

HKUST IEMS and LAPP – EY HONG KONG EMERGING MAR



Angelina Yee (HKUST LAPP), Albert Park (HKUST), Christopher Pissarides, Tony Chan (HKUST), Agnes Chan (EY Hong Kong)

## THE GREEK CRISIS AND THE FUTURE OF THE EUROZONE

HKUST IEMS and LAPP – EY Hong Kong Emerging Market Insights Series (2015.09.22)

**Sir Christopher Pissarides**, Nobel Laureate, Professor of Economics at the London School of Economics, Professor-at-Large at the HKUST Institute for Advanced Studies, and HKUST IEMS Faculty Associate, presented his views on Greece's recent economic crisis, explaining in detail the causes of the crisis and explaining the country's strained geopolitical history. The talk was supported by the HKUST Leadership and Public Policy Program (LAPP) and EY Hong Kong.

Sir Christopher stated that one must go back over 50 years to understand the recent Greek economic conundrum. The 1940s were the most destructive period, immediately after German occupation and during the Greek civil war. Once communism was defeated and their supporters exiled, Cyprus was given to Turkey. Western European politicians had little interest in Greece except to see that it became a democracy. Consequently, as a purely political move without regard to Greece's precarious economic situation at the time, Greece was added to the European Union.

By the time the Euro came along, high inflation and debt made it impossible for Greece to join the Eurozone. Only through the falsification of its debt obligations was Greece able to join,

as high inflation and its untenable fiscal situation made such a prospect otherwise impossible. Greece then had access to capital at Germany's low interest rates and was tempted to borrow increasingly more. Little of this lending went toward the development of local industry or infrastructure, which would have boosted the country's long-term economic prospects. Instead, most of the added liquidity poured into Greece's heavily monopolized domestic economy such as its expansive shipping industry.

In 2010, when doubts about Greece's fiscal strength caught the public's attention, the country received temporary relief from the European Union, and in 2012 some of its debts were forgiven provided Greece undertake austerity measures.

Although both Greek politicians and international lenders made mistakes, Sir Christopher felt strongly that only solidarity between Greece and the Eurozone can lead to recovery. Unfortunately, the current narrative paints a picture of a Greece whose interests are in direct conflict with the rest of the Eurozone. Proposed austerity measures, such as further cuts to the country's domestic labor costs, are unlikely to benefit the Greek economy in the long-run.

Sir Christopher was unequivocal that Greece's best and perhaps only option was to remain in the Eurozone. If Greece were to leave the Eurozone and readopt the Drachma, its original currency, it would have no choice but to default on its Euro-denominated debts, and consequently fail to revitalize its flagging economy.

Video recording available at <http://iems.ust.hk/greek>

## DIRECTOR'S MESSAGE

Albert Park



In the second half of 2015, HKUST IEMS continued its active agenda of events to engage key issues facing emerging markets. We were honored to co-sponsor lectures by three eminent economists: Nobel Laureate and HKUST IEMS Faculty Associate Chris Pissarides talked about the Greek crisis, Nobel Laureate James Heckman (University of Chicago) discussed how best to develop skills that will promote opportunity and reduce poverty, and Partha Dasgupta (University of Cambridge) explained

how nations can better measure national wealth to more accurately reflect the well-being of their citizens. IEMS also hosted

three highly successful academic conferences that each created new synergies by bringing together different groups of scholars for the first time. The Conference on Comparative Studies of Regional Governance in China and Russia brought together leading experts on Russia and China studying the role of local government leaders. The Conference on Urbanization, Structural Change, and Employment brought together leading macroeconomists and microeconomists working on employment issues in emerging and developing countries. Finally, the Workshop on Challenges in Emerging Markets in the 21st Century, brought together leaders and key researchers from Institutes of Emerging Market Studies at HKUST, the Indian School of Business, and SKOLKOVO Moscow School of Management (all supported by EY), to discuss the research agenda on emerging markets for the 21st century and opportunities for collaboration among the three Institutes. The Institute also continued its regular series of academic seminars and business talks, continued to publish its popular Thought Leadership Briefs, and proudly released its first Bi-annual Report.



## CREATING SKILLS TO PROMOTE SOCIAL OPPORTUNITY AND REDUCE POVERTY

HKUST IAS Nobel Lecture, cosponsored by HKUST IEMS (2015.11.17)

**James Heckman**, Nobel Laureate in Economics and Professor of Economics at the University of Chicago, delivered a lecture organized by the HKUST Jockey Club Institute for Advanced Study and cosponsored by HKUST IEMS drawing from recent advances in economics, sociology, and child development to emphasize the critical importance of early-childhood social, emotional, and cognitive skills in explaining outcomes in adulthood. Enhancing these skills during youth is key, Prof Heckman argues, to tackling the problem of growing income and opportunity inequality in developed and developing countries alike.

Inequality is on the rise around the world, and is closely linked to social mobility. Prof Heckman also pointed to empirical evidence from economics linking income inequality and intergenerational mobility, where less income-advantaged families face difficulties in financing their children's education, and in providing them opportunities. This is a serious concern in many places around the world. Some economists believe that inequality is a cause of immobility. On the other hand, the causality might run the other way: low mobility might explain inequality.

Given rising inequality, income redistribution has become an increasingly popular topic. While taxation and transfers may have varied effects on alleviating inequality, Prof Heckman proposed a broader, complementary approach to addressing inequality, namely the development of skills and capabilities that allow people to function better in the economy and fit into society. Prof Heckman's premise is that people with larger skill and capability sets have more freedom to shape their own lives, and those with fewer have more limited choices.

Prof Heckman noted several key lessons from recent findings in economics, sociology, and developmental psychology for skill development. The first lesson is that skills vitally affect performance in life along many dimensions, such as the likelihood of marriage and divorce, health, the ability to stay on task, etc. A second lesson is that gaps in both cognitive and non-cognitive skills across socioeconomic groups emerge at early ages, even before children begin attending school.

The third lesson is about the role of genetics in fostering skills. While genetic heritability plays a part in the development of skills in children, the evidence suggest that parenting and learning environments play more important roles. Fourthly, there are critical and sensitive periods in child development, with Prof Heckman citing the fact that one's intelligence quotient (IQ) becomes rank stable around the age of 10. As previously touched upon, the fifth lesson concerns the substantial differences in children's environments, with children of professional parents hearing as many as four times as many words at age three than those from disadvantaged families.

The sixth lesson, Prof Heckman continued, is that initial disadvantages have a lingering effect that society can partially compensate for. For example, for neglected children, programs targeting socio-emotional and character skills through mentoring are particularly effective. The seventh lesson relates to the importance of "scaffolding", meaning that staying with a child, working with her, and challenging her to take the next step in the "proximal zone" of development through interaction (rather than lecturing) is critical. The final lesson Prof Heckman stressed is the value of early investment, where the skills and abilities created at early ages can propagate throughout one's life.

Concluding the discussion, Prof Heckman emphasized that social and emotional skills support cognitive skills, that cognitive skills lead to better health, and that it is easier to change the skill base of children at early in life rather than later. The early years are especially important because of the malleability and flexibility of young children. Later in life, while certain skills are still malleable, the full base of skills is not. Into adulthood, the skill base plays a powerful role in producing adult outcomes.

Prof Heckman underscored the effectiveness and fiscal prudence of early childhood intervention to address social and economic inequality. While economic redistribution can alleviate some problems of poverty and inequality, disadvantaged families can also greatly benefit from measures to improve parenting skills and to provide a better environment to nurture their children's capabilities.

Video recording available at <http://iems.ust.hk/heckman>



## CHALLENGES IN EMERGING MARKETS IN THE 21ST CENTURY

HKUST IEMS – EY Workshop (2015.12.16-17)

Supported by EY, HKUST IEMS hosted a two-day workshop with senior leaders from EY as well as high-level researchers and faculty from the international network of universities connected through EY's network of emerging market research institutions in Hong Kong, India, and Russia. The current network members include HKUST IEMS, the Moscow School of Management SKOLKOVO IEMS, the Indian School of Business (ISB) IEMS, and the China Europe International Business School (CEIBS) IEMS. The workshop included research presentations on several key emerging market themes: growth and innovation, financial systems, firm strategies, and better jobs.

In addition to providing a platform for researchers at partner IEMS institutes to share their research, the workshop allowed EY to connect with senior faculty and researchers in the IEMS network and communicate its vision and priorities for emerging markets. Participants presented research and agendas prioritized by institutions, exchanged views and perspectives on business challenges in emerging markets in the 21st century, and discussed the intellectual framework best suited to address these challenges through research and education promoted by the IEMS network, and to identify opportunities for collaborative activities among IEMS partners that stand to broaden the current scope of work by individual IEMS partner institutions.

Delivering the opening presentations were **Jay Nibbe**, Global Vice Chair for Tax at EY, and **Ilse Blank**, Global Economic Programs Leader at EY, who described the many programs and surveys the multinational company has implemented to increase their knowledge and understanding of emerging market issues. On the regional growth front, EY has launched business and foreign direct investment attractiveness surveys for India, ASEAN countries, China, Russia, and Africa. On the digital banking front, EY has published an ongoing series of digital banking and digital tax developments related to Brazil, South Korea, Saudi Arabia, Kuwait, the UAE, and other countries in the Middle East. EY plans to continue its research and thought leadership efforts by deepening its efforts and expanding to new countries in coming years.

In a presentation on China as the world's next technology leader, **Naubahar Sharif**, HKUST Associate Professor of Social Science and HKUST IEMS Faculty Associate, emphasized the propitious indicators signaling China's rise. For example, China's spending on research and development (R&D) now outpaces overall economic growth, placing it second in the world behind the United States. China now has over 3.2 million R&D personnel, and is currently the world's largest producer of tertiary and post-tertiary students in science and engineering. Moreover, China now ranks second in the world in research output as measured by papers published in research journals, and third in terms of patent filings with the World Intellectual Property Office. Prof Sharif commented that too few policymakers and financial elites outside China anticipate the rise of Chinese multinationals to positions of global technological leadership, underestimating the massive growth of China's domestic market, the strong government support aimed at turning China into an "innovation nation", and intensified forces of globalization helping China extend its reach abroad.

Addressing the issue of sustainable growth across countries, **Vladimir Korovkin**, Head of Digital Research at the Moscow School of Management SKOLKOVO IEMS, used World Bank GDP per capita data from the 1970s to present day to demonstrate whether a given country's growth model led to a long-term decline, stagnation, or growth. While all countries inevitably experienced at least one bout of significant economic decline in the timeframe observed, the countries most able to sustain long-term economic growth were those with national strategic vision and broad industrial policies driven by collaborations between the state, society, and business. Dr. Korovkin also noted that the key factor in sustainable economic growth was not about how quickly a nation can grow, but how effectively a nation can handle its inevitable economic downturns.

Other presenters at the workshop included **Albert Park** (HKUST), **Alexey Kalinin** (SKOLKOVO), **Sanjay Kallapur** (ISB), **Anand Nandkumar** (ISB), **Kellee Tsai** (HKUST), and **Peter MacKay** (HKUST).

Video recordings available at <http://iems.ust.hk/wcem>



## CONFERENCE ON URBANIZATION, STRUCTURAL CHANGE, AND EMPLOYMENT

HKUST IEMS – World Bank Network on Jobs and Development (2015.12.11-13)

As an institutional member of the World Bank's Network on Jobs and Development, HKUST IEMS hosted a public three-day conference at its HKUST campus. The conference brought together leading researchers with both macroeconomic and microeconomic perspectives to present and discuss original research on a variety of topics related to the economic transformation of emerging market and developing countries, including urbanization, determinants of growth and structural change and consequences for labor demand, and the employment effects of globalization and technological change.

**Sir Prof Christopher Pissarides**, Nobel Laureate, Professor of Economics at the London School of Economics, HKUST IAS Professor-at-Large, and HKUST IEMS Faculty Associate, began the conference by discussing China's labor transition from agricultural to non-agricultural sectors, with overall employment declining as a result of China's urban-rural household registration system acting as a migration barrier. Drawing from his analysis of a 2-sector model using the migration barriers imposed by China's urban-rural household registration system, Sir Christopher suggests that the removal of this registration system could increase the flow of workers to urban jobs, reduce the prices of urban goods, and increase welfare in general.

**Joseph Kaboski**, Professor of Economics at the University of Notre Dame, detailed his study into agglomeration and competition—or the lack thereof—in China's Special Economic Zones (SEZs). Prof Kaboski's analysis centered on data from the annual survey of Chinese Industrial Enterprises comprising all state-owned enterprises (SOEs) and large non-SOEs from the period of 1999 to 2009. His results suggest that 10.6% of Chinese firms located outside of SEZs engage in collusion, whereas 45.3% of firms located within SEZs engage in collusion.

**Xin Meng**, Professor of Economics at the Australian National University, described her research on China's current labor market tensions, and challenges to its future urbanization plans. Between 2012 and 2013 the real wages of migrant workers in China increased by 12.3% – even though real GDP per capita only increased by 7.7% – and increased a further 7% between 2013 and 2014. While

many regard this trend as a sign of unskilled labor shortages due to reduced labor supplies from rural areas or as the inevitable effect of industrial upgrading, Prof Meng insists that urban labor shortages are due to restrictions on rural-urban migration. She bolstered her case by analyzing a variety of micro-data from the Chinese Bureau of Statistics such as migrant worker wage distributions, changes in urban minimum wages, and industrial upgrading data.

On the problems associated with megacities in the developing world, Professor of Agricultural Economics at National Taiwan University **Chu-Ping Lo** outlined the impact of foreign direct investment (FDI) on the phenomenon of rapid urban concentration. To test his theory that urban concentration is reduced with greater trade liberalization, Prof Lo created a two-country model with a developed and developing country, using labor as the single factor of production, an inelastic labor supply in the developing country, a freely mobile workforce, and imported-good tariffs present for the developing country but absent in the developed country. His main conclusions were that, in order to avoid the formation of megacities, developing countries should not only open their doors to traditional trade, but increase their acceptance of FDI. However, before carrying out such liberalization policies, it's imperative that governments in these developing countries first improve their infrastructure in order to reduce local transportation costs, as sufficiently low transportation costs will help discourage workers from migrating from rural areas to burgeoning megacities.

Other presenters at the conference included **Xiaodong Zhu** (University of Toronto), **Feicheng Wang** (University of Nottingham Ningbo), **Rachel Ngai** (London School of Economics), **Ping Wang** (Washington University at St. Louis), **Ming Lu** (Shanghai Jiaotong University), **Loren Brandt** (University of Toronto), **Gary Fields** (Cornell University), **Todd Schoellman** (Arizona State University), **Alessio Moro** (University of Cagliari), **Yong Wang** (HKUST), **Yang Du** (Chinese Academy of Social Science), **Piotr Lewandowski** (Institute for Structural Research Warsaw), **Timo Boppert** (Stockholm University), **Roberto Samaniego** (George Washington University), **Sebastian Monroy** (World Bank), **Pankaj Vashisht** (ICRIER), and **Albert Park** (HKUST).

Video recordings available at <http://iems.ust.hk/urba>



## WORKSHOP ON COMPARATIVE STUDIES OF REGIONAL GOVERNANCE IN CHINA AND RUSSIA

HKUST IEMS – ICSID HSE Workshop (2015.09.24-25)

Cosponsored by the International Center for the Study of Institutions and Development (ICSID) at the Higher School of Economics (HSE), HKUST IEMS hosted this two-day workshop at the HKUST campus. The focus of the workshop was on the latest empirical research on the political economy of local governance and state-business relations in Russia and China, featuring leading scholars from Russia, China, Hong Kong, and the US specializing in the analysis of micro-datasets on local government officials and firms in Russia and China.

**Ora John Reuter**, Assistant Professor of Political Science at the University of Wisconsin, began the workshop with his study on the curious fact that officials in competitive authoritarian regimes such as Russia are appointed and reappointed regardless of the economic performance of their assigned region. Prof Reuter analyzed the variation in political appointment patterns across Russia's 89 regions, focusing on over 3,500 regional vice governors with economic policymaking responsibilities between 2001 to 2012. His results show that performance-based appointments were significantly more prevalent in the less politically-competitive regions of the country. As for the more politically-competitive regions of the country, Prof Reuter attributed the lack of performance-sensitivity to "electoral-machine politics", where the ability to deliver votes and to establish personal connections with top leaders dominate economic performance when it comes to appointments, an argument corroborated by previous qualitative studies.

**Pierre Landry**, Professor of Political Science and Director of Global China Studies at NYU-Shanghai, presented his work on political selection along the Chinese administrative ladder. Specifically, Prof Landry attempted to reconcile the mixed evidence connecting economic performance to political loyalty in China's cadre promotion system. To measure both promotion and the fiscal competence of China's officials, Prof Landry examined the political appointments of party secretaries and government executives between 1997 to 2007 across a wide swath of China's provinces, and controlling for such factors as fiscal revenue, local GDP, and relative growth rates. His main finding was that economic performance drives promotions at the lower levels of the Chinese government, whereas loyalty drives promotions at higher levels of government.

On the topic of how and why new electoral arrangements in China affect who gets elected to local and regional congresses, **Melanie Manion**, Professor of Public Affairs and Political Science at the University of Wisconsin-Madison, discussed the new electoral rules for township and county congresses in China, where Chinese voters share selectorate power with the Communist Party, but where the Party has veto power over which nominees can appear on the ballot. Prof Manion analyzed data from surveys of over 4,000 popularly-elected delegates in 24 township congresses and 18 county congresses in 4 Chinese provinces. Prof Manion's analysis shows that voter-championed ballot nominees exhibit qualities that suggest they will represent community interests, such as being a longtime community resident or recognized as a community leader. On the other hand, Communist Party-championed ballot nominees display a different set of qualities, such as Communist Party membership, holding an official party or government post, a higher-education degree, or having trained at higher-level Communist Party schools.

**Thomas Remington**, Professor of Political Science at Emory College, presented his work comparing pension reform in the authoritarian regimes of Russia and China and contrasting the history of the pension policies in the two countries since the 1980s. Among the many points of comparison and contrast, Prof Remington highlighted two key differences: administrative decentralization (where China is much more administratively decentralized than Russia) has a significant influence on pension policymaking, whereas leadership turnover (where Russia has a much more stable roster of top officials than China) did not.

Other presenters at the workshop included **Chenggang Xu** (HKU), **Andrei Yakovlev** (HSE), **Zhigang Tao** (HKU), **Michael Rochlitz** (HSE), **Cheryl Xiaoning Long** (Xiamen University), **Daniel Berowitz** (University of Pittsburgh), **Franziska Keller** (NYU), **James Kung** (HKUST), **Li Han** (HKUST), **Chen Ting** (HKUST), and **Yiqing Xu** (HKUST).

Find out more about the event at <http://iems.ust.hk/hsew>

## WEALTH AND WELL-BEING

IAS Distinguished Lecture, co-sponsored by HKUST IEMS (2015.10.20)



At this distinguished lecture organized by the HKUST Jockey Club Institute for Advanced Study and cosponsored by HKUST IEMS, **Prof Sir Partha Dasgupta**, Professor of Economics at the University of Cambridge, elucidated his view that economic indicators such as GDP growth neither take into account crucial measures of a nation's present well-being, nor include sufficient consideration for production and

consumption externalities which may affect a nation's future well-being.

Sir Partha began the talk by giving a short account of the evolution of GDP-like measures which began to surface on a wide scale starting in the 1930s. According to Sir Partha, governments wanted a way to investigate and promote their country's economic activities, and found that detailed country-wide statistics were the best available option. As such measures proliferated, it became more difficult to trust such numbers because statistical estimation methods grew more sophisticated and more esoteric. As such, Sir Partha doubts that such measures will ever be comprehensive or accurate enough to be relied upon to confidently make wide-ranging decisions affecting a nation's overall well-being.

While Sir Partha primarily discussed the issue of assessing the state and growth of national economies, he surmised that the problem extends globally, nationally, and even at the family level. Sir Partha listed six questions economic measures should be able to answer about an economy: 1) how is the economy doing; 2) how has it been doing in recent years; 3) what should be our forecast of the economy if policies evolve over time in the way we expect them to evolve; 4) how is the economy likely to perform under alternative policies; 5) which policies should we support; and 6) what would be an ideal set of policies.

Some of these questions are already answered by well-established indicators like GDP per capita, inequality and poverty measures, the human development index, and others. However, there are many times where these simple indicators do not suffice because positive and negative externalities are not taken into account. For example, Sir Partha noted that good health is both a means as well as an end. In this vein, governments can formulate policies to improve health care in general, which will ultimately allow citizens to produce more.

Like most economists, Sir Partha believes that physical capital and human capital contribute to productivity. But productivity measures, as currently constructed, ignore the capital inherent to the land itself: natural capital. Natural capital – just like physical and human capital – is a depreciable asset, offering positive externalities and subject to negative externalities, as rapidly accelerating climate change reminds us. Just like health, natural capital is both a means and an end, affecting and affected by physical capital and human capital productivity.

Sir Partha admitted that his theory raises more questions than answers. The most common criticism is that, like notions of well-being, natural capital is hard to define and measure. Sir Partha counters that just because these concepts are difficult or even impossible to define does not mean they should be ignored. There was a time when extraction costs for fish, minerals, wood, and a myriad other natural resources were high enough to prohibit their over-extraction and depreciation. In contrast, technological advances in recent decades have made it possible to over-extract or even deplete natural resources almost instantly. How these realities impact productivity and well-being in the near and far future is difficult to define, but nonetheless must be considered.

Video recording available at <http://iems.ust.hk/dasgupta>

## EFFECTS OF USING COUNTERFEIT PRODUCTS ON CONSUMER FEELINGS AND PURCHASE INTENTIONS

HKUST IEMS Academic Seminar (2015.11.26)

**Amy Dalton**, HKUST Associate Professor of Marketing and IEMS Faculty Associate, discussed the growing issue of counterfeiting in both developed and emerging economies, with counterfeits posing major challenges for businesses and governments alike. To better grasp the scale of the problem, Prof Dalton referred to some of the most recent statistics, one of which was that counterfeits were estimated to cost U.S. businesses upwards of US \$300 billion in annual revenue and an unmeasurable quantity in brand uniqueness in 2013. In 2014, governments seized over US \$1.22 billion worth of counterfeit and other goods infringing on intellectual property rights. Moreover, the market for counterfeits has grown by more than 10,000% in the past two decades and continues to expand.

This growth in the counterfeiting market is partly attributable to consumer demand. Previous research indicates that many consumers knowingly purchase and use counterfeit products primarily in an attempt to signal social status to others. Prof Dalton's research is novel in that it explores the little-known realm of the post-purchase experience, i.e. the experience of using counterfeit goods and their downstream consequences.

Prof Dalton focused on three key questions in delving into the post-purchase experience of counterfeit goods, namely: 1) how consumers felt while using counterfeit products; 2) how these feelings vary across individuals and situations; and 3) the effect these feelings have on the attractiveness of both counterfeit and genuine brand goods. To answer these questions, Prof Dalton conducted five separate single-factor, between-subject product evaluation surveys administered to students and staff members at HKUST. To gain further insights on how to design more effective anti-counterfeit good advertisements, she also conducted a sixth study using a Google Image search of the keyword "anti-

counterfeit campaigns", coding the content of the first 200 campaign ads into general categories.

Prof Dalton found that the key factor driving consumers to purchase counterfeits—the desire to signal status to others—related to the mixed feelings consumers experience when they use counterfeits. Specifically, consumers who use counterfeits to signal social status experience positive emotions related to the brand's potential signaling value, while also experiencing negative emotions related to the risk of social judgment should their ploy be discovered. She also found that mixed feelings are more likely when counterfeits are used in public settings, and thus are visible to others, compared to private settings, where the counterfeit is less likely to be observed.

Importantly, consumers tend to be averse to experiencing mixed feelings and thus seek to avoid situations that give rise to them. For this reason, mixed feelings lower consumers' willingness to pay for counterfeits and suppress intentions to purchase other counterfeits in the future. Mixed feelings also increase the appeal of genuine products, as these are not associated to feeling mixed. These results suggest that the use of counterfeit products can serve as a stepping stone for purchasing genuine brand goods.

Find out more about the event at <http://iems.ust.hk/cntf>



## WHEN DO CHINESE FIRMS ADVERTISING ON INTERNET JOB BOARDS DISCRIMINATE IN THEIR HIRING PRACTICES?

HKUST IEMS Academic Seminar (2015.10.22)



**Margaret Maurer-Fazio**, Professor of Applied Economics at Bates Colleges and Research Fellow at the Institute for the Study of Labor (IZA), reported her results from three large scale field experiments that investigated how Chinese firms responded to job applications received from fictitious applicants whose resume characteristics were purposefully crafted to vary only in terms of the specific characteristics being considered.

In the first study Prof. Maurer-Fazio and her team focused on ethnicity, as denoted by means of names that are typically Han Chinese and distinctively Mongolian, Tibetan, and Uighur. To do so, she and her research team picked a handful of the best of thousands of real candidate resumes from China's major job boards, and replaced the names on the resumes with fictitious names with extremely obvious ethnic / non-ethnic surnames and given names. Prof. Maurer-Fazio and her team found significant differences in the callback rates by ethnicity and that these differences varied systematically across ethnic groups. Not all firms discriminated, with approximately half treating all candidates equally. State-owned firms were significantly less likely than privately owned firms to discriminate against minorities.

The second study explored how gender and facial attractiveness affected job candidates' chances of obtaining interviews. It examined how discrimination based on these attributes varied over occupation, location, and firms' ownership type and size. Prof. Maurer-Fazio picked a stock photo of a typical job-seeking Chinese male and female youth, and subtly altered the photos to result in 2 photos for each youth, one deemed significantly more attractive and one significantly more unattractive. She and her team then attached these photos to identical resumes and forwarded them to hundreds of Chinese companies in a variety of industries and sectors. Prof. Maurer-Fazio found sizable differences in the interview callback rates of attractive and unattractive job candidates. Job candidates with unattractive faces needed to put in substantially more applications than their attractive counterparts to obtain the same number of interview callbacks.

The third study focused on women's marital status, their current employment status, and whether these factors had any effect on employer call-back rates. To study the question, Prof. Maurer-Fazio took hundreds resumes that were otherwise identical except for marital and employment status, and sent them to a range of companies throughout China. The experiment showed no evidence of discrimination based on either unemployment status or marital status in the hiring practices of the firms who advertised their job openings on China's main Internet job boards. There was, however, clear evidence that HR managers were carefully reading resumes and making distinctions between the desirable and undesirable characteristics of applicants.

Find out more about the event at <http://iems.ust.hk/fazio>

## INTEREST RATE LIBERALIZATION AND CAPITAL ALLOCATION

HKUST IEMS Academic Seminar (2015.11.12)



effectiveness of and potential tradeoffs under such liberalization policies for improving capital allocation and aggregate productivity.

**Pengfei Wang**, Associate Professor of Economics at HKUST, presented his research on interest-rate liberalization in China, and its overall effect on capital allocation. To this end, Prof Wang constructed a two-sector model burdened by financial frictions. The key assumptions in his model are: 1) the relatively well-documented fact that China's state-owned enterprises (SOEs) have lower productivity than privately-owned enterprises (POEs), despite having easier access to credit; 2) China's interest rates are regulated by the central government, giving rise to

Private firms in China have limited access to credit markets, with the central government maintaining tight controls over interest rates and credit availability. These regulations have been considered an important source of inefficiency because they tend to lead to capital misallocation. Various reform plans that aim at liberalizing interest-rate controls and promote financial deepening have been proposed. It is

important to understand the effectiveness of and potential tradeoffs under such liberalization policies for improving capital allocation and aggregate productivity.

a wedge between the loan rate and the deposit rate; 3) private firms both face idiosyncratic productivity shocks, and maximize profit subject to borrowing constraints; and 4) SOEs maximize a weighted average of profit and revenue, with the latter capturing an agency problem specific to SOEs.

Prof Wang's model suggests that, although interest rate liberalization improves within-sector allocation, it worsens cross-sector allocation of capital. In particular, when interest-rate liberalization causes the loan rate to drop, capital flows from private firms to SOEs. This, despite lower SOE productivity relative to POEs. This distortion arises because SOEs have a strong incentive to expand capacity to achieve revenue goals, an incentive that is otherwise absent in most POEs. Additionally, SOEs have much easier access to credit compared to POEs.

Concluding from his analysis, Prof Wang stated that the opposing effects of the within-sector productivity improvement and the cross-sector deterioration make the net effects of interest-rate liberalization ambiguous. As for China pursuing complete interest-rate liberalization, Prof Wang's research indicates that a permanent decline in aggregate total factor productivity would ensue were China to completely liberalize its interest-rate policy. Prof Wang instead recommends that China's economic reform policy would be more effective if it were to address SOE incentives and credit access in general, both of which are thought to be the direct causes of the country's economy and market distortions.

Find out more about the event at <http://iems.ust.hk/rate>

## HKUST IEMS APPOINTS 3 NEW MEMBERS TO EXECUTIVE COMMITTEE

HKUST IEMS is pleased to announce that our Faculty Associates have selected 3 nominees amongst themselves to serve on the Institute's Executive Committee. The three new committee members are **Naubahar Sharif**, Associate Professor of Social Science; **Sujata Visaria**, Assistant Professor of Economics; and **Amy Dalton**, Associate Professor of Marketing. These new members will replace outgoing executive committee members **Sam Garg**, Assistant Professor of Management; **Xiaogang Wu**, Professor of Social Science; and **David Zweig**, Chair Professor of Social Science.



Naubahar Sharif



Sujata Visaria



Amy Dalton

## Thought Leadership Brief

### The Rise of Shadow Banking in China: The Political Economy of Modern Chinese State Capitalism

**Kellee Tsai**, Head & Chair Professor of HKUST's Division of Social Science and HKUST IEMS Faculty Associate, explores China's response to the 2008 global financial crisis, after which time Chinese enterprises both large and small have engaged in unprecedented levels of off-balance sheet activities, which are now estimated to account for an astounding 26-69% of China's total GDP.

## Bi-Annual Report, 2013-2015

This report details the progress the Institute has made over its first two years. Highlights include descriptions of the 28 individual research grants funded by HKUST IEMS, as well as short write-ups on our wide array of events and publications from the founding of the Institute to June 30, 2015, which include 16 conferences and workshops, 11 policy and business talks, 20 academic seminars, 9 thought leadership briefs, and 27 academic working papers.

Read the brief at <http://iems.ust.hk/tlb>  
Read the bi-annual report at <http://iems.ust.hk/bar1>



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