

# Increasing Intra-ASEAN Trade (Part 1): The Production Logic

Azfar Hanif Azizi



As Malaysia's chairmanship of ASEAN draws to a close, the perennial resolution to deepen economic integration remains unresolved. The data is stubborn: trade between ASEAN nations persists at a low 25% of total trade. This stagnation is puzzling to those who view trade merely through the lens of tariffs, given that almost 100% of tariff lines have been liberalised for over a decade. However, the issue is not one of trade barriers, but of industrial structure. To understand why trade isn't flowing, we must look at the firm-level dynamics of fragmented production.

In the current era of dispersed supply chains, the firm most likely to be a significant importer and exporter is the final product assembler of an internationally competitive brand. These firms act as the "hub" in a hub-and-spoke model. As global brand-owning firms pursue economic efficiency—exemplified by Apple contracting Foxconn—they increasingly reduce in-house manufacturing, outsourcing to lower-cost locations. The decision to outsource and offshore is a complex calculation of the ratio between cost and

**Views** are short opinion pieces by the author(s) to encourage the exchange of ideas on current issues. They may not necessarily represent the official views of KRI. All errors remain the authors' own.

This view was prepared by Azfar Hanif Azizi, a researcher from the Khazanah Research Institute (KRI).

Author's email address:  
[azfar.azizi@krinstitute.org](mailto:azfar.azizi@krinstitute.org)

Attribution – Please cite the work as follows: Azfar Hanif Azizi. 2025. Increasing Intra-ASEAN Trade (Part 1): The Production Logic. Kuala Lumpur: Khazanah Research Institute. License: Creative Commons Attribution CC BY 3.0.

Information on Khazanah Research Institute publications and digital products can be found at [www.KRIInstitute.org](http://www.KRIInstitute.org).

capability, financial discipline pressures, and the risk of proprietary technology leakage, as noted by economic geographers Neil Coe and Henry Yeung.

Therefore, the structural prerequisite to increasing intra-ASEAN trade is not more free trade agreements, but the hosting of more complex final product manufacturers. These Tier 1 assemblers—functioning as Original Equipment Manufacturers (OEMs)—integrate large-scale resources for mass manufacturing and serve as the gatekeepers of the supply chain (it is worth noting that while 'OEM' typically refers to brand owners in the automotive sector, in the context of Asian industrialisation, it refers to the contract manufacturers who produce goods to the client's specification). While this dynamic is most visible in the electronics sector—where these firms are known as Electronics Manufacturing Services (EMS)—the concept applies equally to the automotive and heavy machinery industries. Whether acting as an EMS provider for Apple or a Tier 1 systems integrator for Toyota, these firms function as the "factories" for global brands. They provide the process engineering, industrialisation, assembly, testing, and logistics services required to bring a product to life, often without putting their own name on the final box. ASEAN is not starting from zero; firms such as V.S. Industry, Venture Corporation, Cal-Comp, and Integrated Micro-Electronics have long operated in the region. However, their collective gravity has historically been insufficient to pull the full supply chain away from the massive agglomeration of China. From a Global Value Chain (GVC) perspective, if ASEAN does not host a critical mass of these Tier 1 "hubs," there is no demand for the Tier 2 "spokes" (component suppliers) to trade across borders.

If realised, this strategy would manifest as a distinct regional division of labour, fundamentally altering the pattern of trade. Countries with established industrial estates, scale, and labour pools—such as Malaysia, Thailand, Vietnam, the Philippines and Indonesia—would naturally gravitate towards the role of assembly "hubs," importing vast quantities of intermediate goods. Conversely, the frontier markets like Cambodia, Laos, and Myanmar—as well as specialised supplier clusters within the hub nations themselves—would serve as the "spokes," specialising in the export of sub-assemblies, PCBs, and mechanical parts to these regional hubs. This creates a dense web of intra-regional traffic in intermediate goods, replacing the current "radial" pattern where each ASEAN nation trades primarily with China rather than with its neighbours.

However, attracting these hubs is only half the battle. A significant risk in developing economies is that Tier 1 assemblers function as "enclaves"—industrial islands that import 90% of their components from established global networks (often China or Taiwan) rather than sourcing locally. This risk is exacerbated by the governance structure of GVCs, where the lead firm often dictates the 'Approved Vendor List' (AVL) to the Tier 1 assembler. Even if an ASEAN-based assembler wishes to source locally, they may be contractually bound to import components from the lead firm's established network in East Asia, effectively locking out potential regional suppliers. Presence does not guarantee integration. Without active supplier development programmes and targeted incentives to localise the supply chain, hosting a Foxconn results merely in an "import-assembly-export" model with minimal regional value-add. While foreign hubs bring immediate volume, cultivating locally-owned OEMs is ultimately more effective for

deepening regional integration, as these firms are more rooted in the domestic economy and likelier to build long-term local linkages. Intra-ASEAN trade will only rise if the "spokes" are successfully relocated to the region alongside the "hubs."

Currently, ASEAN is struggling to attract these hubs because the incumbent, China, offers a superior industrial ecosystem. Most dominant EMS players (Foxconn, Pegatron, Luxshare) maintain China as their primary factory site. This is not merely due to labour arbitrage. China offers strong government fiscal policy support and massive infrastructure investments. Even as wages rise in the Pearl River Delta (PRD), China retains these firms by facilitating upgrades to specialised manufacturing and R&D, or by redirecting factories to lower-wage interior regions. The clustering of component suppliers in China provides an agglomeration advantage that ASEAN, with its fragmented geography, struggles to match.

This dominance creates a formidable barrier for ASEAN members trying to position themselves as alternative hubs. While Singapore continues to attract significant Foreign Direct Investment (FDI), its role has evolved away from mass assembly. Its high wage structure and advanced infrastructure make it a preferred location for the regional headquarters of brand owners and high-value R&D activities rather than the labour-intensive EMS operations that drive volume trade in components. For other relatively developed members like Malaysia, the hurdle has historically been labour costs significantly higher than China's. While China's rapid wage growth is narrowing the gap with Malaysia—increasing Malaysia's attractiveness for complex, capital-intensive assembly—it remains a difficult calculation for firms accustomed to China's efficiency. Meanwhile, ASEAN countries that can match China's low labour costs, such as Indonesia or Philippines, often lack the requisite infrastructure reliability. China successfully combines the scale of a continent, the infrastructure of the developed world, and a deep, integrated labour pool; ASEAN, by contrast, forces investors to choose between the high costs of its developed members or the infrastructural deficits of its developing ones.

To transform national supply chains into regional ones, ASEAN governments must act with the same interventionist resolve as China, while acknowledging their political constraints. We cannot expect a supranational authority to dictate industrial policy, but we can align incentives. This means harmonising regulations (such as Rules of Origin) to smooth non-tariff barriers and investing heavily in infrastructure to ensure electricity reliability and transport ease. We need to equalise the attractiveness of the region against China's extensive menu of tax breaks, R&D grants, and subsidised utilities.

The ongoing US-China trade war and the "China+1" strategy offer a window of opportunity, but this external shock is not a strategy in itself. If ASEAN cannot establish a network of Tier 1 assemblers supported by a regional base of Tier 2 suppliers, the "economic community" will remain a concept on paper, while the physical production—and the trade that follows it—remains anchored in East Asia. Consequently, current policy obsessions with liberalising services

trade or harmonising financial standards will yield little result if the physical backbone of production is missing.

However, a critical distinction must be made between increasing trade volume and securing economic development. While attracting global Tier 1 assemblers solves the logistics of integration, it risks locking ASEAN into a "low-value" equilibrium. If our industrial strategy stops at simply hosting foreign hubs, we remain structurally vulnerable—forever competing on cost against the next cheaper frontier. The "hub and spoke" model is merely the foundation; it is not the house. The urgent question, therefore, is not just how ASEAN can host these supply chains, but how it can eventually dominate them. How we bridge the gap from subservient assembler to brand owner—and escape the middle-income trap—will be the subject of the next analysis.