

Chapter 1

MAJOR ISSUES IN THE ASIA-PACIFIC REGION IN 2024

Section 1

THE SHAKY INTERNATIONAL ECONOMIC ORDER: SOME MAJOR ISSUES¹⁾

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1. Important Medium- and Long-Term Issues

As Russia's invasion of Ukraine and the protracted war between Israel and Hamas have exposed, the unstable international politics of the "age without hegemony" have dramatically increased the amount of uncertainty in the international economy, making the future outlook less promising. Military conflicts have destabilized food supplies, disrupted energy and commodity markets, and severed supply chains have unintentionally demonstrated the fragility of the global production system. The rise of protectionism has affected cross-border trade and capital flows, and the growing uncertainty and shakiness of the international economic order are undeniable. Furthermore, we cannot ignore the fact that extreme weather events such as droughts and floods are creating so-called "climate refugees."

In general, economic activity is relatively stable in terms of the extent and degree of predictability compared to politics, especially international politics. However, political changes are unpredictable, and the international economic order depends to a large extent on political relations among nations.

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(1) The Future of the “Dollar Order”

Considering the above, several important issues can be pointed out, even if we look only at the economic aspect. All of them are related to the “economic sovereignty” of each nation. However, it is questionable whether the international economic system can be built on the concept of “economic sovereignty” (Milanovic, 2022). It is extremely difficult for developed countries to reach an agreement on how to limit their monopolistic power and protect fair competition through common rules. Looking back through history, it is difficult to say that each country’s “economic sovereignty” has always been equally respected.

The IMF and the World Bank, which continued to maintain a presence even after the collapse of the Bretton Woods fixed exchange rate system in the mid-1970s, have on multiple occasions forced countries to reform domestic institutions that could threaten their “economic sovereignty” in exchange for loans. Objectively, however, there is not much room for international organizations to get involved in fair competition rule-making. The reality of the modern international economy is that it has managed to navigate through a variety of difficult economic challenges in an “economic order” with unstable and unequal hierarchies.

There are two important issues concerning the long-term future of the “international economic order” that are difficult to foresee. The first is whether the “dollar order” established by the US dollar will change as a result of increased trade and technology competition between the US and China. Both China and Russia are gradually increasing the share of financial settlements in their own currencies in response to US economic sanctions. Given the risk of disruptions in trade and investment if access to dollars becomes difficult, it is natural that they would seek to establish non-dollar settlement networks. On the other hand, there are countries that are moving to strengthen the dominance of the US dollar due to security considerations. If US economic sanctions against China and Russia escalate further, there is a possibility that even countries friendly to the US might begin to seek alternative currencies to the dollar in order to avert risks. In addition, as the value of the dollar rises, US domestic manufacturing industries will inevitably suffer further damage as their export competitiveness weakens. As a result, employment in the US might deteriorate. It would not be surprising if there is pressure from within the US to expand the role of the euro, yuan, and SDRs (Special Drawing Rights), and to abandon the “hegemony” of the US dollar.

As far as trade relations with China are concerned, a strategy toward “derisking” rather than a picture-perfect “separation of politics and economics” was reiterated as the “common policy toward China” at the Hiroshima Summit in

May 2023. US export controls are now said to be limited to those technologies that would alter the balance of military power. This trend, however, also makes it clear that China can no longer rely on the free flow of US capital and barrier-free trade with the US. While the actual trade figures show a decline in the dependence of the US and other major industrialized countries on China, ASEAN countries are strengthening their relationship with China, which is visible from the trends in imports and exports (see Chapter 1, Section 6).

One aspect of this problem can be seen by looking at the share of the global foreign exchange market in terms of transaction value by currency. According to the triennial survey report by the Bank for International Settlements (BIS), the ranking of the top four currencies (US dollar, euro, Japanese yen, and British pound) has remained unchanged, but the share of Chinese renminbi (CNY) has jumped to the fifth place (from 0.2% in 2007 to 3.5% in 2022). However, this increase in the Chinese yuan's share is largely due to USD-CNY transactions, and is therefore not directly related to the decline in the dollar's share.

(2) What Will AI Change?

Another important medium- to long-term issue concerns the qualitative changes that AI will bring about in communications, production technology, distribution, consumption, employment, and the quality of people's work and lives. Of course, this question is not new at all. Historically, it has been discussed in a pessimistic tone as "On Machinery" by economist D. Ricard in the early 19th century during the Industrial Revolution, and as "the unemployment problem" brought about by automated machines (automation) since the early 20th century. These are "classic problems. Even recently, simple near-fantasy scenarios and stories about human labor are being told, and the media is full of empirically unverifiable predictions about which jobs among human labor will be eliminated by AI in the near future.

Last year, for example, Elon Musk even went so far as to declare, "There will come a time when no job will be necessary," (Time Magazine, 2023). Of course, no economist who places importance on empirical evidence would agree with such a simple assertion. We must be cautious about how we use AI in the industrial society of the future, and we must be cautious about predictions regarding future changes in social life, production and consumption, that the emergence of AI will bring about.

While the "positive effects" of AI in production are often emphasized, how can we reach a consensus on how to control the various "negative effects" or secondary risks to humans and society in the international arena? What skills will be required for which occupations as a result of AI, and what direction

will the penetration of AI take in terms of economic disparities among people? Below, Subsection 1.1.(2).[1] focuses on the change in digital-related transactions within the Balance of Payments. Subsection 1.1.(2).[2] discusses how AI technology will affect the distribution of income, and whether the phenomenon of “information equalization” can reduce economic disparities.

[1] Digital technology and the Balance of Payments

In the global production system based on digital technology, where in the structure of the so-called international value chain does the “final profit” go? According to calculations by Mitsubishi Research Institute (2024), which calculated the digital-related Balance of Payments (not only computer core software and application usage fees, but also cloud service usage fees, video distribution services, etc.) using Balance of Payments statistics, Japan’s digital-related Balance of Payments in 2023 is expected to record a deficit of JPY 5.5 trillion. This deficit is larger than the JPY 3.4 trillion surplus in the travel balance brought by inbound tourism in the same year. This means that Japan as a whole paid more for foreign digital services than international visitors spent in Japan. Needless to say, there are both positive and negative aspects to this figure.

Even if it is true that digital technology increases productivity, it is also true that service fees are being diverted overseas, especially to the United States. In fact, a similar structure is foreshadowed by the changes in the surplus in the Balance of Payments brought about by inbound travel. Foreign visitors’ spending in Japan does not translate directly into tourism income for Japan. To illustrate, whereas the construction and operation of foreign-capital hotels create many jobs in Japan (see Chapter 3, Section 1), if inbound travelers stay at those Western or Asian brand hotels, the profits generated from visitors’ lodging expenses will flow out of Japan. Since lodging expenses account for a significant rate of travelers’ expenditures, the amount of profit generated is significant.

Considering these points, the impact of digital technology on the Balance of Payments should be closely watched, as well as the question of how the money generated by inbound tourism in Japan can be ultimately transformed into profits for domestic companies. By simply comparing the superficial increase in productivity resulting from the use of AI, and ignoring the implications of the above-mentioned changes in the Balance of Payments, we cannot discuss the long-term economic effects of the introduction of AI.

[2] The diffusion of AI technology and widening economic disparities

In the past, it was often argued that AI technology would bring about a “utopian society of equality,” in which equal access to information would enable economic

disparity (or, more simply, income disparity) to shrink. Observations of recent trends in income distribution have begun to reveal that the opposite trend has been gaining momentum. In order to obtain accurate information in this area, we need to pay attention to the work of Autor (2024), and that of Acemoglu and Restrepo (2022), who have tackled the issue head-on from both theoretical and empirical perspectives. What is noteworthy about their work is that they point out that “information” is merely an input to one step in a multi-layered and sequential production and consumption process that can be divided into multiple steps.

What recent studies have revealed, while painstakingly isolating the occupational changes caused by AI technology, is the fact that whereas the introduction of AI has decomposed and replaced many traditional jobs with partly simplified digital technologies, it has not only created many new occupations, but has also dramatically increased the economic value of the work-related decision making performed by a small number of “elite professionals.” According to Acemoglu and Restrepo (2022), the only essential change AI will bring about on the labor market is that it will increase and expand the value of genuine human expertise, while at the same time creating a large number of low-income AI workers, eventually increasing economic inequalities to an extent similar to the one seen in the US over the past 40 years.

What is actually happening in the process of generating information and using it to increase productivity through high-speed computation is the fact that computationally powerful AI is inducing a concentration of income in the hands of “elite professionals” who perform decision-making tasks with unprecedented decision-making power and resources.

2. The Labor Shortage Phenomenon in Major Countries and Demand-Competition for Immigrants

Advanced countries suffering from a declining population have been forced to change their conventional population policies by launching various policies other than the introduction of AI as a measure to cope with the manpower shortage. A concrete example is immigration policy. It is fair to say that there is competition among economically advanced countries to attract the most highly qualified immigrants. However, this competition also comes with many economic costs as well as hurdles that are difficult to measure in economic terms.

(1) The Onset of Population Decline

First, let's look at the IMF statistics on population changes of the important players in the international economy: China, Germany, India, Japan, the U.S., and Russia (Figure 1-1-1). Of the six countries, in Germany for almost a decade after 2000, and in Japan since around 2005, the rate of change has been negative, and population decline has been accelerating since then. China's population growth has been negative since 2020. Russia saw a decline from 1995 to 2010, then an increase from 2010 to 2020, followed by a renewed decline since 2020. The above population changes are the sum of natural change (births minus deaths), and migration.

Until about 10 years ago, when China recorded double-digit economic growth rates, the economy was driven by external demand (trade surplus), and the country rose to the level of the United States at an astonishingly fast pace. However, bubbles in real estate and infrastructure investment damaged the economy, making it difficult for the economy to continue on a growth trajectory driven by domestic demand, especially domestic consumption. The decline in economic growth is largely the result of labor shortages and rising wages in China, which has severe restrictions on immigration.

It is well known that India's population from 1981 to 2020 increased at a high rate of 2.3% to 1%, and has continued to record nearly 1% after 2020, overtaking China in 2022. It is noteworthy that the United States has continued to record total population growth for nearly half a century since 1980. The total population growth is mainly due to the increase in immigration, as indicated by the fact that

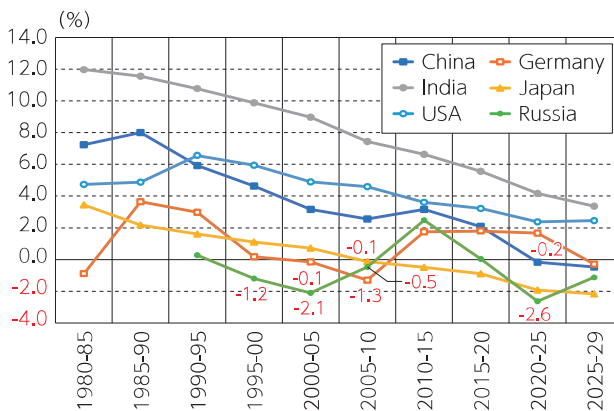


Figure 1-1-1

Total population change rate

Source: Prepared by the author using IMF DATAMAPPER

the total fertility rate (TFR) has been stagnant at around 1.6 since around 2021.

At the end of the 20th century, Russia's TFR temporarily dropped to around 1.2, and the government launched a policy of providing large benefits to parents with two or more children. Although the birth rate has recovered somewhat since then, the Putin administration's concerns about a declining population appear to be substantial. The Russian government seems to be feeling a considerable sense of crisis over the decline in the number of troops and the tendency of highly skilled workers to leave the country.

The future is not bright for either China or Russia as far as working-age population and economic vitality indicators are concerned. Both the expansionism of Xi Jinping's despotic regime and the imperialism of contemporary Russia are in some respects, as it were, escapist actions brought about by a sense of crisis over future governance stemming from population decline and economic stagnation. Population decline is the biggest national challenge even for despotic regimes in liberal economies.

(2) The Case of Canada

We have looked broadly at the rate of change in the total population of some of the major countries. While there are a number of countries that have recorded population declines, we would like to focus on the case of Canada, which is facing several challenges while recording an increase in its total population due to immigration and international students.

According to Statistics Canada (2024), Canada's total population exceeded 40 million on January 1, 2024, growing by almost 1.3 million, or +3.2%, in a single year, the highest level since 1957. However, most these migrants were foreign students and temporary migrants. If only permanent immigrants and natural increase (births minus deaths) are considered, the population growth rate was only 1.2%.

The population of non-permanent residents grew by more than 800,000 (10% of whom are asylum seekers). Over the past three years, these non-permanent residents have clearly become instrumental in addressing the labor shortages on the Canadian labor market.

However, it is also a fact that nearly 100,000 immigrants have been leaving Canada every year for the past three years, mainly for economic reasons, such as the high cost of living in Canada, including the lack of affordable housing.

In consideration of the plight of international students who must study while facing high housing costs, Canada's Minister of Immigration has announced that the number of visas issued to international students will be limited to approximately 364,000 over the next two years, representing a 35% decrease.

These policy changes indicate that even though the labor shortage caused by the shrinking labor force is a pressing issue, in order to rely on foreign labor force as a solution, it is essential that certain qualitative conditions be met as far as immigrants' living environment is concerned.

3. The Growing Presence of the “Global South”

In the “shaky world order,” the countries of the “Global South” are beginning to show their presence as important players that cannot be underestimated in the future. The “Global South” refers to former developing countries that have been catching up with developed countries with high growth rates in recent years and occupy a considerable size in the world economy. There is no clear definition of the concept of the “Global South. The fact that the “Global South” is expanding its relative size and making great strides in the world economy may, from a different perspective, mean that the developed countries have relatively retreated.

The Global South is thought to originate from the BRICS (Brazil, Russia, India, China, and South Africa), the five BRICS nations that have added Argentina, Egypt, Ethiopia, Iran, Saudi Arabia, and the United Arab Emirates as official members since January 2024. Other high-income countries such as Singapore, Chile, and Poland, as well as lower-middle-income countries within ASEAN, could also be included.

However, these countries of the “Global South” are by no means monolithic. Many of them are among the largest countries in the world in terms of total population and total GDP, although their individual economic welfare (GDP per capita) is low. A typical example is India. India's growing presence as a third pole in the world's political and economic arena is certainly a positive development.

Many of the countries grouped together as the “Global South” have severe problems such as debt problems, climate change, demographics, and religious conflicts that lead to violence. India, often seen as a democratic country with shared freedom and equality, in reality has its own problems of inconvenience and inequality. However, India, which is sometimes regarded as an ally in the “Global South,” has made remarkable strides in the past decade or so.

(1) Characteristics of the Indian Nation

India is a complex country with many unknowns: its total population overtook that of China to become the world's largest in 2022, and its nominal GDP is expected to overtake that of Japan and rise to fourth place by 2025, according to the IMF's World Economic Outlook (April 2024). (IMF's forecast is based on the assumption that the JPY will weaken against the U.S. dollar and that the Indian

rupee will remain at 83 to 85 rupees to the dollar. Therefore, if the JPY appreciates, India's GDP will overtake Japan's further into the future.)

However, even though India's GDP may surpass that of Japan, its GDP per capita is not even 140th in the world ranking. In other words, India's level of economic welfare in terms of the level of consumption of its citizens is still very low by global standards. However, many investors around the world believe that India's economy has begun to show its strength in the past few years. Investors from developed countries are beginning to inject more money into the Indian stock market. On the other hand, there are those who point out the immaturity and lateness of the business environment in India. There are also concerns about the stability of the political system, and about the extent to which India can successfully reform the investment environment for the software business, especially the reliability and stability of rules and institutions (Vaishnav, 2023).

However, if we assume that the best indicator of future "national power" is population, it is undeniable that India is a superpower. Its military expenditure, which is considered one of the other indicators of "national power," is the fourth-largest in the world at \$81.4 billion, and it has surpassed China to become the largest importer of Russian weapons. India's technological superiority in space development, which is related to specific military technologies, is also demonstrated by the successful landing of the Chandrayaan-3 lunar probe on the moon in August 2023. India became the fourth country, after the former Soviet Union, the United States, and China, to successfully land on the moon.

In the first two decades of the 21st century, India has certainly continued to offer bright prospects for economic development as a democratic nation, while also taking care to guarantee the rights of the country's linguistic and religious minorities, and to balance the political power between the center and the regions. In recent years, however, Hindu nationalism has gained political power and begun to cause tension in Indian society. After the Covid-19 pandemic, economic stagnation has also been observed, and it has become necessary to watch closely whether India can develop as a true democratic nation. One of the main causes, as often pointed out, is the caste system inherent in the Hindu tradition, which hinders social mobility. Another is the phenomenon of wealth inequality resulting from the absence of a modern inheritance tax, as discussed next.

(2) Impediments to India's Rise

The Indian Parliament held a month-and-a-half long election from April 19 to June 1, 2024, to elect the lower house of the Indian Parliament. As a result, the National Democratic Alliance (NDA), India's ruling coalition led by Prime Minister Narendra Modi, won 293 out of 543 seats in the House of the people,

more than a majority, and will be in power for a third term. However, the number of seats of the Bharatiya Janata Party, Prime Minister Modi's own party, fell dramatically to 240. Whereas various explanations have been offered for the BJP's decline, the root cause is the Hindu extremists' campaign against Islam, Christianity, Sikhism, and Buddhism in India, where Hindus constitute nearly 80% of the population. Many commentators have also pointed to economic factors as the underlying cause, with rising prices in low-income rural areas and growing dissatisfaction with unemployment.

In India, family-owned conglomerates (Tata, Birla, and Reliance Industries) have enjoyed great political power and have played a major role as the main engine of India's economic development. However, because India has no inheritance law in the modern sense, there is virtually no taxation system for the inheritance of wealth accumulated by family-owned enterprises, and the power of wealth equalization through the tax system is extremely weak (see Yamamoto, 2021).

It is interesting to note that this "inheritance tax" was mentioned in an interview that *The Times of India* conducted with Prime Minister Modi during the current Congress election. Mr. Modi was asked whether he believed that wealth tax or an inheritance tax would be instrumental in solving the problems of fairness and equality, which have turned into a social debate. After mentioning discrimination in treatment between men and women, Prime Minister Modi responded that such a tax would not contribute to eliminating inequality or poverty.

The economic disparity between the high per capita income areas of Goa, Sikkim, and the Delhi metropolitan area on the one hand, and other states on the other, as well as religious conflicts, may be factors that have made India's rise difficult. India's internal divisions and disparities are not conducive to future economic growth. The country also faces complex issues of competition and cooperation in the international political arena. India's behavior cannot be seen as that of a liberal democracy that values freedom and equality.

The Japan-US-Australia-India Strategic Dialogue (Quad), which was proposed by Japan and launched in 2007, has attracted attention as the "the orphan of Asian democracy." However, the Quad is hardly a rock-solid collective security arrangement, which is reflected in India's position in military diplomacy with China and Russia. India abstained from voting on the UN Security Council resolution condemning Russia's invasion of Ukraine. This is said to be because India purchases Russian-made weapons. Although India hosts a UNHCR base, it refuses to accept Japanese Air Self-Defense Force planes that are transporting humanitarian aid to Ukrainian refugees. India is not alone in adopting such a

stance. Many countries in the “Global South” are trying to avoid entering into hostile relations with China and Russia.

4. Concluding Remarks

While the world is unstable politically and militarily, the global economy is experiencing certain tectonic shifts in trade and investment, industrial structure, and consumption behavior, among others. It is true that the world is covered with uncertain factors that are difficult to foresee, including the future of the “dollar order,” the transformation of work and life brought about by AI and the emergence of former developing countries on the stage of international politics and economics. However, these uncertain factors of change are only one aspect of the matter.

It is also necessary to recognize the parts that will not change. It would be too hasty to argue that the world economic order has collapsed, and a new order must be formed because we have entered an era of protectionism, war, and military tension. As mentioned earlier, historically, periods in which “economic sovereignty” remained steadfast have been rather exceptional. Although the world economic system has always been marked by turmoil and instability, it has always managed (somehow, some way, through muddling through) to find a stable solution.

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