

Analysis of Income Disparity in Hong Kong

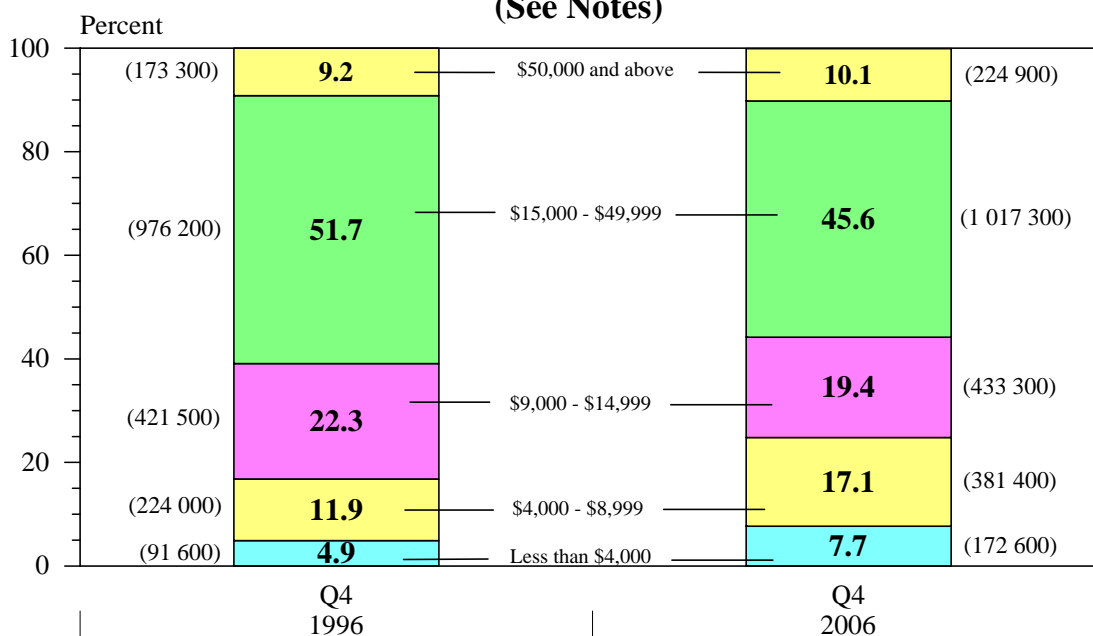
Background

This note aims at providing Members with an analysis of the income disparity situation in Hong Kong, in response to the request made by the Hon Emily Lau during the Budget briefing at the Finance Committee on 1 March 2007.

The income distribution pattern and key contributory factors

2. As *Chart 1* shows, the proportion of households at both the upper and lower ends of the income distribution increased over the past decade, whereas the proportion of middle-income households decreased. Such a change reflects the combined influence of a host of demographic, social and economic factors, with the more important ones being highlighted in the ensuing paragraphs.

Chart 1: Share of all domestic households by monthly household income
(See Notes)



Notes: (1) Excluding foreign domestic helpers. Figures in brackets refer to the number of households in the respective groups.
 (2) The purchasing power of the income (as measured by the Composite CPI) in Q4 1996 was around 6% lower than that in Q4 2006, i.e. \$4,000 in Q4 1996 was equivalent to \$3,776 in Q4 2006.
 (3) The average household size was 3.3 persons in Q4 1996 and 2.9 in Q4 2006. The average number of economically active person per household was 1.7 in Q4 1996 and 1.6 in Q4 2006.

Structural factor: (1) Fall in average household size and population ageing

3. One major factor affecting household income and its distribution is the ongoing change in family structure towards smaller and nuclear families, which has in turn led to a progressive decline in the average household size, from 3.3 persons in Q4 1996 to 2.9 persons in Q4 2006. As household income depends partly on the household size and in particular the number of working household members, a decline in average household size would tend to pose a drag on household income in general. When the comparison is made on a per capita household income basis, household income would show a larger increase and those in the lower income strata would have fared better over the period. Further analysis indicates that the rapid increase in small households, particularly elderly households, was a major contributing factor to the increase in low-income households.

4. Indeed, over 60% of the increase in households having monthly household income less than \$4,000 in the past decade was attributable to a notable jump in elderly households, reflecting the ongoing ageing trend and the fact that many young people are now living away from their parents (*Table 1*). These elderly households typically comprise retirees, who are living on their savings and/or financial assistance from the Government or other family members not living with them. If these elderly people were still living with their children or grandchildren, many of them would not be statistically counted as low-income households⁽¹⁾.

(1) For a more detailed analysis of low-income households, please refer to the “Recent situation of household income”, an annex of the information paper (Ref. CB(1)458/06-07(03), <http://www.legco.gov.hk/yr06-07/english/panels/fa/papers/fa1214cb1-458-3-e.pdf>) for the meeting of LegCo Panel on Financial Affairs on 14 December 2006.

Table 1: Number and share of low-income households[#]

	<u>Elderly households</u>	<u>Economically inactive households</u>	<u>Economically active households</u>	<u>Total</u>
Q4 1996	60 400 (3.2)	19 000 (1.0)	12 200 (0.6)	91 600 (4.9)
Q4 2006	111 600 (5.0)	32 900 (1.5)	28 000 (1.3)	172 600 (7.7)
Change	51 300 [63.2]	13 900 [17.2]	15 900 [19.6]	81 000 [100.0]

Notes : (#) Low-income households are defined as households with monthly household income of less than \$4,000. Elderly households are defined as households with all members aged 60 or above. Economically inactive households are those with none of their members joining the labour force, whilst economically active households are the ones with at least one economically active members. Foreign domestic helpers are excluded.

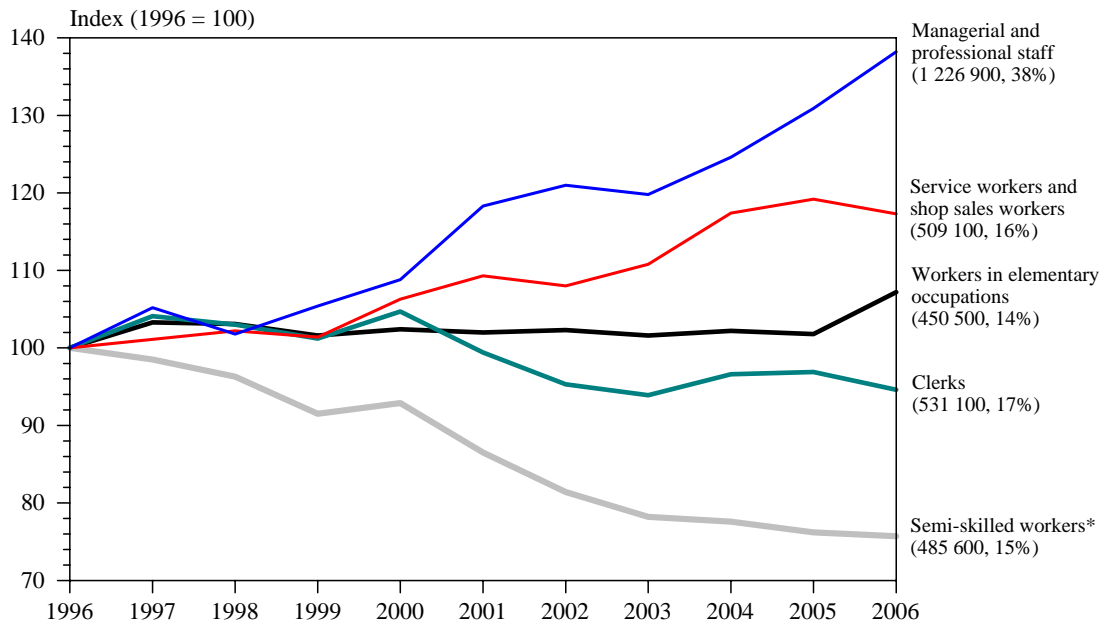
() Share in all domestic households.

[] Share of the increase in low-income households between Q4 1996 and Q4 2006.

Structural factor: (2) Job upgrading and maturing of local workforce

5. Hong Kong is a small, open economy. In the face of challenges and opportunities brought about by globalisation and rapid economic development in the Mainland, it has been continuously undergoing restructuring towards higher value-added activities so as to sustain economic vitality and competitiveness. During this transformation and upgrading process, many high-income jobs are being created along with enhancement of the quality of the local workforce. For instance, over the past decade, the proportion of people with tertiary education has increased notably from 21% to 31% of the total workforce. The proportion of managers and administrators, professionals and associate professionals has likewise increased, from 30% to 38% (*Chart 2*).

Chart 2 : Substantial job upgrading



Notes : Figures in brackets represent the number of employed persons (excluding foreign domestic helpers) in 2006, and the percentage shares refer to the proportion of employed persons engaged in the respective occupations.

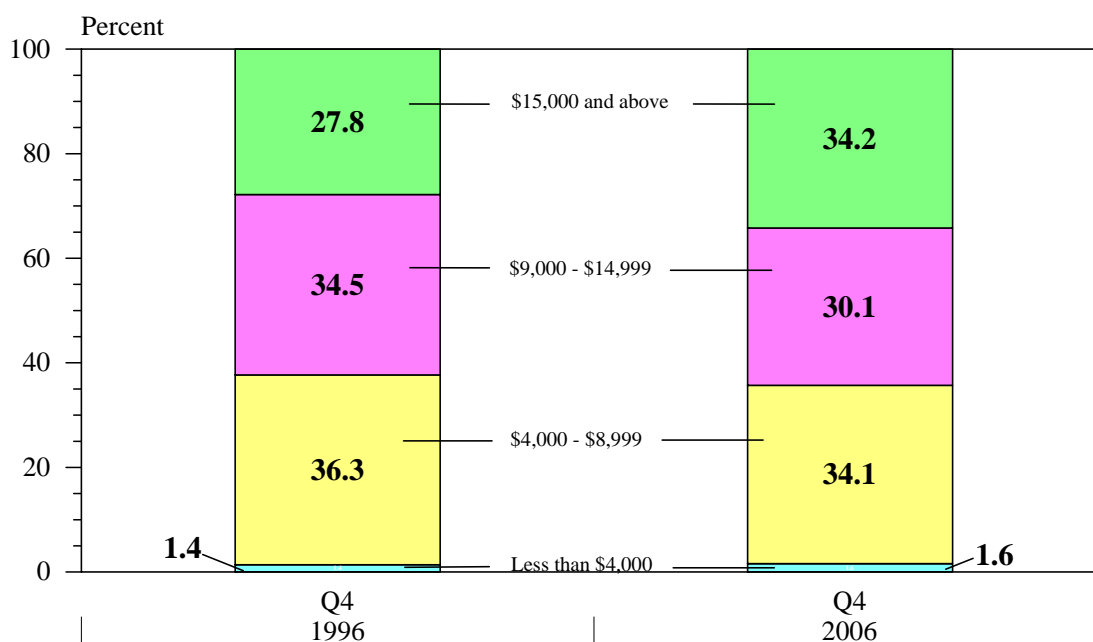
(*) Semi-skilled workers include craft and related workers and plant and machine operators and assemblers.

6. As the number of workers with tertiary education and at the managerial and professional level increases, income distribution in Hong Kong has been thereby affected in the following ways:

- (a) The shift in labour demand towards workers with better knowledge and skills has led to faster increases in income for higher-skilled workers. Meanwhile, market liberalisations in many developing countries have intensified the competition among semi-skilled and unskilled workers. As a consequence, the income disparity between high-income and low-income jobs has widened.
- (b) The economic restructuring of Hong Kong has also led to a rising proportion of high-income workers (*Chart 3*). In the past, income disparity among farmers or labourers in agrarian or lower-skilled industrial community was generally less visible. However, in a post-industrial, service-oriented economy like Hong Kong today, increasing emergence of high-income jobs has led to a wider income gap.
- (c) From a life cycle perspective, whereas the income of workers with lower skills and lower education level will gradually decrease when they reach middle age, the income of those middle-aged workers with tertiary education will nevertheless continue to increase. As a result, income disparity in Hong Kong has increased with ageing of the population.

- (d) The effects of the factors in (b) and (c) above on Hong Kong's income disparity are further magnified in recent years as (i) the number of workers with tertiary education and in management/professional categories as well as (ii) the number of workers aged 40 or above increase over time.

Chart 3 : Share of full-time employees by monthly employment earnings



Note : Excluding foreign domestic helpers. The purchasing power of the income (as measured by the Composite CPI) in Q4 1996 was around 6% lower than that in Q4 2006, i.e. \$4,000 in Q4 1996 was equivalent to \$3,776 in Q4 2006.

Cyclical factor: Prolonged economic downturn

7. The economic downturn in Hong Kong during 1998 to 2003 is another factor contributing to the slowdown in employment earnings among low-income workers in recent years. Unemployment, underemployment and pay cut were more commonly seen in this group than in the higher income group during this period of corporate downsizing and cost cutting, thus leading to a widening of the income gap. While employment earnings of low-income workers are still considerably lower now than in 1997, there has been a notable upturn in employment income among many low-income earners since mid-2003 when the economy staged a strong rebound. Specifically, statistics on labour earnings in the past few years reveal that, average employment earnings of workers in the lowest two deciles bounced back by 7-10% between Q4 2003 and Q4 2006, distinctly faster than the 2% increase in the average employment earnings for all employed persons. Conceivably, the increasing employment opportunities for lower-skilled workers brought about by the robust economic

growth is the primary factor behind the faster income growth among low-income workers⁽²⁾.

Role of the government in income redistribution and the Gini Coefficient⁽³⁾

8. The “social safety net”, public services and the tax system of Hong Kong has been established for many years. Various services in spheres such as education, medical care and housing, and social security are in place and all these services tend to benefit the lower-income households more, including those comprising elderly and economically inactive persons. Meanwhile, income tax and property tax are mainly collected from the high-income group, whereas the low-income earners generally do not need to pay these taxes. Such income redistribution mechanism should have helped narrow income disparity in Hong Kong.

9. Nevertheless, so far the Gini Coefficient in Hong Kong has not taken into account most of the income redistribution effects stemming from such in-kind social benefits and the taxation system. On the other hand, many overseas countries have incorporated the income redistribution effects in the compilation of their Gini Coefficients. Thus, a direct comparison between the Gini Coefficient in Hong Kong and those in other economies is inappropriate.

10. The Administration has strived to improve further the compilation and analysis of the data on income distribution. As a case in point, an attempt was made last year to estimate the impact of the government’s redistribution functions on various types of household income, and the preliminary findings

(2) For a more detailed analysis of the impact of prolonged economic downturn before 2003 on income disparity, please refer to the information paper for the meeting of the Committee on Economic Development and Economic Cooperation with the Mainland of the Commission on Strategic Development on 29 January 2007, titled “the Hong Kong economy: developments since 2003, and a review of the structural and cyclical issues impacting on the economy and the labour market” (Ref CSD/EDC/1/2007, http://www.cpu.gov.hk/english/documents/csd/csd_edc_1_2007.pdf).

(3) The Gini Coefficient is widely used as the aggregate summary indicator of income disparity among households in Hong Kong. This indicator is compiled on the basis of household income data obtained from the Population Census/By-census conducted at five-year intervals. It is defined as a ratio with values between 0 (when all households have the same level of income) and 1 (when a single household has all the income). It should be noted that the Gini Coefficient is only one of many indicators that are used to measure income disparity.

were reported to the Commission on Poverty⁽⁴⁾. While the analysis made in that exercise is still not very comprehensive and precise owing to data constraint, it does show that after taking into account the redistributive effect of income tax, Comprehensive Social Security Assistance, public housing, medical care and education, the household income of a large majority of families in Hong Kong, including in particular those low to middle-class families, has been greatly enhanced. Further work in this area will need to be done.

Conclusion

11. The Administration is fully aware that the community is very concerned about the widening income gap. Based on the above review, it is obvious that analysis of income disparity in Hong Kong is a complex issue. In making the relevant assessment, one should not focus attention on a single indicator like the Gini Coefficient, but should also take into account the other pertinent socio-economic factors, such as changes in family size and structure, ageing of the population, economic restructuring, social security payments and other benefits, etc. Currently, the Census and Statistics Department is conducting an in-depth research study on income disparity, based on the comprehensive data collected via the 2006 Population By-census. Given the complexity of the issues involved and the time needed to analyse the data, a Thematic Report on the subject is expected to be available for release to the public by mid-2007.

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(4) For details, please refer to the information paper for the meeting of Commission on Poverty on 20 November 2006, titled "Study on the Effect of Taxation and Social Benefits on Household Income Distribution" (Ref. CoP22/2006, [http://www.cop.gov.hk/eng/pdf/CoP%20Paper%2022-2006\(e\).pdf](http://www.cop.gov.hk/eng/pdf/CoP%20Paper%2022-2006(e).pdf)).