Peterson Institute for International Economics

Geopolitics and global value chains: Implications for trade policy and development in Asia

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[00:05:28.41] - Arvind Subramanian

Oh yeah. Good morning, good afternoon, good evening, wherever you are. Welcome to the Peterson Institute for International Economics. I'm Arvind Subramanian, a senior fellow here. And today we have for you a really, really exciting, interesting, important topic for discussion with 3 great panelists. The topic is Geopolitics and Global Value Chains: Implications for Trade Policy and Development in Asia. Our three presenters will be first Neil Foster McGregor. He's currently Principal Economist at the Asian Development Bank. He will be followed by Mary Lovely, who is the Anthony Solomon Senior Fellow here at the Peterson Institute, and then by Christine Wan, also works here at the Peterson Institute for International Economics. So we'll have 3 presentations followed by discussion, which will be moderated by me, as well as taking any questions that you will have online as well. So without further ado, and to maximize the time we get for the presentation, let me turn this over to Neil. You're on.

[00:06:52.40] - Mary Lovely

So I think I'm going to go first, Arvind, if you don't mind.

[00:06:56.25] - Arvind Subramanian

No, sorry.

[00:06:57.07] - Mary Lovely

And then we'll have the pleasure of hearing Neil. I think that our two presentations really mesh better that way. The work I'm going to present will appear as a policy brief on the PIE website. It is joint work with Christine Wan. The title we have chosen is Made with China, and the subtitle is The Limits of US Trade Decoupling. So the topic today is— is geopolitics and global value chains. And we know that there's a lot of factors, both natural shocks and policy shocks that have affected global value chains over the last 5 to 10 years. Obviously the Russian invasion of Ukraine, export controls, now oil shocks emanating from the Israel-US war, war in Iran. So there's a lot of shocks here. But one of the main ones, and in fact the most broad-based for trade purposes, is the return to protectionism in the United States. And so Christine and I want to look at the— one of the stated goals of US tariffs on China, which is to promote trade decoupling between the US and China. Now, what has been widely observed is that these tariffs have reduced direct or bilateral exports from China to the United States, as well as, as our colleague Chad Bown has shown in a series of papers, US exports to China.

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We're focusing here just on Chinese— on US imports from China. And they were affected by tariffs, which until the recent Supreme Court ruling invalidating President Trump's use of Emergency Powers Acts to levy so-called reciprocal tariffs, US tariffs on China were quite high. They included the tariffs that were in place from the 2018-2019 trade war, plus additional tariffs of 20% on all goods. After this Supreme Court ruling, the weighted average of US tariffs on China was still about 34%. These tariffs have reduced US reliance on direct imports from China, sometimes called gross imports. In 2017, 22% of US goods imports came from China directly. By 2025, that number had fallen to 9%, which has led— many observers to argue that whatever the successes of the tariff on various other measures, in terms of raising government revenue and decoupling from China, they had had some success. What we want to do is dig a little deeper and look at how this rapid supply chain rearrangement happened. We know

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that there has been multinational adaptation, that is moving suppliers, moving factories away from China to other possible locations, particularly in Asia. There's been Chinese outward FDI, which has brought factories to other countries to produce goods with Chinese capital, know-how, and often, intermediate goods, and of course there's been the development of indigenous capabilities. All of these are things which Neil will pick up in his presentation. What we do know and what we focus on here is that new suppliers to the US are using Chinese content in the exports that they send to the United States. And the question is, have this— has this Chinese content increased in response to the tariffs? And if so, How much? Where is it coming from? And in what sectors? Those are the questions we try to answer in the policy brief. Just a quick note on what we're trying to do in looking at value-added exports as opposed to what we commonly see in the press, which are gross exports or direct exports. What the U.S. Census Bureau and what we see you see reported in the paper reflects is the total value of goods and services as they cross the US border.

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That is important, but not everything that we buy from China is 100% made in China. In fact, if we go back 15, 20 years ago, China argued quite voraciously that its trade surplus with the United States was overestimated because a lot of what it sent to the United States had content that came from other countries because it was often the last stop in a long value chain. So that, for example, a laptop coming from China would include value that had been created in Japan or in Korea, for example, memory chips that have been made by Samsung or other country— other companies. What has— what we want to trace now is something that's almost the reverse, which is Chinese content going out to third countries before it comes to the United States. And to do this, we need to calculate what are called value-added exports. And this is a way of apportioning the value of the content that is in the goods that cross into the US markets. And to do so, we need to rely on databases that are housed at the Asian Development Bank. Thank you very much, Neil, to you and your colleagues.

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And these are, of course, estimates, measures that are based on national input-output tables and trade flows, but they are designed specifically to do this tracing through the value chain that we want to do today. The results of our analysis are here in this first graph, which shows Chinese value-added exports to the United States as well as Chinese direct exports to the U.S. Chinese direct exports are the line in blue, and we see that after the trade war in 2018, that Chinese exports bounced around a little bit due to the— particularly due to the COVID-19 pandemic, but they have ended much lower than they started. In contrast, the orange line, which is value-added exports as we calculate using these national input-output tables and trade data, shows a different trend. It continues upward and has risen dramatically since the trade war. Value-added exports are 34% higher than direct exports by 2024, the last year for which we have data, and the gap appears to be growing. So it'll be interesting to see what happens in 2025, 2026. Before 2017, China's value-added exports to the United States were lower than its direct exports. As I mentioned before, this was part of China's complaint that its trade surplus with the U.S. was overstated.

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Now the opposite has occurred, very interesting reversal of pattern, which we attribute to the trade war, at least in part. U.S. imports from China have therefore shifted toward being received through these indirect channels, that is, via third countries. As opposed to directly from China. In 2017, about 16% of Chinese value added in U.S. imports came through the exports of third countries. By 2024, a full quarter of Chinese value added came via these third countries. Interestingly, this pattern is not seen in the trade patterns of other non-U.S. G7 countries. So what we see is, in some sense, an increasingly separation of US supply chains from those that serve other advanced economies. We might ask, well, what's the top line number? We hear all the time that decoupling has happened, that direct exports from China to the United States fallen precipitously. Is that same pattern seen when we look at actual Chinese content that's entering the United States? And the answer is simply no. While direct imports from China fell 7%age points between 2017 and 2024, and even further in 2025, uh, when we measure Chinese exports in value-added terms, that is Chinese, uh, value-added exports as a share of all US imported value-added, we find that China's share has fallen only 2%age points, so a much smaller decrease.

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And we can look for— see what, what is happening, um, as that blue line, which is the share of U.S. imports coming from China, as that continues to fall in 2025 and 2026, what happens to actual Chinese content that's coming into the U.S. market? In the policy brief, we look at— turn our spotlight on two countries, Mexico and Vietnam. And this graph shows why. On the left-hand side, we see the share of content that's coming indirectly, the orange box. And on the right-hand side, we see the countries from which that Chinese content is coming. And we show that the biggest increases have been for the country of Mexico. And for Vietnam. And we do a bit of a deep dive on those exports. In particular, we look at which broad sectors seem to be experiencing the largest increase in Chinese value added. And as this table shows, number one for both is electrical and optical equipment. And particularly in Vietnam, there has been a very large increase in the share of Chinese content in Vietnam's electronics exports since 2017. It's interesting to note, important to note, that while electrical and optical equipment and textiles and textile products have the most Chinese content for both Vietnam and Mexico, these two countries play very different roles in global value chains, whereas China— I'm sorry, Vietnam is home to a lot of final assembly.

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Mexico also does assembly, but it also does higher-value types of— provides higher-value intermediate inputs, and its exports contain a very large share of U.S. content as opposed to those from Vietnam. So very quickly, implications of our results and the policy brief. Which covers this and more, we see that decoupling from China is happening more slowly in value-added terms than we can learn from looking at direct exports alone. US supply chains are therefore becoming longer. More is going through a third country before getting to the United States. And it's almost surely more costly because of this extra length. Adjustment, this adjustment of US supply chains is not shared with other G7 countries. So these, whatever cost increases will be experienced by US companies, by US exporters, they will not be shared by competitors from advanced economies. We argue that removing China from US supply chains to the extent that that is necessary for economic security or other reasons is not as simple as levying broad tariffs., and we argue that the US needs to prioritize and target on security risks that it wants to effectively ameliorate. Thank you, Mary.

[00:19:47.55] - Arvind Subramanian

That was excellent, um, and you stuck to your time limit very nicely. Over to you, Neil.

[00:19:55.24] - Neil Foster-McGregor

Thank you, Arvind. Yes, what I will present today is, um, a summary essentially of the ADB's Asian Development Policy Report, which in 2026 looks at global value chains and inclusive development. And I'll use this— with this report to try and highlight some of the sort of consequences or implications for economic policy that we think are relevant in order for countries in Asia to— in this environment, some of which Mary has described— to both enter, upgrade in global value chains, but also to ensure that any gains from value chains are inclusive. Underlying the report, I think, are two major motivations. The first is this idea that over the past, say, three decades or so, and taking into account a moderation since the global financial crisis, global value chain trade has risen dramatically. It now accounts for almost half of all global trade. And East Asia— sorry, developing Asia especially has been the major driver of this rise. Developing Asia increased its share of global GVC trade from about 9% in 2000 to 18% in 2024. So much of the benefits therefore, if they are relevant, would be relevant for developing Asia. So we look at the extent to which Asia's rising global value chains has impacts on development, whether that development has been broad-based.

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The second major motivation again links to what Marius just discussed, which is about the changing environment for global value chains, both the external changes, which include the geopolitical tensions that Mary has just discussed, but also the rise of things like climate-related standards, the re-emergence of industrial policy, and so on. But also the global value chains themselves are changing. They're becoming more service-oriented, they're becoming more intangible-based, so using things like data, R&D, and branding, and so on. And they're becoming more automated with the rise of digital technologies. So we also look at the consequences of these changes for this global value chain development model. And then combining this sort of retrospective about what has happened and the sort of this emerging agenda into these challenges, we try and understand the policy messages that are relevant for developing Asia both to enter and upgrade in value chains. So to start with one of the key messages from the report, which again is based on the sort of retrospective to what extent has Asia benefited from global value chains, We look at whether GVC participation has encouraged growth and poverty reduction, and we find that there is strong evidence that economies in developing Asia-Pacific have benefited in terms of growth and poverty reduction from GVCs.

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What we also find, however, is that participation is not enough, and increasingly it's about upgrading and whether countries are able to upgrade in value chains that determines the extent of any benefits. So for example, we distinguish between two types of economies, those that have upgraded by either diversifying into different sectors or by raising the domestic value-added content of their exports, which again linked to what Mary's just been discussing, to other economies that have integrated into value chains but have not experienced that kind of upgrading. And we find notable differences in growth performance between those two groups, again, since the start of the 21st century. So upgrading is increasingly relevant. Capturing the benefits of global value chains. We also show in the report some evidence that how economies are positioned in value chains matters. So this can be whether economies are engaged in sort of forward activities, in sort of producing the raw materials, undertaking the innovation, and so on, that drives value chains, or it could be in those more downstream aspects linked to the assembly of final goods, again, linked to what Marius has been describing. But we also look at positioning in the context of with whom you trade with.

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Are you central to the major global production networks or not? And again, we find notable differences in growth performance between the two. But despite the fact that global value chains have raised growth, both by participating and upgrading, we also find substantial evidence that these gains have been unequal. They've been unequal both across countries and within countries. So across countries, you find that many economies within developing Asia-Pacific remain peripheral to global value chains. They're not central to these networks that drive value chains. And the reasons for those are often clear. It's linked to size, the ability to scale production, and it's linked to geographical impediments. We have a number of island economies in the region. We have a number of landlocked economies. And these factors are one of the drivers of sort of leading to these unequal benefits across countries. Within economies, we also find substantial differences. We find that larger firms are the ones that capture most of the benefits from global value chains. Smaller firms, especially the smallest firms, are often excluded from value chains, or they're unable to upgrade once they enter value chains. We also find that different groups within value chains have benefited to different extents, particularly informal workers and women.

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While GVC creates opportunities for these groups, it's often in low-tech sectors and low-value-added activities. And we also show that GVCs can impact on labor markets. This can on the one hand be through increasing the skill biasness of production, but it also increasingly looks— we also increasingly look at aspects related to the distribution of income between labor and capital, finding that capital owners are benefiting to a greater extent than labor in terms of GVC participation and upgrading. The second major message I think links to this idea of the emerging environments, both the sort of internal and external changes that we've witnessed over the past, say, 15 years or so. So the rise of geopolitical fragmentation, which again Mary talked about, is leading to higher uncertainty. It is impacting on trade and investment decisions by multinationals and resulting in a more fragmented global economy. We also find that the rise of standards, particularly climate-related standards, are raising the compliance barriers in essence to enter and upgrading in value chains. There's important market access issues around these rising standards. Internally, we find that global value chains are becoming more automated. That's impacting value chains in many ways, including through labor market aspects.

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They're becoming more servicified, meaning that service is an increasing component of manufacturing goods., and they're increasingly reliant on digital technologies and intangibles. What we, what we argue is that this is actually raising the thresholds for firms and economies to enter value chains, let alone upgrade. So it's creating higher barriers for that entry into value chains. This is obviously especially true for small firms and for smaller economies, lower-income economies that maybe lack the digital, technological, and organizational depth in order to capture the benefits of value These are the two, I think, major key messages. Obviously, the report covers many more things than this, but if I had to boil it down to two key messages, I think these would be the two. And building up on those, we then argue that given that we're finding that GVCs have been a force for good, a force for development in the region, despite the fact that some of those benefits are unequal, but given the fact that we do see this sort of rising barriers, rising entry barriers to our value chains, this increased fragmentation, the increased importance of things like standards and other barriers to entry. We argue that there needs to be a change in sort of maybe the policy environment in which global value chains take place.

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Within developing Asia, traditionally, we would think of cost competitiveness as the prime driver of global value chains. Entry into low-value sectors using low-value labor would be a typical entry point, and then firms and economies can try and upgrade. But we believe that increasingly that's not enough. And there's a need to be more coordinated in how we organize policy across a set of different policy systems to enable entry and enable upgrading. And particularly, we talk about these 4 different, different policy systems that both need to function effectively themselves but also need to interact effectively together. So we talk about connectivity, which in essence is around building the digital and the physical infrastructure that enables firms to enter global value chains, and again, particularly those smaller firms that individually lack the capabilities to do so. We talk about domestic capabilities, again, in the context of the need to move beyond low-value entry into value chains and enter higher up the value chain. We argue that skills, innovative capabilities, building the innovation system is a crucial determinant of both entry but more importantly upgrading within value chains. And through building these skills and through building this innovation environment, it's also a means of ensuring that the benefits are more broadly shared from entry into global value chains.

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Thirdly, we talk about trade facilitation, which essentially serves two purposes. One is to ensure that goods and services effectively and efficiently cross borders, but also to ensure that firms are able to meet these growing and these diverse standards that are driving value chains in today's world. And then finally, we talk about trade and innovation— investment policy, sorry— which is essentially about market access and encouraging inward FDI. And obviously, an important aspect of this discussion in the report is how these four systems need to work together. So having a good trade facilitation environment need not lead to benefits if we don't have the capabilities within firms to enter and benefit from that. So taking that sort of systemic approach to this question of what are the foundations for success in value chains, let me just focus on 3 or 4 different areas that we think are relevant. The first relates to capabilities, and again links back to this argument that firms find it increasingly difficult to enter value chains, this sort of low-value assembly-type activities in global value chains. There needs to be this effort to build the capabilities to ensure that firms can enter in different parts of the value chain and then subsequently upgrade, which has not always been easy for economies and firms in developing Asia.

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So the building of technological capabilities, managerial capabilities, and so on is a crucial aspect, especially in the context of this fragmenting world where technology diffusion may be slow and technologies may develop in different ways in different, different trade blocs, for example. Secondly, we sort of— again, we sort of highlight the fact that manufacturing is increasingly reliant upon services. So services account for an increasing share of manufacturing value, manufacturing exports, and services themselves. About half of services trade within Asia is actually embedded in manufacturing goods. That means that manufacturing is reliant upon things like logistics, finance, and software and so on. So economies need to build the digital infrastructure and the digital skills to ensure that they can, they can both enter services value chains, but also ensure that this interaction between manufacturing and services is possible within their economy. We also talk about resilience. And here again, it links to what Mary was saying, the fact that if you look over the past 15 years or so, we've seen a series of shocks. Mary mentioned the Russia-Ukraine war. We've got the recent closure of the Hormuz Strait. The COVID pandemic, the financial crisis, various climate-related shocks, all of which have impacted on, on global value chains.

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One important aspect therefore is how to build resilience within value chains, and we argue that one way of doing this is to ensure that firms have multiple suppliers, multiple markets, they have multiple production possibilities, ultimately with the aim of building a more resilient set of— a more resilient value chain environment which can be done through things like diversification, ensuring a flexible system. So this idea of interdependence but not overdependence is one aspect that we talk about. And then finally, we talk about this idea that while firms compete within global value chains individually, many of the systems that are needed to sort of get over these rising barriers in global value chains are actually collective. They're things like the building of transport corridors, ensuring that that standards are harmonized and so on, which implies that there needs to be cooperation and regional cooperation is an important aspect of this. But to summarize, again, this very brief summary of the report, and there's obviously a lot more in the report that I can't talk about in 10 minutes or so, what we have found is that GVCs have been an important driver of growth and development in the region.

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This is increasingly reliant upon upgrading., and even then the benefits are not necessarily evenly shared. So we argue that in order to make sure that global value chains continue to serve the development role, that any benefits are broad-based, we need to focus on building competitiveness through the rise and through the sort of coordination across these different systems that I've described, ensuring that they're both interoperable and that they serve to sort of lower these barriers that are increasingly evident in this new environment of global value chains.

[00:32:54.21] - Arvind Subramanian

Thanks very much. Thank you, Neil, for that excellent presentation. Over to you, Christine.

[00:33:06.31] - Christine Wan

Hello everyone. Thank you so much for joining us online. So today what I'm going to present is complementary to Mary's talk on US-China decoupling, and it is about a blog post we published on the PIIE website. So my part of today's presentation looks at the new set of US trade instruments, the Agreement on Reciprocal Trade, or we call ARTs. I focus on how these agreements may create a framework for what we call indirect decoupling, that is, efforts to reduce China's role in supply chains that reach the United States through the third countries. The central question I want to address here is how do these new reciprocal trade agreements try to discipline those indirect channels. Let me begin by briefly explaining what ARTs are. So these are bilateral trade deals negotiated under the pressure of U.S. reciprocal tariffs. As of May 2026, 9 partners had signed agreements on reciprocal trade, and including 5 in Asia. Those are Bangladesh, Cambodia, Malaysia, India, Indonesia, and Taiwan, and 4 in Latin America. Another group of countries, including Vietnam and Thailand, had signed frameworks for agreements. These agreements are not conventional free trade agreements. They go beyond market access to include commitments on trade remedies, export controls, investment screening, and supply chain security.

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And efforts to keep benefits exclusively shared by only the two signatories. That is why they should be understood not simply as trade deals, but as a new architecture for managing geopolitical risk in global value chains. One important caveat that I want to say is that the legal status of these instruments is still evolving. The frameworks appear less formalized than the trade deals, And the agreements themselves include room for further modification and even quick termination. So these instruments do not really provide the stability and predictability traditionally associated with trade deals. But from a policy perspective, their direction is very clear. They give the United States new tools to push trading partners away from China, and their objective is to achieve indirect decoupling without mentioning China. So why do indirect channels matter? The reason is that Chinese value added still is increasingly reaching the US through Asian trading partners. This slide shows the share of selected Asian partners' exports to the United States that is attributable to Chinese value added. The data are calculated using the ADB MIO tables. The pattern is striking. Since the start of the first US-China trade war, Chinese value added embodied in those countries' export to the US has increased substantially.

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Cambodia rose from 14% to 26%. Vietnam rose from 14% to 21%. Taiwan rose from 7% to 10%. Bangladesh, Malaysia, Thailand, Indonesia, they all see increase. So now, are these just reflecting transshipment? No, research shows that transshipment only accounts for about 8.8% of Vietnam's exports. Exports increased to the US in the first US-China trade war. So if illegal trade diversion caused by tariff evasion only explains such a small proportion of increased exports, the rest of the increase in Chinese value-added must reflect a significant incorporation of Chinese inputs into those Asian partners' domestic production. Almost certainly, this also reflects foreign direct investment from China into these countries. For offshore production. In other words, across the board, Chinese value-added increasing Asian countries exports to the US reveals China's increasingly deep integration in Asian production network. So this graph shows the dollar value of Chinese value-added embodied in these countries' exports to the US. In 2024, Vietnam alone embodied more than $24 billion of Chinese value-added in export to the US. Taiwan ranks number 2. With more than 12 billion of Chinese value added. So this creates a policy problem for Washington, of course. If the US only restricts direct imports from China by levying tariffs, the Chinese value added can still reach the US through partner countries.

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So how do ARTs respond to this problem? We found 7 mechanisms after reading all 9 agreements. I don't want to go through every provision on the slide one by one. Instead, I want to say 3 things these provisions try to do. First, they try to control what enters the partner countries. This includes forced labor import exclusion and other restrictions that require partners to block goods associated with the practices that U.S. has already targeted. Second, they try to control how partner countries trade with third countries. Some agreements require partner to adopt measures with similar effect when the US imposes restrictions on a third country. In practice, these provisions almost are largely China-facing, including a range of specific commitments like US trade remedies prohibiting certain transactions and agreeing not to sign a preferential trade deal with China. Third, they try to control who participates in production networks This is where provisions on third-country control firms, export control, investment screening, and rules of origin become especially important. These are not just about where the product is shipped from or produced. They're about regulating Chinese capital ownership, inputs, and technology presence in partner countries. Taiwan is particularly important. It's a particularly important case on the export control side.

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It's also quite interesting that the NT Circumvention is addressed here as a security matter rather than framed as an effort to combat legally questionable transshipment, as it is in Southeast Asian ARTs. It implies a recognition that China is already deeply integrated in Taiwan's electronics production networks, and that circumvention in this case means preventing Chinese companies from indirectly benefiting from their access to restricted, to high-tech inputs. Taking example of AI supply chain, Taiwan specializes in CPUs, GPUs, and other complex integrated circuits. China participate in these production networks by importing Taiwanese high-end inputs and producing electronics, basic equipments, and those unsexy mechanical machineries. That said, these agreements are not identical. Some agreements impose much more demanding obligations than others. Taiwan faces especially extensive commitments on export controls. Indonesia, Cambodia, and Malaysia are specifically required to combat transshipment. Other partners appear to have narrower obligations. For example, Argentina and El Salvador do not appear to include penalty clauses in their agreements. So I would say the ART framework is not one uniform template. It's more like a flexible toolkit with different provisions emphasized depending on the partner's role in global value chains. So to quote from the president, this is the deal of the art.

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Let me end with 3 reasons why we think this framework might be hard to sustain. First, China remains deeply embedded in Asian production networks. For many goods, China often provides the scale supplier ecosystem and intermediate inputs that are very difficult to replace quickly. For one obvious example, Chinese rare earth permanent magnets are essential for industrial motors, electric vehicles. For another example, clean tech goods are still using Chinese-supplied batteries. The building of data centers for the global AI boom has resulted in a surge in demand for less glamorous yet absolutely necessary inputs. And so far, China is the only country with the capacity to meet this demand. And second, ART partners are placed in a very difficult position.

[00:42:04.28] - Mary Lovely

They either—

[00:42:05.04] - Christine Wan

I mean, they either comply with the US demands, but they risk facing Chinese retaliation, or they defy the US but might face the snapback of reciprocal tariff rates or lose access to US market. So far, no partners have passed domestic enabling legislation for the agreements, and domestic pushback must be anticipated. Third, the legal basis for ARTs is fragile. If AIPA-based authority is struck down by the Supreme Court, Washington might they have to rely more heavily on other trade tools, for example, Section 301, but it is too early to tell if Section 301 will be an effective basis to enforce the ART commitment. So the big takeaway is ART may provide a framework for indirect decoupling, but they do not eliminate the underlying interdependence between the two countries that makes decoupling difficult. They are likely to expose the limits of US-China decoupling a deeply integrated production network. Thank you.

[00:43:14.50] - Arvind Subramanian

Great, Christine, thank you very much. So I think we've had 3 very nice presentations, and kind of, I think of this as 2 presentations focused more on the US-China, and Nils, yours focused more broadly on, you know, GVCs and development. So let me try and kind of combine the two with a, with a set of questions. So the takeaway, Mary, from your presentation is, look, gross imports from China may be coming down, but value-added less so. So my question is the following, that— and this is for both you and Neil— what is happening therefore, on balance, what is the impact on third countries, especially third country developing countries in Asia? What is the net effect of this? So one can think of at least two channels, right? One is that even though some of the value added is going via third countries, these third countries are benefiting in terms of their exports to the US, right? So net-net, they gain. But just to plug my own work with Soumitra is that however, because China is seeing some reduction in value added to the US, not as great as we think. Is it kind of transmitting that to other countries via the China squeeze?

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So what is the kind of net impact on third countries? And kind of the related question for you, Neil, is that, When you set out this, how can it be inclusive and the changing external dimension of which the Trump tariffs are one part of that, should we make or think about differently between how this will affect low-skill exports of countries and more higher-skill imports? So for example, if you say you benefit more from this if you've upgraded more services content. Well, there are lots of countries who are not in that stage who still want to rely on, you know, low-skilled goods. How would— how should we think about that in terms of inclusive development? So two sets of questions, but trying to bring together the US-China angle and the broader, you know, development angle.

[00:46:17.38] - Mary Lovely

I think that's a great thing to do, so thanks for the question. I'll speak just to the beginning. You point out that the net effect on developing countries, particularly in Asia, is complicated of this geopolitical rearrangement of supply chains. One of the things we know from research done at the multilateral development banks is that improving capabilities and upgrading takes time. China didn't, you know, start out producing camera modules in Apple cell phones. It started with assembly. And to the extent that this transference of production responsibilities from China to other countries in Asia allows them to begin to get a foothold on that ladder can potentially be quite important. On the other hand, much of it, or let's say it's a researchable question, how much is being done by the movement of Chinese capital and Chinese technology to these countries. And it's a question as to whether that will permit the type of indigenization of these capabilities that these countries need to prosper within global value chains, to do the upgrading that Neil mentioned. So that is, of course, in addition to the pressures, the geopolitical pressures that come with this whole package, which is the US telling these countries through these, as Christine called them—

[00:48:02.24] - Arvind Subramanian

Yeah, exactly, as Christine just said.

[00:48:04.26] - Mary Lovely

ARTs to get rid of the Chinese content, and China saying, don't you dare, we'll retaliate. So it's really a mixed bag. In terms of China's direct exports to these countries, which you also mentioned, you know, your own work has raised a very provocative and interesting line of research, I think. And I do think more research is needed because China is exporting, but also within categories it's upgrading. And how is this trade evolving?, and will it eventually, or will it in foreseeable future, permit these countries to enter as we also desire? Neil?

[00:48:50.43] - Neil Foster-McGregor

Yeah, so I'm going to echo many of the things you just said, because I think if we go back to, say, the original phase of globalization, maybe starting with China's accession to the WTO, there was this sort of feeling, I think, particularly in academic circles, that actually China was maybe preventing opportunities for the countries in the region. It was because of its scale, because of the amount they could produce, it maybe limited opportunities. And maybe this sort of reconfiguration is actually changing China's role within the region as well, that it's no longer acting as that burden, but actually it's encouraging other countries to integrate into value chains. And one of those is through this sort of, as I said, sort of shuffling value added through countries like Vietnam and Thailand., but also because, as Mary has mentioned, it's upgraded itself and it's also become a richer economy. So, it's also a source of demand that we show in the report that China has become— well, Asia in general is now accounting for a much bigger proportion of global demand, largely because of China. So, that's a positive in a sense, now that the countries are able to integrate into value chains, in essence, through China's development itself now and through this geopolitical fragmentation.

[00:49:59.02]

The challenge, I think, and I think we do see that, is that much of that activity is in the sort of low-skill assembly-type activities, the manufacturing. And that partially reflects, again, this fact that China has upgraded, and therefore actually one of the reasons why you see that sort of relatively small decline in domestic value added in China could actually be also because it's capturing a bigger share of the gains in value chains from its gross exports. Then the question comes, what are the opportunities that exist for other countries in the region to upgrade? And the report highlights a few, and we use examples from the past, so examples of industrial policies that have enabled countries to upgrade. So we talk about examples of supply development programs, which was used in China and elsewhere to basically build upon that entry into value chains. Now, the idea that these countries are now in value chains, they're building those networks in value value chains, but now how to move beyond that assembly activities to sort of higher value activities, and one of those is to build domestic firms, domestic capabilities around that activity. So we talk about those kind of activities that can essentially build domestic value within value chains.

[00:51:09.22]

So ultimately, what I'm trying to get at, I guess, is that what's already happened and is happening is a big opportunity for those other countries in the region because it's creating jobs. It's creating jobs in those low-tech sectors that have traditionally been a source of benefits of value chains. I think an important conclusion is that we shouldn't necessarily ignore that fact. And I've talked about the fact that GBCs are changing, they're becoming more servicified, but it doesn't exclude those benefits in those lower sort of tech sectors, lower value sectors that can be an entry point. But I think increasingly what this needs— what's happening, what it needs to do is that these countries need to build the capabilities around that As I say, supply development programs are one option. Local content requirements have been used by others. Joint ventures were used by China as a means of capturing the technology that allows countries to upgrade and so on. So, I think there are opportunities, opportunities in job creation, but ultimately, to capture the growth benefits, there needs to be this effort to build the capabilities around that activity.

[00:52:04.52] - Arvind Subramanian

Christine, do you want to add something?

[00:52:06.36] - Christine Wan

Yes. So, I want to add something to Mary's answer, and I think, as far as I am concerned, there are two obvious impact that I can think right now. One obviously positive, one obviously somewhat less positive. The positive is these third countries do see a dramatic increase in their export to the US, and that's definitely economically benefiting to the countries. You know, for example, Vietnam had seen this huge increase in its solar exports to the US after just like narrowly following the trade, the first US-China trade war and those 302 sections tariff on Chinese solar parts. So I think that's one. And I think by the end of 2024, Vietnam solar export to the US, no, US accounted for about like 98% of the total Vietnam export. Export market. So that's one thing. And the second, I think, which is less positive, is that these countries are now gradually realizing it is hard to reduce Chinese imports in such a short time because U.S. demand is somewhat stable, or not stable, even enlarging. And it's like a great opportunity for the countries to export stuff because who doesn't want to make money. So you don't wanna lose opportunity to make money, you wanna catch up with the demand, but then you realize that you definitely need to import the parts and inputs that are necessary to make, to meet the demand.

[00:53:50.34]

So that creates some, somewhat the places for Chinese to levy their choke points. So like, It's like, so the demand is there and everybody wants to make money. And now we have the parts, we have the necessary inputs, then we have more leverage.

[00:54:12.01] - Arvind Subramanian

So there is a question online, but before I get to that, something that puzzles me, Mary, on this is, so supposing you're sitting in USTR, yeah, and in circa 2026, and they see your lovely policy brief and basically they say, well, we haven't been very effective because, you know, the value added from China has not declined very much. So is it that they are not aware of this or that, you know, somehow in the consciousness it's just gross exports that matter? Or is it that they try very hard via rules of origin, whatever, transshipment controls, but they're just unable to change that. So how does this work from a US implementation point of view? You know, because they look at your thing and say, well, they have not— we've not been very successful in reducing Chinese content into our imports.

[00:55:19.47] - Mary Lovely

Yeah, I mean, this is exactly what we struggle with in the concluding sections of the policy brief. I think they are aware. I think that the Articles of Reciprocal Trade and the mechanisms that are embedded in those ARTs that Christine outlined show, illustrate that they are very much aware and are trying to use these other mechanisms to control the supply chains that feed into U.S. exports through these third countries. I think one of the main problems is that they continue to use blanket tariffs. Blanket tariffs just do not have any strategic focus on actual security risks. So they're expensive. Study after study has shown that the burden of these is paid by American importers, some of which then gets traveled to American families, American businesses, and reduces US export competitiveness. So we bear a burden. The question is, what is the value that we're receiving? I think that any mature strategy has to begin to look at where actual risks are and target. I mean, let's think about things that have been proposed like a limit on how much Chinese content, 3%, 5%, 10%. Well, what, how would, you know, firms respond, multinationals that do most of the trading?

[00:56:53.07]

Well, they are going to swap out Chinese inputs for other inputs, and they will go to those that are most easily substitutable. Those are exactly the ones that you may say, okay, That's fine. We have alternative sources. They're not our security risk. Our security risks are where we're sole sourcing. That's going to be the last thing that blanket tariffs is going to actually move. So in a sense, we need a more mature strategy that prioritizes— and the US government within Departments of Defense, Commerce, Energy already has looked at these supply chains. I'm sure they're ready to provide some guidance to USTR on where these trade policies need to be altered. So the idea would be to ease the burden on American families and firms and focus more closely and carefully on actual economic security risks.

[00:57:54.16] - Arvind Subramanian

Lee, would you like to add something?

[00:57:56.59] - Neil Foster-McGregor

I mean, maybe just one other thing. Of course, we've not just seen the rise of tariffs on China, of course. And trade costs are relative. So maybe this explains part of the dynamics as well as the fact that we also see increase in tariffs in some of those countries that we just talked about. So we talk about Vietnam as a connector economy connecting China and the US, but it was obviously hit hardest by the reciprocal tariffs back in— back last year. So there's also this aspect which actually links back to the previous question about some of the other challenges for these countries that are impacted positive and negative through this kind of activity. But that would be one thing that maybe will help us explain a little bit the lack of movement as well, is the fact that these rising trade costs in China in the context of rising trade costs globally.

[00:58:43.47] - Christine Wan

Yes. So, I also think the US probably would want to consider more for when it tries to restrict Chinese value contents in in other countries' export to the US, US might consider more for developing countries. And as Mary just mentioned, the USTR, I think it's, I'm not sure if it's in practice, but the US tried to restrict third countries' export to the US with Chinese content value under 30%. And so you hear the numbers might seem like high, but, you know, for Cambodia, as I just showed in the PowerPoint, Cambodia carries 26% in the export to the US. But like, if you dive into the sector, you can see the highest sector with, that the sector with highest Chinese contents is textile. And you see Cambodia is such a poor country that it doesn't have many sophisticated manufacturing sector and the textile is, probably one of the, not very few means of export the country can try to make money. So I think the US probably want to consider more for the benefits of developing countries when making the trade policy.

[01:00:09.26] - Arvind Subramanian

Right. So I have a question. We have a question online. Let me read out the question, but I want to ask a provocative question at the end, right? So quickly, 'Global value chains are becoming essentially defensive in structure.' This is from Anthony Rowley of the South China Morning Post. 'Global value chains are becoming essentially defensive in structure and presumably diminishing global economic efficiency. How great is the loss so far and how great could it become?' I guess that's a question for you, Mary. Question for Neil: intercountry value chains in Northeast Asia are underdeveloped, to say the least. I find that puzzling. Maybe you can explain that. What impact could that have on regional growth if they were better developed? Mary, the cost of the value chains becoming more defensive in structure.

[01:01:11.19] - Mary Lovely

Yeah, I don't think we really know. I mean, we have had certain modeling of these for the US where we see a decrease in, a small decrease in US GDP. Globally, I don't think we really know. I think part of it is the question of how far will this trend go? Right now we see primarily the US. There is some demand within Europe, for example, to raise tariffs on China. We've seen more discussion of that within the past month. So the question really is, how far will it go? And how the system adapts. I think one of the things we've seen is that the system, both countries and multinationals who organize global production, are very nimble. And they are going to reduce costs within the constraints that are set by the U.S. government and other governments. So I think it's an experiment that we're watching partly with trepidation and certainly with scientific interest.

[01:02:27.57] - Neil Foster-McGregor

Maybe just pick up on that quickly as well, because in the report, we show that that while trade has— the growth rate has fallen, it's not tailed off. We're not seeing declining trade, we're not seeing declining GVC trade. So deglobalization in an absolute is not really happening. We're seeing a restructuring, and I think that's important. So in the past, maybe GVCs were reliant on price competitiveness. Now it's a bit more about resilience, about security, about reliability, and so on. But the fact that the GVC trade has not really tailed off suggests that the short-run gains I think Mary was hinting at have not been huge. It's the longer-term aspects that that are relevant. And here things, again linked to the report, would be things about the importance of entry for new industrializers, the role of technology and how firms and countries can access new technology in a more fragmented economy. So I think the longer-term costs could be much larger than what we've witnessed so far. But turning to the question about Northeast Asia, my presumption is this is referring to countries like the People's Republic of China, like North and South Korea, Japan, maybe Mongolia.

[01:03:31.14]

And I think that these are sort of highly— well, let's say they have highly complex production networks, but maybe they're not fully integrated together in that region. Maybe that's what the question is referring to. But they are highly integrated into global value chains more generally, often in sort of higher-tech segments and sectors like electronics and so on. If we think of Japan, South Korea, and other people China. So there would be gains from further integration in between, between those economies, but actually maybe the bigger gains are from broader integration across the region that would enable these sort of high-tech producers within these countries to integrate better in sort of some of the emerging economies in South Asia, Southeast Asia, where you can have the complementarities between sort of these high-capability economies and sort of the lower-end value chain participation that we already talked about, you know, taking advantage of low-skilled labor. So maybe there are opportunities to increase the efficiency of these economies' GVC activities, but the bigger gains may be from a sort of more region-wide perspective in terms of how to capture those benefits.

[01:04:40.34] - Arvind Subramanian

So the last question, but before I do that, a plug both for the policy brief that Mary and Christine have written and for the excellent report on global value chains that— so please, all those who are watching online, please go and read them. The last question I want to end on is, so we've come to the conclusion that, you know, in the last 5, 10 years that there are obviously the gains from integration are there, but now because of geopolitics, you also have to think about resilience building, reducing dependencies and so on. So if Mary and Christine, you've written about the US wanting to decouple from China, do you think that if you were a really devious American planner, that the real aim is really to get everyone in Asia to also think about decoupling from China because they too have to balance the gains versus all the things that, especially if China develops choke points, then how does that kind of thinking, is that a concern or not? That everyone has to think about being more self-reliant, building resilience, and so on?

[01:06:12.19] - Mary Lovely

I think we're seeing these economies, you know, trying to build their own self-reliance independently of what the US wants it to do. We certainly see Japan, for example, which itself has been subject to economic coercion from China, advancing its own program to stockpile materials, to develop alternative sources. So in some sense, the US is pushing on an open door in terms of trying to increase resilience and reliability of supply. However, I think the US takes a very US-centric approach, and these countries are under enormous pressure from China. They're deeply integrated into China. They have important development goals through through entry into GVCs. These need to be taken into account if the US is going to be effective in terms of coordinating with these countries.

[01:07:12.04] - Arvind Subramanian

Neil?

[01:07:12.48] - Neil Foster-McGregor

I don't have much to add. I mean, I guess the additional aspect, and I think it's what Mary just said, is the motivations for these countries is also relevant in this context. So, I mean, Mary mentioned the fact that development is an important aspect of that. What is the alternative for them? I think that's an important question that the US and others would have to ask if they think about how to decouple from China or anybody else. I think this is the important question. What is the alternative pathway for these economies?

[01:07:40.31] - Arvind Subramanian

Christine, last word?

[01:07:44.14] - Christine Wan

I don't have much to add.

[01:07:45.40] - Arvind Subramanian

Yeah, good. Well, anyway, Christine, Neil, Mary, thanks for an excellent discussion. I learned a lot listening to the presentations. And I hope all of you joining online enjoyed it as much as I did. Thank you very much, and please do keep coming to these Peterson events as and when they're held. Thank you.