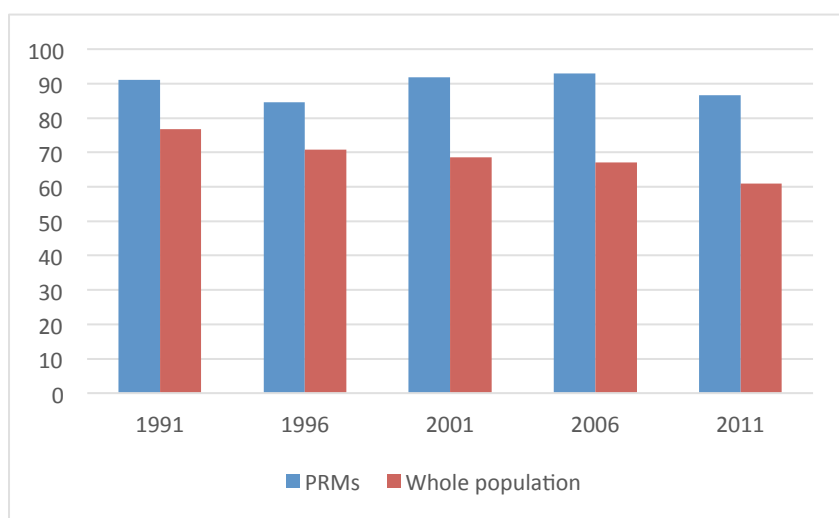
Source: Census and Statistics Department, HKSAR (2002, 2007b, 2012b); author's calculation

**Table 4.6: Percentage of Working PMR by Occupation, 1991-2011**

	1991	1996	2001	2006	2011
Managers and administrators	4.9%	8.5%	3%	2%	3.6%
Professionals	0.9%	1.8%	0.9%	0.9%	2.7%
Associate professionals	3.2%	5.2%	4.1%	4.2%	6.9%
Clerical support workers	10.3%	13.5%	10.9%	11.3%	9.9%
Service workers and shop sales workers	15.2%	22%	30.7%	37.7%	38.1%
Craft and related workers	15.7%	14.7%	11%	9.2%	9.1%
Plant and machine operators and assemblers	24%	8.3%	4.1%	3%	2.2%
Elementary occupations	25.4%	25.3%	34.9%	31.7%	27.3%
Skilled agricultural and fishery workers; and occupations not classifiable	0.5%	0.7%	0.3%	0.1%	0.1%

Source: Census and Statistics Department, HKSAR (2002, 2007b, 2012b)

**Figure 4.5: Percentage of Working PMR in Non-professional and Non-managerial Positions, 1991-2011**



Source: Census and Statistics Department, HKSAR (2002, 2007b, 2012b); author's calculation

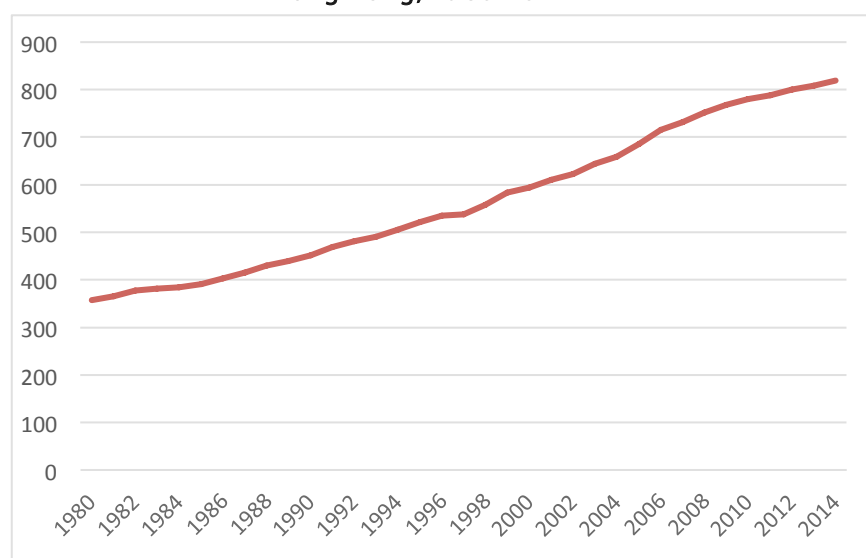
## 4.2 Institutions and Power Relations

### (i) Insufficient Labour Market Institutions and Policies

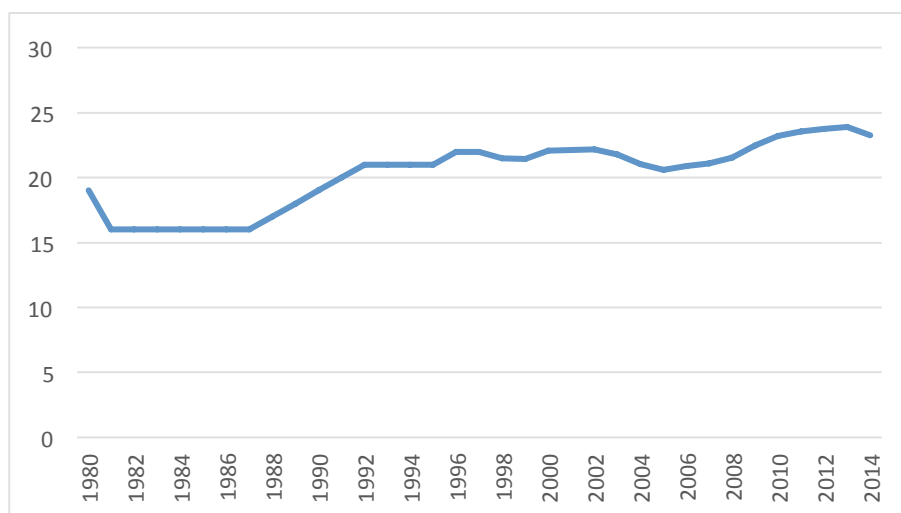
#### Unionization and Collective Bargaining

Statistically, workers' participation in trade union in Hong Kong is far from inactive. While the number of trade unions increased by more than double since 1980 (Figure 4.6), there is also a growing proportion of workforce participating in trade unions.

**Figure 4.6: Number of Employees' Trade Unions Registered in Hong Kong, 1980-2014**



Source: Registry of Trade Unions, Hong Kong SAR (2015); author's representation

**Figure 4.7: Union Density in Hong Kong, 1980-2014**

Note: Union density from 1980 to 1995 was rounded off to nearest integral, while in later years was corrected to first decimal place.

Source: Registry of Trade Unions, Hong Kong SAR (2015); author's representation

However, the above figures failed to depict union strength. Despite having a fairly satisfactory union density rate, the function of trade unions in coordinating collective bargaining for workers is extremely weak and the role of unions in wage determination, in many cases, is rather insignificant. New unions formed were mostly with small number of memberships which lead to greater fragmentation of union activities. Besides, it is likely that these unions are established with the political agenda to take advantage of the current institutional setting, rather than working for the purpose of collective bargaining. On the other hand, the rise in union density should not be misinterpreted as strengthened power of unions. It is widely believed that considerable amount of workers join unions to take advantage of the welfare benefits instead of collective bargaining (Chan & Tai, 2013). For instance, it is common for workers to obtain union membership for the purpose of enjoying concessionary prices on enrolling in courses organized by the unions, as well as buying certain goods and services at discount. Also, union density rate may have been over-estimated as the calculation did not take into account workers who joined more than one union.

In general, the power of Hong Kong's trade unions is exceptionally weak and its powerlessness is linked to several characteristics of its own. First, solidarity is undermined by fragmentation of trade unions, especially in terms of political ideology, which result in limited collective strength. Second, trade unions have adapted to institutional constraints, including absence of legal protection on strike as well as collective bargaining rights, and shifted their function from acting as collective bargaining agents to welfare societies, which offer a wide range of benefits to their members, in order to maintain union membership. Third, focus of the unions also shifted from collective bargaining to "community unionism" owing to the reform of the Legislative Council (LegCo), the law-making body in

Hong Kong, in 1990s (Ng, 2015). To win seats in the LegCo, the trade union federations articulate a broad range of issues in partnership with major political parties for the interest of the grassroots community (Ng, 2015). These characteristics altogether resulted in the erosion of traditional role of trade unions for safeguarding workers' interest in wage determination.

Development of collective bargaining system in Hong Kong is not only hindered by weak unions, but also institutional factors in the labour market. It was estimated that less than 1% of worker were covered by collective agreements in 2011 (International Trade Union Confederation, 2012), which is not surprising when collective bargaining right is by no means protected by law. Consequently, majority of employers in Hong Kong do not recognize trade unions (Ng, 2015). On the other hand, institutionalizing collective bargaining has never been the government's priority. Rather, it advocates voluntary joint consultation as a mean to align workers' and employers' interests on industrial issues, without emphasizing the need of collective negotiation of wages. Furthermore, protection for workers against "retaliation" for participating in union activities, mostly in the form of unfair dismissal, is limited (International Trade Union Confederation, 2012). As a result, attempts for collective bargaining, mostly remained at the firm-level, were limited and rarely succeed. Also, extension mechanism undoubtedly does not exist in such a neoliberal labour market. Subsequently, wage bargaining in Hong Kong is highly decentralized and the determination of wages largely remained at an individual level and on a bilateral basis between employers and employees.

Hong Kong faces a strong resistance in institutionalizing collective bargaining as it is viewed as violation of the free market principles that has been long-established in the small-open economy. Considered as market rigidities, stronger protection for labour is not preferred by SMEs and even workers, let alone large enterprises. Concern over politicizing industrial issues also discouraged the government to legalize collective bargaining rights. To avoid undesirable electoral bidding, it incline to leave the job to the market.

Reluctance to initiate reform in labour market institutions also allows prevailing market condition to weaken further the function of unions. Sectoral shift since 1980s has led to formation of more white-collar unions which intensified fragmentation. Relocation of factories also drained blue-collar members from better established trade unions (Ng, 2015). Widespread adoption of nonstandard employment in recent years further increased the difficulty for unions to organize their membership (Ng, 2015). Continuously decreasing union strength undermines the bargaining power on the workers side, which enable the development of low wage sector.

#### Minimum Wage and Labour Market Policies

Other legislations to protect labour in Hong Kong are also limited in scope. Prior to the implementation of minimum wage, there is basically no anchor to prevent wages from falling below subsistence level. Statutory minimum wage only came

into effect in 2011 in response to the rising public concern over the below-subsistence wage level at the bottom part of the distribution. Its initial effect on wage dispersion, however, cannot be fully reflected in the data presented in Section 3, which focuses on the period up to 2011. Nevertheless, contrasting to the neoclassical predictions, no significant change in unemployment rate has been observed from its implementation up to 2015<sup>10</sup>. The level of minimum wage in Hong Kong is also rather decent in terms of international standard. It has been able to maintained at 50% or above of the median hourly wage (Table 4.7) since its implementation.

**Table 4.7: Level of Minimum Wage in Hong Kong**

	<b>Hourly Minimum wage (in Hong Kong dollar)</b>	<b>Median Hourly Wage (50th percentile)</b>	<b>Minimum wage as a % of median hourly wage</b>
2011	28	52.4	53%
2012	28	54.8	51%
2013	30	57.5	52%
2014	30	60.0	50%
2015	32.5	62.9	52%

Sources: Census and Statistics Department, HKSAR (2016a), Labour Department, HKSAR (2015); author's calculation

Although the legislation appeared to be effective, its function as a wage anchor is expected to deteriorate gradually. Under the current framework, the level of minimum wage is reviewed biennially, which not only fails to reflect timely the macroeconomic changes in a volatile economic environment, but also makes reaching a consensus between workers and employers more difficulty than it would otherwise be if the review is conducted annually. Also, the minimum wage is proposed to the government by the Minimum Wage Committee after negotiation between the representatives of employers and workers. Workers, who are constantly at the weaker side of the negotiation table in Hong Kong, are expected to face an unfavourable outcome. Thus, it is unlikely that the decent level of minimum wage could be maintained for long as workers' bargaining power experienced a constant decline.

Remaining labour legislations in Hong Kong chiefly focuses on safety, employment standards and compensation for occupational injuries. Unlike other industrialized countries, protection against unfair dismissal in Hong Kong is limited, unemployment insurance is even absent. In general, protection for Hong Kong workers offered by legislation is rather inadequate.

Insufficient labour market policies resulted in the development of low and medium wage sector under prevailing market condition. Increasingly volatile business environment raise employers' demand for wage flexibility. Performance-

<sup>10</sup> However, the increased wage level at the lower end of the distribution did not necessarily imply an improvement in welfare for the low-wage workers. Although massive layoff did not appear, it is still possible for employers exploit workers through other means to offset the increased in wage cost.



related pay system coupled with low contractual wage is extensively used, which enables employers to adjust wage cost downward when business performance is unsatisfactory. Furthermore, absence of unemployment insurance forces workers to accept poor employment terms such as low wage and nonstandard employment condition including short-term contracts and seasonal positions.

The above discussion concerning collective bargaining and labour legislation shows that the labour market institutions in Hong Kong created a severe imbalance of power between workers and employers. Such imbalance is intensified by changing market conditions, which led to the emergence of employment and payment forms that further undermined workers' bargaining power. Macroeconomic conditions since the Asian Financial Crisis in 1997, including higher average unemployment rate and more volatile business cycles, put workers in an even weaker bargaining position under the existing institutional framework.

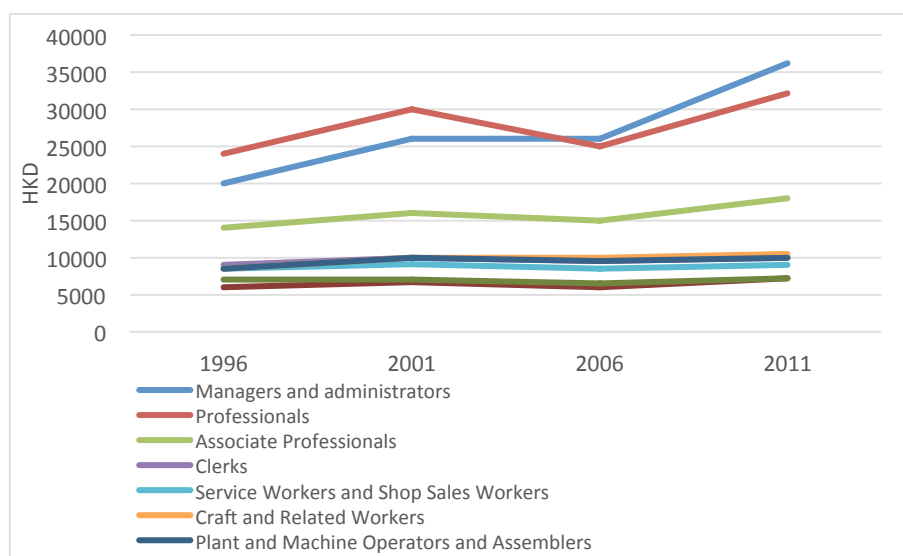
### **(ii) Shareholder-value Corporate Governance System**

The free-market ideology in Hong Kong created a business environment with fierce competition such that firms always seek to squeeze as much profit as possible. Shareholder-value corporate governance system, exacerbated by the finance-led economic growth strategy after economic restructuring, is widely adopted and businesses focuses primarily on maximizing owners' return. On one hand, businesses pursue wage flexibility and reduce wage cost as much as they can. On the other hand, incentives are created for senior management and executives to push up profits through offering attractive salary packages.

Businesses increases flexibility by offering nonstandard job and compress the wage of workers in the low and middle wage segments. Performance-related pay coupled with modest basic salaries also help businesses to offset risks. Outsourcing is also a common practice to save cost and enhance economic efficiency. In Hong Kong, subcontractor often compress wages to an extremely low level (especially before the implementation of minimum wage) so as to offer attractive prices to win the tender. In a labour market with insufficient institutional protection, these practices caused detrimental effects especially on the low and medium wage sectors.

Conversely, disproportionally high compensation for top management and professionals, especially in the finance, banking and real estate sector, were offer to retain talents and motivate executives. Divergence in earnings among various occupation in Hong Kong is reflected in Figure 4.8, which shows that the nominal wage of the high-wage occupations is rising relative to the low-wage occupations, resulting in a growing wage gap. Such development has likely contributed to the overall increase in wage dispersion in Hong Kong during the recent decades.

**Figure 4.8: Median Employment Income in Hong Kong, by Occupation, 1996-2011**



Source: Census and Statistics Department, HKSAR (2007a, 2012a); author's representation

### (iii) Government's Pursuit of Efficiency

Government is the largest employer in Hong Kong. The initiatives adopted by the government to enhance efficiency, began shortly before the handover in 1997, have tremendous direct and indirect impact on the labour market and contributed to the growing wage inequality. Since early 1990s, the colonial government has already implemented several reform proposals to improve the efficiency of the public sector (Cheung, 2006). These measures included privatization of public enterprises, promotion of customer-oriented and a management-for-results culture as well as outsourcing.

In the post-handover era, the government further launched the 'Enhanced Productivity Programme' in 1999 as a civil service reform to improve efficiency and reduce cost of the public sector in response to the political pressure to streamline the public sector after the Asian Financial Crisis. Several policies under the programme have direct influence on the workforce. First, non-civil service contract appointment and performance-related pay were introduced to replace some of the regular civil servant positions (Civil Service Bureau, HKSAR, 2012). Workers in the new positions received less benefits compare to their predecessors. Also, a bill was draft to revise downward the civil servant pay scale and was passed in 2002 despite strong opposition among civil servants (Cheung, 2006). Furthermore, extensive outsourcing was used as a mean to enhance efficiency. The government was often criticized for being not able to secure the protection of low wage workers for its outsourced work. Majority of the tenders were awarded to bidders offering the lowest price, which creates an incentive for the subcontractors to offer lower wage to their workers (Ngo, 2015).

As one of the largest employers in the market, the government acted as a precursor and provided the ground for private sector to pursue forms of employments that reduces worker's benefit. Its practice indirectly legitimized the widespread use of nonstandard and fixed-term contract employment as well as subcontracting in the private sector in the name of efficiency improvement.

#### **(iv) Pro-business Institutions**

Institutional framework in Hong Kong enable businesses to secure their privileged position which distorted the power relations between workers and employers. The government is frequently being accused of colluding with businesses and allow them to extract rent in the expense of general public's interest. Several institutional advantages enjoyed by businesses put them in a privileged position. First, the composition of the LegCo is highly favourable for rent-seeking<sup>11</sup>. The Functional Constituency, which was created after the reform of the LegCo in 1990s, consists of professional or special interest groups. Unlike Geographical Constituency which comprises of all voting-age individuals as electors, electoral base of many seats in the Functional Constituency merely consist of organizations and businesses instead of individuals. Legislators in these Functional Constituency are therefore only acting for the interest of organizations and corporations (employer side), without taking into account the interest of the workers in the corresponding industries.

Also, pro-democratic trade unions are often excluded in consultation and policy making. Official consultation groups in most cases only include labour representatives from the pro-establishment unions, which are usually less demanding and more willing to compromise with businesses. As such, the advisory boards on labour issues are often unable to manifest a balanced interest, if not entirely pro-business. Without taking into account the preference of the pro-democratic trade unions and the workers they represent, the severe imbalance of power between businesses and workers over labour issues persists.

Third, the government colludes with a few real estate giants to keep the Hong Kong property prices excessively high, leading to a distortion in price structure and causing undesirable impact on the labour market. With a simple tax system of low tax rate, proceeds of land sales become one of the major sources of government's revenue. By restricting the supply of land deliberately, the government is able to generate more income from land sales. The practice is welcomed by real estate giants as the high land price helps to keep new entrants out and secure their market power. The resulting high property price, also fueled by lenient regulations on speculative activities, distort the price structure and adversely affected certain segments of the labour market. It increases rental price of shops and offices, which creates cost pressure for SMEs to pursue wage flexibility. In some industries, unaffordable rent drove small firms out of market.

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<sup>11</sup> The Legislative Council in Hong Kong currently consists of two constituencies, functional and geographical. Majority votes in both constituencies is required to pass a bill proposed by the legislators. See the LegCo website ([http://www.legco.gov.hk/english/education/teach\\_sheets.html](http://www.legco.gov.hk/english/education/teach_sheets.html)) for further information on the composition of the council and how it works.

Large corporations can then exercise certain degree of market power over wage setting and undermines the bargaining power of workers.

Lastly, there are limited policies to restrict the market power of large corporations. Under the free market principle, legislation to avoid the abuse of market power is largely absent before the Competition Law was enforced in 2015. Unfortunately, the delayed action may not be able to change the overall situation in Hong Kong, in which many industries are already dominated by well-established large corporations. Their leading position inevitably lend them greater power over wage bargaining.

Without sufficient labour market institutions to protect workers, the above institutional features enables employers exercise greater power over wage setting relative to its employees. These institutions not only contributed to a more uneven earning distributions through creating imbalanced bargaining positions, but also by limiting the channels through which better labour protection can be institutionalized.

To sum up Section 4, increasing wage dispersion in Hong Kong is primarily a result of changing supply-demand conditions in the labour market and the pursuit of greater wage flexibility of businesses to absorb economic shocks. Rise of performance-related payment system and nonstandard employment, mostly in the form of temporary employment and fixed term contract, is observed in Hong Kong since 1990s. Even though official statistics is unavailable, Chan and Tai (2013) estimated that around 40% to 60% of the position in the private sector were contract-based in early 2010s. Meanwhile, a considerable growth in part-time employment since 1990s has possibly contributed to the rising wage dispersion as well. The sharp rise in part-time employment since 1997 (Table 4.8) is likely a result of stagnated growth after the Asian Financial Crisis, such that part-time position was used as a strategy to increase wage flexibility<sup>12</sup>. Against such change in employment trend, the neoliberal labour market institutions failed to safeguard workers' interest and allowed wage inequality to grow. The situation is worsened by a pro-business institutional setting, which posts great obstacles for reform in labour market institutions. However, the underlying problem is essentially the deep-rooted belief of free market capitalism, shared by society, businesses and government alike, which considers labour protection as market rigidities that should be minimized.

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<sup>12</sup> However, other reasons may have contributed to the increase in part-time employment as well. With limited availability of statistics, it is impossible to determine the major reason behind this change.

**Table 4.8: Part-time Employees as a Percentage of Working Population in Hong Kong, 1994-2009**

Period	Part-time Employees as a Percentage of All Employees
November 1994 to March 1995	2.7
October to December 1997	2.8
January to February 1999	4.1
July to September 2000	4.3
April to June 2002	4.7
July to September 2003	5.2
April to June 2005	5.2
April to June 2009	5.1

Note: The survey only consider main employment of employees. No regular survey on part-time employment is conducted in Hong Kong and the above data is compile from various general household surveys with part-time employment statistics.

Source: Census and Statistics Department, HKSAR (2010)

## 5. POLICY IMPLICATION AND RECOMMENDATION

### 5.1 Key Policies to Reduce Wage Dispersion

The strong belief in free market within the unique economic model of Hong Kong leaves low political feasibility for large-scale reform on labour market institutions. Rather, less ambitious measures should be consider to strengthen protection under the current institutional framework, as well as to reduce the imbalance of power between employers and workers. Recommendations with respect to the factors discussed in the Section 4 can be broadly summarized into two approaches: (i) fine-tuning labour market institutions and policies, and (ii) reforming pro-business institutions.

#### 5.1.1 Fine-tuning Labour Market Institutions and Policies

In light of the current labour market institutions in Hong Kong, firm-level collective bargaining should be promoted gradually to pave way for a more extensive wage bargaining system in the long run. Critical steps to achieve this objective include recognizing and protecting collective bargaining rights through legislation. The new legislation should require firms exceeding a certain size to recognize collective bargaining rights, which help to promote coordination within firm and strengthen firm-level bargaining.

On the other hand, stronger protection against unfair dismissal is also essential to promote firm-level bargaining. Higher statutory requirements in filing a dismissal should be imposed under the employment law to avoid spontaneous termination

of contract in the names of misconduct and incapability. Also, compensation for workers being laid off should be raised to deter unreasonable dismissal as a mean of retaliation. Proper protection allows workers to express themselves with fewer concerns and encourage their participation in firm-level bargaining.

Apart from empowering workers to take part in union activities, greater employment protection is also necessary to combat nonstandard employment. Legislation should be set up to raise the standard of precarious work contracts to reduce its discrepancies with corresponding regular positions in terms of pay, benefits and rights. Beside, requirement to keep short-term employment below a particular percentage of total workforce should be applied to firms exceeding a certain size. These measures could improve the pay and bargaining position of nonstandard employees who are mostly low and middle wage earners.

In addition, offering unemployment insurance serves as a safety net that empowers low wage workers to demand for better wages. It enables them to look for a job with more decent wages rather than accepting the soonest offers available. Financially feasibility of an unemployment insurance in Hong Kong is high, though further effort has to be made to change the attitude of a society giving low priority to issues of social justice in order to enhance political feasibility of the proposal.

Amendments on the minimum wage level review mechanism should also be made to reduce its functional deficiencies. For instance, frequency of revision should increase from biennial to annual in order to enable an increment level that can better reflect the change in macroeconomic conditions. In addition, the tripartite social dialogue among workers, employers and the Minimum Wage Committee should be strengthened such that the effect of power imbalance during negotiation of minimum wage revision the can be reduced. Yet, the condition of equality during the negotiation process may require the support of corresponding adjustment in legal and institutional framework.

### **5.1.2 Reforming Pro-business Institutions**

To ensure balanced interests over labour issues, representatives from broader political ideology should be included in consultation and policy making. In particular, as the second largest labour union federation in the territory, the Hong Kong Confederation of Trade Unions, should be invited for official participation regarding labour issues. Delegates with a more representative composition enable an improved balance of interest over policy setting.

Besides, a higher level institutional reform should be performed to prevent the overriding influence of the business sector. In LegCo, broader electoral based should be incorporated through either reducing or eliminating organization or company votes, or the Functional Constituency should be abolished as whole. Only with more democratically elected legislators can the voice of workers be better reflected in the law-making process.

Government policies on the real estate sector is also critical in reducing nonstandard employment. High property price that distorts price structure increases the pressure for the private sector to adopt more flexible means of wage payment. Actions should be taken by the government to correct failure in the property market and restore a healthy business environment for firms. For example, penalties or tax should be imposed to avoid artificially high price created by hoarding land or delayed development and sales of properties. Direct intervention, such as raising transaction tax and capital gains tax on resale of properties, could be considered to combat speculation activities. Alternatively, rent control could be consider to avoid escalating shop rent which hurts SMEs and weakens competition, when necessary.

Most importantly, the government should terminate its mutual relationship with the major real estate developer by opening up new sources of government revenue, including a reform on the taxation system. Reducing the reliance on real estate giants allow government to pursue policies to cool down the property market without jeopardizing its fiscal position.

## **5.2 Other Policy Considerations**

Remodeling institutions and policies with the combined efforts of government and trade unions is necessary but far from sufficient. Expecting great improvements in earning distribution subsequent to fine-tuning of current policy architecture is definitely over-optimistic. With persistent imbalance of power between workers and employers, Hong Kong should also seek greater remedies to mitigate the impact of wage dispersion on economic development. The major ex-post policy direction, indisputably, is to re-engineer the taxation and social welfare system such that it enables a more favorable redistribution of earnings and reduces the impact of wage dispersion on consumption demand. Feasible proposals include increasing progressivity of income taxes, widening tax base by levying general sales tax, offering universal protection on health and retirement. Even though increasing reliance on redistribution and social protection may experience political opposition and create greater social tension, it is undeniably a compromise for maintaining a relatively flexible labour market.

## 6. CONCLUSION

This paper attempts to study the development of wage dispersion in Hong Kong since 1980s and the factors behind these changes. It begins with a literature review on the theoretical explanation of wage dispersion, which shows that different factors might have contributed to the development of wage dispersion in recent decades. Changes in wage structure under prevailing market forces are determined by labour market institutions, power relations and government policies in an economy.

Examination on earning statistics reveals that wage dispersion has been growing between 1981 and 2011 in Hong Kong. Share of employment income has been increasing in the upper part of the distribution, with a small tendency of “fanning-out” in the top decile, while that of the middle and bottom deciles have declined. Such development is mostly a result of changing supply-demand conditions in the labour market and the pursuit of greater wage flexibility of businesses to absorb economic shocks. With a neoliberal labour market and pro-business institutions, limited protection is offered to workers which allowed wage inequality to grow.

Policies to reduce wage dispersion in Hong Kong are then recommended in the paper. Even though it is hard to uproot the firm belief of free market capitalism and conduct large-scale reform on labour market institution, less ambitious measures are suggested to combat wage inequality. Actions to fine-tune labour market institutions and policies, including legislation to protect collective bargaining rights, adjusting minimum wage review mechanism as well as strengthening employment and unemployment protection is necessary in the short to medium run to bolster workers’ bargaining position. Meanwhile, pro-business institutions should be rebalanced through reforming the LegCo, widening the labour representative base in consultation groups and heavier regulation in the real estate market. Apart from the suggested initiatives and division of work, ex-post policies, including reform on taxation and social security systems are also possible and necessary ways to mitigate the impact of growing wage dispersion on growth and employment.



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