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The New Geopolitics and South Asia's Trade Architecture – What Next?

by **Ganeshan Wignaraja**, Professorial Fellow for Trade and Economics,
Amit Bhandari, Senior Fellow for Energy, Investment and Connectivity
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GLOSSARY

AARDO	African-Asian Rural Development Organization
ADB	Asian Development Bank
AIIB	Asian Infrastructure Investment Bank
ASEAN	Association of Southeast Asian Nations
B2B	Business-to-Business
BBIN	Bangladesh, Bhutan, India, Nepal Initiative
BIMSTEC	Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation
BPWC	BIMSTEC Permanent Working Committee
BRI	Belt and Road Initiative
BRICS	Brazil, Russia, India, China, and South Africa
CEPA	Comprehensive Economic Partnership Agreement
CII	Confederation of Indian Industry
COM	Council of (Foreign) Ministers
COMPACT	Catalyzing Opportunities for Military Partnership, Accelerated Commerce & Technology
CPTPP	Comprehensive and Progressive Agreement for Trans-Pacific Partnership
CSO	Committee of Senior Officials
ECTA	Economic Cooperation and Trade Agreement
EIB	European Investment Bank
FDI	Foreign Direct Investment
FICCI	Federation of Indian Chambers of Commerce and Industry
FTA	Free Trade Agreements
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
IBSA	India, Brazil, South Africa
IEA	International Energy Agency
IMF	International Monetary Fund
IORA	Indian Ocean Rim Association
IPEF	Indo-Pacific Economic Framework
LDC	Least Developed Countries
MEA	Ministry of External Affairs
MNC	Multinational corporations
MSME	Micro, Small and Medium Enterprises
NDB	New Development Bank
NPP	National People's Power
OIC	Organisation of Islamic Cooperation
PLI	Production Linked Incentive
PMI	Purchasing Managers Index
QUAD	Quadrilateral Security Dialogue
RAPID	Research, Analysis, Programme Implementation and Data Intelligence
SAARC	South Asian Association for Regional Cooperation
SAFTA	South Asia Free Trade Agreement
SASEC	South Asia Subregional Economic Cooperation
SCO	Shanghai Cooperation Organisation
SEZ	Special Economic Zones
SG	Secretary General
UNODC	United Nations Office on Drugs and Crime
WTO	World Trade Organization

Executive Summary

South Asia today is the world's most populated region and fastest growing, in a global economy experiencing a period of tepid growth and suddenly faced with mounting risks. This economic reality has put the international spotlight on South Asia with some economic historians drawing parallels between the gloomy world economy today and the economic uncertainties and trade protectionism of the 1930s era. This paper critically analyses South Asia's trade architecture in the sluggish world economy in the 2020s and makes recommendations for closer regional economic integration.

Four issues relating to South Asia's growth, trade and trade architecture are examined, with a focus on the period since the Covid-19 pandemic and April 2025:

(1) Messy geopolitics, the global and South Asian outlook, and India's relations with smaller neighbours,
(2) Shifts in China-centric global supply chains to South Asia,
(3) Patterns of regional energy connectivity and cooperation in South Asia, and
(4) The effectiveness of regional institutions for South Asia's trade and regionalism.

Main Findings

Messy geopolitics, global and South Asian outlook and India's relations with neighbours

Geopolitics is increasingly intertwined with the economic destiny of South Asia. In the last few years, messy and complex geopolitics has heightened polycrisis risks to the global economy. In the words of Adam Tooze, Professor of history at Columbia University, a polycrisis simply means, "disparate shocks interact so that the whole is worse than the sum of its parts." At least four such shock waves should be mentioned:

(1) The Covid-19 pandemic; Ukraine war; Red Sea conflict; energy, cost-of-living and climate crises.

(2) Deglobalisation; the "hollowing out" of U.S. manufacturing; supply-chain fragmentation in Asia; and artificial intelligence (AI).

(3) A new Cold War – the West versus an aligned China/Russia – and a rising global arms race.

(4) Slower growth in U.S. and China and divergences in the developing world.

Furthermore, since taking office on 20 January 2025, the administration of U.S. President Donald Trump has imposed trade tariffs on all steel and aluminium imports and increased tariffs on imports from three of the biggest U.S. trading partners (Canada, Mexico and China). In response, Canada, China and the EU have announced retaliatory tariffs on U.S. exports. On 2 April 2025, the Trump administration also imposed retaliatory tariffs to achieve different geopolitical goals. The new tariff policies set a baseline tariff of 10% on all imports into the U.S., taking the maximum rate to more than 50% on imports from some countries. The tariffs were be effective as of April 2025. On 9 April, U.S. announced a 90-day pause for most countries hit by higher U.S. tariffs but a trade war with China has escalated with 145% tariffs on all imports to the U.S. South Asia faces U.S. tariffs at the higher end of the spectrum ranging from 26% for India, to 44% for Sri Lanka. Pakistan (29%) and Bangladesh (37%) fall in between.

India has pursued quiet high-level diplomacy to attempt to mitigate the impact of U.S. tariffs. Prime Minister Modi met with President Trump in Washington on 13 February 2025, followed by a meeting with Vice President J.D. Vance in New Delhi on 21 April 2025. There is expectation of a trade deal between U.S. and India, which suggests that quiet diplomacy works.

These dramatic trade moves by the U.S. pose the biggest challenge to a rules-based international trading system since World War II. Rising protectionism typically fuels mistrust and uncertainty about global trade and growth. However, the situation was evolving at the time of publication. While tit-for-tat tariffs are stoking fears of a global trade war, it seems premature to offer a precise analysis of the Trump tariffs' impact, since it will depend on several factors, including: (1) the response of U.S. trading partners, (2) how companies, consumers and financial markets react, (3) how tariffs evolve over time, and (4) trade dependence on the U.S. Further research will be required when actual data become available.

Even before the U.S. tariffs were rolled out, growing polycrisis risks were looming large on the global economy, which has been struggling since the Covid-19 pandemic. Polycrises, geopolitical risks and trade protectionism could have serious knock-on effects such as rising food and fuel prices; volatile capital markets; subdued trade and foreign direct investment (FDI) flows; and, ultimately, slower global growth. For instance, global growth over the next few years is likely to be lower than the 3.7% per year recorded in the period 2000-2019 and 4%+ global growth in the heyday of trade liberalisation and globalisation (1980-2008).

While facing challenges in this era of messy geopolitics, South Asia seems a relatively bright beacon of regional trade and growth. Apart from global trade policy uncertainty, the challenges facing South Asia include a difficult and deteriorating India-Pakistan relationship, political upheaval in Bangladesh, and debt distress in Sri Lanka and the Maldives, along with China's overtures in the region, to name a few.

But South Asia's economic fundamentals suggest cautious optimism about its future economic trajectory. South Asia is projected to grow at about 6% in 2025-26, more than double that of the global economy and many developed economies. The region's key fundamentals for growth include economic strategies emphasising powerful engines of foreign trade and investment, a vibrant Indian economy attracting record FDI, the demographic dividend of a youthful skilled population, strategically located container ports along the key global East-West Sea routes, and the possibility of closer economic and cultural ties with Indo-Pacific powers.

The following recommendations could tackle the polycrisis risks facing South Asia:

- Instead of harmful retaliatory tariffs, pursue quiet diplomacy with the U.S., while constructively using external tariff pressure to 'lock in' domestic tariff reform, while joining supply chains and keeping other policy options open.
- India should explore closer ties with the BRICS, both to promote BRICS centric economic cooperation, and in international fora to advocate for a rules-based international order. It is suggested that the BRICS set up an expert group on global economic challenges including assessing the effects of U.S. import tariffs in 2025.
- Maximise efforts at economic diplomacy, re-orient networks of overseas missions and invest in specialist skills to develop a hub and spoke system of missions.
- Develop foreign policy foresight/scenario planning capacity in ministries of foreign affairs and work with think tanks and business associations.
- Encourage the media and think tanks to educate and raise public awareness of the economic and political benefits of closer regional cooperation and integration.

Shifts in China-centric global supply chains to South Asia

Reflecting global turbulence, there is a re-thinking of conduct of international relations, business, regionalism and bilateral economic ties and the rules of engagement by countries in South Asia. One impetus for an altered positioning has been the slowdown of the Chinese economy, and the shift, particularly by multinational corporations (MNCs), from China to other more competitive locations. Available evidence suggests that Southeast Asia and some South Asian countries like India, Sri Lanka and Bangladesh are beneficiaries of the supply chain shift, particularly in labour-intensive segments. This shift has been underpinned not only by geopolitics but also the availability of skilled, relatively low-cost labour and a large middle class.

However, these factors carry constraints. Southeast Asia may not offer sufficient scale, and South Asia which can, is a latecomer to trade led regionalism, hampered by policy barriers and infrastructure gaps leading to high trade costs. Key issues include tariff and non-tariff barriers, cumbersome business regulations and excessive reliance on paperwork, poor trade-related transport infrastructure, and little regionalisation of supply chains.

Reducing these barriers and tackling policy gaps can help South Asia double its present share in global supply chains to 5% of the world total by 2030, with growing trade and investment within the sub-region. Bangladesh and Sri Lanka, for instance, could be notable beneficiaries of regional spillovers in labour-intensive activities, while Nepal could engage in niche activities. Accordingly, India can reap economic gains through cooperation with smaller South Asian neighbours like Sri Lanka. Over time, supply chain trade is likely to be a powerful engine of growth, job creation and poverty reduction for the region. South Asia can also improve its positioning as a significant global services exporter.

Several recommendations are suggested to augment the growth of global supply chains and trade, more generally to South Asia and within the region:

- Diversify to de-risk geographically concentrated supply chains, sourcing of inputs, suppliers and markets.
- Strategically reduce FDI and trade barriers and improve national government/local government investment promotion efforts.
- Cut red tape regulations hindering ease of doing business, digitise business procedures and reduce corruption vulnerabilities.
- Improve the performance of Special Economic Zones (SEZs) to attract foreign and domestic investors and clustering of business activities.
- Invest in transhipment ports, trade-related logistics services and port-road network connectivity.
- Provide limited time-bound fiscal and financial incentives to promote regionalisation of supply chains in India's neighbourhood.
- Conclude comprehensive trade deals with neighbours to reduce regional trade barriers and provide for regional rules-based trade.
- Following Prime Minister Modi's historic visit to Sri Lanka in April 2025, enhanced India-Sri Lanka connectivity and trade offers a possible model for regional economic cooperation.

Regional energy connectivity and cooperation in South Asia

The climate change crisis and rising oil prices widen the scope of a green transition and energy security. Not surprisingly, this shift requires big investments - the projected investment needed just till 2030 for South Asia's energy needs, conventional and renewable, is estimated at $1.06 trillion. Cross border energy trade can help bring down costs and develop hydel and wind energy resources in the region, but is hampered by the lack of adequate connectivity.

South Asian countries lag in three key areas when it comes to regional energy connectivity: lack of capital, cheap energy, and increased market access.

Many challenges require urgent policy attention including a) national energy demand and supply deficits, and transitions to a greener grid; b) building high-level skills and advanced manufacturing capacity; c) modern port and rail infrastructure; d) regional integration with services, goods and energy, and in that context; e) understanding norms-setting, developing negotiation skills, local and regional standards, and (f) moves towards regional regulatory convergence to ensure the spread of the benefits of regionalism to neighbouring countries.

Several recommendations are suggested to improve regional energy connectivity and cooperation in South Asia:

- Invest $100 billion to build efficient cost competitive, clean, regional and national energy infrastructure.
- Create a regional energy finance institution, with South Asian governments as shareholders, with the specific objective of funding cross border energy connectivity projects within the region and completing them in about 24 months.
- Create a venture capital fund with a mandate to encourage MSME (micro, small and medium enterprises) in the energy space, with a special focus on new and emerging green technologies such as green hydrogen and electric vehicles.
- Explore clean energy partnerships with the World Bank, Asian Development Bank (ADB) and the European Investment Bank (EIB).

Regional institutions for South Asia's trade and regionalism

As mentioned above, the global economy is witnessing rising protectionist tendencies and there are worries of a trade war involving major economies. Meanwhile, global trade governance under the World Trade Organization (WTO) led rules based multilateral trading system - established in 1995 to treat all countries alike - remains weak, with its negotiating function and dispute settlement mechanism stalled.

The successive G20 presidencies of India, Brazil and South Africa have brought into focus alternate structures like BRICS and the Global South, to support new trade and economic agendas and appropriate rules. The Asian Infrastructure Investment Bank (AIIB) and the BRICS Bank are also increasingly important financiers of development projects in South Asia.

Encouraged by the region's economic prospects, some South Asian countries have begun to join Free Trade Agreements (FTAs) with bilateral trading partners to reduce trade barriers and encourage regional rules-based trade. India has entered into four significant agreements with UAE, Australia, UK and the European Free Trade Association (non-EU countries), Sri Lanka has just signed an FTA with Thailand on top of an FTA with Singapore. Bangladesh has also been discussing FTAs with Asian countries.

Regionally, the patchwork of regional organisations (e.g. South Asian Association for Regional Cooperation (SAARC), Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC), Bangladesh-Bhutan-India-Nepal Initiative (BIBN), and Indian Ocean Rim Association (IORA) supporting trade cooperation and integration has been dormant. Many problems - limited political will, inertia and a lack of national interest, severe financial under-resourcing, inadequate technical/professional skills and a lack of delegated powers – have constrained their effectiveness. The under-resourcing is chronic with the combined budgets of SAARC, BIMSTEC and IORA supposedly less than half of ASEAN. But there is some hope with political support and focus on BIMSTEC and IORA.

Several recommendations are suggested to strengthen trade-related regional institutions in South Asia:

- Negotiate deep FTAs and plurilateral agreements with trading partners and neighbours. The India-Australia FTA and the Comprehensive Economic Partnership Agreement (CEPA) with UAE are examples of how to establish regional trade trust.
- Support reforming the WTO-led multilateral trading system and explore regional alternatives.
- Significantly resource and retool regional institutions, particularly BIMSTEC and IORA to support regional trade and FDI in an uncertain international economy.
- BIMSTEC should prioritise concluding an FTA in the next year. If a comprehensive one is not possible, a united agreement on tariffs will be better.
- India can play a key role (with other regional powers) to shape the mandate and better resource BIMSTEC and IORA since senior Indian diplomats currently lead these institutions.
- Provide aid for trade for Least Developed Countries (LDCs) and small states to develop export capacity and reduce the economic costs of trade opening.

The Last Word

There is little doubt that it is South Asia's time to integrate with global markets and deepen regional economic integration. International development experience suggests that such integration is supportive of regional prosperity and it's global rise. Political will to implement the proactive national and regional agenda outlined in this paper can transform the lives of billions of South Asians for the better.

Geopolitics, Trump 2.0 and South Asia's Outlook

Growing Global Polycrisis Risks and South Asia's Outlook

Geopolitics is increasingly intertwined with the economic destiny of South Asia. In the last few years, messy and complex geopolitics has heightened polycrisis risks to the global economy. As Adam Tooze, Professor of History at Columbia University, recently remarked: "In the polycrisis the shocks are disparate, but they interact so that the whole is even more overwhelming than the sum of the parts."

Four recent shock waves have contributed to the polycrisis facing the global economy:

1 The Covid-19 pandemic; the war in Ukraine; the Red Sea conflict; energy, cost-of-living and climate crises (Table 1.1).

2 Deglobalsation; the "hollowing out" of U.S. manufacturing; supply-chain fragmentation in Asia; and artificial intelligence (AI).

3 A new Cold War – the West vs. an aligned China/Russia – and a rising global arms race.

4 Slower growth in the U.S. and China and divergences in the developing world.

Table 1.1 MAJOR ONGOING CONFLICTS IN THE WORLD

CONFLICT	TIMESPAN	CASUALTIES	ESTIMATED DAMAGE
Israel-Hamas War	7 October 2023 – Present (1 year)	Israel:1706 Palestine: 48,405	Over $15 billion, with extensive destruction to housing, healthcare facilities, and utilities
Russia-Ukraine War	24 February 2022 – present (2 years, 7 months)	Russia: ~300,000 Ukraine: ~200,000	Over $500 billion, with severe impacts on housing, energy infrastructure, and industrial facilities
Myanmar Civil War	1 February 2021 – Present (3 years, 8 months)	~31,000 + 18,471 (until September 17, 2024)	~$27 billion in economic losses, with severe damage to infrastructure, agriculture, and small industries

Source: Authors' compilation

The effects of a lingering polycrisis are partly reflected in assessments of the short-term global economic outlook. The International Monetary Fund (IMF) in the April 2025 edition of its flagship World Economic Outlook forecasts that world economic growth could fall from 3.3% per year in 2023-2024 to 2.8%-3.0% in 2025-2026 (Table 1.2). Meanwhile, emerging and developing Asia could grow at 4.5%-4.6% in 2025-2026, faster than the global economy, underlining developing Asia's key role in driving global growth. Two of the region's major economies - China and India - have spurred Asia's performance but have slowed since 2023. China could grow at 4.0% in both years and India at 6.2% in 2025 and 6.3% in 2026.

Table 1.2 GROWTH AND TRADE 2023-2026
(real GDP and world trade volumes, annual percentage changes)

ITEM	2023	2024	2025*	2026*
World Real GDP growth (% per year)	3.3%	3.3%	2.8%	3.0%
Emerging & developing Asia real GDP Growth (% per year)	5.7%	5.3%	4.5%	4.6%
China real GDP growth (% per year)	5.3%	5.0%	4.0%	4.0%
India real GDP growth (% per year)	8.1%	6.5%	6.2%	6.3%
World trade vol. of goods & services growth (% per year)	0.7%	3.8%	1.7%	2.5%

Note: * forecast
Source: IMF World Economic Outlook Update April 2025, Washington DC: International Monetary Fund

The polycrisis has also affected smaller and weaker South Asian economies. For instance, Pakistan's GDP in 2023 is lower than what it was in 2017. Similarly, Sri Lanka's GDP contracted significantly, following its external debt default in April 2022 - its 2024 GDP is around 10% lower than its pre-crisis GDP. While Bangladesh's macro-economic numbers may look better, mounting economic difficulties in 2023-2024, including a loss of business confidence and capital outflows have induced a 29% currency depreciation since 2022. An economic crisis has sometimes morphed into a political crisis in South Asia. Sri Lanka's default and political protests over the cost of living and shortages led to Gotabaya Rajapaksa's resignation in July 2022 as President and his replacement by Ranil Wickremesinghe. The change of government in Bangladesh from Sheikh Hasina to Muhammad Yunus in August 2024 was linked partly to economic hardship of the people and political protests. Pakistan, too, saw a regime change, with the engineered exit of former Prime Minister Imran Khan, followed by an election that was managed from behind the scenes by the military.

Table 1.3 GDP GROWTH RATE AND INFLATION IN 2024 AND PROJECTIONS FOR 2025 (%)

	GDP GROWTH		INFLATION	
	2024	2025*	2024	2025*
Developing Asia	5.0	4.9	2.6	2.3
South Asia	5.8	6.0	6.6	4.9
India	6.4	6.7	4.7	4.3
Afghanistan	2.3	2.6	-7.7	-5.3
Bangladesh	4.2	3.9	9.7	10.2
Bhutan	5.5	8.5	2.8	3.4
Maldives	5.5	5.0	1.4	4.7
Nepal	3.9	4.4	5.2	5.2
Pakistan	2.5	2.5	23.4	6.0
Sri Lanka	5.0	3.9	1.2	3.1
East Asia	4.7	4.4	0.5	0.6
People's Republic of China	5.0	4.7	0.2	0.4
Hong Kong, China	2.5	2.3	1.7	1.9
Republic of Korea	2.0	1.5	2.3	1.9
Mongolia	4.9	6.6	6.8	9.1
Taipei, China	4.6	3.3	2.2	2.0
Southeast Asia	4.8	4.7	3.0	3.0
The Pacific	4.2	3.9	1.9	3.4

Note: *represents projections
Source: Asian Development Bank (April 2025)

The polycrisis era has also provided opportunities for notable bilateral economic cooperation between India and smaller neighbours. The India-Sri Lanka bilateral offers the best example: India was a first responder during Sri Lanka's economic crisis, stepping in with emergency humanitarian and financial assistance, in the process, building up trust between the two countries. India has also provided emergency financial assistance to Maldives (Prime Minister's Office, Government of India, 2024) helping it avert a potential default (Fitch Ratings, 2024). This aid came shortly after the election of Maldives President Mohamed Muizzu who had campaigned on an 'India Out' plank – underlining local sensitivities in regional relations.

However, in Bangladesh, ties with India remain strained under the new regime, with Indian concerns about violence affecting the Hindu minority there and Bangladesh concerns about India providing a safe haven for the former Prime Minister Sheikh Hasina. It is an open question as to whether Bangladesh's historic trade links to India and weak economic fundamentals provide sufficient incentives for it to attempt a restoration of ties with New Delhi in the future. India-Pakistan bilateral relations are strained with its long history of mistrust, cultural differences and conflicts. Additionally, in the aftermath of the Pahalgam attack in April 2025, India has downgraded diplomatic relations by holding the Indus Waters Treaty of 1960 in abeyance; closing the Integrated Check Post Attari; cancelling SAARC Visa Exemption Scheme (SVES) visas for Pakistani nationals and expelling military personnel who were posted in the Pakistan High Commission in New Delhi (Ministry of External Affairs).

Despite challenges in a polycrisis era, South Asia seems a bright spot in a gloomy global economy. As Table 1.2 shows, the IMF projects higher Indian growth (6.2%) than the global economy in 2025. The ADB in the April

2025 edition of its flagship Asian Development Outlook is also bullish. Despite ADB cutting its forecast from the December 2024 edition to the April 2025 edition, its forecasts expect India to grow at 6.7% in 2025 and South Asia at 6.0%. The forecasts for Afghanistan (2.6%), Bangladesh (3,9%), Bhutan (8.5%.), Maldives (5.0%), Nepal (4.4%), Pakistan (2.5%) and Sri Lanka (3.9%) are also mentioned (Table 1.3). These perspectives reflect the region's strong economic fundamentals, including strategies emphasising the powerful growth engines of foreign trade and investment, India's vibrant economy attracting record FDI, a demographic dividend of a youthful skilled population, strategically located container ports along the key global East-West sea route, and the possibility of closer economic ties with Indo-Pacific powers evolving into an Indo-Pacific alliance.

New International Trade Policy of Trump 2.0

Joseph Nye, former dean of the Kennedy School of Government at Harvard University, succinctly sums up President Donald Trump's underlying global perspective, keeping in mind the adoption of his so-called America First Agenda.

"*In Trump's view, the post-1945 world order of rules, institutions and alliances has suckered the U.S. into accepting unfair trade practices and paying for foreign defense. He describes himself as a deal maker ("My whole life is deals"), and sees the U.S.-led world order as a bad deal. He is so obsessed with the problem of free riders that he forgets it has been in America's interest to drive the bus.*"

A flurry of economic policy decisions - taken at warp speed without consulting U.S. trading partners and allies – to implement the America First Agenda have added to the strangeness of the global economic situation. For our purposes, Trump's emerging trade policy can be characterised as yet another economic shock hitting a fragile global economy. On 1 February 2025, the new Administration made a landmark trade policy announcement, adding to uncertainties about world trade. To tackle problems caused by illegal immigrants and drugs, the White House said "the U.S. is implementing a 25% additional tariff on imports from Canada and Mexico and a 10% additional tariff on imports from China. Energy resources from Canada will have a lower 10% tariff." Since then, the confusion over U.S. trade policy has been nonstop.

During the period, 1 February-mid-March 2025, the Trump Administration changed course and delayed some tariffs on some imports from Mexico and Canada for a month amid growing fears of the economic fallout from a broader trade war. Furthermore, it has launched investigations of trade imbalances and unfair trade practices while engaging in trade talks with some trading partners. It also said that the EU would face tariffs and that China's goods would be hit with another 10% tariff. In response, Canada, China and the EU announced retaliatory tariffs on U.S. exports.

Going further, on 2 April 2025, the Trump administration also imposed retaliatory tariffs (Figure A2.1) to achieve different geopolitical goals. The new U.S. tariff policies set a baseline tariff of 10% on all imports into the U.S., taking the maximum rate to more than 50% on imports from some countries. On 9 April 2025 the U.S. announced a 90-day pause for most countries hit by higher U.S. tariffs but a trade war with China has escalated, with 145% tariffs on all imports to the U.S. South Asia comes out at the higher end of US tariffs. Bangladesh (37%) and Sri Lanka (44%) face higher US tariffs than India (26%) and Pakistan (29%). At the time of writing, trade talks between the U.S and many countries are on-going including those in South Asia and the outcome is unclear.

There is little doubt that growing polycrisis risks, coupled with rising global trade policy uncertainty are casting a dark shadow over the global economy which has been struggling since the Covid-19 pandemic. Near-term risks include heighted trade policy uncertainty, inflationary pressures and headwinds (e.g. energy in Europe and real estate in China). Knock-on effects of such risks could include disrupted global supply chains, rising business costs, volatile capital flows, and ultimately, slower global trade and growth. Worse than expected downside risks for the world economy and trade-dependent Asia could mean lower global growth in 2025-2026 than the 3.7% per year recorded in the period 2000-2019 and below the 2.8% projected by the IMF in April 2025. The 4%+ global growth in the heyday of trade liberalisation and globalisation (1980-2008) seems a distant memory.

A few studies have attempted to estimate the economic impacts of the Trump tariffs on the U.S. economy, and some findings are noteworthy. For instance, the DC-based Tax Foundation's York and Durante (2025) estimates that the tariffs on Mexico, Canada and China could shrink U.S. GDP by 0.4% and increase taxes by $1.1 trillion between 2025 and 2034, amounting to an average tax increase of more than $800 per U.S. household in 2025. U.S. job losses could be as many as 330,000. In addition, the Peterson Institute for International Economics' Clausing and Lowely (2025) estimates that Trump's tariffs on Canada, Mexico, and China would cost the typical U.S. household over $1,200 a year.

These moves pose the biggest challenge to a rules based international trading system since the Second World War. Rising protectionism typically fuels mistrust and uncertainties about global trade and growth. However, this is an evolving scenario at the time of writing. While tit for tat tariffs are stoking fears of a global trade war, it seems premature for precise analysis of Trump tariffs impacts on the global economy and South Asia. This would depend on many factors including: (1) the response of U.S. trading partners, (2) how firms, consumers and markets react, (3) how tariffs evolve over time, and (4) trade dependence on the U.S.[1] Further research is needed when actual data becomes available.

India's Quiet Diplomacy with the U.S. in 2025

Prime Minister Narendra Modi's state visit to Washington on 12-13 February 2025 made him the third world leader to visit Trump since he took office. New Delhi's quick diplomatic work helped organise the high-level visit within the first month of a new administration. (Box 1.1). Both leaders discussed a broad agenda for India and the U.S., bilaterally and geopolitically. Principal among them were the status and impact of the wars in West Asia and Europe; the Indo-Pacific and China's continued regional activities, and the impact of Trump's changes in U.S. domestic and foreign policy in terms of trade and migration for India. Trump's positions on the three issues were already well known, and India moved quickly to avoid confrontation with its largest trading partner, with which it also has a surplus.

Box 1.1 INDIA'S DIPLOMATIC WORK AND DOMESTIC REFORMS BEFORE MODI'S VISIT TO WASHINGTON

JANUARY 20-22: External Affairs Minister represented the Government of India at the swearing-in of Donald Trump as the 47th U.S. President. During this trip, he also participated in the Quad Foreign Ministers' Meeting and met National Security Advisor Mike Waltz; Secretary of State Marco Rubio; House Speaker Mike Johnson; Senate Majority Leader Senator John Thune and six Cabinet members of the administration.

JANUARY 24: Ministry of External Affairs (MEA) spokesperson Randhir Jaiswal stated that India is against illegal immigration, especially because it is linked to several forms of organised crime and emphasised that Indian nationals overstaying or residing without proper documentation in any country, including the United States, would be taken back once their nationality is verified.

JANUARY 27: Prime Minister Modi spoke on the phone with President Trump, and congratulated him on his 'historic second term'. Both the leaders reaffirmed their commitment to a mutually beneficial and trusted partnership. They discussed various facets of the wide-ranging bilateral Comprehensive Global Strategic Partnership and measures to advance it, including in the areas of technology, trade, investment, energy and defence.

FEBRUARY 1: Finance Minister Nirmala Sitharaman reduced import duties on 32 products, including electronics, chemicals, textiles, and premium motorcycles while presenting the Union Budget for 2025-2026.

FEBRUARY 6: Defence Minister Rajnath Singh spoke on the phone with U.S. Secretary of Defence Pete Hegseth. They reviewed India-U.S. defence cooperation and agreed upon a 10-year comprehensive framework to bolster the extensive defence partnership, especially in the spheres of intelligence, logistics, operational and industrial engagement.

FEBRUARY 6: A U.S. military plane flew 104 illegal Indian immigrants to Amritsar, as part of Trump's deportation policy.

Source: Ministry of External Affairs, Government of India; Press Information Bureau, Government of India

[1] See, for instance, an early IMF's reaction to the global economic impact of Trump's tariffs.

While the Modi-Trump meeting may have stalled an immediate tariff onslaught from Washington, New Delhi must think fast and plan seriously for trade equity.

Some of this has already begun. The recent FTAs signed with Australia and the UAE and the trade and investment agreement with four EFTA countries are signs of India becoming more open to trade and of other countries understanding India's stand.

When they met in person, Modi and Trump decided to take a positive approach and set an ambitious annual bilateral trade target of $500 billion and gave themselves time to negotiate a bilateral trade agreement by the Fall of 2025. This reflects the aspirations of the newly launched bilateral initiative, the U.S.-India COMPACT (Catalyzing Opportunities for Military Partnership, Accelerated Commerce & Technology) for the 21st Century.

Vice President J.D. Vance paid an official four-day visit to India on 21-24 April 2025 and met Prime Minister Modi, where the two leaders announced the Terms of Reference, laying down a roadmap for the negotiations on reciprocal trade (Office of the United States Trade Representative). The leaders are also committed to enhancing cooperation in energy, defence, strategic technologies and other areas of mutual benefit (Ministry of External Affairs).

India's $36.8 billion trade surplus with the U.S. in 2023-24 is dominated by engineering goods such as auto parts, and non-ferrous metals; the U.S. is also the single largest beneficiary of India's IT trade: 62% of India's total IT-ITeS (Information Technology Enabled Services) exports go to the U.S. Since Covid and the opportunity presented by a China+1 scenario, Prime Minister Modi has doubled down on making Indian goods competitive, to help the country transform into a global design and manufacturing hub. Additionally, the increase in U.S.-origin defense items into India's inventory and U.S. as a leading supplier of crude oil, petroleum products and liquified natural gas to India will create a strategic trade balance in the bilateral.

India should be willing to do more on reforming import tariffs, no matter the domestic difficulty. Currently, U.S. tariffs on Indian goods and services are at 3%, whereas India's tariffs on the U.S. stand at 11%. India must bridge this gap in a calibrated manner, as it will provide the country with a unique opportunity to implement necessary reforms and open up its economy, as it did in 1991. This will, in turn, increase foreign capital, encourage R&D- and investment and innovation, - moving the country towards a more competitive and open economy. However, India faces the challenge of meeting the expectations of the U.S. with its ambitious plans to step up agricultural exports to India.

As noted before, the state of global trade is in extreme flux, and India's quiet diplomacy appears to be a partial success. The Trump administration imposed a 26% tariff on India, as compared to retaliatory tariffs on China (34%)[2], Thailand (36%), Taiwan (32%) and Vietnam (46%). Furthermore, India has attracted the lowest tariffs in South Asia (Figure A2.1). Additionally, UK was the first one to secure a trade deal with the U.S., and India is soon expected to conclude the bilateral trade agreement, helping New Delhi sidestep the 26% reciprocal tariffs that might be implemented from July 2025.

Role of the BRICS and China

The interests of non-Western global and regional powers such as China, Russia, Brazil and India don't always coincide with those of the West. One of the non-Western institutions to have emerged, is BRICS – a grouping of Brazil, Russia, India, China and South Africa – originally created to highlight economic opportunities, it is evolving into a geopolitical bloc. The membership has expanded beyond the original five, with more emerging economies keen to join (see Table 1.4).

2 This may be additional to the 10% tariff figure announced earlier.

Table 1.4 NEW BRICS MEMBERS WITH DATE OF JOINING

NEW BRICS MEMBER STATES	DATE OF JOINING
Egypt	2024
Ethiopia	2024
Iran	2024
Saudi Arabia	2024
United Arab Emirates	2024
Indonesia	2025

Source: Authors' compilation

There is also speculation around BRICS creating an economic bloc to rival the dollar zone, and a currency of its own. This speculation is partly due to the widespread use of sanctions by the U.S. Following the 2022 conflict with Ukraine, Russia has become one of the most heavily sanctioned countries in the world, making normal commercial relations all but impossible. Part of Russia's foreign exchange reserves held with Western banks, worth about $300 billion, continues to remain frozen (Fabrichnaya and Faulconbridge, 2023). This experience has led to calls for the creation of financial architecture that cannot be blocked. BRICS's response to the new U.S. tariffs and other possible measures need to be carefully studied and a measured response formulated. To this end, it would be worthwhile for BRICS to set up an expert group on responses to the U.S. import tariffs in 2025.

South Asian states have historically sought closer ties with China except for India and Bhutan. This is partly to reduce their dependence on India and partly as a hedge against perceived Indian dominance. China has also emerged as a major supplier of affordable military hardware since the 1960s and is now the major source of weaponry for Pakistan, Bangladesh and Sri Lanka. This has enabled it to cultivate closer ties with the military, especially in Pakistan.

In 2013, China launched the Belt and Road Initiative (BRI), with South Asian countries as early and enthusiastic adopters. Pakistan, Sri Lanka and Maldives now boast power plants, ports and roads built with Chinese debt. These borrowings are partly linked to the external debt build up and weak economies in South Asia. Sri Lanka, Pakistan and Bangladesh have all gone to the International Monetary Fund (IMF) for bailouts and their economies are subject to IMF monitoring. Simultaneously, the money tap from China – in the form of debt or equity investments has also reduced.

Unlike its South Asian neighbours, India has not joined China's BRI initiative and has a troubled relationship with China. The two countries fought a war in 1962, and China claims parts of disputed territory. In 2020, a confrontation between Indian and Chinese soldiers at the border resulted in several deaths. While India continues to trade with China, it has placed restrictions on Chinese investments. While both the countries are members of groupings such as BRICS and the Shanghai Cooperation Organisation (SCO), a normal relationship between the two Asian giants seems unlikely. India is suspicious of Chinese investments in South Asia, especially investments in ports like Hambantota in Sri Lanka.

Conclusions and recommendations

The vulnerabilities within South Asia require advance planning, rather than a reactive approach to each successive crisis. Governments need to develop the capacities to plan ahead, especially in identifying potential trouble – economic, political, or other. This will require inputs from multiple sources including the government, industry and academia. A formal structure is needed where such discussions can take place, and scenario planning can be conducted.

Better regional connectivity – physical and economic – can help mitigate some of these shocks and reduce vulnerabilities. However, the region continues to lag in this crucial aspect. There needs to be greater awareness of the benefits of improved regional connectivity and economic cooperation. This is not purely an economic decision, and also requires political buy-in. Creating awareness about the benefits of closer economic cooperation, and how this can create more opportunities, should be a part of government outreach. The overseas missions also need to play a role here and need to work on commercial relations as well.

The following recommendations can serve as actionable steps toward achieving these goals:

- Instead of harmful retaliatory tariffs, pursue quiet diplomacy with the U.S., and constructively use external tariff pressure to 'lock in' domestic tariff reform while joining supply chains and keeping other policy options open.
- India should explore closer ties with the BRICS, both to promote BRICS centric economic cooperation and in international fora to advocate for a rules-based international order. It is suggested that the BRICS set up an expert group on global economic challenges including assessing the effects of U.S. import tariffs in 2025.
- Maximise efforts at economic diplomacy, re-orient networks of overseas missions and invest in specialist skills to develop a hub and spoke system of missions.
- Develop foreign policy foresight/scenario planning capacity in ministries of foreign affairs and work with think tanks and business associations.
- Encourage the media and think tanks to educate and raise public awareness of the economic and political benefits of closer regional cooperation and integration.

The Promise of Trade and Supply Chains in South Asia

Multinational companies began reducing their dependence on China before Covid-19, with its popularity as a manufacturing source receding, particularly among Western companies. The migration of labour-intensive supply chains from China to lower-cost locations can be attributed to factors such as rising wages, domestic supply chain bottlenecks and investor concerns about tighter regulation of foreign companies, coupled with the escalating trade war between Washington and Beijing.

The disruption of China-centric global supply chains seems to be occurring, with reports indicating that inward FDI is falling to historic lows for this G2 economy (Baldwin, Freeman & Theodorakopoulos, 2023). Countries like Vietnam (dubbed as the new China by some), and Thailand are big winners in supply chain shifting. India also has the potential to become a complementary Asian manufacturing hub to China (Wignaraja, 2023). Studies place India as a reliable alternative destination among the largest global FDI recipients, driven by its rapid economic growth, a large educated labour pool, and large domestic market (Economic and Social Commission for Asia and the Pacific, 2023).

India Rising in Global Manufacturing?

The available evidence suggests that supply chain pessimism in relation to India seems to be finally shifting. One indication comes from within the manufacturing sector itself. The Purchasing Managers Index (PMI) summarises whether market conditions for manufacturing are expanding, staying the same, or contracting, as viewed by purchasing managers. India's PMI is well above 50 which is relatively high compared to the comparator economies including China and Indonesia (Table 2.1). Furthermore, there have been significant micro-level investments by global MNCs in India (Table A2.1). Prominent examples include Apple ramping up its manufacturing of iPhones in India, Toyota increasing its investment by setting up a new plant in Karnataka, and Hyundai increasing its capacity and fostering technological advancement by its recent investment in Maharashtra. Airbus (along with Tata Advanced Systems) inaugurated a C295 final assembly line complex in Vadodara, Gujarat, to produce military transport aircraft. India's manufacturing sectors in areas such as automotives, pharmaceuticals, and electronics assembly are already well-established, and may benefit from a series of policy initiatives which have increased FDI equity inflow in the manufacturing sector by 69% over the past decade (2014-24) compared to the previous decade (2004 -14).

Supply chains rely on a multitude of services inputs. In this vein, India's service sectors (including information and communications technology, financial and professional services, and transport and logistics) are also positioned for growth. To sustain its economic transformation, India needs reforms that promote trade openness, cut red tape regulations strangling businesses, and facilitate investments in renewable green energy (Das, 2024). Closer policy coordination between the central government and India's semi-autonomous states is also necessary.

Table 2.1 MANUFACTURING PURCHASING MANAGERS' INDEX IN SELECTED DEVELOPING ASIAN ECONOMIES, 2024

Economy	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct
Manufacturing PMI										
India	56.5	56.9	59.1	58.8	57.5	58.3	57.5	56.5	56.5	57.5
Phillipines	50.9	51.0	50.9	52.2	51.9	51.3	51.2	51.2	53.7	52.9
VietNam	50.3	50.4	49.9	50.3	50.3	54.7	54.7	52.4	47.3	51.2
Singapore, nsa	50.7	50.6	50.7	50.5	50.6	50.4	50.7	50.9	51.0	50.8
People's Republic of China	50.8	50.9	51.1	51.4	51.7	51.8	48.9	50.4	49.3	50.3
Taipei, China	48.8	48.6	49.3	50.2	50.9	53.2	52.9	51.5	50.8	50.2
Thailand	46.7	45.3	49.1	48.6	50.3	51.7	52.8	52.0	50.4	50.0
Malaysia	49.0	49.5	48.4	49.0	50.2	49.9	49.7	49.7	49.5	49.5
Indonesia	52.9	52.7	54.2	52.9	52.1	50.7	49.3	48.9	49.2	49.2
Republic of Korea	51.2	50.7	49.8	49.4	51.6	52.0	51.4	51.9	48.3	48.3

nsa = not seasonally adjusted; PMI = purchasing managers' index
Notes: Pink to red indicates deterioration (<50) and white to green indicates improvement (>50). All series are seasonally adjusted unless otherwise indicated

Source: Asia Development Bank (2024)

The final goods produced in these factories rely on sophisticated semi-finished goods from abroad which has contributed to growing Indian imports of intermediate goods. Thus, a second indication of India's global supply chain ascent, is its growing role as a major global intermediate goods importer. The fourth quarter of 2023, WTO ranked India as the fifth-largest importer of intermediate goods (Table 2.2) – up from the 10th rank in the second quarter of 2021. In 2023, India was behind top global importers such as China, the U.S., Germany and Hong Kong. Moreover, the country is positioned ahead of European developed country importers (the UK, Netherlands, and France), as well as Japan. Few foresaw India's emergence as a leading global importer of intermediates a decade ago.

Table 2.2 INDIA - THE WORLD'S 5TH LARGEST INTERMEDIATE GOODS IMPORTER IN Q4, 2023

RANK	COUNTRY	Value ($ Billion)	YoY change (%)
1	China	409	1
2	United States	302	-6
3	Germany	157	-11
4	Hong Kong, China	124	17
5	India	94	8
6	United Kingdom	79	5
7	Netherlands	79	-10
8	France	78	-2
9	Japan	77	-14
10	Mexico	74	0

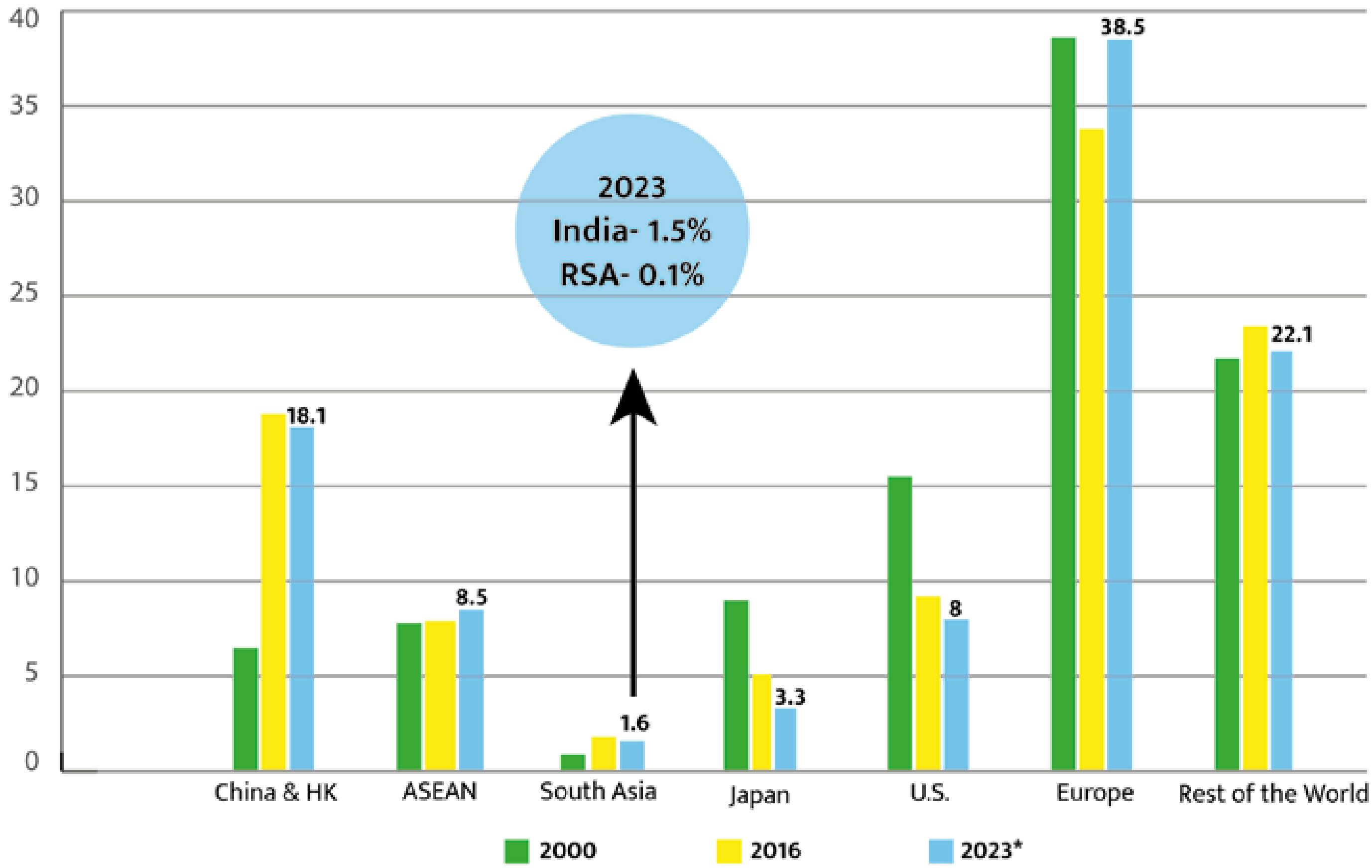
11	Republic of Korea	73	-9
12	Italy	70	-2
13	Belgium	61	-14
14	Canada	59	-1
15	Singapore	59	-1

Source: World Trade Organization, 2023

A third indication of India's role in global supply chains is as an exporter of intermediate goods. Here the data suggest that India and South Asia as a whole, are relatively small players in supply chains compared to East Asian economies and developed economies. It would be commendable if India closes the deal. Between 2000 and 2023, India's share of world intermediate goods exports increased modestly from 0.8% to an estimated 1.5%. Adding the rest of South Asia (an estimated 0.1% of world intermediate goods exports) to India's share yields a modest regional share of only 1.6% in 2023. Meanwhile, China and Hong Kong make up 18.1% of the world share and ASEAN another 8.5% (Figure 2.1). Though declining, Japan and the US have larger world shares than South Asia, while the EU is significant in world terms.

Furthermore, there are extremely limited regional spillovers from India's supply chain activities to the rest of South Asia. Intra-regional trade in South Asia at 5% (2017) is amongst the lowest in the world. This suggests that South Asia is one of the world's most disconnected regions in economic terms. Despite its growing trade volume with the world, India's trade with its neighbours has remained roughly between 1.7% and 3.8% of its global trade. India's largest regional trading partner is Bangladesh, followed by Sri Lanka and Nepal.

Figure 2.1 SOUTH ASIA IN WORLD SHARES OF INTERMEDIATE GOODS EXPORT (%)



Note: * represents estimates

Source: WTO (2023), Wignaraja (2023)

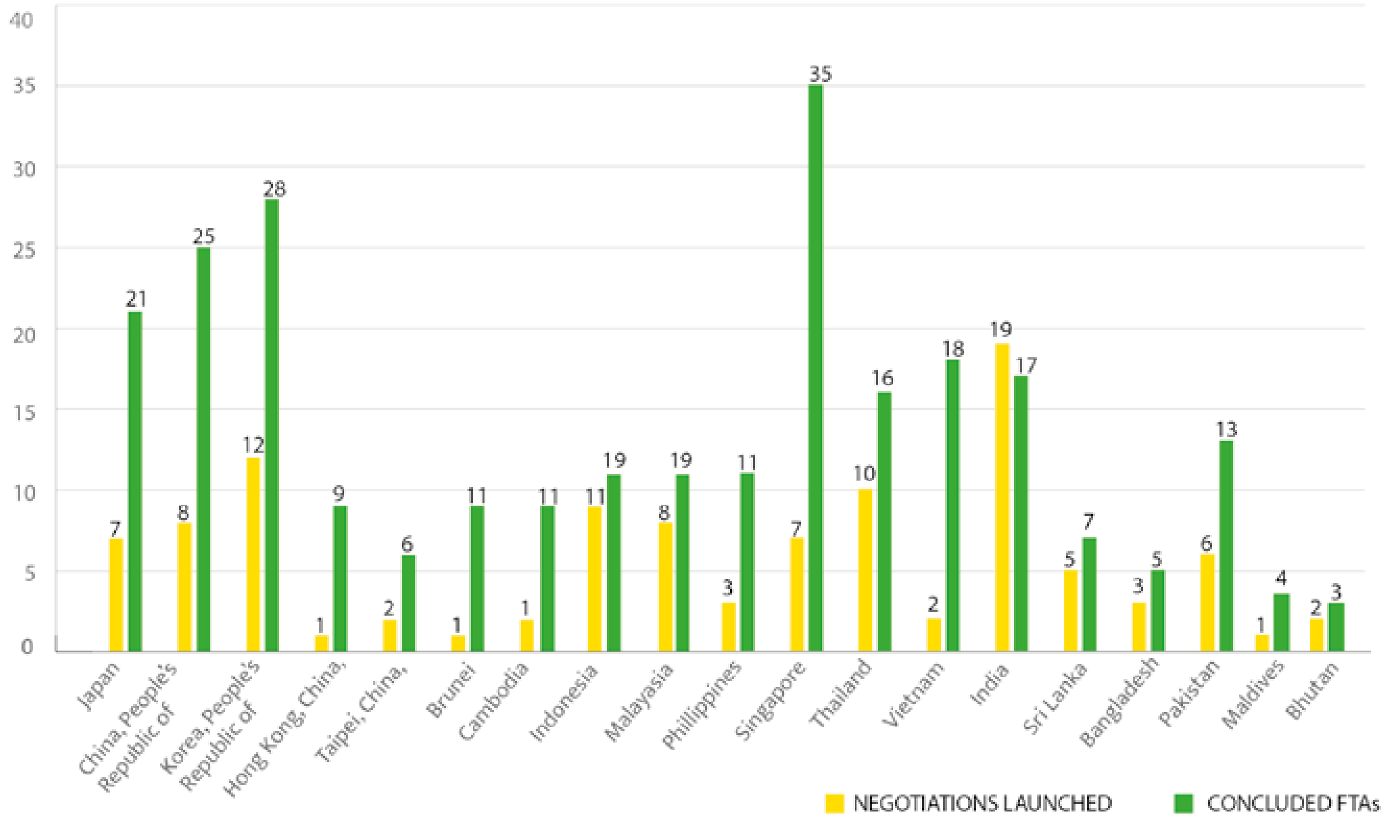
Trade Diplomacy in High Gear

The latest data from the Asian Development Bank is on the status of free trade agreements in Asia including concluded FTAs and FTAs under negotiation (Figure 2.2). The rise of FTAs in the 2020s largely occurred in East Asia with Japan, South Korea, China and Singapore taking the lead. Over time, such deals can increase trade and FDI gains for India too, leading to better market access for exports, cheaper intermediate goods and food imports, enhanced technology and skill transfer, more investment in productive capacity and locking in structural reforms (Kawai and Wignaraja, 2013).

Since 2022, the Modi government has placed renewed emphasis on preferential openings with trading partners through a flurry of bilateral trade deals such as the UAE-India Comprehensive Economic Partnership Agreement, the Australia-India Economic Cooperation and Trade Agreement (ECTA), UAE, Australia, UK and the India-UK Free Trade Agreement. Additionally, there are ongoing negotiations on trade deals with the EU, New Zealand and Oman to conclude comprehensive high standard FTAs.

It will be useful for India to carefully re-evaluate the gains from mega FTAs in Asia, such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which includes agendas for services, trade, investment rules, intellectual property rights, government procurement, and other pertinent issues to support the spread of supply chains. Consultations with businesses during FTA negotiations and providing business development services for FTA implementation is also essential, as trade and investment do not necessarily pick up because an FTA is signed.

Figure 2.2 SOUTH ASIA: JOINING THE BANDWAGON OF FTAs



Source: Asia Regional Integration Center, February 2025

Lessons from China

Some aspects of China's industrial policy may be relevant to India, including better targeting of multinationals with which to partner new industrial endeavours that may deliver potential comparative advantages. That means improved coordination between the central government and state administrations. Equally important is upstream investment in tertiary-level education in science, technology, engineering and mathematics.

Still, industrial policy remains a controversial area and caution should be exercised before India attempts to emulate China's state interventionist template wholesale. Significant risks include government failure and cronyism. It might be prudent to actively engage with think tanks to gain insights into what might work. That said, India can learn much from China's experience.

Lesson 1: Promoting export-oriented FDI
Trade liberalisation means an open-door policy towards FDI in manufacturing and facilitating investment at a high level, with competitive incentives and the creation of modern SEZs as public-private partnerships.

Lesson 2: Reducing business hassles
Digitalisation of taxes, customs fees and business administration is essential. Industrial policy to facilitate the green transition and trade are increasingly used and can bring gains.

Lesson 3: Fostering regional supply chains
India should promote regional supply chains by scaling up the Make in India programme to a Make in South Asia initiative. India could offer fiscal incentives to its manufacturers to make further inroads into Bangladesh and Sri Lanka. The food processing, textiles, apparel and automotive sectors might be candidates for regional expansion, given the factories and experience of these neighbours.

Box 2.1 POLICY INITIATIVES BY THE GOVERNMENT OF INDIA TO BOOST MANUFACTURING

Source: Make in India, Press Information Bureau

Make in India: Launched in September 2014, the initiative was launched with the goal of transforming India into a global design and manufacturing hub. The programme focused on ease of business, by reforming policies governing businesses, making them more investor friendly and focusing on infrastructure development.

Atmanirbhar Bharat: The Self-Reliant India Campaign was launched in May 2020 to make India self-sufficient and independent in all aspects. The campaign focused on seven sectors, bringing in reforms and introducing new initiatives for ease of business.

Product Linked Incentive (PLI) Scheme: The PLI Scheme was launched as a continuation of the Atmanirbhar Bharat Abhiyaan. It gave companies financial incentives for higher production and incremental sales. The goal of the scheme was to support and grow the manufacturing sector of India, and incentives were provided in 14 sectors.

Lifting Up India's Neighbours

Currently, much of South Asia is not a major part of India's trade story, despite the economic potential of some countries. Thus, it makes economic sense for India to spread the gains from this trade regionally, promoting resilient and cost-effective regional supply chains in South Asia. This would stabilise the region, create jobs, and make its neighbours less vulnerable to Chinese investments.

In this spirit, India-Sri Lanka FTA talks have resumed, with a view to concluding an investment deal, followed by a more comprehensive FTA. Stronger investor protections in Sri Lanka are crucial to attracting Indian foreign investors in the country's ports, renewable energy, and privatisation of state-owned enterprises. Over time, such ventures will help generate much-needed foreign exchange and provide Sri Lanka with a path away from indebtedness and towards transformative growth. India-Sri Lanka economic ties are discussed further below.

A sure way for South Asia to have resilient and cost-effective regional supply chains is for Indian businesses to invest in the region and foster significant local linkages and spillovers for its South Asian partners (Kathuria, Yatawara & Zhu, 2021). This is already happening to a limited extent in Sri Lanka and Bangladesh. The Adani Group, for example, has invested in a joint venture with John Keells Holdings, to develop the West Container Terminal in Colombo Port. This project capitalises on Sri Lanka's favourable geographical location along the main East-West global sea route and windy land, comprising about 6% of the country which could support almost 20,000 Megawatts of potential installed capacity (Sri Lanka Sustainable Energy Authority, n.d.). Foreign investment from India and elsewhere, offers Sri Lanka an opportunity to raise non-debt creating foreign exchange and a route out of indebtedness towards economic transformation in the future.

Bangladesh was growing rapidly, with a larger domestic market and cheaper wages than Sri Lanka, until its internal crisis. That made it attractive for Indian FDI in the manufacturing sector. Tata Motors, Hero MotoCorp, Sun Pharma, Godrej, VIP, CEAT Tyres and Aditya Birla Cement have all built factories in Bangladesh. Increased private investment in consumer-oriented sectors and start-ups focused on fintech, healthcare and agritech could further develop a local ecosystem with access to seed funding and technology transfer from India.

India-Sri Lanka: a model for South Asian Cooperation

The joint statement released after Prime Minister Narendra Modi's latest visit to Colombo and Sri Lanka's President Anura Kumara Dissanayake's latest visit to New Delhi highlighted India's pledge to help Sri Lanka become an energy hub, enhance India-Sri Lanka defence cooperation and boost education, health and technology exchanges and encourage Indian FDI in Sri Lanka.

It is clear that India recognises a new Sri Lanka – one that has moved on from just domestic security concerns, to one that can be a premier partner in making South Asia a progressive economic region in an uncertain global economy. Dissanayake brings a different set of politics to Sri Lanka domestically and internationally. His National Peoples Power (NPP) won the presidential elections on September 21, and the November 12 parliamentary election with a two-thirds majority – a first for Sri Lanka, indicating that all Sri Lankans, across ethnic and economic lines, voted for his 'clean Sri Lanka' manifesto. Within two weeks of Dissanayake's win, Foreign Minister S. Jaishankar travelled to Colombo and invited the new President to make a state visit to India at the earliest.

This visit's success was imperative. Sri Lanka has been South Asia's highest GDP per capita economy, reaching a peak of $4,388 in 2017, a productive, medium and small enterprises machine. Its fall, in five years, to $3,3431 per capita, was a blow to a country accustomed to a good life. This is what Dissanayake has vowed to reverse. Already, since he was elected president in September, he has confirmed that Sri Lanka will continue with its 17th IMF programme but with increased social spending to reduce high poverty. He is improving governance by adopting anti-corruption measures, digitising the government and modernising agriculture.

The bilateral agreements with India will help him continue these efforts and change the focus of the relationship from aid to trade. Dissanayake acknowledged India's significant assistance through Sri Lanka's economic crisis. India promised to continue that support. It has agreed to help Sri Lanka in the digitalisation of its public services, a model which India has pioneered, and which will help achieve some of the promises NPP made for targeted social protection and anti-corruption. Further, it entered into an Memorandum of Understanding (MoU) with Sri Lanka to establish a high-voltage direct current (HVDC) connection for importing and exporting power. India, UAE and Sri Lanka have signed an agreement to develop Trincomalee into an energy hub. The States' Ministries of Health and Pharmaceutical regulatory bodies also entered into a cooperation agreement. On his part, Dissanayake reiterated he would respect India's security concerns and not allow Sri Lanka to be used against India, by signing an MoU with India on Defence Cooperation. No specific mention was made of the $440-million Adani wind power project for Sri Lanka, signed in 2023, which Dissanayake had said he would reconsider or annul if elected.

It's a promising start, and there's much more that can elevate the bilateral to make it like the close cooperation visible between Thailand, Cambodia and Lao People's Democratic Republic, for instance, in the Greater Mekong sub-region.

First, Sri Lanka can broaden its engagement beyond Tamil Nadu to all four southern Indian states, through business-to-business (B2B) ties. Traditionally, Indian and Sri Lankan business collaborations have been led by the two apex chambers of commerce in India, the Confederation of Indian Industry (CII) and the Federation of Indian Chambers of Commerce and Industry (FICCI) in New Delhi, and the Ceylon Chamber of Commerce in Colombo, which are focused on big business.

As geography determines trade flows, these B2B ties can expand with the states and cities geographically closest to Sri Lanka and most importantly, between the smaller business chambers and firms. For both countries, MSMEs are the base on which their economies run. This needs sincere effort and activation by more inbound business visits and participation in trade fairs, for instance, to build trust which translates into actual deals. Specific sectors of mutual business interest could include food processing, textiles and garments, auto parts and IT-related services.

Second, New Delhi and Colombo can consider piloting a regional PLI scheme in Sri Lanka. The PLI scheme lies at the core of the Government of India's efforts to build domestic capabilities in sophisticated manufacturing industries including solar panels, electric vehicles and electronics components. This has led to success and reduced India's dependence on imports of those items into which it seeks inroads, such as green energy and energy security. A limited extension of the domestic PLI scheme to Indian businesses to make solar panels in Sri Lanka will limit the risks of overseas investment and build regional supply chains in the neighbourhood – a key goal for India's China+1 strategy.

Third, it's time to conclude an upgraded India-Sri Lanka FTA. India-Sri Lanka trade negotiations resumed under former President Ranil Wickremesinghe, and there was expectation of an early harvest investment agreement in 2024. This was to be the agreement that sets the terms and conditions for Foreign Direct Investment, thereby promoting bilateral business and protection for investors. However, such talks were paused as the new Sri Lankan government took stock of trade negotiations, in order to develop its FTA stance.

India's commerce ministry, now on a roll as it negotiates FTAs with several countries, can restart bilateral FTA talks with a view of concluding an investment agreement in 2025 and a comprehensive trade deal in 2026, covering expanded goods coverage, services trade, investment and trade facilitation. There can also be a built-in agenda for including new trade issues such as intellectual property, competition policy and government procurement, when the conditions are right. To alleviate domestic Sri Lankan concerns about opening up trade, India can maintain asymmetrical treatment for Sri Lanka in the new deal – and consider providing some aid for trade. This will help to foster B2B ties, stimulate inward investment, and provide for market access, and regulatory cooperation.

Fourth, improving physical connectivity is vital for trade and tourism. Indigo and Air India have increased flights between Indian cities and Colombo airport. Palaly Airport in Jaffna has been modernised to enable flights to and from South India and the ferry service has been re-started to cover 60 nautical miles from

Nagapattinam to Kangesanthurai. This is showing results particularly in northern Sri Lanka, where projects have been co-financed by Indian aid and Sri Lankan public expenditure. The Adani Group has co-invested with John Keells Holdings, Sri Lanka's largest conglomerate, in developing the West Container terminal in Colombo port which largely tranships to India.

Indian finance for a multi-product fuel pipeline between India and Sri Lanka is an important next step. The notion of a land bridge between the two countries such as a motorway/railway bridge between Denmark and Sweden, has provoked scepticism in Sri Lanka.

Sri Lanka's economy is stabilising in 2024 from a crippling debt default and economic crisis in 2022. Indian aid and an IMF programme were instrumental in the economic turnaround.

Tourism arrivals during the European winter season have increased, bringing in much-needed foreign exchange – tourism receipts were $2.5 billion in January-October 2024, an increase of 59% over January-October 2023. To its credit, Sri Lanka's new government has reiterated support for the IMF programme and the new budget is eagerly awaited in early 2025. Apart from limited fiscal space for social spending, the island faces the serious risk of repayments (capital) on its external debt starting in 2028 if it is unable to generate sufficient foreign exchange through trade-led growth. Working in partnership with the IMF and World Bank, India should stand ready to help if Sri Lanka falters a second time.

Such enhanced cooperation with Sri Lanka is almost a necessity. India is facing a hostile neighbourhood in 2025. Ties with Bangladesh are strained; debt-distressed Maldives reluctantly accepted a short-term liquidity inflow of an RBI swap after Chin's request for aid cooled down. Nepal's PM K.P. Sharma Oli just signed a framework agreement with China to implement the Belt and Road Initiative's infrastructure projects. Struggling economically under the Taliban rule, Afghanistan risks becoming a regional centre for narcotics trade and illegal migration, as does Myanmar to India's East. Relations with Pakistan remain in cold storage.

These issues concern both India and Sri Lanka. An economic partnership in South Asia that works, can become a model for others, enhance India's Neighbourhood First Policy and India's status as a regional power.

Conclusions and recommendations

The slowdown of the Chinese economy, and the shift, particularly by MNCs, from China to other more competitive locations has opened up business opportunities for latecomers in supply chains in the developing world. The available evidence suggests that Southeast Asia and some South Asian countries like India, Sri Lanka, Bangladesh, could be beneficiaries of the supply chain shift, particularly in labour-intensive segments. This shift has not only been underpinned by geopolitics but also the availability of skilled and relatively low-cost labour and a large middle class. However, these carry constraints: Southeast Asia does not offer scale, and South Asia which can, is a latecomer to trade led regionalism, therefore constrained by policy barriers and infrastructure gaps.

Several recommendations can be suggested to promote the role of India and smaller South Asian countries to participate in and deepen their positioning in the global supply chains.

- Diversify to de-risk geographically concentrated supply chains, sourcing of inputs, suppliers and markets.
- Strategically reduce FDI and trade barriers and improve national government/local government investment promotion efforts.
- Cut red tape regulations hindering ease of doing business, digitise business procedures and reduce corruption vulnerabilities.

- Improve the performance of Special Economic Zones (SEZs) to attract foreign and domestic investors and clustering of business activities.
- Invest in transhipment ports, trade-related logistics services and port-road network connectivity.
- Provide limited time-bound fiscal and financial incentives to promote regionalisation of supply chains in India's neighbourhood.
- Conclude comprehensive trade deals with neighbours to reduce regional trade barriers and provide for regional rules-based trade.
- Following Prime Minister Modi's historic visit to Sri Lanka in April 2025, enhanced India-Sri Lanka connectivity and trade offers a possible model for regional economic cooperation.

Energy Connectivity in South Asia

South Asian countries consume less energy on a per-capita basis compared with the global average. This is in line with the lower levels of industrialisation and incomes in the region. India, which is relatively more industrialised than some of its neighbours, accounts for 85% of regional energy consumption. However, its per-capita energy consumption is still just one-third of the world average. The lower energy consumption is due to lower levels of industrialisation and economic activity - the region has been historically under-developed, and some of the countries are now beginning to catch up with the rest of the world. These low per-capita numbers will increase as these economies grow – India and Bangladesh, for example, are amongst the fastest-growing economies globally, with annual GDP growth of over 6% each. The other issue for South Asia is energy quality - which includes metrics such as access to electricity. In Bangladesh, Bhutan, India and Sri Lanka, 99%+ population has acces to electricity, the figure falls to 95% for Pakistan, 91% for Nepal, and is even lower for Afghanistan and Myanmar.

Table 3.1 SOUTH ASIA ENERGY CONSUMPTION IN PERSPECTIVE

	ENERGY CONSUMPTION (BOE)*	VS WORLD AVERAGE
Bangladesh	1.7	0.14
India	4.2	0.34
Pakistan	2.5	0.20
Sri Lanka	2.6	0.21
China	18.3	1.48
USA	46.3	3.75

Note: *BOE: barrels of oil equivalent

Source: BP Statistical Review of World Energy, 2023

There are significant variations in the energy mix within the region. While India relies heavily on coal, natural gas is the main fuel used in Pakistan and Bangladesh. Sri Lanka's electricity supply is split among hydropower, coal and fuel oil, while Nepal relies almost entirely on domestic hydropower and electricity imports from India. These choices are due to the historical availability of fuels, as well as of finance.

India had the technical and financial base to build coal-fired power plants, while other South Asian states needed external finance. Global institutions no longer finance coal-fired power projects. As a result, these countries are saddled with gas and oil-fired power plants, which produce expensive electricity in the best of times. During a crisis such as the invasion of Ukraine in 2022, which pushed up the global gas prices, these plants were impossible to operate. Pakistan and Bangladesh, for example, faced severe energy/electricity crises in 2022.

Table 3.2 ENERGY MIX IN SOUTH ASIA

	OIL	GAS	COAL	RENEWABLE	ENERGY CONSUMPTION (MTOE)*
India	27.6%	5.7%	55.1%	5.9%	871
Pakistan	27.5%	38.4%	17.7%	1.7%	86.1
Bangladesh	30.7%	58.6%	10.0%	0.3%	42.9
Sri Lanka	58.1%	0.0%	17.9%	4.5%	8.2

Note: *MTOE: million tons oil equivalent
Source: BP Statistical Review of World Energy, 2023

South Asia is projected to grow at a rate of 6% in 2024 and 6.1% in 2025 (World Bank Group, 2024). However, the overall figures hide many disparities. While India's growth is projected to be 7% and 6.5% for 2023 and 2024, respectively, Sri Lanka and Pakistan are expected to record GDP growth in the 2-2.5% range for those two years. Bangladesh was also projected to grow at a solid 5.6-5.7% for that period, but might be affected by internal political upheaval.

With their current low energy consumption and high projected rates of growth, South Asia will require major investments in all forms of energy – traditional and renewable – to meet its requirements. According to the International Energy Agency (IEA) estimates, India needs to invest $160 billion annually in its energy infrastructure up to 2030 (IEA, 2021) – implying a total investment of $960 billion. For the other South Asian economies (Bangladesh, Sri Lanka, Nepal and Bhutan), given their smaller energy base, $100 billion is a conservative estimate for energy-sector-related investments over the period. Thus, the total investment required can be pegged at $1.06 trillion by 2030. It will be difficult for many of the smaller economies to finance this growing demand for energy. A more ambitious push towards green energy will also mean greater requirements for investment. Integrating the region can make it easier for regional economies to raise resources for their energy needs and aid in the green transition.

Within the region, India accounts for over 85% of the total energy consumption. India's central position means that any regional initiative will require India's participation to be successful.

The Energy Future

The major South Asian economies are all net energy importers, and their energy ties have been with energy exporting regions such as West Asia, Australia and Russia. While the region is energy deficient, Nepal and Bhutan have a potential surplus of hydroelectricity, which can be exported to other countries. Better connectivity – with power transmission lines and oil & gas pipelines – can also help countries of the region bring down their overall energy costs. This has already started to happen – with India taking the lead.

New Delhi and Indian companies have funded five hydropower projects in Bhutan that generate up to 2,262 MW and now export electricity to India (Ministry of Power, Annual Report 2022-23). Two additional projects, with a total capacity of 2,220 MW, are now under construction. There are existing transmission links connecting Bhutan with India. India sells electricity to Nepal, and Indian companies are working on multiple dams in that country, which will meet local energy needs and generate surplus power for export to India. Nepal, India and Bangladesh have recently concluded a three-way agreement to allow Bangladesh to buy electricity from Nepal via India. The first sale of electricity under this agreement took place in November 2024 (South Asia Subregional Economic Cooperation, 2023).

In addition, India has power transmission connectivity with Bangladesh, which imports electricity. The 1,600-megawatt Godda Power Project in eastern India, completed in 2023, sells 100% of its electricity to Bangladesh (Adani Power, 2023). After the abrupt government change in Dhaka in August 2024, this project has come under scrutiny and has reduced electricity supply to Bangladesh due to pending payments (Rahman, 2024).

In the case of petroleum, while India imports crude oil, it is also a large exporter of refined petroleum products such as petrol and diesel due to its excess refining capacity. Other countries in the region – notably Sri Lanka, Bangladesh and Nepal – are importers of petroleum fuels. India and Nepal completed in 2019, a petroleum product pipeline delivering fuel to Nepal (Prime Minister's Office, 2019). A similar pipeline, delivering petroleum fuels from Assam in India to Bangladesh was commissioned in 2023 (Prime Minister's Office, 2023). Pipelines are a cheaper way to move liquid fuels compared to road or rail. Sri Lanka and Bangladesh have one petroleum refinery each, both built in the 1960s, that use old technologies and lack economies of scale. Upgrading these old refineries or building new ones will be a multi-billion-dollar undertaking, which these countries cannot afford. Sourcing their petroleum needs from India would be financially prudent for both the countries.

Box 3.1 ANALYSIS OF EXISTING ENERGY CONNECTIVITY INVESTMENTS IN SOUTH ASIA

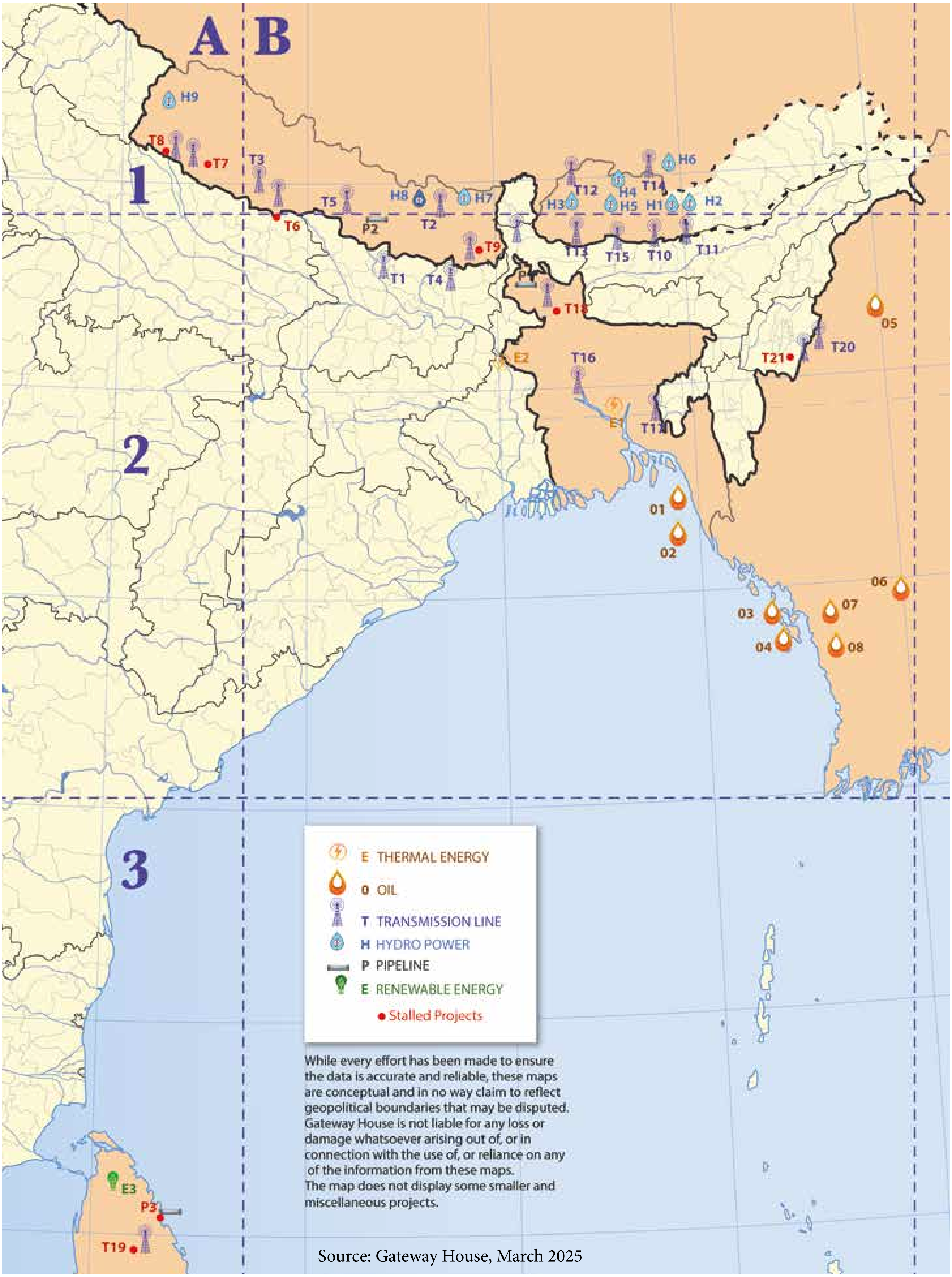
At this point, cross-border energy connectivity in South Asia means bilateral connectivity with India. In November 2024, Nepal exported 40 MW of electricity to Bangladesh via the Indian grid, marking the first such transaction amongst two South Asian states (Prasain, 2024).

Cross-border energy connectivity in the region started as a government-to-government project – India-Bhutan and India-Bangladesh – but is now moving beyond that stage. The Upper Karnali Hydropower Project in Nepal is being developed by GMR, a privately owned Indian company. Likewise, the 1,600-megawatt Godda Power Project in Jharkhand, which supplies power to Bangladesh, has been developed by the private Adani Group. However, the bulk of these projects continue to be backed by Indian state-owned companies.

Investments in regional energy connectivity will have to deal with political and economic instability. The Adani power project supplying electricity to Bangladesh has run into controversy following the change in government. The financial crisis in Bangladesh and Sri Lanka also creates a payment risk for investors. In this scenario, regional connectivity will be largely driven by government-owned firms in the short-to-medium term.

The financial crises in Sri Lanka and Bangladesh underline the benefits of greater regional trade in petroleum and natural gas and can also provide a catalyst for such connectivity. Both the countries have outdated petroleum refineries and will need to spend billions of dollars on upgrading these – or they can import these fuels from India. Bangladesh already has an oil pipeline importing petroleum products from India. A similar pipeline is proposed for Sri Lanka. In the longer term, these countries can also seek connectivity with the Indian gas grid.

Map 3.1: CROSS-BORDER ENERGY PROJECTS IN SOUTH ASIA



Source: Gateway House, March 2025

PROJECT CODE	PROJECT COORDINATES	PROJECT COUNTRY
HYDRO POWER		
H1 Chukha Hydropower Project	B1	Bhutan
H2 Kurichhu Hydropower Project	B1	Bhutan
H3 Tala Hydropower Project	B1	Bhutan
H4 Punatsangchhu-I Hydropower Project	B1	Bhutan
H5 Punatsangchhu-II Hydropower Project	B1	Bhutan
H6 Kholongchhu Hydropower Project	B1	Bhutan
H7 Arun-III Hydropower Project	B1	Nepal
H8 Himtal Hydropower Project	B1	Nepal
H9 Upper Karnali Hydropower Project	A1	Nepal
RENEWABLE ENERGY		
E3 Adani Group Wind Power Project	A3	Sri Lanka
THERMAL ENERGY		
E1 2x660 MW Rampal Maitree Power Project	B2	Bangladesh
E2 Adani Godda Thermal Power Station	B2	Bangladesh
TRANSMISSION LINE		
T1 Muzaffarpur-Dhalkebar 400kV D/c Line	B2	Nepal
T2 Sitamarhi-Dhalkebar 400kV D/c (Quad) Line	B1	Nepal
T3 Gorakhpur-New Butwal 400kV D/c (Quad) Line	A1	Nepal
T4 Kataiya-Kusaha 132kV S/c Line	B2	Nepal
T5 Raxaul-Parwanipur 132kV S/c Line	B1	Nepal
T6 New Nautanwa-Mainhiya 132kV S/c Line	B2	Nepal
T7 Nanpara-Kohalpur 132kV S/c Line	A1	Nepal
T8 Bareilly-New Lumpki 400kV Line	A1	Nepal
T9 New Purnea-New Duhabi 400kV Line	B2	Nepal
T10 Salakati-Kurichu HEP/Geylephu Salakati 132kV S/c Line	B2	Bhutan
T11 Rangia-Deothang/Motonga 132kV S/c Line	B2	Bhutan
T12 Siliguri-Tala HEP 400kV 2xD/c Line	B1	Bhutan
T13 Birpara-Chukha HEP 220kV (3 circuits) Line	B2	Bhutan
T14 Alipurduar-Mangdechhu 400kV D/c (Quad) Line	B1	Bhutan
T15 Alipurduar-Jigmeling 400kV D/c (Quad) Line	B2	Bhutan
T16 Baharampur–Bheramara 400 kV 2xD/c Line	B2	Bangladesh
T17 Surajmaninagar-North Comilla South Comilla 400kV Line	B2	Bangladesh
T18 Katihar-Bornagar-Parbatipur 765kV Transmisson Line	B2	Bangladesh
T19 Madurai-New Habarana HVDC Overhead Link with 2x500MW HVDC Terminals	A3	Sri Lanka
T20 11kV Moreh-Tamu Transmission Line	B2	Myanmar
T21 Imphal–Tamu cross-border interconnection with 400/230 kV Substation	B2	Myanmar
OIL		
O1 Block SS-04 Oil Field	B2	Bangladesh
O2 Block SS-09 Oil Field	B2	Bangladesh
O3 Block-A1 Oil Field	B2	Myanmar
O4 Block-A3 Oil Field	B2	Myanmar
O5 Block B-2 Oil Field	B2	Myanmar
O6 Block EP-3 Oil Field	B2	Myanmar
O7 Pipeco-1 Oil Field	B2	Myanmar
O8 Pipeco-2 Oil Field	B2	Myanmar
PIPELINE		
P1 India-Bagladesh Friendship Pipeline	B2	Bangladesh
P2 Motihari-Amlekhgunj Pipeline	B2	Nepal
P3 Proposed Multi-Product Pipeline	A3	Sri Lanka

Energy Transition in South Asia

The South Asian region has a population of nearly 1.9 billion – which currently uses energy at a fraction of the global average. Energy demand in South Asia will grow at a faster pace compared with the rest of the world, and the large population of the region means this increase will have a global impact – underlining the need for a green transition. Within the region, India gets 5.9% of its energy from renewable sources – the highest in the region – followed by Sri Lanka at 4.5%. India has a net-zero target of 2070, with a short-term plan to decarbonise energy to 50% by 2030.

The other South-Asian countries have set 2050 as the net-zero target. However, these goals will require significant funding in the form of climate finance – concessional loans and grants – which has not materialised. Given the economic problems in Sri Lanka, Pakistan and Bangladesh, it seems unlikely that these countries will be able to mobilise the required capital on their own.

Table 3.3 NET ZERO TARGETS OF SOUTH ASIAN COUNTRIES

COUNTRY	TARGET YEAR	PLAN	REQUIRED BUDGET
India	**2070**	Take non-fossil energy capacity to 500 GW and 50% of energy requirements from renewable energy by 2030.	$1.4 trillion by 2070.
Nepal	**2050**	77% of total electricity generation from renewables by 2050.	$5.35 billion by 2050.
Bhutan	**2050**	20 MW of renewable energy (excluding hydropower) by 2025.	N/A.
Bangladesh	**2050**	Increase up to 40% of total electricity generation from clean energy by 2041. 37.8GW of renewable energy capacity by 2050 (17% wind power and 19% hydrogen).	$37.4 billion by 2030.
Sri Lanka	**2050**	70% of total electricity generation from renewables by 2030. No coal fired plant additions.	$12 billion in foreign investment in renewable energy sources by 2030.
Pakistan	**2050**	59% of total electricity generation from renewables by 2030.	N/A.

Source: Economic Survey, Government of India; Water and Energy Commission Secretariat, Government of Nepal; International Renewable Energy Agency, Kingdom of Bhutan; Ministry of Finance, Government of Bangladesh; Ministry of Environment, Government of Sri Lanka; Economic Survey, Government of Pakistan

China's Role in South Asia's Energy Architecture

As a part of its BRI, China built coal-powered power plants in Pakistan, Bangladesh and Sri Lanka. As a result, the share of coal has increased in the energy mix of these countries over the past decade. While coal needs to be phased out in the long term, it is required to meet the basic energy needs of poor nations. South Asia's per-capita consumption of energy and other resources is a fraction of the global average, and these coal power plants need to be viewed from that perspective. Chinese companies had signed agreements to build six hydropower plants in Nepal, though these projects are currently stalled. Chinese companies had signed agreements to build 11 coal-fired power plants in Bangladesh, of which three have been completed and three more are under construction. China is a global leader in the manufacture of green technologies, and Chinese companies are also building solar and wind farms in Bangladesh, Sri Lanka and Nepal.

However, there have been concerns on sustainability of the debt that was incurred by the host governments to finance this infrastructure. Sri Lanka, which has the highest debt-to-GDP ratio in South Asia, is a case in point. The country defaulted on its external debt obligations in early 2022 and continues to remain in default. The debt-to-GDP ratio for Sri Lanka was 125% in 2022 (IMF, 2023). Bangladesh has also faced pressure on its balance of payments – with forex reserves declining from $42 billion in May 2022 to $25 billion in April 2024 (Bangladesh Bank, Economic Statistics). Nepal, too, had faced concerns of falling forex reserves – and had imposed restrictions on several imports in 2022 (Prasain and Prasain, 2023). Financial sustainability of new energy infrastructure has to be a major consideration.

Benefits of Greater Energy Connectivity

Many of the smaller South Asian economies – Sri Lanka, Nepal and Bangladesh – have faced difficulties in mobilising investments for their energy needs. Being part of a larger South Asian energy ecosystem will enable Bangladesh, Sri Lanka and Nepal to get electricity from India - amongst the lowest cost in the world. Access to the Indian market will also help develop the domestic energy resources within these countries. For instance, hydropower projects in Nepal will find it easier to raise finance if customers in India and Bangladesh are ready to buy the power. Likewise, Sri Lanka's wind energy potential can be developed if there are buyers for this electricity elsewhere in South Asia. Bangladesh can source electricity from India and Nepal – which will be cheaper than the gas-fired power that it currently uses.

If this connectivity expands to natural gas as well, the other South Asian economies can benefit from India's economies of scale: It is one of the top global importers of oil and gas, and has a world-scale petroleum industry. Payments in Indian Rupees instead of the U.S. dollar can help bring in additional savings for intra-regional energy trade.

Principles and Challenges for an Energy Trade Agreement in South Asia

Energy can form a basis for greater economic integration within South Asia. Given its economy, size and geography, India will have a vital role to play in this initiative. The poor state of India-Pakistan ties makes any meaningful collaboration unlikely between the two. Myanmar's participation at this stage seems unlikely given the political and security situation.

Closer energy cooperation within South Asia will need to follow certain principles, to ensure it is acceptable to member countries:

1. South Asian nations should have a clear control of the initiative – to ensure that it is in line with the priorities of the participating nations.
2. While India accounts for the bulk of energy consumption and regional GDP, it cannot dominate the grouping, or the regional institutions created for it.
3. This mechanism should finance technologies that are suitable for the participation countries based on their level of development. It should also encourage sustainable and renewable technologies.

4. The infrastructure and assets created for this initiative should be financially sustainable for the participating governments.
5. If possible, special purpose companies can be formed to own and operate assets such as cross border pipelines and power grids, and for financing these projects.
6. This mechanism needs to encourage local innovation and business models, especially with respect to new energy technologies.

Conclusions and recommendations

The existential crisis of climate change mingled with rising oil prices has prompted a focus on energy security and green transition. Not surprisingly, this transition requires big investments – the projected investment needed just till 2030 for South Asia's energy needs, conventional and renewable, is estimated at $1.06 trillion. South Asian countries face three problems: lack of capital, lack of cheap energy, and lack of market access.

South Asia energy connectivity will have to be between India and the other regional economies – Bangladesh, Sri Lanka, Nepal and Bhutan. To achieve this, the following recommendations are proposed:

1. Invest $100 billion to build efficient cost competitive, clean, regional and national energy infrastructure.
2. Create a regional energy finance institution, with South Asian governments as shareholders, with the specific objective of funding cross border energy connectivity projects within the region and completing them in about 24 months.
3. Create a venture capital fund with a mandate to encourage MSME (micro, small and medium enterprises) in the energy space, with a special focus on new and emerging green technologies such as green hydrogen and electric vehicles.
4. Explore clean energy partnerships with the World Bank, Asian Development Bank (ADB) and the European Investment Bank (EIB).

Regional Institutions in South Asia

South Asia has a multi-tiered global and regional institutional architecture. Since the late 1940s, South Asian countries have engaged with various multilateral institutions supporting global cooperation and economic integration. As part of gathering momentum towards regional cooperation and economic integration, in mid-1980s, South Asian countries set up and engaged in a myriad of diverse regional institutions. These ranged from SAARC and BIMSTEC to South Asia Subregional Economic Cooperation (SASEC) and IORA. More recently, some South Asian countries have become members of specialised interest-based institutions such as the G20, BRICS, Shanghai Cooperation Organisation (SCO) and the Organisation of Islamic Cooperation (OIC) to advance their agendas and project influence.

Table 4.1 MEMBERSHIP IN KEY REGIONAL AND MULTILATERAL INSTITUTIONS BY SOUTH ASIAN COUNTRIES

Country	Regional institutions	Multilaterals	Other Specialised Institutions
Bangladesh	SAARC, BIMSTEC, IORA, SASEC	WTO, IMF, ADB, World Bank, AIIB, AARDO, UN and its specialised agencies.	OIC
Bhutan	SAARC, BBIN, BIMSTEC, SASEC	IMF, ADB, World Bank, UN and its specialised agencies.	
India	SAARC, BIMSTEC, SASEC, IORA, Association of Southeast Asian Nations (ASEAN) (dialogue partner)	WTO, IMF, ADB, World Bank, AIIB, AARDO, New Development Bank (NDB), UN and its specialised agencies.	BRICS, G20, Quad, India, Brazil, South Africa (IBSA), SCO
Maldives	SAARC, IORA, SASEC	WTO, IMF, ADB, World Bank, AIIB, UN and its specialised agencies	OIC
Nepal	SAARC, BBIN, BIMSTEC, SASEC	WTO, IMF, ADB, World Bank, AIIB, UN and its specialised agencies.	
Pakistan	SAARC	WTO, IMF, ADB, World Bank, AIIB, UN and its specialised agencies.	OIC, SCO
Sri Lanka	SAARC, BBIN, BIMSTEC, IORA, SASEC	WTO, IMF, ADB, World Bank, AIIB, AARDO, UN and its specialised agencies.	

Source: Authors' compilation

While South Asian countries are well represented in regional and multilateral institutions, India has the most and broadest engagement (Table 4.1), followed by Bangladesh, Sri Lanka, Maldives, Pakistan, Nepal and Bhutan. India's role in the G20, BRICS and the Quad is noteworthy, putting it at the centre of the geopolitical stage and reflecting its increasing global importance.

South Asia is commonly referred to as the least economically integrated region in the world, reflecting historical political tensions and mistrust.

Origin, Mandate and Functions

Much of the policy discussion in South Asia centred around the effectiveness of SAARC, the oldest regional institution in South Asia. The SAARC Secretariat was set up in Kathmandu. Its charter has an ambitious set of objectives including promoting the welfare of the people; accelerating economic growth, social progress, and culture development; strengthening collective self-reliance; and cooperating with international and regional organisations.

SAARC witnessed some success through the South Asia Free Trade Agreement (SAFTA) in 2006; South Asian University in 2007; SAARC Development Fund in 2010 and COVID Fund in 2020. However, worsening India-Pakistan ties; suspicions about India's intentions as the largest country in the region and security concerns, resulted in SAARC's failure to move the ball. Its outlook seems bleak.

Recognising this, India is switching its diplomatic efforts to bilateral engagement and other regional institutions such as BIMSTEC and IORA, which are more relevant to South Asia and fits neatly with three important policy initiatives guiding India's approach to regional cooperation – Neighbourhood First policy, Act East and the Indo-Pacific construct.

Table 4.2 STATUS OF SOUTH ASIAN COOPERATIVE INSTITUTIONS

Institution	Members	Founding date	Headquarters	Charter
SAARC	Afghanistan, Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka	1985	Kathmandu, Nepal	Adopted in 1985
BIMSTEC	Bangladesh, Bhutan, India, Nepal, and Sri Lanka, Thailand and Myanmar	1997	Dhaka, Bangladesh	Adopted in 2023

IORA	Bangladesh, India, Maldives, Sri Lanka, Indonesia, Singapore, Thailand, Oman, United Arab Emirates, Yemen, Comoros, Kenya, Madagascar, Mauritius, Mozambique, Seychelles, Somalia, South Africa, Tanzania, Australia and France	1997	Ebene, Mauritius	Adopted in 1997; Amended in 2010 and 2014

Source: Authors' compilation

BIMSTEC is a unique grouping connecting South Asia and Southeast Asia. Its institutional evolution has been gradual with the establishment of the Secretariat in 2014 in Dhaka. Since 2018, the grouping is viewed as an instrument of regional cooperation and integration, which was further reiterated with the Colombo Summit in 2022, where a new charter was signed. The grouping's vision and functions of its constituent parts were spelled out and the sectors of cooperation (reducing them from 14 to seven, with each member-state serving as the lead country for an assigned sector) were prioritised.

IORA, an inter-governmental organisation has 23 countries from South Asia, Southeast Asia, West Asia, Europe and Australia. Its charter was adopted in 1997 and amended in 2010 and 2014, respectively. The main objective of the grouping is promoting economic growth, maritime security, sustainable development, cultural exchanges and capacity building. The Secretariat was set up in 2013 in Mauritius, marking a significant step to institutionalise the association and enhance capacity to facilitate regional cooperation among member states.

The region produces a combined total of $1 trillion in goods and services and intra-IORA trade is billed at around $800 billion, making it an important grouping for economic integration within the Indian Ocean. The association launched a Special Fund in 2008 to provide assistance for projects promoting economic cooperation and knowledge sharing among members. Though small, it has been implemented. According to the latest available information, the fund disbursed $80,000-$150,000 for project grants.

Issues and Challenges

The patchwork of regional organisations supporting trade cooperation and integration in South Asia has been dormant.

Regular leader summits and high-level ministerial meetings (Table 4.3) play an important role as they signal political will and facilitate the creation of institutional mechanisms to foster regional cooperation and economic integration. The last SAARC Summit took place in 2014, and IORA has only held one summit in 2017 since its establishment (Bhatia 2022). BIMSTEC has held just six summits since its inception but in 2018, it resolved to hold regular summits once in two years. This has improved its tally and the most recent one was held in Thailand on April 2-4, 2025, which resulted in significant policy decisions and commitments (Box 4.1), but implementation has to be monitored at the highest political level, across member nations, if progress is to be made (Bhatia, 2025).

Table 4.3 MOST RECENT SUMMIT AND FOREIGN MINISTERS' MEETINGS OF SAARC, BIMSTEC, IORA AND ASEAN

REGIONAL INSTITUTION	SUMMIT	FOREIGN MINISTERS MEETING
SAARC	November 2014	March 2016
BIMSTEC	April 2025	July 2024
IORA	March 2017	October 2023
ASEAN	October 2024	July 2024

Source: Authors' compilation

Box 4.1 OUTCOMES OF THE BIMSTEC SUMMIT 2025, BANGKOK

The sixth BIMSTEC Summit resulted in significant policy decisions and commitments. The primary achievement of the Summit was the adoption of the BIMSTEC Bangkok Vision 2030, providing a comprehensive roadmap for the organisation to follow over the next five years. The roadmap focuses on:

1. Increasing prosperity in the region by strengthening regional supply chains and facilitating trade, investment and growth, while also aiming to reduce poverty by targeted programs.
2. Building capacity for the region's crisis-preparedness, crisis-responsiveness and human security.
3. Opening the BIMSTEC region by promoting tourism and collaboration between entrepreneurs and academia in various sectors.

The declaration adopted by the leaders at the summit directed the Trade Negotiating Committee and its Working Groups to finalise the constituent Agreements of the BIMSTEC FTA without further delay and emphasised the need to accelerate trade facilitation measures within the BIMSTEC region.

The summit also saw the signing of Memorandums of Understanding with the IORA and the United Nations Office on Drugs and Crime (UNODC).

Other key outcomes included:

Business:
- Establishment of BIMSTEC Chamber of Commerce.
- Organisation of BIMSTEC Business Summit every year.
- Feasibility study on the possibilities of trade in local currency in the BIMSTEC region.

Information Technology:
- Pilot study to understand the needs of BIMSTEC countries to share the experience of Digital Public Infrastructure (DPI).
- Connectivity between UPI and payment systems in the BIMSTEC region.

Security:
- Holding the first meeting of the Home Ministers' Mechanism in India.

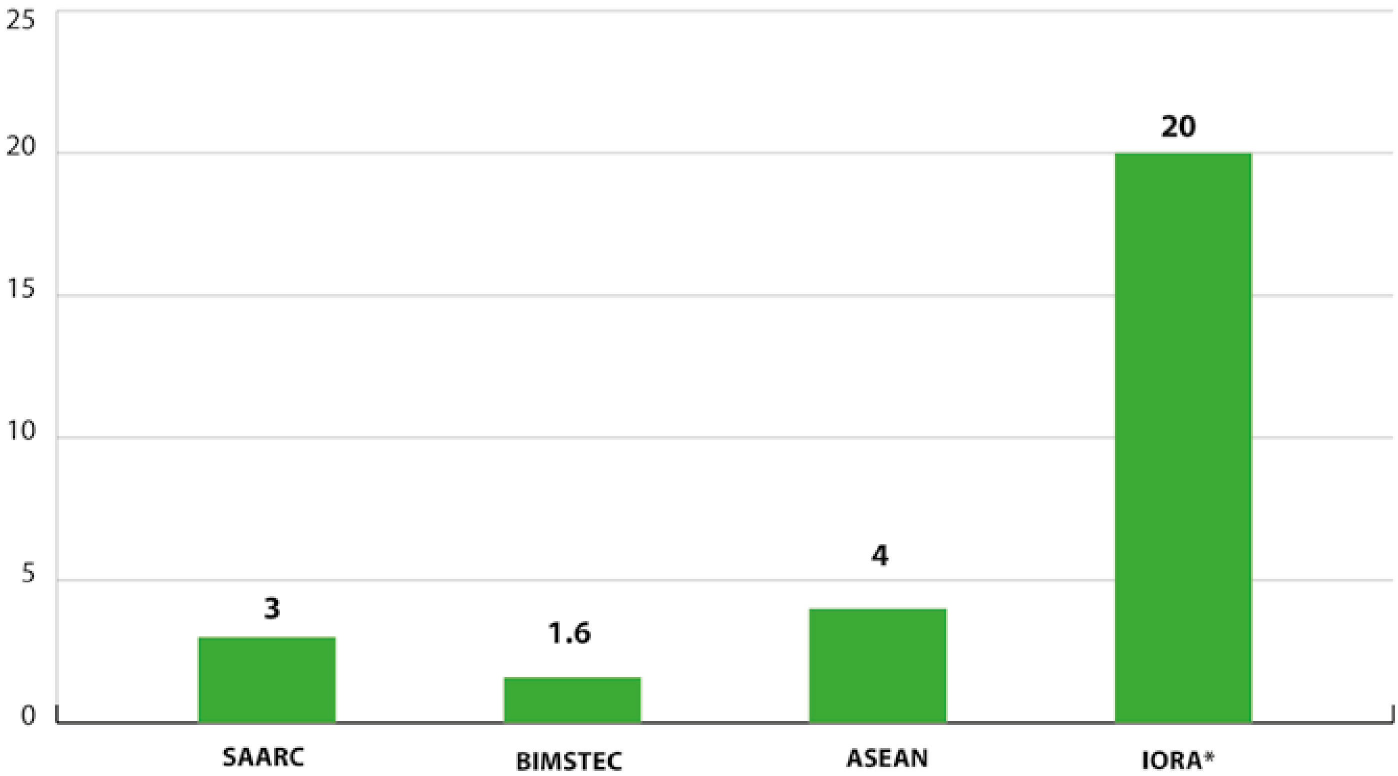
Space:
- Setting up ground stations for manpower training for BIMSTEC countries, manufacturing and launching of Nano Satellites, and use of remote sensing data.

Energy:
- BIMSTEC Energy Centre in Bengaluru is functional.
- Faster work on electric grid interconnection.

Connectivity:
- Establishment of Sustainable Maritime Transport Centre in India to work to enhance coordination in capacity building, research, innovation and maritime policies.

The combined operational budgets of SAARC, BIMSTEC and IORA are less than half of ASEAN, which represents a sorry state of chronic underfunding of regional institutions (Figure 4.1). SAARC has faced various historical challenges in securing consistent funding, as its members make unequal financial contributions on a voluntary basis, with some states hesitant to provide funds. The lack of financial resources also hampers the effectiveness of BIMSTEC and IORA, preventing them from implementing the necessary large-scale projects or coordinating on extensive regional initiatives. BIMSTEC restricts its capacity to support member countries in areas like infrastructure development and trade facilitation, further limiting progress of the 10-year BIMSTEC Masterplan for Transport Connectivity and delaying the establishment of the BIMSTEC Development Fund. Similarly, IORA has a modest budget, capping its capacity to conduct research, manage programs, and restricting its Special Fund to not make significant impact in the Indian Ocean Region.

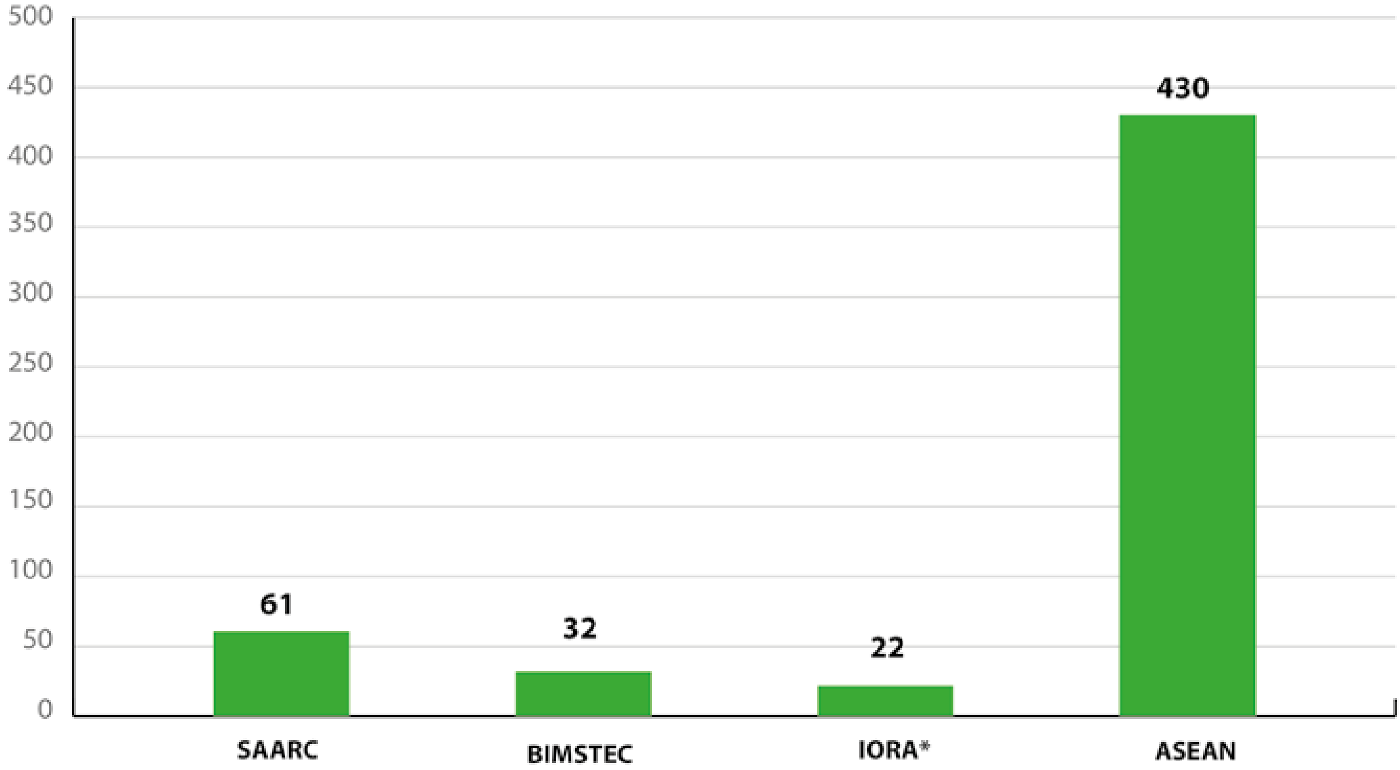
Figure 4.1 COMPARISON BETWEEN OPERATIONAL BUDGETS OF SAARC, BIMSTEC, IORA AND ASEAN (IN $ MILLION)



Note: *represents estimates; SAARC, BIMSTEC, IORA numbers are as of 2024; ASEAN numbers are as of 2016
Source: Authors' compilation

Staff in regional organisations play a significant role in managing operations, coordinating initiatives, and ensuring the smooth execution of policies. The staff size of the ASEAN secretariat is three and a half times that of the combined SAARC, BIMSTEC and IORA personnel (Figure 4.2), resulting in inefficiencies and difficulties in managing their goals.

Figure 4.2 COMPARISON BETWEEN STAFF SIZE OF SAARC, BIMSTEC, IORA AND ASEAN



Note: *represents estimates; SAARC, BIMSTEC, IORA numbers are as of 2024; ASEAN numbers are as of 2022
Source: Authors' compilation

There is a growing recognition that for regional institutions to contribute to economic and regional integration, Secretariats must be autonomous. The Secretariats of SAARC, BIMSTEC and IORA currently can only coordinate and monitor but take no initiative of their own (Table 4.4) and therefore have limited delegated authority.

Table 4.4 COMPARISON BETWEEN THE SECRETARIATS OF SAARC, BIMSTEC, IORA AND ASEAN

SAARC	BIMSTEC	IORA	ASEAN
Administrative head of SAARC. Does not have a separate budget for publicity and media relations	Represents BIMSTEC and participates in meetings with external parties	Representation and promotion of IORA; collation and dissemination of information; maintenance of an archive, depository and registry for IORA documentation and research material;	Acts as spokesperson and representative for ASEAN
Secretary General (SG) is a senior official on deputation	SG is of Ambassadorial rank	SG is of Ambassadorial rank	SG has ministerial rank (usually of Deputy Foreign Minister status)

SG chosen by alphabetical rotation for 3 years initially, extendable by another term	SG chosen by alphabetical rotation for 3 years, non-renewable term	SG chosen by alphabetical rotation for 3 years, extendable by another term	SG chosen by alphabetical rotation for 5 years
	SG and staff on deputation enjoy immunities and privileges		Senior staff enjoy diplomatic immunity in Jakarta and when travelling

Source: Authors' compilation; SAARC Charter, BIMSTEC Charter, IORA Charter, ASEAN Charter

The lack of a cohesive institutional framework, well-established and functional Secretariat, regular summits, and a culture of consensus-building is why bureaucratic inertia is more pronounced in regional institutions in South Asia compared to ASEAN. This leads to less intra trade between South Asian countries and minimal economic integration.

ASEAN underwent a process of evolution in response to the growing requirements of managing and implementing the ASEAN FTA. Similarly, the time may be ripe for IORA members under the leadership of India, South Africa and Australia to work towards a regional trade agreement and for India and Thailand to play a key role in restarting negotiations of the BIMSTEC FTA, which must go beyond the remit of tariff concessions in good trade, custom cooperation, investment cooperation and dispute settlement (Wignaraja, 2022). For IORA and BIMSTEC, the trade agreements must look at WTO plus issues such as government procurement, competition, intellectual property and digital economy, which are essential to make the region a hub of global value chains.

Conclusion and Recommendations

The patchwork of regional organisations (e.g. SAARC, BIMSTEC, and IORA) supporting trade cooperation and integration has been dormant. Many problems – limited political will, inertia and a lack of national interest, severe under-resourcing, inadequate technical/professional skills and a lack of delegated powers – have constrained their effectiveness. But there is some hope for political support and a focus on the trade future by BIMSTEC and IORA. However, regional institutions in South Asia will need to be significantly resourced and retooled to support trade and regionalism.

Several recommendations are suggested to strengthen regional institutions focussed on economic integration in South Asia:

1. Negotiate deep FTAs and plurilateral agreements with trading partners and neighbours. The India-Australia ECTA and CEPA with UAE are examples of how to establish regional trade trust.
2. Support reforming the WTO-led multilateral trading system and explore regional alternatives.
3. Significantly resource and retool regional institutions particularly BIMSTEC and IORA to support regional trade and FDI in an uncertain international economy.
4. BIMSTEC should prioritise concluding an FTA in the next year. If a comprehensive one is not possible, a united agreement on tariffs will be better.
5. India can play a key role (with other regional powers) to shape the mandate and better resource BIMSTEC and IORA since senior Indian diplomats currently lead these institutions.
6. Provide aid for trade for LDCs and small states in South Asia to develop export capacity and reduce the economic costs of trade opening.

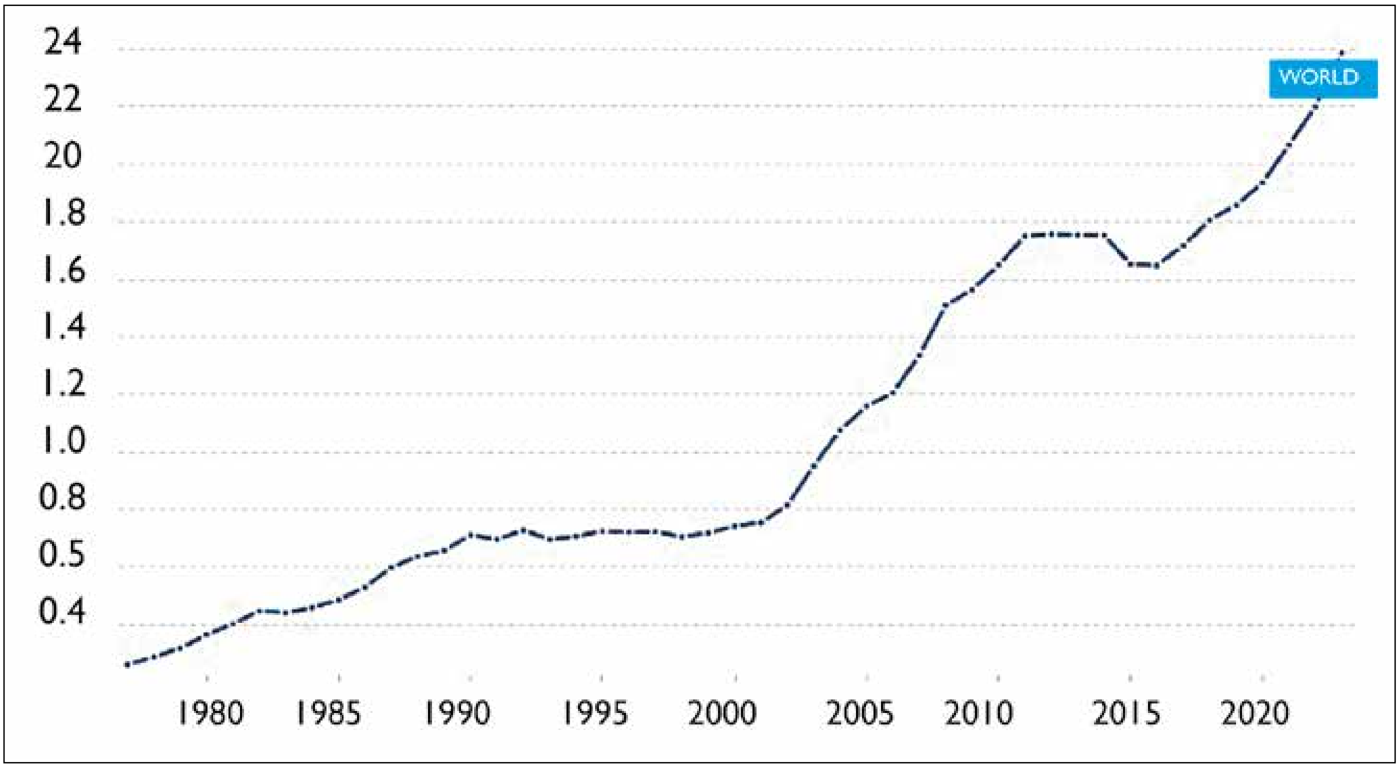
Annexure I

Rising Military Expenditure

Since 2020, there have been many geopolitical disruptions linked to conflicts and great power rivalry. There are ongoing conflicts (Table A1.1), Russia-Ukraine and West Asia, which continue to impact global trade, and could further spiral. The Taiwan Strait is another potential flashpoint, with China's regular military exercises raising tensions. The US-China rivalry plays in the background, with China trying to match the US militarily. China's smaller neighbours – Japan, Philippines, Vietnam and India – have all developed closer ties with the US due to their fears of China.

In the South Asian context, the ongoing conflicts create uncertainty at a time when many of the regional economies face economic crises. Among India's neighbours, Sri Lanka, Pakistan, Bangladesh and Nepal, are all facing a forex crunch – caused by the Covid-19 pandemic, the commodity shock from the Russia-Ukraine conflict, and worsened by poor domestic policy choices. South Asian economies largely fall either in lower income or lower-middle income levels globally – and are more affected by economic shocks.

Figure A1.1 TOTAL MILITARY EXPENDITURE BY WORLD NATIONS IN $TRILLION (1960-PRESENT)



Source: World Bank Group

Figure A1.1 shows a significant rise in global military expenditure, reaching a record high of $2.39 trillion in 2023. Table A1.1 provides a comparative overview of the top global military spenders, including the percentage of their Gross domestic product (GDP) that the defence budget constitutes, alongside South Asian countries, highlighting regional spending trends.

Table A1.1 TOP MILITARY SPENDERS: A COMPARISON WITH SOUTH ASIA

WORLD RANKING	COUNTRY	MILITARY EXPENDITURE (IN $BILLION)	% OF GDP
1	United States	916.01	3.36
2	China	296.44	1.67
3	Russian Federation	109.45	5.86
4	India	83.57	2.44
5	Saudi Arabia	75.81	7.09
6	United Kingdom	74.94	2.26
7	Germany	66.83	1.52
8	France	61.3	2.06
9	South Korea	47.93	2.81
10	Japan	50.16	1.2
24	Pakistan	8.52	2.8
44	Bangladesh	4.21	1.02
65	Myanmar	2.49	3.79
80	Sri Lanka	1.17	1.64
103	Nepal	0.41	1.08

Note: Maldives does not have a military budget
Source: World Bank Group

Box A1.1 CONFLICT IN THE SOUTH CHINA SEA

Duration: Ongoing since the 2010s

Major Developments

2021: The Philippines and Vietnam reported repeated incursions by Chinese vessels into their claimed waters, with China deploying alleged maritime militias and coast guard ships in contested areas.

2023: U.S. and allied naval exercises increased in response to China's assertiveness; the Philippines reinvigorated defence partnerships with the U.S., granting expanded access to military bases.

2024: The Philippines lodged multiple protests against Chinese "dangerous manoeuvres" near its coast and renewed calls for multilateral solutions. China's activity around the Second Thomas Shoal, where the Philippines has a military outpost, remains a key flashpoint.

Source: Authors' compilation

TABLE A1.2 SOUTH ASIA – TRADE VS REMITTANCES

	EXPORTS	REMITTANCES
India (FY24)	437	106.6
Pakistan (FY24)	31.1	30.25
Bangladesh (FY24)	55.59 (FY23)	23.91
Sri Lanka (2023)	11.91	5.97

Note: Figures in $ billion

Source: Government of India, Economic Survey 2023-24; State Bank of Pakistan, Economic Data; Bangladesh Bank, Economic Statistics; Central Bank of Sri Lanka, External Sector: Exports, Imports and Trade

Annexure 2

TABLE A2.1 MAJOR FOREIGN INVESTMENTS IN INDIAN MANUFACTURING SECTOR SINCE 2020

COMPANY	SECTOR	COUNTRY OF ORIGIN	PRODUCTS MANUFACTURED	LOCATION	
Apple	Consumer Electronics	United States of America	iPhones and accessories	Tamil Nadu, Karnataka	Apple's iPhone exports from India nearly doubled from $6.27 billion in 2022-23 to $12.1 billion in 2023-24. Starting with the iPhone 14 in 2022, Apple now assembles high-end models in India, exporting 70% of its output with prospects for further expansion.
Samsung	Electronics	South Korea	Mobile phones, Display panels	Noida, UP	In July 2018, Samsung opened the world's largest mobile factory in Noida, a key production base for the company. In 2024, Samsung began manufacturing laptops at this facility.

Oppo & Vivo	Consumer Electronics	China	Smartphones	Greater Noida, UP	Oppo has a manufacturing facility spread across 110 acres with state-of-the-art machinery and facilities that can manufacture one smartphone every three seconds.
Siemens	Industrial Automation & Energy	Germany	Energy solutions, Automation equipment	Maharashtra, Gujarat, Goa	Siemens Limited is expanding the capacity of its Power Transformer factory in Kalwa and its Vacuum Interrupter factory in Goa, as announced in November 2023.
Panasonic	Consumer Electronics	Japan	Energy-efficient home appliances	Haryana, Daman, Andhra Pradesh, Uttarakhand	Panasonic has opened a new manufacturing unit in Daman, Gujarat, investing Rs.15 million to enhance its manufacturing capabilities and increase PEWIN's lighting production capacity in India.

Cisco	IT/Networking	United States of America	Networking equipment, electronics	Tamil Nadu	In 2023, Cisco announced that it will begin manufacturing in India to expand its presence and support the country's goal of becoming a global manufacturing hub, aiming to generate over $1 billion in combined domestic production and exports in the coming years.
Volvo	Automotive	Sweden	Electric buses	Karnataka	Volvo was considering setting up a new electric vehicle manufacturing facility in India, following its announcement in 2022 to expand its certified used-car business across the country by early 2024.

Hyundai	Automotive	South Korea	Electric Vehicles (EVs)	Tamil Nadu, Maharashtra	Hyundai Motor plans to invest Rs. 7,000 crore in establishing its second plant in India after acquiring an inactive factory from General Motors Co.
Airbus	Aviation	France	Airbus C295 military transport aircraft	Gujrat	Tata Advanced Systems and Airbus have inaugurated a C295 final assembly line in Vadodara, Gujrat, for producing military transport aircraft domestically.
Amazon	Consumer Electronics	United States of America	Fire TV Stick	Tamil Nadu	Amazon has partnered with Foxconn's Cloud Network Technology to start producing Fire TV sticks at its Chennai plant.

Micron Technology	Semiconductors	United States of America	Semiconductor chip assembly & testing	Gujarat	Applied Materials plans to establish a manufacturing unit in Chennai, Tamil Nadu, and develop an AI-enabled technology centre, with the first chip production expected in December 2024.
Applied Materials	Semiconductors	United States of America	Semiconductor equipment manufacturing	Karnataka	Applied Materials plans to set up a manufacturing unit in Chennai, Tamil Nadu, and develop an AI-enabled technology centre.

Source: Authors' compilation

Figure A2.1 RECIPROCAL TARIFFS IMPOSED BY U.S. PRESIDENT DONALD TRUMP

Reciprocal Tariffs

Country	Tariffs Charged to the U.S.A. Including Currency Manipulation and Trade Barriers	U.S.A. Discounted Reciprocal Tariffs
China	67%	34%
European Union	39%	20%
Vietnam	90%	46%
Taiwan	64%	32%
Japan	46%	24%
India	52%	26%
South Korea	50%	25%
Thailand	72%	36%
Switzerland	61%	31%
Indonesia	64%	32%
Malaysia	47%	24%
Cambodia	97%	49%
United Kingdom	10%	10%
South Africa	60%	30%
Brazil	10%	10%
Bangladesh	74%	37%
Singapore	10%	10%
Israel	33%	17%
Philippines	34%	17%
Chile	10%	10%
Australia	10%	10%
Pakistan	58%	29%
Turkey	10%	10%
Sri Lanka	88%	44%
Colombia	10%	10%

Reciprocal Tariffs

Country	Tariffs Charged to the U.S.A. Including Currency Manipulation and Trade Barriers	U.S.A. Discounted Reciprocal Tariffs
Peru	10%	10%
Nicaragua	36%	18%
Norway	30%	15%
Costa Rica	17%	10%
Jordan	40%	20%
Dominican Republic	10%	10%
United Arab Emirates	10%	10%
New Zealand	20%	10%
Argentina	10%	10%
Ecuador	12%	10%
Guatemala	10%	10%
Honduras	10%	10%
Madagascar	93%	47%
Myanmar (Burma)	88%	44%
Tunisia	55%	28%
Kazakhstan	54%	27%
Serbia	74%	37%
Egypt	10%	10%
Saudi Arabia	10%	10%
El Salvador	10%	10%
Côte d`Ivoire	41%	21%
Laos	95%	48%
Botswana	74%	37%
Trinidad and Tobago	12%	10%
Morocco	10%	10%

Source: White House (2025)

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