

ENHANCING REGIONAL TRADE FOR ASIA*

Chair: Arvind Panagariya

Speakers: Taeho Bark, Kristy Hsu, Heiwei Tang, Anne Krueger

Interactive
Session

5B

Date: 05th October 2025 | Time: 12:00 – 13:30 hrs

Asia is no longer just a participant in the global trade and value chain; it is where the future of global commerce is being written. It accounts for 55% of the world's GDP and around 60% of the global manufactured products. The Asian Development Bank has mentioned in its report on 'Asia 2050' that Asia's GDP will increase to \$174 trillion by 2050, or half of the world's GDP. Amid the rising geopolitical uncertainties, the structural transformation among Asian countries is redefining the very architecture of Asian trade. The Regional Trade Agreements become imperative to safeguard manufacturing competitiveness and supply chain resilience while promoting open markets. The opportunities for countries like Taiwan, Vietnam, India, and Indonesia have been emerging due to recent challenges China is facing, including overcapacity, deflation, low consumption, and shifting manufacturing units to other emerging economies. This policy brief aims to distil the important insights from the conclave discussion on 'Enhancing Regional Trade for Asia', where a large part of the focus was on shifting opportunities, trade flow, and institutional capacities.

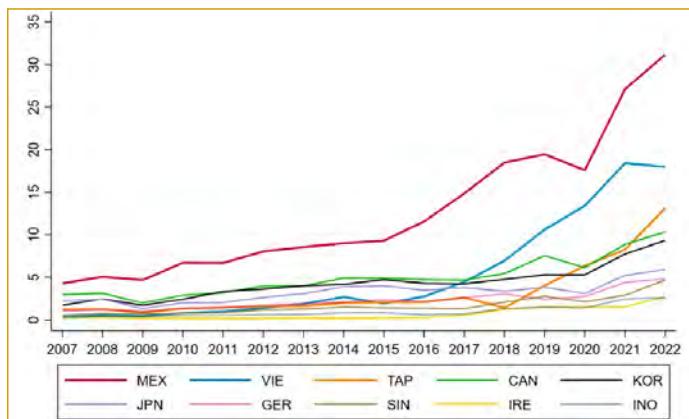
Shifting Dynamics of Asian Trade

The expansion of Asia's trade has largely been composed of electronics, primary & intermediate inputs, and manufactured products. One of the Asian countries that benefited the most from globalisation is China. Its value addition in exports to the US has been rising largely due to the country's comprehensive industrial policy, equipped with, initially, low labour cost, strong institutions, massive state investment in infrastructure and technology, robust medical care, and judicious steps like SEZs. Speakers also emphasised that the central factor of China's strategic victory lies in its strong and self-driven institutions at the local level. These institutions have the power to allocate resources and incentives to promote production at the local level. Even the tax revenue of local governments is linked to the local production. Moreover, the labour market in China is driven by market forces, which set the wage rate. The involution policy of China has led to a massive problem of overcapacity and deflation, which is much more diffuse now than in the past. These problems are largely associated with the similarities in public policies across different regions of China.

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However, China has been creating global trade problems by “weaponizing” its dominant stance in influencing the global supply chain for semiconductors, and rare earth minerals. This has led to the US–China Trade War, which has created both opportunities and challenges for the rest of the world.

Furthermore, the panel also highlighted the occurrence of the “connector economies”. It refers to countries that act as intermediaries, especially during geopolitical fragmentation, by not aligning with any single major bloc like the US or China. These countries link supply chains, trade routes, and a production networks across regions. From Figure 1, Vietnam, Taiwan, South Korea and Mexico have been showing major upward trends in commodities like semiconductors and technology in the global value chain, likely by reallocation of supply chain from China (China + 1 strategy), and integration among Asian and Western supply networks, especially post-2018 period.



Speakers further focused on some insights from AER's "Fajgelbaum, Goldberg, Kennedy, and Taglioni (2024) "The US-China Trade War and Global Reallocation". Figure 2 depicts one of the

snapshots from the paper. It shows relative export growth in targeted products across countries, where the X-axis shows a list of countries represented by labels, and the Y-axis represents the log change in exports. The graph measures how each country's exports change in response to the trade war, especially for products that became subject to tariffs. The bars going downward show countries whose exports deteriorate in those goods (lost share in reallocation), and bars going upwards show countries whose exports have been increased (benefited a greater market share from the trade reallocation between the US and China). The vertical line represents confidence intervals, and small triangles represent estimates. Emerging economies like Vietnam, Mexico, Taiwan, Malaysia and Thailand gained the most, confirming the global supply chain reallocation away from China toward these emerging economies.

FIGURE 2: RELATIVE EXPORT GROWTH IN TARGETED PRODUCTS ACROSS COUNTRIES

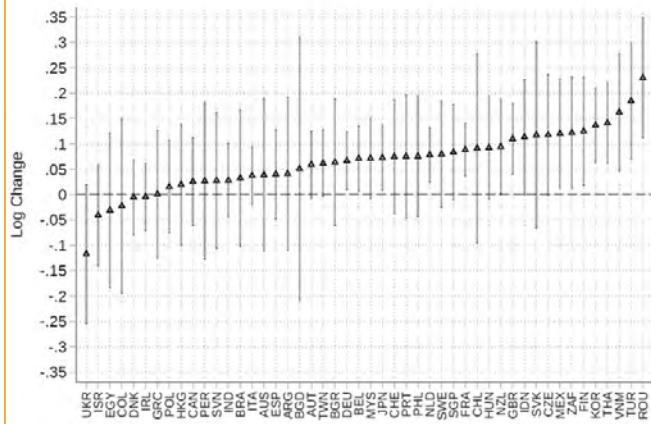


Figure 3 depicts that China's weak domestic consumption, decentralised policy and top-

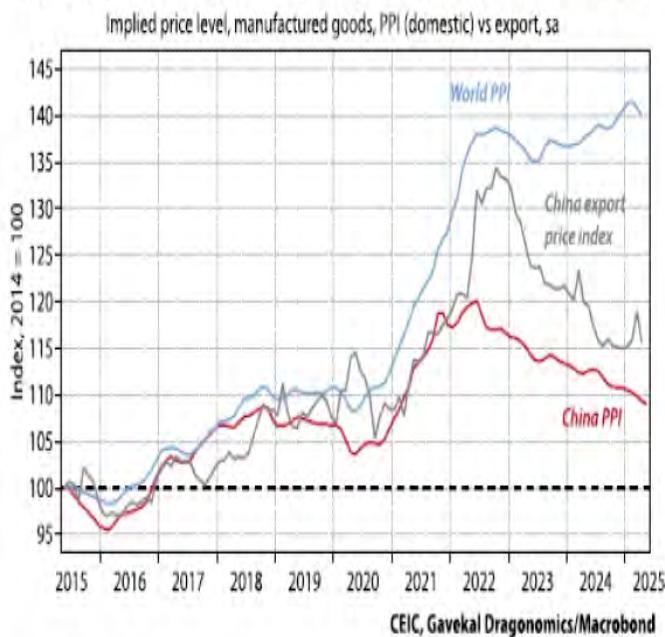
down industrial expansion have made the nation reliant on export as an engine of growth. The left graph shows that the export prices are much lower than the global average export prices, but higher than the domestic prices. The right graph shows that all the major sectors, including electronics, are becoming export-dependent. Due to lower domestic demand, it is difficult for the Chinese economy to absorb all the production. Consequently, Chinese firms cut costs abroad to stay competitive despite falling domestic prices due to overcapacity. The notation 'China PPI' depicts consistent deflationary pressure on the

countries like Taiwan is marginal because 70% of Taiwan's exports consist of products like ICT, semiconductors, etc., which are exempted from the reciprocal tariff. Further, Taiwan's export to the US has increased by 30% likely to be affected by the 'rush order effect' (US importers import more than required due to the threat of high cost from reciprocal tariff).

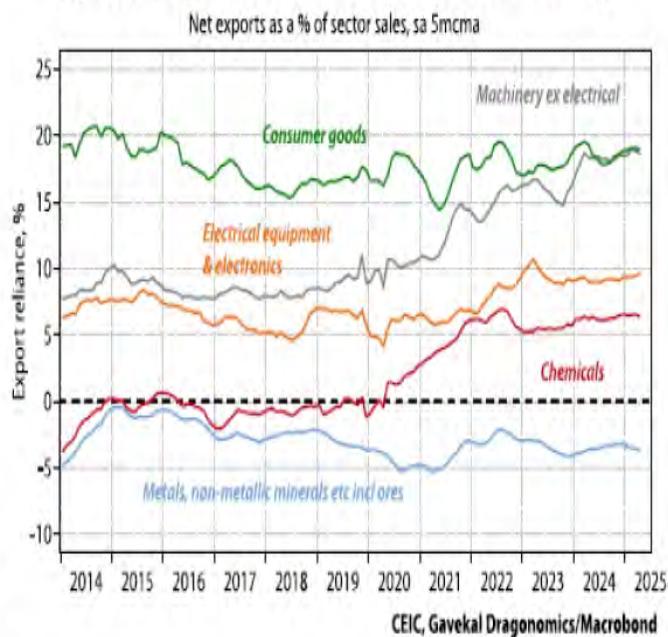
There are also drastic changes in the composition of the export basket of different countries. Vietnam's export basket is largely comprised of telephones, integrated circuits, computers, and broadband accessories, with a

Weak domestic demand + Decentralized economic policy making + Top-down Industrialization in China = Export Reliance

Export prices are cheaper than global prices, but higher than domestic



Export reliance continued to climb, particularly for machinery



manufacturing sector.

Moreover, the recent reciprocal tariff impact on

total export value of \$424 billion in 2023, up from \$80.4 billion in 2010. Similarly, the share of

Integrated circuits in Malaysia's export basket has increased from 13.3% to 19.6%, followed by refined petroleum, crude petroleum and gas. The total value of exports from Malaysia has increased from \$248 billion in 2010 to \$371 billion in 2023.

Comment on the Indian Economy

India plays a vital role in transforming the Asia trade landscape. The country has made significant progress in diversifying its export basket and destination across the world. Though India's merchandise trade share has drastically increased to \$437 billion in the financial year 2024, its presence in the global supply chain has remained marginal than other Asian countries.

Sectors such as chemicals, engineering goods, wearable electronics, pharmaceuticals and drugs, and semi-precious metals showed robust growth and a significant increase in their share of India's total export basket. Despite this, its share in the world's merchandise export hovers around less than 2%, which is negligible. This can be traced to different bottlenecks like rigid labour laws, high logistics cost (the ship around time in India is three times that of other Asian countries), inefficiencies at the regional production level, and high tariffs on imported inputs. Due to the trade reallocation from China's manufacturing sector, India has a great incentive to increase its presence in the global value chain. However, fiscal policy will be required to build India's capacities; the actual need, though, would be to focus on logistics modernisation, labour market freedom, and a reduction in tariff rates on imported inputs which are relatively very high.

Policy Recommendation

The panel suggested a few recommendations, including:

- India needs to get ready for internal and external challenges by making its foundation strong. Policies that focus on logistics efficiencies, freedom in labour laws, re-engagement through sectoral partnerships, and supply chain coordination would create strong foundation for the nation.
- Bilateral trade agreement with Asian countries to take advantage of the rising reallocation of trade benefits.
- Expansion of open markets and strengthening India's regional footprint.
- WTO reforms are vital, and countries with similar interests need to come together to keep discussions open.
- India needs to become a proactive architect of Asia's integration by combining institutional modernisation.

As global trade fractures due to tariffs and geopolitics, regional integration among Asian countries becomes imperative. As production opportunities diversify and new markets are opening, the idea that nations should be open, adaptive and institutionally strong will make them ready for future uncertainties. Aligning national interests and reforms with regional integration and opportunities, the future of global trade doesn't lie in the Western interest, but in the most connected, coordinated and confident nations.



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