

## REDIRECTED INVESTMENTS AMID US-CHINA TRADE CONFLICTS: OPPORTUNITIES AND CHALLENGES FOR SOUTH ASIA'S MANUFACTURING INDUSTRY

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### Abstract

The US-China trade conflict has significantly reshaped global value chains, prompting a strategic redirection of Foreign Direct Investment (FDI) as multinational enterprises diversify their manufacturing bases away from China. This paper explores the resulting opportunities and enduring challenges for South Asia's manufacturing industry as it emerges as a critical alternative production hub. The region, particularly India and Bangladesh, benefits from competitive labor costs, a large demographic dividend, and government initiatives like 'Make in India,' attracting increased FDI into key sectors such as electronics, textiles, and machinery. However, the long-term sustainability of this growth is challenged by significant structural weaknesses, including persistent infrastructure deficits (logistics, energy supply), bureaucratic regulatory inefficiencies, a critical skill mismatch in the labor force, and the destabilizing risk of capital flight. Sustained success hinges on the urgent implementation of comprehensive policy reforms. These must prioritize substantial investment in smart infrastructure, streamlining regulatory frameworks, aggressive skill development, and fostering deeper regional cooperation to improve competitiveness relative to Southeast Asian counterparts and fully capitalize on the shifting global economic landscape.

## INTRODUCTION

As the US-China trade war reshapes global supply chains, South Asia has emerged as a critical alternative manufacturing hub, witnessing a 25% increase in foreign direct investments (FDI) as companies seek to diversify away from China (Dai, 2025). The US-China trade wars are reshaping global supply chains with significant implications across sectors, including the manufacturing industry in South Asia. As a result of these conflicts, foreign direct investment (FDI) and trade patterns are now shifting towards other areas rather than China and the US. Thus, the global manufacturing and investment patterns are being altered (Sugianto et al., 2024). As depicted in **Figure 0.1**, the tariff escalation during the trade war has prompted companies to seek alternative manufacturing hubs, shifting FDI towards South Asia.

One significant change noticed here is the change in investment flows. American companies are now turning their gaze to Southeast Asia, including parts of South Asia, to cut down on their dependence on the Chinese market. This shift is due to the need to stabilize the market as well as ensure disruption to the supply chain (Jung & Park, 2024). As a result, these changes have opened avenues for economic growth and industrial development of South Asian countries which are emerging as alternative manufacturing and supply chain hubs (Bhaskaran et al., 2025).

The trade tensions showed how trade policies can affect global value chains (GVCs). As a result, firms have adapted by changing their locations of supply and demand, as well as their supply-chain partners. Such strategic shifts have, in part, helped South Asian countries enter and expand in the global manufacturing market. Businesses in sectors like apparel, automobiles and electronics have tweaked their supply chains to factor in new **Table 0.1** the manufacturing value added as a percentage of GDP in Southeast Asia has consistently been higher, reflecting a more

trade realities, thus allowing scope for manufacturers in South Asia to be a part of these GVCs (Gereffi et al., 2021).

China is designing suppliers from other regions due to the US-China trade war. Due to the high production cost and geopolitical instability in China, many businesses worldwide are shifting to the other countries. This has benefited countries like Bangladesh, India, and Vietnam as they are capitalizing on low production costs as well as low tariffs to attract businesses. The move of facilities and setting up of new sub-tier suppliers to South Asia indicates the importance of global supply chains (Golgeci et al., 2025).

Apart from the immediate shift in trade and investment, the global supply networks will suffer a bigger brunt because of the conflicts. The recent focus on making supply chains resilient and sustainable has brought South Asia into the spotlight as a key player in meeting the demand for diversified sourcing and production bases. With the aid of adaptive measures, South Asia's manufacturing industry can benefit from new opportunities that were earlier dominated by China. As a result, it can contribute to regional economic development and the global economy (Sugianto et al., 2024). This paper will explore how South Asian countries can capitalize on the shifting investment flows, highlighting both the opportunities for economic growth and the challenges in building sustainable and competitive manufacturing sectors.

As the US-China trade war reshapes global supply chains, South Asia has become an increasingly attractive alternative manufacturing hub. Despite this shift, South Asia's contribution to GDP from manufacturing remains lower than that of Southeast Asia. As shown in

established and diversified manufacturing base in the region compared to South Asia. (Jung & Park, 2024).

**Table 0.1: Manufacturing Value Added as % of GDP - South Asia vs. Southeast Asia (2018–2023)**

| Region         | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|----------------|------|------|------|------|------|------|
| South Asia     | 14.5 | 14.2 | 13.0 | 13.8 | 13.5 | 13.4 |
| Southeast Asia | 21.0 | 20.8 | 19.5 | 20.2 | 20.5 | 20.3 |

Trade Conflicts and Investment Diversion

The US-China trade war has significantly reshaped global supply chains, leading to shifts in foreign direct investment (FDI) patterns. South Asia has emerged as a critical alternative manufacturing hub, benefiting from redirected

investments across various sectors such as electronics, textiles, and machinery. This diversification of investments is driven by companies seeking to mitigate risks associated with reliance on China due to rising tariffs and geopolitical instability (Sugianto et al., 2024)

US-China trade war tariffs: An up-to-date chart

Last updated August 27, 2025

a. US-China tariff rates toward each other and rest of world (ROW)

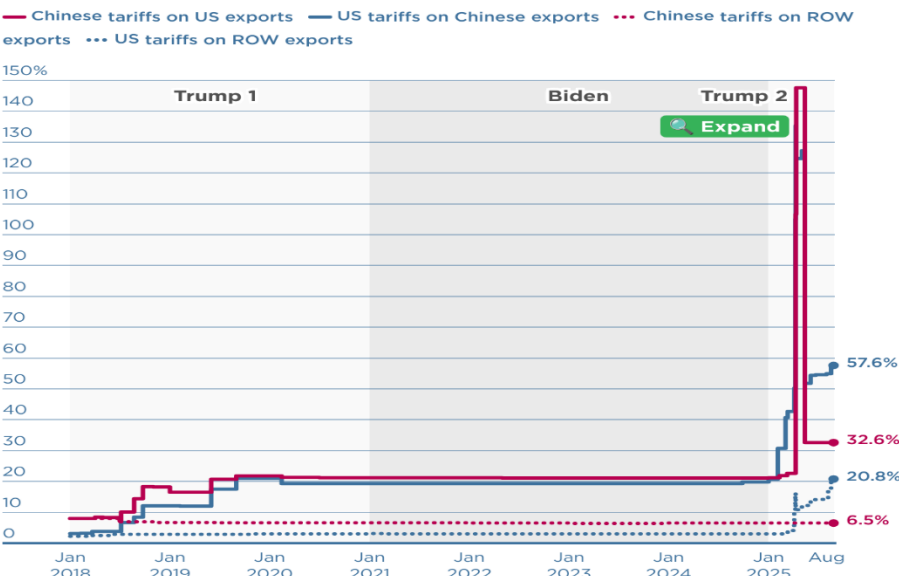


Figure 0.1: US-China Trade War Tariffs: A Visual Overview of Shifting Tariff Rates Across Administrations, 2018-2025

Electronics Sector

The electronics sector in South Asia has seen substantial inflows of FDI as global companies, particularly from the US, reallocate their manufacturing bases away from China. This shift is driven by the desire to diversify supply chains and reduce dependency on a single market, especially given the trade tensions between the US

and China. For example, Samsung has increased its production in India as part of its strategy to avoid potential tariff impacts on Chinese imports (Jung & Park, 2024). Additionally, Apple has been shifting some of its production to India and Vietnam, aiming to expand its supply chain beyond China to ensure greater resilience in light of the trade war (Abiad et al., 2018) As a result,

South Asia's electronics manufacturing sector is becoming more integrated into global supply chains, marking a significant opportunity for economic growth (Anwar et al., 2021).

### Textiles Sector

The textile industry in South Asia, particularly in Bangladesh, has also been a major beneficiary of the investment redirection. Due to the ongoing geopolitical tensions and rising production costs in China, many companies are turning to South Asia, where labor costs are significantly lower. Bangladesh, already a key player in the global ready-made garment (RMG) industry, has seen increased foreign investment, particularly in light of China's struggles with maintaining competitive pricing in textiles (Pepe et al., 2023). Additionally, the relaxation of textile quotas and growing consumer demand for low-cost textiles have further solidified Bangladesh's position in global supply chains, attracting even more FDI (Yang & Mlachila, 2007).

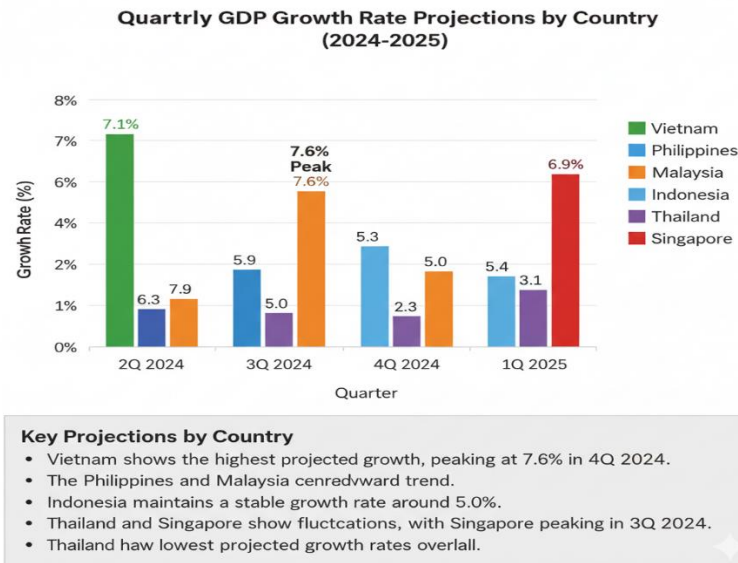
### Machinery Sector

The machinery sector has also been adapting to the redirected investments, particularly as the US-China trade war has created opportunities for South Asian countries to expand their manufacturing capabilities. As companies scale back their reliance on Chinese suppliers, countries like India and Vietnam are stepping in to fill the

gap. For instance, India's focus on manufacturing high-tech equipment and machinery, spurred by the government's Make in India initiative, has attracted new foreign investments in this sector (Anwar et al., 2021). The machinery sector's growth aligns with the overall trend of South Asia becoming a more prominent player in the global supply chain, offering companies competitive advantages due to lower labor costs and favorable trade agreements (Bhaskaran et al., 2025).

### Investment Diversion: The Bigger Picture

The trade war has led to a broader trend of investment diversion from China to other regions, and South Asia is emerging as a key beneficiary of this shift. Investment diversion refers to the strategic reallocation of FDI by companies seeking to avoid the growing risks of doing business in China, such as increased tariffs, supply chain disruptions, and geopolitical instability. South Asia's appeal lies in its lower labor costs, strategic location, and improved trade agreements, particularly with countries like India, Bangladesh, and Vietnam. As a result, the region is witnessing an influx of investments previously directed towards China, which is helping to drive economic growth and industrial development across South Asia (Sugianto et al., 2024) as illustrated in **Figure 0.2**.



**Figure 0.2: Quarterly GDP Growth Rate Projections for South Asian and Southeast Asian countries (2024-2025)**

These changes reflect a broader trend in global supply chains, where firms are increasingly looking for diversification and resilience. American firms have been particularly proactive in reducing their reliance on China, turning their focus to Southeast Asia, including parts of South Asia (Jung & Park, 2024). As South Asia becomes a more integral part of global manufacturing networks, the region is benefiting from increased FDI, which, in turn, contributes to economic growth. The impact of the US-China tariff hikes, as seen in **Figure 0.1**, has driven companies to reconsider their production strategies and diversify their supply chains away from China.

#### Long-Term Prospects

While the short-term effects of the trade war on South Asia are positive, with increased investments in electronics, textiles, and machinery, the long-term sustainability of this trend remains uncertain. The future of these redirected investments will depend on the stability of geopolitical conditions, including the resolution of the trade conflict and the evolution of China's trade policies. Moreover, South Asian countries must ensure they continue improving

their infrastructure, regulatory environments, and workforce skills to maintain their attractiveness as alternative manufacturing hubs in the long run (Anwar et al., 2021). The US-China trade war has led to a reconfiguration of global supply chains, with South Asia emerging as a critical player in the diversification of manufacturing and investment flows. The region's ability to sustain and further benefit from redirected investments will hinge on continued improvements in infrastructure, policy reforms, and skills development (Yamamoto et al., 2012).

#### Geopolitical Risks and Capital Flight

The rising geopolitical risks stemming from the US-China trade war have had significant repercussions for capital flows across emerging economies. One such impact is capital flight, where investors withdraw their investments from riskier markets and redirect them to more stable, mature economies. This process is driven by the desire to mitigate the uncertainty caused by trade wars, tariffs, and the shifting global economic dynamics. The US-China trade conflict has intensified this phenomenon, pushing capital towards developed markets and away from

emerging economies, including those in South Asia (Carney et al., 2024)

#### Capital Flight and its Impact on South Asia

South Asia, with its growing economies and dependency on foreign direct investment (FDI) for infrastructure development, is particularly vulnerable to the effects of capital flight. As firms and investors seek safer investments in developed economies, the region's ability to attract and retain FDI is diminished. This situation is exacerbated by the uncertainties of the trade conflict, which creates a volatile investment environment. India, in particular, has experienced a decline in FDI as investors become increasingly wary of the risks associated with trade tensions (Carney et al., 2024).

For instance, in 2019, India saw a 10% drop in FDI inflows, largely attributed to the growing geopolitical risks and shifting trade policies (World Bank, 2023). This trend is not unique to India; other South Asian countries like Pakistan have also witnessed a slowdown in foreign investments in critical sectors such as energy, manufacturing, and technology. The capital outflows from these countries have been a direct result of the US-China trade dispute, as investors sought more stable economies to safeguard their assets (Murshed et al., 2022).

#### Geopolitical Risk as a Determinant of Investment Decisions

Geopolitical risks, particularly those related to trade conflicts, can increase the cost of equity in emerging economies. Firms in these regions must offer higher returns to attract investment, compensating for the additional risks associated with political instability and trade disruptions. Capital flight often results from these elevated risks, pushing investments away from emerging markets and into mature economies with lower perceived risks (Globerman et al., 2006).

The Investment Development Path Hypothesis suggests that as countries develop economically, they begin to invest abroad, extending their influence and capital in more stable markets (Goldstein & Pusterla, 2010). This trend is evident in countries like Brazil and China, where firms

have started to diversify their investments outside their home countries, seeking safer returns amid geopolitical tensions. For South Asia, however, this trend presents a challenge: countries must compete for the limited available capital while also managing the risks associated with being viewed as high-risk investment destinations (Qi et al., 2025).

#### Long-Term Implications for South Asia's Economic Growth

If capital flight continues at its current pace, South Asia's long-term economic growth prospects could be severely compromised. The region's economies rely on FDI for infrastructure development, technological advancements, and industrial growth. A sustained reduction in capital inflows could hinder these areas, limiting the potential for sustained growth. South Asia's integration into global value chains (GVCs) could also be delayed, as businesses may not have the necessary capital to upgrade their technologies or improve their manufacturing capabilities (Scheela et al., 2015). South Asia must, therefore, address the dual challenges of attracting investment while simultaneously managing the risks associated with capital flight. Strategies to improve political stability, enhance regulatory frameworks, and strengthen economic partnerships with non-traditional partners (such as the UAE and Turkey) are essential to reduce the region's vulnerability to geopolitical risks (Lazaj et al., 2024). Furthermore, enhancing the investment climate through improved infrastructure, tax policies, and workforce development will be key to ensuring that South Asia remains an attractive destination for long-term investments (Singh et al., 2025).

#### The Role of Emerging Economies in Global Capital Flows

As multinational enterprises (MNEs) continue to move their operations to markets with perceived political stability, the impact of capital flight becomes even more pronounced in emerging economies like those in South Asia. MNEs play a critical role in shaping economic processes in developing economies, often creating spillover effects that benefit local industries. However, the influx of MNEs can also create market congestion,

where multiple firms compete for the same resources, driving up costs and reducing the profitability of investment (Meyer, 2004).

For South Asia, sustaining long-term investment growth will require carefully balancing the influx of MNEs while ensuring the region's economies are prepared to manage the risks associated with capital flight. The evolution of these risks, particularly in the context of the US-China trade war, underscores the importance of maintaining a competitive edge in attracting global investments (Bhaskaran et al., 2025).

### South Asia's Manufacturing Landscape

The manufacturing sector in South Asia offers a unique mix of strengths and weaknesses that determine the region's ability to capitalize on redirected investments in the wake of the US-China trade war. While South Asia has significant advantages in terms of labor costs and market size, it faces major challenges in infrastructure and regulatory inefficiencies, which can hinder its competitiveness as a manufacturing hub (Su Hui et al., 2024).

### Strengths of South Asia's Manufacturing Landscape

South Asia, particularly India and Bangladesh, benefits from a competitive labor force that offers cost advantages for foreign investors. The region's demographic dividend, characterized by a young and growing population, ensures a steady supply of workers, which enhances the manufacturing capacity of countries like India and Bangladesh. India's labor costs remain significantly lower than China's, making it an attractive destination for labor-intensive industries, such as textiles and electronics (Anwar et al., 2021).

In addition to cost competitiveness, South Asia's geographical location is another strength. The region is strategically positioned to serve key markets in Asia, the Middle East, and Africa. This strategic advantage allows for better access to trade routes and facilitates the integration of South Asia into global supply chains. India's Make in India initiative has been particularly instrumental in attracting foreign manufacturing investments,

aiming to position India as a global manufacturing hub (Gunasekaran et al., 2024).

For example, Bangladesh's textile industry has become a significant player in global supply chains, benefiting from low labor costs and its integration into the global garment supply chain. With the trade war creating new opportunities for countries outside China, Bangladesh has seen a surge in FDI in textiles, becoming the second-largest exporter of ready-made garments (Swazan & Das, 2022).

### Weaknesses of South Asia's Manufacturing Landscape

Despite these strengths, South Asia faces substantial challenges that undermine its ability to fully capitalize on redirected investments. One of the biggest obstacles is the region's infrastructure deficits. South Asia's logistics, transportation networks, and power supply are often inefficient, which increases production costs and delays the movement of goods. In countries like Pakistan and India, inadequate infrastructure has been a significant deterrent for investors seeking reliable and cost-effective production bases (Gunasekaran et al., 2024).

For instance, India's infrastructure needs considerable investment to support its manufacturing sector's growth. According to a 2023 report by the Asian Development Bank (ADB), India's poor infrastructure adds an estimated 2-3% to production costs, which makes it less competitive compared to countries like Vietnam and Thailand, which have more advanced infrastructure networks (World Bank, 2023).

Additionally, South Asia's regulatory challenges further complicate the business environment. Bureaucratic red tape, complex tax systems, and inconsistent enforcement of labor laws create barriers for businesses looking to enter the region. The lack of streamlined business regulations and cumbersome processes for obtaining permits often result in delays and increased costs for manufacturers (Sugianto et al., 2024).

Comparison to Southeast Asia

In comparison to Southeast Asia, South Asia has both advantages and disadvantages. Southeast

Asia has made significant strides in attracting foreign investments, especially due to trade agreements like the Regional Comprehensive Economic Partnership (RCEP) and the ASEAN Economic Community (AEC), which reduce trade barriers and enhance regional integration. Countries like Vietnam and Thailand have developed robust infrastructure, streamlined regulatory processes, and efficient logistics networks, which have made them more attractive to investors (Shimizu, 2021).

While South Asia offers lower labor costs and a larger domestic market, it lags behind Southeast Asia in terms of infrastructure and regional integration. India, as the largest economy in the region, plays a significant role in promoting growth, but it must overcome its infrastructure and regulatory hurdles to compete more effectively with its Southeast Asian counterparts. The trade war has opened opportunities for South Asia, but the region must improve its competitiveness in these areas to fully capitalize on the shift in investment flows (Yoganandham et al., 2025).

#### **The Need for Infrastructure and Policy Reforms**

To sustain long-term growth in the manufacturing sector, South Asia needs to focus on addressing its infrastructure gaps. Investment in transportation, energy, and logistics infrastructure is crucial to ensuring that the region remains an attractive destination for foreign manufacturing investments. Governments in countries like India and Bangladesh must prioritize these sectors, alongside regulatory reforms, to reduce business costs and improve the ease of doing business (Lazaj et al., 2024).

Furthermore, adopting Industry 4.0 technologies is essential for improving productivity and competitiveness in South Asia's manufacturing sector. Countries like India are gradually integrating these technologies, but more substantial investments in automation, AI, and big data analytics are needed to ensure that South Asia can remain competitive in the global manufacturing landscape (Prasanna, 2010).

#### **Opportunities and Growth Potential**

The US-China trade conflict has opened up significant opportunities for South Asia, as redirected investments are increasingly flowing into the region. South Asia, with its competitive labor costs, strategic location, and growing manufacturing capacity, is well-positioned to attract these investments, particularly in sectors like textiles, electronics, and machinery. The shift in global supply chains, triggered by the trade war, has made South Asia an attractive alternative to China for multinational companies seeking to diversify their production bases (Waqas et al., 2020).

#### **Redirected Investments in South Asia**

South Asia's growth potential lies in its ability to capitalize on the redirected investments flowing into the region. The region's labor competitiveness is a key strength that makes it an attractive destination for foreign manufacturers. For instance, Bangladesh has seen significant growth in its textile sector, with foreign investments increasing due to the country's low labor costs and established manufacturing infrastructure. According to Swazan and Das (2022), Bangladesh is now the second-largest exporter of ready-made garments globally, benefiting from a shift in production away from China as a result of the trade conflict. Similarly, India's manufacturing sector saw a 15% increase in FDI in 2020, highlighting the region's potential to attract investments that were once directed towards China (Swazan & Das, 2022).

The shift in investment flows is not only limited to textiles but also extends to other sectors such as electronics and machinery. India's 'Make in India' initiative has been instrumental in attracting foreign investments, particularly in the electronics and automotive sectors. For example, Samsung and Apple have expanded their manufacturing bases in India as part of their strategy to reduce dependency on China (Anwar et al., 2021). The electronics sector in India has benefited from lower production costs and a rapidly growing domestic market, making it an increasingly attractive hub for multinational corporations (Jung & Park, 2024).

### Long-Term Growth Prospects for South Asia

The long-term growth prospects for South Asia's manufacturing sector are substantial, provided the region can maintain the momentum of redirected investments. Sustained FDI inflows are likely to lead to greater integration into global value chains (GVCs). As the region becomes more deeply embedded in global supply chains, countries like India and Bangladesh will experience increased technological advancements, improved infrastructure, and a higher level of industrial diversification. Sugianto et al. (2024) emphasize that the diversification of supply chains away from China is likely to spur growth in South Asia's manufacturing capacity, leading to increased exports and higher levels of industrial output (YOGANANDHAM et al., 2025)

Moreover, South Asia can become a key player in the emerging green economy. As global demand for sustainable products increases, South Asian countries are uniquely positioned to leverage their manufacturing capacities in industries like textiles, electronics, and automobiles to meet this demand. Investments in renewable energy and green technologies can further enhance the region's competitiveness. According to Lazaj et al. (2024), the adoption of green technologies in manufacturing sectors will help South Asian economies gain a competitive edge in the global market.

### Policy Reforms and Strategic Initiatives

For South Asia to fully capitalize on these opportunities, the region must implement a series of policy reforms and strategic initiatives. The 'Make in India' initiative, alongside other country-specific strategies, plays a crucial role in improving the investment climate. However, policy coherence and better infrastructure development are essential to ensure the long-term sustainability of growth in manufacturing. Infrastructure gaps, particularly in logistics, transportation, and energy supply, must be addressed to improve the efficiency of manufacturing operations (Gunasekaran et al., 2024). Governments in South Asia should prioritize investments in these areas to enhance the attractiveness of the region for

multinational firms seeking long-term production bases.

Moreover, trade agreements and regional cooperation will be key to South Asia's continued growth. South Asia must actively engage in initiatives like the Regional Comprehensive Economic Partnership (RCEP) to ensure that the region remains competitive and integrated into the global market (Shimizu, 2021). Strengthening regional trade agreements will help reduce barriers to trade and increase the flow of investments.

### Challenges for South Asia in Leveraging Redirected Investments

Investment diversion in South Asia has its own set of challenges, such as infrastructure gaps, policy instability, and skill shortages. The redirected investments resulting from the US-China trade war have opened substantial opportunities for South Asia. However, the region faces significant challenges that hinder its ability to fully capitalize on these opportunities. Key challenges include infrastructure deficits, regulatory inefficiencies, and skill shortages, which reduce South Asia's attractiveness as a destination for foreign direct investment (FDI). To harness the potential of redirected investments, South Asia must address these structural issues and improve its investment climate (Mendoza et al., 2025)

### Infrastructure Deficits

One of the most pressing challenges for South Asia is its infrastructure deficits. Poor transportation networks, unreliable power supply, and underdeveloped logistics systems significantly raise the cost of doing business in the region. According to Gunasekaran et al. (2024), infrastructure inefficiencies in India alone add an estimated 13% to the cost of production, compared to Southeast Asian nations where logistics costs are lower. These infrastructure bottlenecks deter foreign investors from establishing long-term production bases in South Asia. As a result, countries like India and Pakistan, despite offering lower labor costs, struggle to match the infrastructure capabilities of their competitors in Southeast Asia, such as Vietnam and Thailand (Bhaskaran et al., 2025)

For instance, India's logistics performance index (LPI) is far lower than countries like Vietnam and Malaysia. The high logistics cost, combined with inadequate transport and power supply, makes India less competitive in attracting redirected investments, especially in manufacturing sectors that require efficient and reliable infrastructure (World Bank, 2023).

### Regulatory Challenges

South Asia also suffers from regulatory challenges that impede its ability to attract redirected investments. Bureaucratic inefficiencies, complex tax structures, and inconsistent enforcement of labor laws create barriers to doing business in the region. The World Bank (2023) has ranked India and Pakistan among the lower performers in terms of ease of doing business, citing challenges in securing permits and navigating regulatory requirements as major deterrents for foreign investors. These inefficiencies delay projects and increase the cost of starting and operating businesses, leading many investors to reconsider South Asia as a manufacturing hub (Singh et al., 2025).

Bangladesh, despite its success in the textile industry, faces similar regulatory challenges, such as delays in obtaining necessary permits and inconsistent policy enforcement. These challenges diminish the region's attractiveness as an investment destination. To improve the investment climate, South Asia must focus on simplifying its regulatory frameworks and making business processes more transparent and efficient (Sugianto et al., 2024).

### Skill Mismatches

Another significant hurdle for South Asia is the mismatch between available skills and industry needs. Despite having a large workforce, South Asia struggles with a shortage of workers with the technical skills required for modern manufacturing processes. For example, while India has a large pool of labor, the demand for skilled workers in sectors like electronics and automotive manufacturing often outpaces supply. As noted by Lazaj et al. (2024), skill shortages in key sectors, such as engineering and technology,

make it difficult for South Asia to fully capitalize on investments in high-tech industries.

The skills gap is particularly evident in countries like Pakistan, where industries such as automobiles and IT face significant challenges in hiring workers with the necessary expertise. This mismatch between available labor and industry needs limits South Asia's ability to move up the value chain and participate in more technologically advanced global supply chains (Lazaj et al., 2024). Investing in vocational training and higher education tailored to industry needs is critical to bridging this skills gap and making South Asia more competitive.

### Regional Cooperation as a Solution

To overcome these challenges, South Asia must enhance regional cooperation. SAARC (South Asian Association for Regional Cooperation) and other regional initiatives, such as BIMSTEC (Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation), can play a key role in improving trade facilitation, reducing infrastructure barriers, and harmonizing policies across countries. According to Shimizu (2021), regional cooperation can lead to improvements in transportation infrastructure, energy distribution, and logistics systems, which would significantly enhance South Asia's competitiveness in the global market (Mendoza et al., 2025).

Moreover, collaborative efforts in addressing regulatory issues and reducing trade barriers would help the region become more attractive to foreign investors. South Asia's lack of integration is a significant disadvantage when compared to regions like Southeast Asia, where countries have created strong economic and political ties to foster investment and trade (Shimizu, 2021).

### Policy Recommendations

To better leverage redirected investments, South Asian countries must adopt comprehensive policy reforms focused on improving infrastructure, regulatory efficiency, and skill development. Countries like India and Bangladesh need to focus on investing in infrastructure, particularly in transportation and energy, to make manufacturing operations more efficient and cost-effective. Policy

reforms that simplify business registration, reduce bureaucratic hurdles, and offer incentives for green technologies will also enhance the region's attractiveness to foreign investors (Bhaskaran et al., 2025)

Additionally, South Asia needs to make substantial investments in education and vocational training to ensure that the workforce is adequately prepared to meet the demands of high-tech industries. The growth of the electronics and automotive sectors, for example, depends on having skilled labor to support advanced manufacturing processes (Gunasekaran et al., 2024). Governments should also consider targeted investment incentives to encourage FDI in emerging sectors such as renewable energy, artificial intelligence, and green technologies.

### Country Perspectives

The redirected investments resulting from the US-China trade war have led to differing opportunities for South Asian countries, each of which is navigating these changes in its own way. India, Bangladesh, and Pakistan are all striving to position themselves as key players in global manufacturing, but they face unique challenges and must adopt tailored strategies to attract foreign investments (Mendoza et al., 2025).

### India's Manufacturing Growth and Strategic Positioning

India, as the largest economy in South Asia, has benefited most significantly from the shifting of supply chains. With India's 'Make in India' initiative, the country has sought to position itself as a global manufacturing hub, particularly in electronics, automobiles, and information technology (Anwar et al., 2021). India's FDI inflows saw a 15% increase in 2020, largely due to multinational companies like Apple and Samsung relocating some of their production lines to India (Jung & Park, 2024). However, to maintain its momentum, India must focus on improving its logistics infrastructure and power supply. According to Gunasekaran et al. (2024), high logistics costs in India continue to be a significant barrier to investment.

**Policy Recommendations:** To continue attracting FDI, India should enhance its transportation infrastructure, improve power reliability, and streamline regulatory processes. Additionally, tax incentives for manufacturers investing in green technologies would make India a more attractive destination for sustainable manufacturing (Bhaskaran et al., 2025).

**Bangladesh's Textile Industry as a Case of Success**  
Bangladesh has emerged as the second-largest exporter of ready-made garments (RMG) globally, largely due to its low labor costs and established textile infrastructure. The textile sector in Bangladesh has experienced substantial growth in recent years, and redirected investments have only accelerated this trend. According to Swazan & Das (2022), Bangladesh has seen a 10% annual growth in the textile sector, with multinational companies seeking to diversify away from China. Despite the growth, Bangladesh still faces challenges in sustainability and worker conditions within its garment industry (Zakaria et al., 2019)

**Policy Recommendations:** Bangladesh must continue to modernize its textile industry by investing in sustainable technologies such as recycled fabrics and energy-efficient machinery. Furthermore, improving working conditions and ensuring compliance with international safety standards will enhance Bangladesh's reputation and attract more long-term investments (Waqas et al., 2024).

### Pakistan's Struggle with Energy and Infrastructure Challenges

Pakistan, while benefiting from the general shift of investment away from China, faces substantial challenges in manufacturing. Energy shortages, inefficient infrastructure, and regulatory inefficiencies continue to hamper the growth of the manufacturing sector. The textile and oil refinery industries in Pakistan have struggled to meet production expectations, and the raw cotton sector has seen stagnant growth (Tanveer et al., 2021). Moreover, Pakistan's reliance on imported energy makes manufacturing costs significantly higher compared to regional competitors.

**Policy Recommendations:** Pakistan should prioritize energy infrastructure reform by investing in renewable energy solutions and improving logistics and transportation networks. In addition, improving vocational training programs will help address the skills mismatch and enhance the country's ability to participate in advanced manufacturing sectors (Lazaj et al., 2024).

**Regional Integration and Collaborative Efforts**  
While India, Bangladesh, and Pakistan have distinct challenges, their individual efforts must be seen within the context of regional integration. South Asia's future competitiveness in the global manufacturing landscape depends on the cooperation of these countries to improve infrastructure, reduce trade barriers, and harmonize policies across borders. Regional initiatives like SAARC and BIMSTEC can play a

**Table 0.1,** India has been the largest recipient of FDI in the region, followed by Bangladesh and

critical role in improving trade facilitation and ensuring that South Asia remains competitive compared to Southeast Asia (Shimizu, 2021).

**Policy Recommendations:** Strengthening regional economic cooperation and cross-border infrastructure projects should be a priority. Harmonizing tax regulations, improving transport connectivity, and enhancing labor mobility across South Asian countries will create a more integrated manufacturing environment and enhance the region's competitiveness (Zakaria et al., 2019).

In recent years, South Asia has seen substantial shifts in foreign direct investment (FDI), particularly as businesses seek alternatives to China due to the US-China trade war. As shown in

Pakistan. This trend underscores the growing investment potential of South Asia as a manufacturing hub amidst the changing global trade landscape.

**Table 0.1: FDI Net Inflows to Key South Asian Countries (2018–2024, in USD billion)**

| Country    | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|------------|------|------|------|------|------|------|------|
| India      | 42   | 51   | 64   | 45   | 70   | 71.3 | 81   |
| Bangladesh | 3.61 | 2.87 | 2.56 | 2.89 | 3.48 | 3.00 | 1.47 |
| Pakistan   | 2.22 | 2.28 | 2.80 | 2.59 | 1.26 | 1.56 | 1.33 |
| Sri Lanka  | 1.61 | 0.67 | 0.43 | 0.59 | 0.88 | 0.73 | 0.51 |

### Policy Directions

Policies related to infrastructure, reforms, skills, and technology can help to take maximum advantage of redirected investment to South Asia. To capitalize on the redirected investments from the US-China trade war, South Asia must implement policy reforms that address infrastructure deficits, regulatory inefficiencies, and skill shortages. These reforms should focus on improving the investment climate in key sectors such as textiles, electronics, and machinery. Governments in the region need to

create an environment that encourages sustainable, high-tech manufacturing and fosters deeper integration into global supply chains (Yang et al., 2007).

### Infrastructure Development and Regulatory Reforms

A key policy direction for South Asia is infrastructure investment. Governments must prioritize improvements in transportation, energy, and logistics to reduce production costs and improve efficiency. For example, India's 'Make in India' initiative aims to attract foreign manufacturing investment, but infrastructure challenges, especially in roads and ports, continue to pose a significant barrier (Gunasekaran et al.,

2024). Countries in the region must invest in smart cities, green infrastructure, and energy-efficient technologies to create a conducive environment for high-tech manufacturing (Sugianto et al., 2024).

Additionally, regulatory reforms are essential to streamline business operations and attract long-term investments. Simplifying business registration processes, improving tax policies, and creating investment promotion laws will help reduce the bureaucratic hurdles that often delay projects and increase operational costs for foreign investors. These efforts should be accompanied by strong intellectual property (IP) laws to protect investments and foster innovation (Shimizu, 2021).

### **Regional Cooperation and Integration**

South Asia's ability to leverage redirected investments will also depend on enhanced regional cooperation. Initiatives like SAARC and BIMSTEC must be utilized to harmonize policies across borders, enhance trade facilitation, and improve cross-border infrastructure. As Shimizu (2021) highlights, successful regional integration, as seen in Southeast Asia, has contributed significantly to attracting FDI. South Asia should adopt a similar approach, fostering greater trade openness, improving logistics, and addressing non-tariff barriers that limit the flow of goods and services within the region (Zakaria et al., 2019).

### **Skill Development and Education Policies**

South Asia also faces a critical challenge in the form of skills mismatches, which hinder the region's ability to fully capitalize on the opportunities presented by redirected investments. To overcome this, governments should invest in vocational training programs and STEM education initiatives. India, for instance, should expand its skill development programs to support industries such as electronics, automotive manufacturing, and renewable energy. Public-private partnerships can help align educational curricula with market needs and ensure that workers are adequately prepared for the demands of modern manufacturing (Lazaj et al., 2024).

Additionally, targeted efforts should be made to address the skill shortages in advanced manufacturing and technology. Countries like Bangladesh and Pakistan can benefit from similar skill development policies to ensure their labor forces are competitive in high-tech industries such as AI, robotics, and electric vehicles (Tanveer et al., 2021).

### **Encouraging Sustainable and Green Investments**

South Asia's future growth in manufacturing will depend not only on traditional industries but also on embracing green technologies and sustainable manufacturing practices. Policies should encourage green investment through tax incentives, sustainable energy solutions, and recycling programs. Bangladesh, with its robust textile industry, can lead the way by adopting more environmentally friendly manufacturing practices and focusing on sustainable sourcing (Swazan & Das, 2022). Additionally, renewable energy projects and energy-efficient technologies should be incentivized to reduce the carbon footprint of manufacturing and attract eco-conscious investors (Ahmed et al., 2013).

### **Future Outlook**

The long-lasting US-China trade clashes will offer different possibilities which may shape the future of South Asia's manufacturing industry. The US-China trade war has led to significant shifts in global supply chains, offering South Asia substantial opportunities for economic growth through redirected investments. Over the next decade, the region's manufacturing sector is positioned to benefit from increased investments, particularly in sectors like textiles, electronics, and machinery. If South Asia can effectively leverage these redirected investments, the region could become a major player in global manufacturing, driving both regional economic growth and global supply chain diversification.

The long-term benefits of redirected investments are clear. As Sugianto et al. (2024) suggest, South Asia's role in the global manufacturing landscape will expand, supported by technological advancements, improved infrastructure, and regional integration into global value chains.

(GVCs). Countries like India, Bangladesh, and Pakistan stand to gain economically, particularly in high-value manufacturing sectors. However, these opportunities are contingent upon addressing the region's infrastructure deficits, regulatory inefficiencies, and skills mismatches.

In particular, India must address logistics bottlenecks and energy supply issues to remain competitive in the global market. According to Gunasekaran et al. (2024), high logistics costs in India make it less competitive compared to countries like Vietnam and Thailand, which have superior infrastructure networks. As such, policy reforms focused on improving transportation infrastructure and ensuring power reliability are critical for India's continued growth in manufacturing. In Bangladesh, the textile sector has been thriving due to low labor costs, but Swazan and Das (2022) emphasize the importance of adopting sustainable practices and improving working conditions to attract more long-term investments.

For Pakistan, addressing energy infrastructure challenges and developing vocational training programs are vital steps toward preparing the workforce for high-tech industries. Lazaj et al. (2024) highlight that South Asia's skill shortages need to be addressed through collaborations between governments and industries to develop specialized programs in sectors like electronics, automotive manufacturing, and renewable energy (Yang et al., 2007).

Moreover, regional cooperation will play a central role in South Asia's future competitiveness. As Shimizu (2021) points out, initiatives like SAARC and BIMSTEC can significantly improve cross-border trade, infrastructure development, and policy alignment. These collaborative efforts will help reduce investment barriers and enhance the region's attractiveness to multinational corporations. Strengthening these regional partnerships will be essential for overcoming South Asia's infrastructure challenges and improving the business environment (Ahmed et al., 2013).

Additionally, green investments in renewable energy and sustainable manufacturing technologies will position South Asia as a

competitive region for environmentally conscious investors. Tanveer et al. (2021) suggest that South Asia's growth in green technologies and energy efficiency will be pivotal in securing the future of redirected investments, as global demand for sustainable products continues to rise.

## Conclusion

The US-China trade war has created significant shifts in global supply chains, presenting South Asia with unique opportunities for growth in its manufacturing sector. Redirected investments are flowing into the region, especially in sectors such as textiles, electronics, and machinery, as multinational companies seek to diversify their production bases and reduce reliance on China. South Asia, with its competitive labor costs, strategic location, and growing infrastructure, is well-positioned to benefit from these investments and emerge as a key global manufacturing hub. However, the region faces several challenges that could hinder its ability to fully capitalize on these opportunities. Infrastructure deficits, regulatory inefficiencies, and skills mismatches remain major barriers to attracting long-term investments. To overcome these challenges, South Asian countries must implement comprehensive policy reforms that prioritize infrastructure development, simplify regulatory processes, and invest in education and skill development. Strengthening regional cooperation through initiatives like SAARC and BIMSTEC will also be crucial to ensuring smoother trade flows and addressing cross-border infrastructure gaps. In the long term, South Asia's growth will depend on its ability to integrate into global value chains (GVCs) and adopt sustainable, high-tech manufacturing practices. By leveraging its strengths in labor competitiveness and capitalizing on the redirected investments, South Asia can position itself as a competitive force in the global manufacturing industry. However, this will require a concerted effort from policymakers, businesses, and regional organizations to foster the necessary reforms and cooperation. The redirected investments resulting from the US-China trade war provide South Asia with a window of opportunity to reshape its manufacturing landscape, diversify its industrial

base, and drive sustainable economic growth. If the region can address its infrastructure and regulatory challenges, enhance workforce skills, and strengthen regional integration, it will be well-equipped to take advantage of the new dynamics in global supply chains and secure long-term prosperity.

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