FALL 2019 NEWSLETTER

HONG KONG AND THE GREATER BAY AREA

Also in this issue:

• A Resurgent East Asia
• Belt and Road Country Case Studies
• Hyperloop’s Economic Effects
• Big Brother and Big Data in India
• Improving Jobs Outcomes in Developing Countries
DIRECTOR’S MESSAGE

During the first half of 2019, HKUST IEMS organized a full slate of events covering a range of topics relevant to businesses and policy makers in emerging markets. Highlights include hosting a launch event for a new World Bank report on policies to sustain growth in East Asia and make it more inclusive, a workshop featuring case studies on the implementation of China’s Belt and Road Initiative in countries in different regions of the world, an Emerging Market Insights series talk on promoting innovation in the Greater Bay Area and Hong Kong’s role, and co-organizing the third Jobs and Development Conference held at the World Bank in Washington D.C. The role of innovation and technological change featured prominently in the presentations and discussions in all of these events. Several of our academic seminars also examined the benefits and pitfalls of activities that take advantage of new technologies (P2P lending in Indonesia, biometric ID cards in India, providing an online forum for market actors to discuss socially appropriate behavior market behavior in China and Switzerland). Another assessed how technology and globalization explain differences in the nature of work across countries. Others addressed longstanding questions in development, including poverty traps, gender gaps in education, and African economic development. I hope you will enjoy reading about some of the key insights arising from these events.

A RESURGENT EAST ASIA

World Bank Report Launch

The success of the East Asian development model featuring outward-oriented, labour-intensive growth has been described as the ‘East Asian Miracle’. However, a new World Bank report titled ‘A Resurgent East Asia, Navigating a Changing World’ argues that East Asia’s resurgence is far from complete as income, productivity and human capital levels in many countries in the region are still far lower than in high-income countries. Countries in the region will need to adjust their development model to adapt to changing technologies, slowing trade growth, and changing country circumstances if progress is to be sustained.

Coauthors of the report, Sudhir Shetty, Chief Economist of the East Asia and Pacific Region of the World Bank and Andrew Mason, Lead Economist in the Office of the Chief Economist of the World Bank presented key findings from the report and discussed how policymakers in East Asia will need to adjust their traditional development model to one that is able to effectively address these challenges.

They identified Policy priorities in five key areas. To boost economic competitiveness, in addition to continuing to strengthen the business climate and regulatory environments, emerging priorities include: reforming the service sector, deepening trade agreements, broadening innovation policies, and improving access to finance for small and medium enterprises. The second policy priority is to build people’s skills with emphasis on higher-order cognitive, and socio-emotional skills, develop continuous skills development systems and enhance people’s digital and technical capabilities in the face of the changing nature of jobs. Thirdly, to foster inclusion, policymakers need to strengthen employment support services, broaden unemployment benefit schemes and make digital technologies widely accessible and affordable. Fourth strengthening state institutions and bureaucratic quality will require expanding mechanisms to promote citizens’ voice and participation, increasing government transparency and accountability and strengthening the systems of checks and balances. Finally, financing the transition to high-income status will require measures to increase domestic revenue mobilization, including expanding the tax base and limiting tax competition.

In discussing the report, Danyang Xie, Professor of Economics at HKUST, reflected upon China’s 40 years of opening up and reform to argue that the measures used to advance its production possibility frontier were consistent with the “Growth with Equity” development model proposed in the report. He suggested that China’s new development strategy should continue with inclusive growth and technological innovation, and should shift emphasis from the export of manufacturing goods based on “cheap labor” to the export of professional services and R&D based on “cheap human capital”. Albert Park, Director of HKUST IEMS, echoed Xie’s recommendation for the need to develop human capital, specifically to adapt to technological advances, globalization and structural change in to prepare workers for the changing nature of work. He also called for more critical discussion of the role of industrial policy, criticizing the uneven benefits of China’s industrial policies that favor some firms over others. Park concluded with comments on the relevance of the report’s findings for Hong Kong, arguing for significant expansion of higher education and increased economic integration with mainland China.
China’s Belt and Road Initiative intends to increase connectivity between China and over 60 countries along the old Silk Road’s land and maritime routes, and will be the main platform for China’s global integration efforts in the foreseeable future. In February, the HKUST IEMS organized a Belt and Road case studies workshop inviting discussion on the implementation of the Belt and Road Initiative in 5 countries in different regions of the world.

Barry Sautman (HKUST) describe the implementation of the BRI in Ethiopia as a “case that negates the negation”. He and Yan Hairong Hong Kong Polytechnic University dispelled the US-led anti-BRI theory that China is vying for world domination by addicting developing countries to debt and infringing upon their sovereignty. Instead, they characterize the BRI as a mobilization that mainly focuses on infrastructure building and investment. Sautman and Hairong argued that China comports with host country demands and, in the case of Ethiopia, the BRI fits into its manufacturing centered development strategy.

Naubahar Sharif (HKUST) and Athar Mansoor (HKUST) trace the China-Pakistan collaboration on the BRI back to a long history of diplomatic and trade relations. The China Pakistan Economic Corridor (CPEC), featuring large investments in ports, transportation, and energy, is the largest bilateral arrangement under the BRI. It has been disparately characterized as both a “game changer” and “imperial colonialism”. In reality, quantitative and qualitative field research conducted in Pakistan over two years shows that CPEC has huge potential to positively contribute to the country’s economic development. The scale of investment from one country is unprecedented in Pakistan’s history and is expected to bring foreign direct investment from countries other than China. However, CPEC also creates significant challenges, including concerns about the government’s ability to effectively manage so many large projects and the risk that Pakistan may not be able to repay the loans from China. They called for a need to create more awareness and transparency about CPEC, including the long term benefits and methods of debt repayment.

Angela Tritto (HKUST) looked closely at how the Chinese government has approached investments and infrastructure in Indonesia. She described Indonesia as central to the BRI’s success in Southeast Asia and found that recent improving foreign relations have paved the way for investments such as the construction of the Jakarta-Bandung High-Speed Rail, the Morowali Industrial Park, and investments in regions targeted for Chinese BRI investments. While a surge in Chinese investment will undoubtedly bring about opportunities and potential for growth in the country consistent with the government’s development planning, there is increasing evidence that inadequate attention is being paid to the environmental and social costs of BRI projects.

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Anastasia Lazariva (SKOLKOVO IEMS) showed that improving Sino-Russian relations has led Russia to become the main destination of Chinese FDI in Eurasia, mostly in the mineral resources and energy sectors that are of strategic importance to both countries. However, these closer political ties have contrasting significance for the two states. Lazariva argued that Russia’s “Pivot to the East” is one of very few economic and political opportunities for the country. For China, the US continues to be the largest trade partner.

Belt and Road Country Case Studies

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Belt and Road Case Studies Workshop
2019.02.18
Find out more about the workshop at https://iems.ust.hk/events/conference/2019/belt-and-road-case-studies-workshop
The Greater Bay Area (GBA) Development Plan provides unprecedented opportunities for Hong Kong, especially in the areas of innovation and technology (I&T) which in turn have the potential to become key drivers of further economic growth in the region. In an IEMS & IPP – EY Emerging Market Insights panel discussion, leading experts from the academic and business sectors came together to discuss the role Hong Kong plays in the development of the GBA and the opportunities that lie ahead.

Prof Joseph Lee (HKUST) presented key findings from the first cross border independent policy study on the integrative development of innovation and technology in the Guangdong - Hong Kong - Macao GBA, which was prompted by the belief that Hong Kong would need to transform itself through I&T and closer integration with the Mainland in order to maintain the competitiveness of its industries and overall economy. The HKUST study, conducted in collaboration with the Hong Kong Academy of Engineering Sciences (HKAES) and the Chinese Academy of Engineering (CAE), found that Hong Kong’s out of date and inadequate I&T policy has left the region in desperate need of reinvention to sustain its competitive edge and economic growth. Hong Kong must prioritise upgrading the traditional industries of today to create high valued-added industries of tomorrow. Lee suggested that Hong Kong leverage the research strengths of Hong Kong universities to enable synergistic development of I&T in collaboration with Mainland partners.

Lee argued that I&T transformation and development sat largely with government leadership and decision making at the highest level. He called on the Hong Kong government for policy support, investment and funding in industry research and development and local technology innovation, and noted promising recent government initiatives. Policies to attract and retain Hong Kong trained talents in I&T are needed as well as strategic collaboration between Hong Kong and the GBA, and integrative collaboration between Hong Kong and Mainland.

Prof Xun Wu (HKUST) echoed Prof Lee’s comments on the instrumental role of Hong Kong universities in the creation of a global technology and innovation hub. Drawing on findings from his ongoing project on “Accelerating the Development of a Global Innovation and Technology Hub in the Guangdong-Hong Kong-Macao Bay Area: The Roles of Public Research Universities in Hong Kong,” Wu lamented Hong Kong’s inability to place in the “World’s Most Innovative Universities” rankings. He cited factors such as patent volume, patent success and global patents as indicators used the ranking methodology and called for a closer look at the contribution Hong Kong universities are making towards I&T. He argued that universities can serve as an open innovation platform and supported university-industry collaboration both inside and outside the GBA to further strengthen the region’s global competitiveness.

Jasmine Lee, a key member of the Greater Bay Area Task Force of EY Hong Kong, presented Hong Kong and Shenzhen as the main focus for the GBA to develop financial services in order to enable innovation and transformation. She emphasised free movement in investment, technology, talent and resources as goals for the region to showcase China’s openness and competitiveness. Prospects and opportunities in the region include recent FinTech success that has seen China dominate the industry and develop into a digital financial market. Chinese FinTech companies will play an important role in global cooperation and in driving technological innovation. She also argued for the importance of a treasury and financial center to drive growth in the GBA and called for Hong Kong to leverage its experience and expertise in the financial services to help achieve this. Another area of opportunity for the GBA is the promotion of green financing.

“Innovation and Collaboration – Role and opportunities for Hong Kong in the Greater Bay Area”
Organized by HKUST IEMS with support from IPP and EY
2019.05.16
GOVERNING CHINESE-BACKED ONLINE LENDING IN INDONESIA

Online peer-to-peer (P2P) lending has the potential to provide credit to the underbanked population in emerging markets. Driven by the enforcement of tighter regulations in China, Chinese capital entered the Indonesian P2P lending market. Out of 50 P2P platforms registered with the Financial Services Authority (OJK), at least 34% received Chinese investment, making China the largest foreign country investor in such platforms. In her academic seminar, Yujia He, HKUST IEMS Postdoctoral Fellow, examined the influx of Chinese capital into the online P2P lending sector in Indonesia and the resultant policy response.

Using a mix of primary data from expert interviews, literature reviews and firm-level investment and product data, Dr. He and coauthors found that Chinese investment dominates foreign investment not only in legal P2P providers but also in illegal ones. The Legal Aid Institute of Jakarta and the OJK have reported over 5500 cases of illegal and unethical practices by P2P providers, including the exploitation of users’ lack of digital literacy, cases of data privacy abuse and harassment issues. In response, the OJK created a “regulatory sandbox” allowing startups the freedom to innovate within a controlled environment to learn how to meet regulatory standards before approval of their business licenses. Illegal practices also prompted the establishment of a self-regulating institution for market conduct oversight as well as inter-agency government efforts to block illegal FinTech applications. Illegal practices also promoted the establishment of a self-regulating institution for market conduct oversight as well as inter-agency government efforts to block illegal FinTech applications. She argued that emerging market governments follow a reactive approach in governing fintech to ensure financial and social stability without stifling innovation’s potential to facilitate growth by effectively utilizing foreign capital. Dr. He called for a proactive approach towards regulating the FinTech sector by establishing broader regulatory frameworks that encompass relevant and emerging risks and working with industry and civil society groups to improve market conduct and consumer protection. Policymakers should be more aware of global FinTech trends and seek international cooperation. She suggested that future policy could include greater cooperation with other countries in law enforcement and knowledge exchange, and regional cooperation through entities such as the ASEAN Financial Innovation Network.

HYPERLOOP’S ECONOMIC EFFECTS

In late 2017 the Government of Maharashtra embarked on plans to build a Hyperloop network to connect the city of Mumbai with the city of Pune. Hyperloop is a new high-speed transport technology featuring specially designed pods in a vacuum tube that would reduce commute time from more than 3 hours by car, to under 30 minutes. Indradeep Ghosh (MDAE) and Senior Consultant at FTI Consulting gave an academic seminar on the potential economic effects of the Hyperloop in India.

Ghosh argued that the dramatic reduction in travel time raises new challenges for conventional models of urban economics. They proposed the concept of “cost-of-distance” arbitrage to understand the impact of a Hyperloop line. The network may connect a central hub in Mumbai, such as Dadar or the Bandra-Kurla Complex, to a central hub in Pune offering access to an airport in either city. The creation of a mega-airport will bring about more jobs and other economic benefits to both locations. Similarly, a completely different route may connect Pune to the critical Jawaharlal Nehru Port indirectly offering access to central Mumbai. Whatever the exact layout of the network, Ghosh and Kanade imagine that it will create a Mumbai-Pune megalopolis of 23 million citizens.

Because of these multiple possibilities, Ghosh argued that “cost-of-distance” arbitrage will be the primary economic force at work to eliminate existing differences between the two cities. Large swaths of the distance separating the two cities will come under development, particularly in Pune. Pune will therefore grow faster and laterally via in-migration of individuals, families and businesses. We may also see the trend of co-working spaces relocate from Mumbai to Pune. In order to derive the maximum economic benefits from the Hyperloop, Kanade suggested that policymakers elaborate on four key policy levers including line capacity, multi-modal connectivity, and fare structure.

The Economic Effects of a Hyperloop Line Connecting 2 of India’s Largest Cities
HKUST IEMS Academic Seminar 2019.04.11
Watch event video at http://iems.ust.hk/hyperloop

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Aadhaar, India’s unique biometric identity card system, was introduced in 2009 with the stated purpose of creating a more inclusive and efficient welfare system. Hundreds of millions of Indians were enrolled into the biometric database, with successive governments making enrolment compulsory to receive social benefits. In her academic seminar, Reetika Khera (IIM, Ahmedabad) argued that contrary to government claims Aadhaar was never really about inclusion or welfare. Instead, it hinders democracy, creates opportunities for government surveillance and commercial data-mining, and creates dangers associated with the use of biometric data.

Is there a trade-off between the right to life and right to privacy? In Khera’s view, Aadhaar not only violates Indians’ fundamental right to privacy, it also violates their right to live. The use of one centralized database that contains the biometric and demographic data of hundreds of millions of people creates multiple opportunities for error. In the business of welfare administration, these errors can be deadly. Khera casts doubt on the government’s use of the inclusion narrative and explained that multiple knowledge and administrative hurdles at the enrolment, registration and finishing stages of Aadhaar have led to the exclusion of vulnerable populations from accessing welfare. She described the Aadhaar system as a “remedy-worse-than-the-disease” that increases transaction costs without substantially reducing fraud, and has led to death and hunger due to high rates of exclusion.

Khera argues that the implementation of Aadhaar was primarily for commercial mining of personal data and therefore impinges on the fundamental right to privacy. The use of one unique number seeded with every possible public and private database in the country serves as a dangerous bridge between previously isolated data silos. Profiling has been made possible by Aadhaar. It allows people to pull information from different databases using a single identifier leading to self-censorship, choking free thought and expression.

Gender gaps in health and educational outcomes are ubiquitous, and are larger in developing countries compared to developed due to supply and demand side factors. Asian countries such as China and Korea have been commonly associated with strong son preference, manifested in sex-selective foeticide/infanticide. In rural Maharashtra (India), a society with deep-rooted son preference, girls born when parents hoped for a boy are called “nakusha”, which means “unwanted”.

Ashwini Deshpande (Ashoka University) examined whether gender gaps in the quantity and quality of education can be explained by outcomes in families that have “unwanted” girls. Deshpande and coauthors used pooled data between 1986-87 and 2014 from three nationally representative special education rounds of the National Sample Survey (NSS) of India, to investigate the role of son preference in explaining children’s education outcomes. They found that over the last two decades, the quantity of education has increased for all children as seen by greater enrolment and higher years of education. This increase is seen among girls and boys and across all family types, including families with unwanted girls. She suggested that successive national and state governments pushing for universal enrolment have provided a conducive environment for this change to take place.

However, there is evidence of persistent and worsening discrimination against girls in terms of the quality of education (based on school type), especially in families with unwanted girls. She argued that patrilocal cultural norms sustain the notion that girls are “paraya dhan” or “another’s property” and families will therefore not benefit from investment in their daughters’ education. The normal channel of women being valued for their economic contribution to the family is not raising the status of women due to their low and even declining labour force participation rate. Deshpande called for an urgent need for mainstreaming gender concerns in educational and labour market policies, as well as highlighting the multitude of positive contributions by Indian women in multiple fields to dispel the notion that investment in the quality of daughters’ education is a waste of resources.

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DIVISION OF LABOR AND PRODUCTIVITY ADVANTAGE OF CITIES: THEORY AND EVIDENCE FROM BRAZIL

Why are firms more productive in larger cities? Lin Tian (INSEAD) examined whether division of labor within firms plays an important part in driving productivity advantage in larger cities. Using data from the Brazilian Annual Social Information Report 2010, which contains linked employer-employee records covering all registered firms in Brazil, she presented two stylized facts related to firms’ division of labor. First, division of labor defined as the number of occupations within firms is significantly and positively correlated with city size. Second, within cities there is greater division of labor within firms producing in more complex sectors.

To quantify the importance of division of labor in explaining productivity advantages of cities, Tian develops a quantitative model that embeds firms’ endogenous decisions on optimal division of labor in a spatial equilibrium framework. Using this model, she shows that firms producing more complex products benefit more from greater division of labor and that the costs of division of labor are lower in larger cities. In equilibrium, within a sector, firms’ division of labor, profit, revenue, and productivity all increase with city size. Firms in larger cities exhibit a greater division of labor for two reasons: larger cities make it less costly for all firms to increase the level of worker specialization; and larger cities also attract more complex firms that choose to have a deeper division of labor.

Using the gradual roll-out of broadband internet infrastructure in Brazil as a natural experiment to study how new technology affects the division of labor, Tian finds that the firms’ division of labor increased (the number of occupations increased by 1.3%) in treated areas, a figure that increases significantly for firms in larger cities and for firms producing more complex products. Through a counterfactual analysis, Tian concludes that division of labor contributes to 15% of the productivity advantages of larger cities in Brazil, half of which is due to firm sorting and the other half to the treatment effect of being a larger city.

IMPROVING JOBS OUTCOMES IN DEVELOPING COUNTRIES

The third Jobs and Development Conference was held at the World Bank in Washington DC, co-organized by the World Bank, IZA (Institute of Labor Economics) and the Network on Jobs and Development (including HKUST IEMS). Almost 100 researchers and policymakers from around the world presented and discussed ideas on improving public policies to create better jobs.

The conference kicked off with a policymakers’ panel where Prakash Loungani (International Monetary Fund), Steven Ayres (DFID), Kunal Sen (UNU-WIDER, University of Manchester) and Indhira Santos (World Bank) discussed ways to improve labor market institutions to provide greater social protection to workers while preserving economic efficiency and growth, gender issues in access to jobs, and ways to transform agriculture for better jobs in Sub-Saharan Africa.

In his keynote speech, Daron Acemoglu (MIT) pointed out that although we have seen automation and robotics replace workers in a widening range of tasks and industrial processes, the acceleration of new technologies is missing productivity growth. In the US, growth in labor demand has been anemic. Acemoglu argued that the technologies that are more likely to reduce the demand for labor are not those that are highly productive, but are “so-so” technologies which are “just productive enough to be adopted but not much more productive than the processes they are replacing.” To remedy this, Acemoglu called for technologies that increase productivity, and for preparing the workforce with skills relevant for the 21st century.

Ricardo Hausmann (Harvard Kennedy School) delivered a keynote speech on “Growth Diagnostics vs Jobs Diagnostics”. He highlighted the fact that production requires a complex combination of many inputs, which are complements rather than substitutes. Thus, the inputs which are in shortest relative supply become the binding constraints on growth. With regard to employment, Hausmann pointed out that there is enormous heterogeneity across countries in the number, diversity and tolerance of migrants. But being closed off to migration, especially of skilled labor, comes at a tremendous developmental cost.

In a session on “Automation and the Future of Work”, Piotr Lewandowski [Institute for Structural Research (IBS) and IZA] presented research conducted with Albert Park [HKUST] and other coauthors on cross-country differences in the nature of work. Using task measurements from surveys in 42 countries at varying stages of development, they found that the routine intensity of tasks is higher in less developed countries, both overall and within specific occupations. Lewandowski highlighted that greater routine intensity of tasks in poorer countries compared to richer countries is explained by four key factors: technological progress, which explains the largest amount of the gap; globalization, which explains a large share of the gap for workers in low-skilled occupations and offshorable occupations; structural change, and the supply of skills.

Albert Park (HKUST) delivered a presentation on “Uneven Enforcement of Social Insurance Regulations in China”. Using 2016 survey data on manufacturing firms in China, Park and coauthors find that the average social insurance contribution rate as a share of wages is 16.5% compared to nationally mandated rates of more than 40%, reducing concern that the burden of such payments is undermining competitiveness. He explained that enforcement was highly unequal across both cities and firms, creating a highly uneven regulatory playing field for enterprises.

Jin Wang (HKUST) presented a paper that examines the incidence and effectiveness of a prominent place-based policy in China: Special Economic Zones. Establishing zones has a positive effect on capital investment, employment, output, productivity and wages as well as the number of firms. Operating in a zone is significantly more beneficial for capital-intensive firms. The special zone program’s net benefits over three years are estimated at around US$15.42 billion.
Also in Fall 2019

Shlomo Weber (New Economics School, Moscow) gave an academic seminar examining the impact of the Cold War on African economic and political development. He used a game-theoretical approach and historical evidence to develop an interpretation of this important event by constructing a pattern of alignment among states that impacted their economic development.

“Cold War Alliances in Africa and Its Impact on Economic Development” Hosted by HKUST IEMS 2019.03.25

Maitreesh Ghatak (LSE) delivered an academic seminar exploring two explanations as to why people stay poor. The first view, the poverty traps view emphasizes that access to opportunities depend on initial wealth and hence people stay poor because they are born poor. The second view, the equal opportunity view emphasizes that differences in outcomes must be due to individual traits.

“Why do people stay poor?” Co-organized with the Division of Social Science and the Department of Economics, HKUST. 2019.04.11

Björn Bartling (U of Zurich) examined the impact of public discourse on socially responsible market behaviour. He found that such public discourse substantively increases market social responsibility in two distinct samples, from Switzerland and China.

“Public Disclosure and Pro-Social Market behaviour” Co-organized with the Division of Social Science, HKUST 2019.04.24

Piotr Lewandowski (IBS, Warsaw) and Albert Park (HKUST) use survey data to explain international differences in routine and nonroutine work. They found substantial cross-country differences in the content of work of occupations. Differences in technology endowments and in the supply of skills explain most of the cross-country differences in the task content of jobs.

“Technology, Skills, and Globalization: Explaining International Differences in Routine and Nonroutine Work Using Survey Data” 2019.04.25
Watch event video at https://iems.ust.hk/events/academic-seminar/2019/piotr-technology-skills-and-globalization

Thought Leadership Briefs

The Institute published Thought Leadership Briefs to disseminate research results effectively to business leaders, policymakers, the media and the public. Latest additions include the following which can be read in full at http://iems.ust/tlb

<table>
<thead>
<tr>
<th>Issue #</th>
<th>Topic</th>
<th>Author(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>25</td>
<td>Understanding Emerging Market Consumers Through the Lens of Social Mobility</td>
<td>Wei-Fen Chen (IEMS), Xue Wang (Chinese University of Hong Kong), Ying-yi Hong (Chinese University of Hong Kong)</td>
</tr>
<tr>
<td>26</td>
<td>Connecting the Emerging Markets: China’s Growing Role in Global Digital Infrastructure</td>
<td>Yujia He (IEMS)</td>
</tr>
<tr>
<td>27</td>
<td>Financial Fraud and Investor Awareness</td>
<td>Yangguang Huang (ECON)</td>
</tr>
</tbody>
</table>

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