

Beyond tariffs: why Europe and India must prioritise investment into manufacturing

Alicia García-Herrero, Rajeswari Sengupta and Nina Vujanović

The signing of the EU-India Free Trade Agreement (FTA) in January 2026 represents a significant milestone in bilateral economic relations, for both sides. However, it fails to address a more critical challenge: India's persistent struggle to attract manufacturing foreign direct investment (FDI). This paper argues that India requires more manufacturing FDI not only for financial resources, but as the principal means of knowledge transfer and boosting employment creation. This paper documents India's substantial underperformance in attracting FDI compared to China and ASEAN countries. China's manufacturing FDI ecosystem has yielded high returns for foreign investors and technological spillovers for domestic firms. In contrast, India has primarily attracted capital to the services sector, where investment has flowed largely into captive, foreign-owned offshore units with limited backward linkages to independent domestic firms, or into private equity and venture capital funds that typically acquire existing assets, thereby weakening the typical knowledge-transfer channels. The European Union, already India's largest investor and the world's leading source of outward FDI, possesses both the strategic interest and the financial means to help bridge this gap, especially as European firms re-evaluate their exposure to China, and because India offers a vast and rapidly growing consumer market. Despite this, EU FDI into Indian manufacturing remains significantly lower than what India's growth rate and investment returns would suggest. A lack of credible investor protection could be partially responsible for this, and the FTA, as it stands, lacks investment-protection provisions which could play a vital role in meaningfully redirecting European manufacturing capital towards India.

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1 Introduction

On 27 January 2026, the European Union (EU) and India finalised their free trade agreement (FTA) after nearly two decades of negotiations. Announced at the 16th EU-India summit in New Delhi, the agreement has been hailed¹ as the most ambitious trade deal to date for India. Early estimates by the European Commission suggest the FTA will eliminate or significantly reduce tariffs on approximately 96.6 percent of EU goods exported to India, potentially doubling these exports by 2032².

While the agreement achieves substantial tariff liberalisation, it represents a missed opportunity to tackle a longstanding, structural weakness in India's investment climate. The Investment Protection Agreement (IPA), which would offer a mutually acceptable dispute resolution system, protection against uncompensated expropriation and standards for fair and equitable treatment, remains a separate and unfinished negotiation, distinct from the main FTA framework. This structural separation likely reflects deeper tensions within the negotiations and leaves a significant gap in the bilateral economic architecture.

The practical consequence of this gap is considerable. In the absence of clearly defined investment protection provisions, the FTA is unlikely to serve as a meaningful catalyst for EU foreign direct investment (FDI) into India, particularly in manufacturing, which holds enormous untapped economic potential. This is further reinforced by the fact that the FTA does not include commitments on investment market access in the manufacturing sector, and that India is one of the few countries that has not subscribed to the WTO Investment Facilitation for Development Agreement, which simplifies procedures and increases transparency for foreign investors.

Historically, India's FDI profile has been imbalanced. While the country has attracted substantial FDI inflows into services – notably IT, finance and telecommunications – investment into manufacturing has remained comparatively modest³. This is partly due to concerns about regulatory unpredictability, the enforceability of contracts, issues related to dispute settlement and the risk of policy reversals. These are precisely the issues that a credible investment protection agreement could have been designed to mitigate. Moreover, the EU is actively pursuing supply chain diversification, especially away from China, and seeking to reduce strategic dependencies as described in the Industrial Accelerator Act published in March 2026. In this context, India could position

1 This FTA is the largest trade deal signed by both the EU and India. See European Commission press release of 27 January 2026, 'EU and India conclude landmark Free Trade Agreement', https://ec.europa.eu/commission/presscorner/detail/en/ip_26_184.

2 See the European Commission factsheet, undated, 'Factsheet - EU-India Free Trade Agreement: Main benefits', https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/india/eu-india-agreements/factsheet-eu-india-free-trade-agreement-main-benefits_en.

3 Capital follows comparative advantage, and India's comparative advantage has always been in skilled-labour-intensive services rather than capital-and-infrastructure-intensive manufacturing. India's growth followed an unusual path relative to other developing economies – it industrialised less and 'serviceified' faster than its peers at a comparable income level. Manufacturing contributes only about 15 percent to 17 percent of India's GDP while services account for close to 55 percent, indicating a pattern of 'premature deindustrialisation'.

itself as an alternative manufacturing hub in the post-China+1 era⁴. The failure to integrate investor protection into the FTA framework may thus dampen the transformative economic potential that both sides have publicly celebrated.

The significance of this issue is further amplified by India's looming jobs challenge. As discussed by García-Herrero and Sengupta (2026), India's economy has grown at an average annual rate of around 6.5 percent since the early 2000s yet has struggled to generate sufficient formal employment for the eight to ten million workers entering the labour force each year. The manufacturing sector's share of GDP has remained at 15 percent to 17 percent for over two decades – well below China's historic peak of roughly 32 percent and short of India's own National Manufacturing Policy target of 25 percent⁵. One credible way to stimulate accelerated growth in the manufacturing sector is through FDI. Beyond alleviating investment constraints, manufacturing FDI also serves as a vital conduit for technology transfer, process upgrading and integration into global value chains through backward linkages (Adarov and Stehrer, 2021) which can in turn help boost productivity growth. Furthermore, multinational corporations typically create formal, higher-quality jobs, offering wages above the domestic average, thereby directly addressing India's persistent employment challenge.

Section 2 of this paper documents India's underperformance in attracting FDI compared to China and the ASEAN economies, with a specific focus on the sectoral bias towards services and the increasing strategic importance of European investment. Section 3 delves into the structural and institutional constraints that contribute to the shortfall in manufacturing FDI. Section 4 explores the role of FDI in fostering innovation and technology transfer, highlighting India's widening gap with China and the potential for technological catch-up. Section 5 examines the EU as the world's leading source of outward FDI and assesses India's limited success in securing a proportional share of European investment. Section 6 analyses the recently concluded FTA, arguing that the absence of a robust IPA remains the most consequential unresolved issue in the EU-India economic partnership.

4 China + 1 is a business strategy advocating investment in Asian economies other than China, including India, to diversify their supply chains and mitigate geopolitical risks.

5 See the Indian Ministry of Commerce & Industry's press release of 25 October 2011, 'National Manufacturing Policy', <https://www.pib.gov.in/newsite/PrintRelease.aspx?relid=76843®=3&lang=2>.

2 India's underperformance in foreign direct investment

2.1 Absolute foreign direct investment inflows: far behind China and ASEAN

India's gross FDI inflows grew from negligible levels in the early 1990s to a peak of roughly \$64 billion in 2020 (UNCTAD, 2021) – mainly in construction and IT – as a consequence of its liberalisation policies. Yet three critical caveats significantly temper this achievement. First, inflows have plummeted sharply since then, falling to approximately \$27.5 billion by 2024⁶, precisely when China's declining investment attractiveness might have been expected to redirect global capital towards India. Second, a considerable portion of gross FDI is intermediated through offshore financial centres such as Mauritius, Singapore, the British Virgin Islands and the Cayman Islands, representing round-tripped domestic capital⁷ rather than genuine foreign investment (Aykut *et al*, 2017). Here, India is not an exception: China's FDI flows are dominated by Hong Kong (an offshore centre) for the same reason. Third, and most crucially, India's FDI performance appears modest when benchmarked against peer economies (Figure 1).

Throughout the 2000s and 2010s, China consistently attracted three to five times India's FDI volume, despite being similar in population⁸. However, China's inflows have decreased since then, from around \$189 billion to roughly \$116 billion in 2024, primarily due to geopolitical friction and deteriorating operating conditions for foreign firms. But the more striking pattern is the concurrent acceleration of FDI into ASEAN countries. Far from merely capturing diverted Chinese FDI, ASEAN economies have actively leveraged China+1 strategies, as well as the investment disciplines embedded in the Regional Comprehensive Economic Partnership (RCEP)⁹, which includes national treatment, most-favoured-nation treatment and prohibitions on performance requirements such as forced technology transfer; and the 2009 ASEAN-China Investment Agreement, which provides expropriation protections and security guarantees to attract growing volumes of manufacturing investment (ASEAN Secretariat and UNCTAD, 2024)¹⁰. Meanwhile, India has largely failed to benefit from this global capital reallocation.

6 See the UNCTAD Data Hub, <https://unctadstat.unctad.org/datacentre/dataviewer/US.FdiFlowsStock>.

7 Round-tripped FDI is the local capital that leaves a country to a foreign market and then returns to the local economy, being relabelled as FDI.

8 The population of China was 1.41 billion and the population of India was 1.46 billion, according to the World Bank 2025 assessment. See World Bank Group website, undated, 'Data for China, India', <https://data.worldbank.org/?locations=CN-IN>.

9 RCEP formed the biggest trade block in history, comprising ten ASEAN economies, Australia, China, Japan, New Zealand and South Korea. It has been in force since 2022. India considered joining RCEP but it withdrew its membership from the negotiation process in 2019.

10 RCEP's Chapter 10 (Investment) covers what is conventionally called the 'four pillars' of investment agreements: protection, liberalisation, promotion and facilitation. RCEP does not provide for investor-state dispute settlement (ISDS), though it includes a built-in work agenda to consider amending the agreement to add ISDS within two years of entering into force. So, protection commitments exist, but the enforcement is weaker than in agreements with full ISDS.

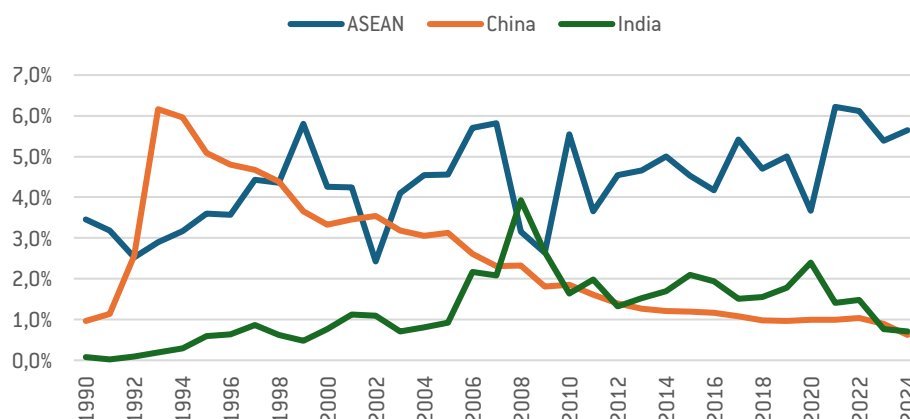
Figure 1: Foreign direct investment 1990-2024 (\$ billions)



Source: Bruegel based on UNCTAD. Note: FDI data is presented on the directional principle, according to which a loan affiliate's loan to its parent company is subtracted from inward FDI.

When examining incoming FDI as a percentage of GDP, India's performance is notably weak, particularly when contrasted with ASEAN countries (Figure 2). India's FDI-to-GDP ratio reached a peak of 3.9 percent in 2008, on the cusp of the global financial crisis, and has since steadily declined to 0.7 percent by 2024. This is a mere fraction of the ASEAN average of 5.7 percent. China's FDI-to-GDP share has also decreased in recent years, but from a considerably higher baseline: when China's income *per capita* was similar to India's present income *per capita*, China received much higher levels of FDI. Furthermore, China's strategic choice of a joint-venture model, and prioritising technological transfer over the volume of funding, means that its reported FDI figures may underestimate the actual positive spillover effects. As compared to India, China also possesses a larger pool of domestic savings to finance investment, reducing its reliance on FDI for funding purposes.

Figure 2: FDI inflows, as percentage of GDP

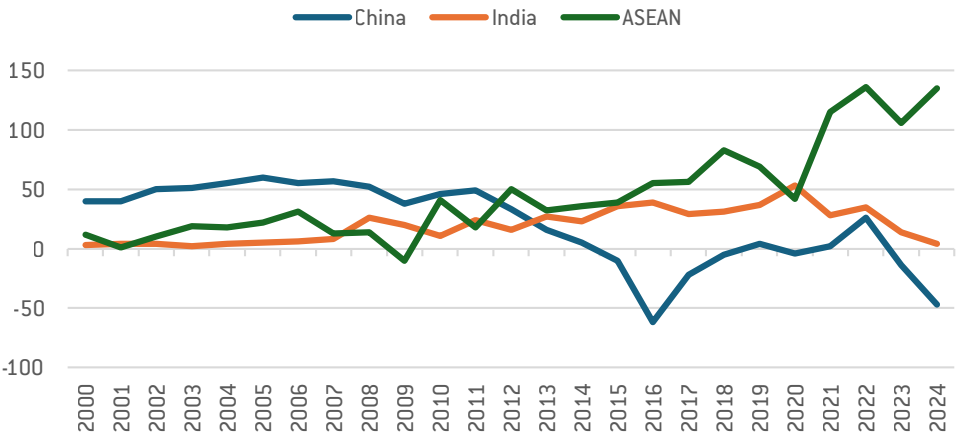


Source: Bruegel based on UNCTAD and World Bank.

When considering net FDI flows (controlling for outflows) rather than just gross inflows, India's situation becomes even more striking. Net FDI is significantly lower than

gross FDI, nearing zero levels in recent years (Figure 3). While China also experiences this effect, its surge in outbound investment in 2021, when China's *per capita* income was already three times higher than India's current level, suggesting a stronger level of Chinese economic development to counterbalance investment abroad, and away from the local economy but also the ability of its firms to compete abroad. Similarly, ASEAN countries, with an economic development level more comparable to India's, exhibit even higher net FDI figures.

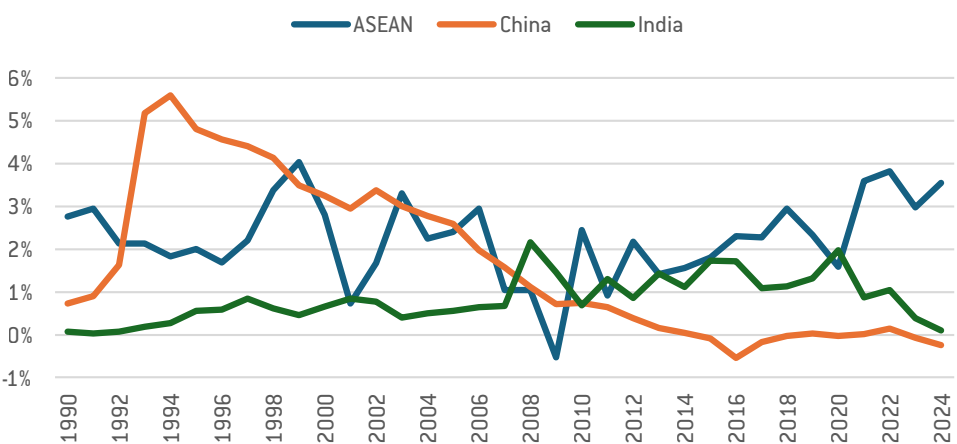
Figure 3: Net FDI inflows (\$ billions)



Source: Bruegel based on UNCTAD. Note: FDI data is presented on the directional principle, according to which a loan affiliate's loan to its parent company is subtracted from inward and outward FDI.

India's distinctive situation regarding net FDI, particularly given its *per capita* income, can be attributed to two parallel trends. First, outbound FDI has grown remarkably rapidly in recent years, with Indian multinational corporations increasingly pursuing global expansion through outward investment. Second, there has been a significant surge in the repatriation of foreign capital and disinvestments, exceeding \$44 billion in 2023-24.

Figure 4: Net FDI, as percentage of GDP



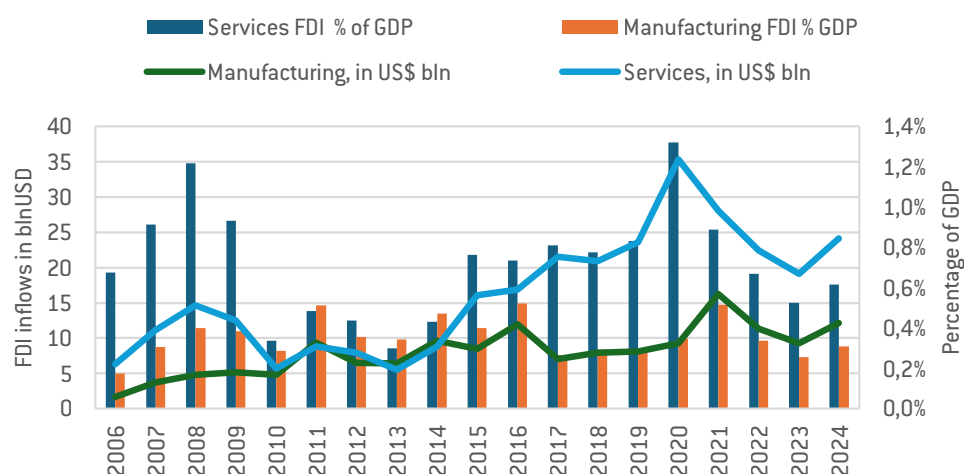
Source: Bruegel based on UNCTAD and World Bank.

2.2 Sectoral composition of foreign direct investment

The sectoral composition of India's FDI inflows offers perhaps the most telling evidence of its underperformance. Data from the Reserve Bank of India (RBI) for 2006-2024¹¹ reveals a persistent and self-reinforcing trend: services have consistently attracted the majority of inflows, accounting for approximately 60 percent of FDI in 2024 – a figure only marginally lower than the 67 percent recorded in 2006 (Figure 5). A growing proportion of this investment is channelled into knowledge-intensive subsectors, including business services, ICT, financial services, education and research and development (R&D) (Figure 6). While these sectors generate high added value, they create relatively limited amounts of employment per unit of invested capital.

More specifically, while FDI in knowledge-intensive services benefits a high-skilled workforce and may contribute to upgrading skills and associated positive spillover effects, it provides limited opportunities for the unskilled and semi-skilled workers who form the vast majority of India's unemployed population – the demographic that manufacturing-focused FDI would most help. This is because manufacturing FDI could address both low- and high-skilled unemployment, depending on whether it generates knowledge-intensive labour activities at the higher end of functional specialisation or production operations requiring low-skilled labour at the lower end of functional specialisation (Coveri and Zanfei, 2023).

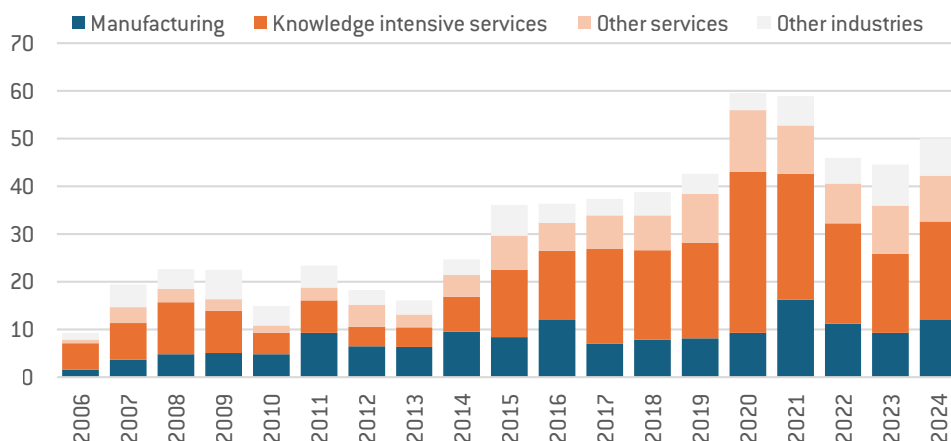
Figure 5: Manufacturing and service FDI inflows to India (\$ billions) – gross and as percentage of GDP



Source: Reserve Bank of India. Notes: the services sector is the sum of various service industries: business services, communication services, computer services, education and R&D, financial services, miscellaneous services, real estate activities and restaurants and hotels. RBI uses the asset-liability principle in defining FDI (instead of UNCTAD's directional principle), whereby direct investment statistics are organised according to whether the investment relates to an asset or a liability for the reporting country. This also leads to differing figures of FDI inflows as per UNCTAD (directional principle).

11 For sectoral decomposition of Reserve Bank of India data, this level of disaggregation is available. See Reserve Bank of India website, 29 May 2025, 'Foreign Direct Investment Flows to India: Country-wise and Industry-wise', <https://www.rbi.org.in/scripts/AnnualReportPublications.aspx?Id=1454>.

Figure 6: Sectoral decomposition of Indian FDI (\$ billions), 2006-2024



Source: Reserve Bank of India. Notes: knowledge-intensive services are defined with the help of Eurostat. For India, they include business services, computer services, communication services, education and R&D, financial services and real estate activities. RBI uses the asset-liability principle in defining FDI (instead of UNCTAD's directional principle), whereby direct investment statistics are organised according to whether the investment relates to an asset or a liability for the reporting country. This also leads to differing figures of FDI inflows as per UNCTAD (directional principle).

However, manufacturing's share of total FDI inflows into India has remained modest, fluctuating between 18 percent and 25 percent. A temporary spike to around 40 percent in 2014 coincided with early investor optimism about the 'Make in India' initiative and expectations of structural reform under the new government to transform India into an FDI manufacturing hub (WEF, 2021). However, this surge proved short-lived, as underlying obstacles remained largely unaddressed. The initiative's increasingly protectionist tilt – increasing tariffs on intermediate inputs, frequent and unpredictable revisions to the tariff schedule and India's eventual withdrawal from RCEP in 2019 – raised the costs and uncertainty for the export-oriented, global-value-chain-seeking investors that 'Make in India' had originally sought to attract. By 2024, manufacturing accounted for only 24 percent of FDI according to the Reserve Bank of India – merely six percentage points higher than in 2006, signifying minimal progress after two decades and despite dedicated industrial policy efforts from 2014 onwards.

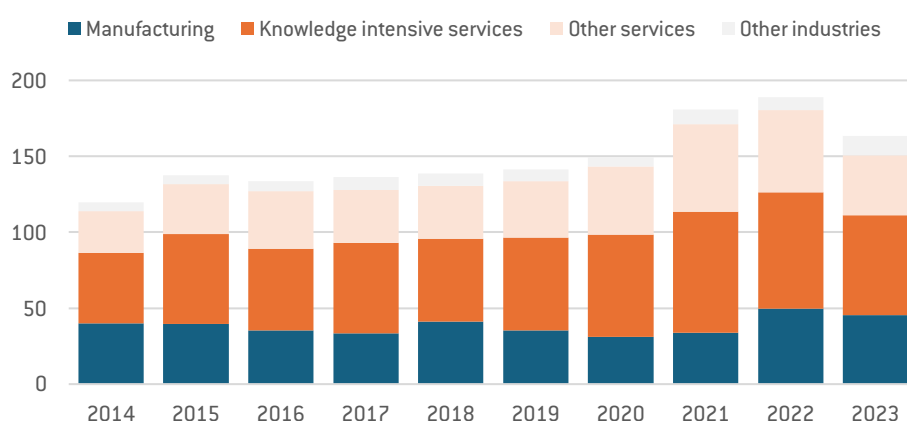
The persistence of this bias towards services highlights the profound structural barriers that continue to deter manufacturing investment in India, elaborated on in greater detail in section 3. Additionally, India's merits – a large, English-speaking, technically trained workforce and a mature IT and business-services ecosystem built up since the 1990s – give foreign investors a genuine efficiency-seeking rationale to locate knowledge-intensive service operations in India, a phenomenon most visible in the rapid expansion of Global Capability Centres¹². On the demand side, India's sheer market size makes market-seeking FDI in banking, insurance, telecommunications and retail trade attractive.

A comparison with China offers crucial nuance (Figure 7). While manufacturing

12 See Government of India Press Information Bureau press release of 11 December 2025, 'From Policy to Prosperity: GCCs Leading India's Growth Journey', <https://www.pib.gov.in/PressReleasePage.aspx?PRID=2202046®=3&lang=1>.

accounts for roughly 28 percent of total FDI in China – broadly similar to India’s proportional share – the absolute magnitudes are much larger. More significantly, the nature of manufacturing FDI in China has evolved considerably, transitioning from labour-intensive assembly in the 1990s to capital goods and high-technology sectors in recent decades (Liu, 2022). Foreign firms operating in China’s high-technology manufacturing sectors exhibit innovation performance largely comparable to that of leading domestic Chinese firms – a dynamic explored further in Section 4. India, by contrast, remains at an earlier stage of this transition.

Figure 7: Sectoral decomposition of FDI in China (\$ billions), 2014-2023



Source: Bruegel based on Ministry of Commerce, People’s Republic of China. Note: using Eurostat, we categorise the following industries as knowledge-intensive services: information transmission, software and ICT, finance, real estate, scientific research, technology services and geological prospecting, resident services and other services, education, health and social work, culture, sports and entertainment¹³.

Finally, the composition of India’s FDI is not only skewed toward services but, within that, increasingly skewed toward ‘brownfield’ rather than ‘greenfield’ activity. From 2021 onwards, there has been a rise in private equity (PE) and venture capital (VC)-led investment, which is overwhelmingly ‘brownfield’ in nature, eg acquiring shares within an existing firm in services sectors such as fintech, healthcare platforms and retail, rather than building new productive capacity (‘greenfield’) within its distribution channels. A few ‘greenfield’ investments in the manufacturing sector have been completed with Apple’s supplier ecosystem (Foxconn, Wistron) under the Production Linked Incentive (PLI) scheme, but they are the exception rather than the rule.

2.3 Europe as India’s most important strategic investor

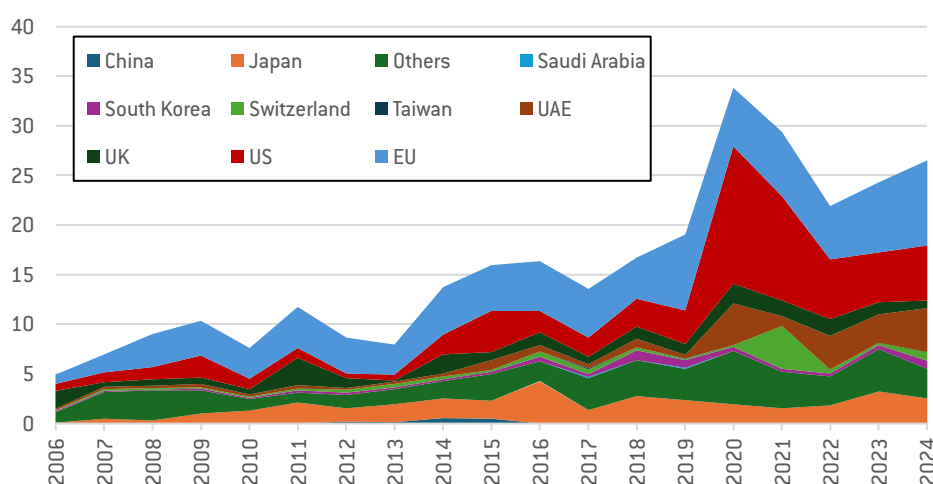
The geographic source of India’s FDI inflows is as revealing as its volume and sectoral distribution. Approximately 47 percent of recorded FDI in India originates from offshore

¹³ Knowledge-intensive industries, according to Eurostat, are high-tech, knowledge-intensive services, knowledge-intensive market services, knowledge-intensive financial services and other knowledge-intensive services. For more details, see Eurostat website, undated, ‘Glossary: Knowledge-intensive services’, [https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Glossary:Knowledge-intensive_services_\(KIS\)](https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Glossary:Knowledge-intensive_services_(KIS)).

financial centres (OFCs), with Singapore alone contributing a third of total inflows. As previously noted, OFC-intermediated investment predominantly represents round-tripping or third-country routing rather than genuine cross-border capital flows. Given that OFC investors are driven primarily by financial motives rather than productivity enhancement (Vujanović *et al*, 2021), up to half of India's reported FDI stock may offer limited developmental benefits compared to FDI from traditional foreign investors.

When OFC flows are excluded, the picture changes significantly. As illustrated in Figure 8, the EU and the United States emerge as the principal sources of genuine FDI into India, with the EU taking the lead in recent years. In 2024, the EU accounted for 17 percent of total inflows, surpassing the US (11 percent), the second largest foreign investor in India. This positions the EU not only as India's largest trading partner but also as its most significant source of non-intermediated foreign investment. This makes the absence of robust investment provisions in the EU-India FTA even more noteworthy.

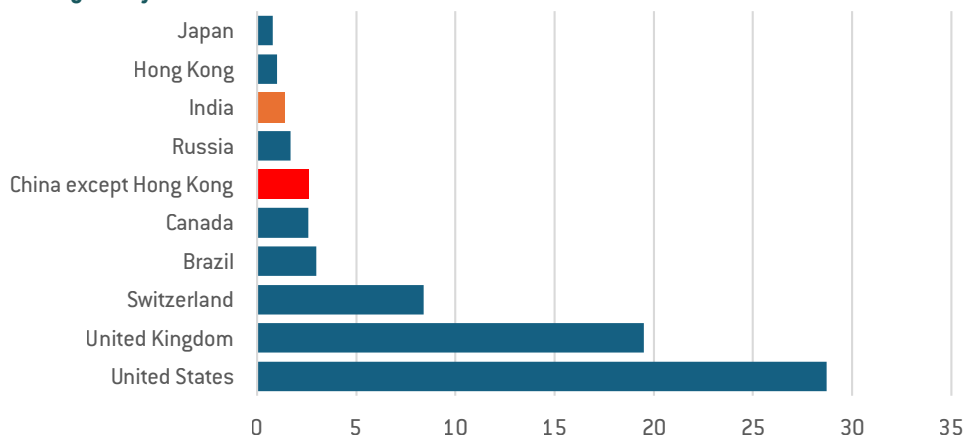
Figure 8: India FDI inflows by origin (\$ billions), 2006-2024 (excluding OFCs)



Source: Reserve Bank of India.

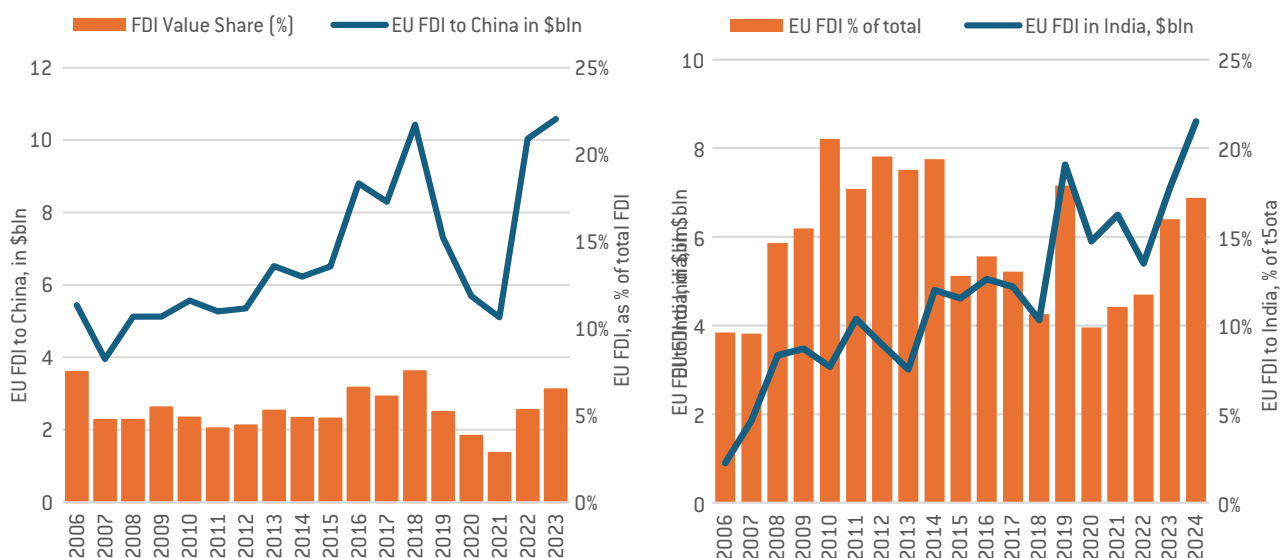
The EU, the US and the United Kingdom remain primary investment destinations. India has a marginal role in outward investment, as does China relative to its economic scale (Figure 9). European investment in China collapsed during COVID-19 but has recovered; investment in India, however, continues to rise steadily from a low baseline (Figure 10).

Figure 9: Top 10 EU FDI destination countries in 2024, percentage of total EU FDI outward stock globally



Source: Eurostat (bop_fdi6_ind_custom_20426235).

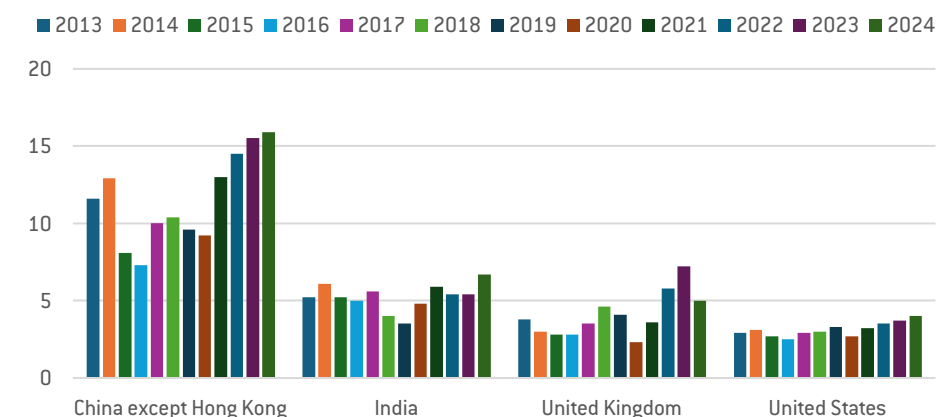
Figure 10: EU FDI (\$ billions) to China 2006-2023 (left) and EU FDI to India 2006-2024 (right), relative to total



Source: Ministry of Commerce of the People's Republic of China and Reserve Bank of India. Note: Chinese FDI is reported using the directional principle, whereas Indian FDI is reported using the asset-liability principle. Although these approaches make the two series formally noncomparable (blue line), they still provide useful information: EU FDI plays a larger role in India because it is measured against a much smaller overall FDI base than in China. FDI data from the Ministry of Commerce of the People's Republic of China are available until 2023.

Overall, while the EU ranks as India's top foreign investor, India is only the eighth most popular destination for EU multinationals' investments (Figure 9). This represents a missed economic opportunity, particularly given India's significant investment returns (Figure 11).

Figure 11: Rate of return of EU FDI, per country



Source: Bruegel based on Eurostat.

In recent years (2023–2025), India’s FDI returns have consistently outperformed major advanced economies, including the US and UK, the EU’s top FDI destinations (Figure 11)¹⁴ despite them being mature and saturated markets with compressed margins and slower growth. Notably, Figure 11 also shows that China historically delivered comparably high returns on EU FDI. This stemmed from China’s unique combination of a vast domestic market, world-class manufacturing infrastructure, deep supply-chain integration and a highly productive workforce, enabling foreign firms to earn returns exceeding those in advanced economies (Ji and Jiang, 2025; IMF, 2024). However, rising policy uncertainty, geopolitical risk and intensified domestic competition, coupled with low profitability and deflationary pressures, cast doubt on future profits for European companies in China (García-Herrero *et al*, 2025). India, offering a comparable market-size trajectory, is increasingly positioned to attract investment that China can no longer retain – if the appropriate legal and regulatory framework is established.

3 Structural and institutional barriers to foreign direct investment into manufacturing

The FDI shortfall documented in Section 2 is not accidental. It reflects a set of structural and institutional constraints that have made India a less attractive destination for manufacturing investment than its economic size and growth performance would suggest. The literature, supported by recent empirical evidence, points to five main explanatory factors.

3.1 Infrastructure deficits and logistics costs

Manufacturing investment is inherently sensitive to infrastructure quality and demands

¹⁴ Return of investment is calculated by Eurostat as ratio of FDI income over FDI stock.

reliable electricity, efficient transport networks (road, rail and maritime). Historically, India has underperformed on these crucial aspects. Frequent power outages, for instance, impose significant operating costs and erode the competitiveness of Indian-made goods.

Indian logistics remain heavily road-reliant, which is both more expensive and carbon-intensive than rail or maritime transport. While highways have enhanced inter-city travel speeds, 'last mile' connectivity to industrial clusters remains fragmented and costly, posing a significant hurdle (Kapoor *et al*, 2024).

Furthermore, India faces a structural shortage of shipping containers, with a near *de facto* monopoly held by Chinese manufacturers. This creates a geopolitical vulnerability that foreign investors into export-oriented industries may perceive as a substantial risk.

Land acquisition for 'greenfield' manufacturing sites continues to be one of the most significant structural barriers to manufacturing FDI in India, remaining legally precarious despite incremental reforms. The primary land-acquisition legislation mandates high consent thresholds for private and public-private partnership projects, along with social impact assessments that routinely add one to two years to project timelines – a delay that multinational firms accustomed to faster processes may find prohibitive^{15,16}. A recent legislative amendment adds additional restrictions to the acquisition of agricultural land in climate-vulnerable districts, potentially further shrinking the available land pool for industrial corridors¹⁷.

The current landscape is increasingly defined by competitive federalism. A few southern and western states have effectively circumvented traditional acquisition hurdles by implementing GIS-enabled land banks, pre-approved industrial zones and integrated single-window clearance systems. Consequently, they have captured a disproportionate share of manufacturing FDI. In contrast, most other states still grapple with delays of three to five years due to land ownership-related disputes. Unless similar, streamlined frameworks become more widespread, India's manufacturing FDI gains risk remaining geographically concentrated.

3.2 Labour-market rigidities

India's labour market presents another obstacle to its FDI strategy. Legacy provisions of the 1947 Industrial Disputes Act, especially those governing factory closures and workforce adjustments, have historically deterred large-scale manufacturing investment (Mishra and Dwivedi, 2024). This has created a well-documented dynamic: firms tend to remain small to avoid regulatory thresholds, thus limiting their capacity to scale production for competitive exports.

The new Labour Codes on Wages, Industrial Relations, Social Security, and Occupational Safety, passed by India's Parliament in 2019-20 and ratified in 2025, aim

15 For example, the 2013 Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement (LARR) Act requires the consent of 80 percent of affected families for private projects and 70 percent for public-private partnerships.

16 PRS India, 'The Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement (Second Amendment) Bill, 2015', *Legislative Brief*, undated, <https://prsindia.org/billtrack/prs-products/prs-legislative-brief-2459>.

17 The proposed 2025-26 Amendment to the LARR Act seeks to prohibit the acquisition of multi-cropped agricultural land in designated climate-vulnerable districts.

to alleviate some of these rigidities¹⁸. Notably, the Labour Code on Industrial Relations raises the threshold for mandatory government permission for retrenchment or company closure from 100 to 300 workers. However, implementation remains uneven across states, with some states fully implementing them while others have yet to signal their intent. In this context, the 300 worker threshold may still discourage firms from expanding formal employment beyond that level. Furthermore, one third of Indian states have yet to fully align their specific rules with the new Labour Codes. This results in a patchwork of compliance, where foreign companies might encounter different labour legislation depending on which state they operate in.

3.3 Protectionist trade policy

India's fundamentally protectionist trade regime acts as a serious impediment for multinational firms. While India has pursued bilateral trade agreements with several key partners, including the EU, its trade policy remains more inward-looking compared to its ASEAN counterparts. India's average Most Favoured Nation (MFN) applied tariff stands at approximately 17 percent. This contrasts sharply with Thailand (11.5 percent), Vietnam (9.6 percent) and Malaysia (5.6 percent), which have strategically used lower tariffs to establish themselves as manufacturing hubs for electronics and machinery (García Bercero and Sapir, 2025). This inward-looking stance is compounded by the proliferation of Quality Control Orders (QCOs) – technical standards that, while ostensibly aimed at improving product quality, have functioned as non-tariff barriers, surging from just 88 in 2019 to 765 by December 2024, with the bulk concentrated on intermediate and capital goods that are the backbone of manufacturing supply chains (Prabhakar, 2025)¹⁹.

The paradox is stark: India's consistently protectionist stance undermines the manufacturing FDI it aims to attract^{20,21}. By making imports costlier, this framework compels multinationals to establish local supply chains. As a result, firms reliant on components not yet available in India find production costs prohibitively high, disincentivising the very FDI that could, over time, build local supply chains. As García-Herrero and Sengupta (2026) argue, India's inward trade orientation is a critical obstacle and reversing it could significantly boost manufacturing growth and job creation.

3.4 The collapse of bilateral investment treaty protection

India's 2015 Model Bilateral Investment Treaty actively dismantled widely accepted international investor protections at precisely the moment the country was setting out

18 See the Government of India pamphlet, undated, 'New Labour Code for India, Biggest Labour Reforms in Independent India', <https://www.labour.gov.in/static/uploads/2025/07/e6e2df267f39a63f0061041ab0a07db4.pdf>.

19 Perna Prabhakar, 'India's Quality Control Orders: Understanding Key Trends', *Blog*, 24 September 2025, Centre for Social and Economic Progress, <https://csep.org/blog/indias-quality-control-orders-understanding-key-trends/>.

20 Launched in September 2014 with the aim of transforming India into a global manufacturing hub, the government's 'Make In India' initiative focuses on encouraging domestic production, attracting foreign investment and strengthening India's position in global supply chains. See the 'Make in India' website, <https://www.makeinindia.com/>.

21 Perna Prabhakar, 'Rebalancing India's Trade Policy: From Protection to Competitiveness', *Blog*, 9 April 2026, Centre for Social and Economic Progress, <https://csep.org/blog/rebalancing-indias-trade-policy-from-protection-to-competitiveness/>.

to attract global manufacturing capital. Triggered by an adverse arbitration outcome²² and the ensuing political backlash against investor-state dispute settlements, the new Model BIT prompted India to unilaterally terminate regular bilateral investment treaties (BITs) with 77 countries between 2016 and 2024. This included BITs with 22 EU countries, among them the Netherlands – a common gateway for investment into India – whose treaty India terminated with effect from December 2016.

The problem is not only the termination of the BITs themselves, but the substance of their replacements. Criticisms of the 2015 Model BIT include its narrow definition of investment, an extremely restrictive fair and equitable treatment provision and the exclusion of most-favoured-nation treatment – all of which are standard features in EU-style investment agreements²³. This creates a substantive gap between the two sides' starting positions in any future negotiation on investment protection.

India terminated every BIT it was legally entitled to exit: treaties still within their initial fixed term could not be unilaterally denounced and thus remained in force, while the rest were cancelled as their terms expired. The empirical evidence on the consequences of this BIT shock is unambiguous. Because the timing of each termination was dictated by the treaty's expiry date rather than by the characteristics of the partner country, the terminations were quasi-random – a feature that Hartmann and Spruk (2023) and Kotyrló and Kalachyhin (2023) lean on to confirm their negative impact on inward FDI: flows from countries whose BITs were cancelled fell by 30 percent relative to those whose treaties remained in force. This is widely seen as a key reason why India's manufacturing FDI has stagnated at around 1.5 percent to 2 percent of GDP.

The termination of these BITs meant that 'legacy' investments generally remained protected, but all new capital entering India after 2015 was essentially unprotected and exposed to domestic judicial delays. The timing of this legal change is particularly unfortunate, coinciding with the de-risking of multinational firms from China under the China+1 strategy²⁴. Arguably, India could have benefited more significantly had it kept a framework with stronger investor protection in its trade agreements²⁵. On the positive side, the Indian government has officially signalled its intent to reform the 2015 Model BIT²⁶ in the Union Budget 2025-26, but no specific steps have yet been taken in this direction.

22 The arbitration was brought under the Australia-India BIT (1999). The tribunal found India in breach of the treaty's 'effective means' standard because of the Indian courts' nine-year delay in enforcing a commercial award in *White Industries*' favour and ordered India to pay approximately 4 million AUD, plus costs. It was the first known investment treaty award rendered against India, which catalysed the 2015/2016 Model BIT and the subsequent wave of BIT terminations. See *White Industries Australia Limited v The Republic of India*, 30 November 2011, <https://www.italaw.com/cases/1169>.

23 Prakash Pillai and Perry Wong, 'India-EU Free Trade Agreement: An Unfinished Treaty', *Insights*, 24 February 2026, Clyde & Co, <https://www.clydeco.com/en/insights/2026/02/india-eu-free-trade-agreement-an-unfinished-treaty>.

24 Michaela Madden, 'Everything You Need to Know About China Plus One', *Insight*, 29 September 2025, Z2, <https://www.z2data.com/insights/everything-you-need-to-know-about-china-plus-one/>.

25 Since adopting its revised Model BIT in 2015, India has concluded new BITs only with Brazil, Belarus and Kyrgyzstan – none of which are yet in force – leaving a significant and prolonged gap in investment protection coverage.

26 See International Institute for Sustainable Development's news article of 19 January 2026, 'India Moves to Revise Its Model Bilateral Investment Treaty', <https://www.iisd.org/itn/2026/01/19/india-moves-to-revise-its-model-bilateral-investment-treaty/>.

3.5 Regulatory complexity

Despite India's significant improvement in the World Bank's Ease of Doing Business index –jumping from 142nd in 2014 to 63rd in 2020 (World Bank, 2020) – surveys of European and American multinationals consistently reveal a sharp divergence between such composite rankings and the actual investment experience²⁷. While headline reforms like the Goods and Services Tax (GST), the Insolvency and Bankruptcy Code and Production Linked Incentive (PLI) schemes have enhanced India's appeal on paper, foreign investors still encounter substantial on-the-ground challenges that rankings fail to fully capture.

Foremost among these are the persistent regulatory complexities stemming from overlapping central and state government jurisdictions. Even with the National Single Window System²⁸, investors frequently face a multitude of approvals, clearances and compliance requirements across different ministries and state authorities. Some of these problems could be addressed through a modernised approach to investment facilitation, but India continues to resist²⁹ the adoption of the WTO Investment Facilitation for Development Agreement, and was the only country blocking it at the WTO March 2026 ministerial conference³⁰. Furthermore, unpredictable indirect tax enforcement – particularly concerning GST input tax credit claims, audits and classification disputes – adds further uncertainty to financial planning (Deloitte India, 2026). Most critically for manufacturing investors, the slow and unpredictable nature of commercial dispute resolution remains a major deterrent. Lengthy court proceedings and high case backlogs continue to push companies towards arbitration, yet even these alternative mechanisms often face practical delays.

These frictions impose real costs that disproportionately affect marginal or mid-sized manufacturing investments, which tend to be the most sensitive to risk and predictability differences. While large anchor investments in sectors like electronics and automobiles have secured government backing and materialised, many European and American companies report that the cumulative burden of regulatory uncertainty, tax unpredictability and slow dispute resolution makes India less competitive than

27 The FEBI Business Sentiments Survey 2026 reported that 71 percent cited regulatory approvals and compliance as an operational challenge, while 41 percent highlighted difficult or opaque taxation rules (FEBI, 2026).

28 The National Single Window System is a digital portal launched by the Department for Promotion of Industry and Internal Trade in September 2021 that allows investors to identify, apply for and track the regulatory approvals required to establish a business in India, consolidating clearances from over 30 central ministries and most state governments into single interface.

29 Kirtika Suneja, 'India rejects China-backed WTO investment facilitation proposal', *The Economic Times*, 23 October 2025, <https://economictimes.indiatimes.com/news/economy/foreign-trade/india-rejects-china-backed-wto-investment-facilitation-proposal/articleshow/124747765.cms>.

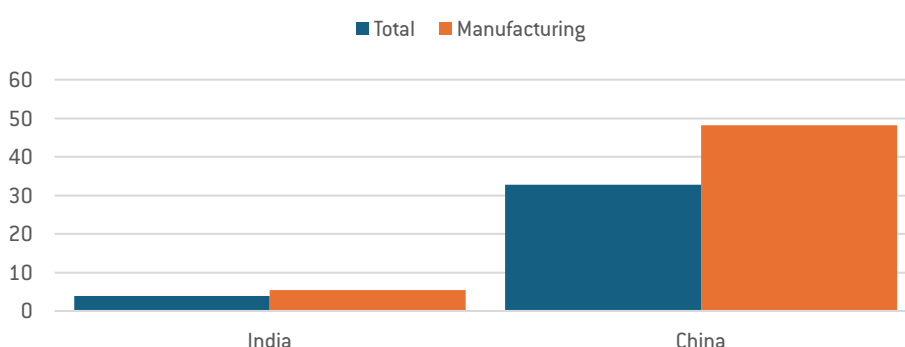
30 Karl P. Sauvart and Rajesh Aggarwal, 'Impasse at the WTO on investment facilitation—the way forward', *International Economic Law and Policy Blog*, 5 June 2026, <https://ielp.worldtradelaw.net/2026/06/impasse-at-the-wto-on-investment-facilitation-the-way-forward/>.

4 Why should India attract foreign direct investment?

For emerging economies needing to catch up to technological leaders, FDI stands as one of the most consequential conduits for technology transfer, knowledge diffusion and skills enhancement. This reality stems from the structural advantage of multinational firms, which command the world's most advanced proprietary knowledge and contribute a disproportionate share of global R&D (Vujanović *et al*, 2022; Ghodsi *et al*, 2025). For India, where innovation remains weak when compared to other large emerging economies, harnessing this technology-transfer channel represents perhaps the strongest imperative for actively encouraging FDI.

World Bank Enterprise Survey data for India reveal pervasive innovation underperformance (Figures 12 and 13)³². During the 2023-2025 period, fewer than 4 percent of Indian firms across all industries introduced a new product or service. The manufacturing sub-sample fares only marginally better, with 5.4 percent of firms innovating. In contrast, around 35 percent of Chinese firms, and nearly half of its manufacturing firms, introduced product or service innovations over the same period. The divergence in R&D spending is perhaps most striking: only 1 percent of medium and large Indian manufacturing firms conducted formal R&D, compared to 64 percent of their Chinese counterparts.

Figure 12: Percentage of firms that introduced a new product/service in India (2023-2025) and China (2022-2024)



Source: Bruegel based on World Bank. Note: surveys were conducted one year apart in the two countries.

31 The same frictions that depress manufacturing FDI do not apply to services FDI, as these frictions are largely manufacturing-specific by construction. Services FDI does not depend on importing intermediate goods potentially subject to tariffs, nor does it typically require large industrial land parcels, uninterrupted power supply or integration into a cross-border physical supply chain – the very channels through which the hurdles mentioned above operate. A bank, an IT services firm, or a Global Capability Centre needs office space, connectivity and a skilled workforce, none of which is materially affected by these hurdles.

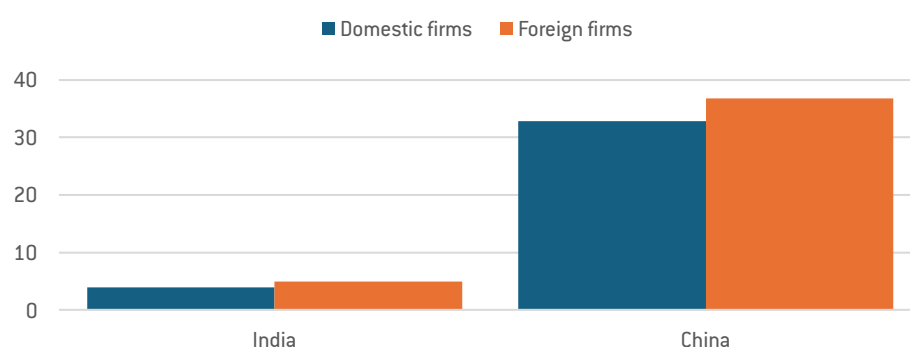
32 See the World Bank Enterprise Survey dataset, 'Economies - Formal Sector Enterprise Surveys: India (2022)', undated, <https://www.enterprisesurveys.org/en/data/exploreeconomies/2022/india>.

These findings align with and are further detailed by García-Herrero and Sengupta (2026), who demonstrate that India's gross R&D expenditure as a share of GDP has stagnated. Although India climbed to 38th place among 139 economies in WIPO's Global Innovation Index 2025³³ – leveraging its strengths in market size, entrepreneurial activity, ICT services exports (where it ranks first globally) and a dynamic venture capital scene – gross expenditure on R&D remains stuck at around 0.65–0.7 percent of GDP, far below China (2.4 percent), South Korea (4.9 percent) and the OECD average of over 2.5 percent. The composition of that spending compounds the problem: nearly 75 percent comes from the public sector, whereas in most advanced economies private firms contribute the major share, and a persistent disconnect between academic research and industry needs limits the commercialisation of research. The result is an economy that consistently overperforms relative to its income level – India has been an “*innovation overperformer*” for fifteen consecutive years – yet remains unable to convert scientific capacity into the industrial R&D base that manufacturing-led growth requires³⁴.

FDI can enhance host country innovation through several well-documented channels of knowledge transfer from foreign to local firms. The most prominent mechanism operates through backward linkages whereby foreign customer firms source inputs from domestic suppliers (Javorcik, 2004; Vujanović *et al*, 2021; Vujanović *et al*, 2022; Stojčić *et al*, 2025). This is because foreign firms have a strong incentive to upgrade local suppliers to ensure reliable, high-quality inputs instead of relying on imports.

In India, however, the FDI knowledge spillover channels in general have remained significantly muted, largely because foreign firms innovate very little within the country. As mentioned in Section 2, one reason for this could be that PE/VC-driven FDI in India mainly acquires existing firms rather than creating new production capacity, thus limiting their role in knowledge transfer.

Figure 13: Percentage of domestic and foreign firms that introduced a new product or service, India (2023-2025) and China (2022-2024)



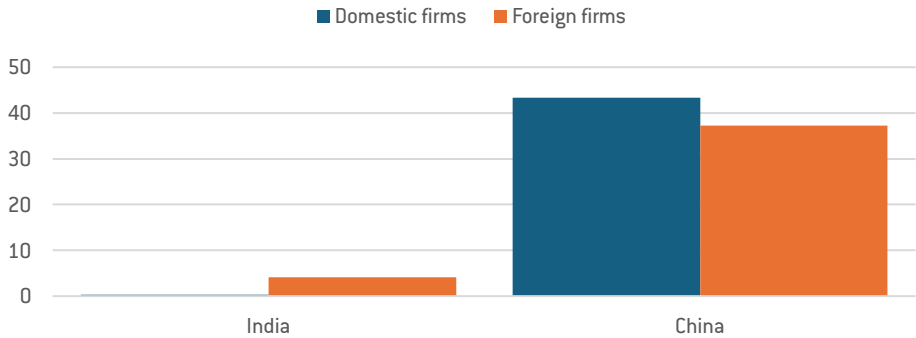
Source: World Bank. Note: surveys were conducted one year apart in the two countries.

33 WIPO (2025) *Global Innovation Index 2025: Innovation at a Crossroads*. 18th edition. Geneva: World Intellectual Property Organization. Available at: <https://www.wipo.int/web-publications/global-innovation-index-2025/en/gii-2025-results.html>.

34 *Ibid*.

The same data reveals that only 4.1 percent of foreign medium and large firms invest in R&D in India, suggesting their core innovative activities remain elsewhere, at headquarters or in high-IP-protection jurisdictions. India attracts the commercialisation of innovations developed elsewhere, rather than frontier innovation. In China, approximately 40 percent of both foreign and domestic firms conduct domestic R&D, a higher rate than in many higher-income countries, indicating China's ability to compete at the technological frontier³⁵.

Figure 14: Percentage of medium and large firms that spend on R&D in India (2025) and China (2024)



Source: World Bank. Note: a foreign firm is any firm with at least a 10-percent foreign-ownership stake. Surveys were conducted one year apart in the two countries.

The high proportion of foreign firms conducting R&D in China indicates that they transfer significant knowledge-intensive activities to their subsidiaries there. This transformative innovation process in China is further bolstered by Chinese outward investments, which strategically target R&D-intensive or supply-chain-linked firms in other economies. These investments generate within-network spillovers, enhancing innovation performance in China. This explains why foreign firms in China innovate at similarly high levels as local Chinese firms, suggesting that China's innovation ecosystems are conducive to such activities. The situation in India is the opposite. The low number of foreign firms conducting R&D suggests that multinationals in India are more focused on production-based activities than knowledge-intensive ones. Given the difference in R&D spending, it is possible that manufacturing firms in India are more likely to innovate incrementally, rather than radically via R&D spending that can lead to breakthrough innovations.

With an innovation landscape favouring incremental innovation, particularly in manufacturing, India is positioned to potentially compete at the lower end of supply chains and in functional specialisation. This positioning can make India attractive to European foreign investors seeking to diversify and extend their supply chains and production networks. At the same time, such investment can support India's technological upgrading through deeper integration into global value chains.

35 World Bank Enterprise Survey data suggests that in high-income countries 24.2 percent of medium and large firms spend on R&D. Available at <https://espanol.enterprisesurveys.org/en/enterprisesurveys>.

5 Europe as the world's largest foreign direct investor

5.1 The EU's position as global outward investor

The European Union is the world's largest source of outward foreign direct investment. According to Eurostat, the EU accounted for 39.8 percent of the world's outward investment stocks in 2024 – some €16.7 trillion out of a global FDI stock of €45.5 trillion – making it the leading outward investor globally. Europe's outward stocks exceeded the inward FDI held by the rest of the world within Europe, making it the only continent that was a net investor at the end of the period. Focusing on the EU-27 specifically, net FDI stocks held in non-EU countries by EU-resident investors amounted to €9.3 trillion at the end of 2024, against €7.0 trillion held by non-EU residents in the EU – a net creditor position that has few parallels among major economies. In flow terms, the EU has consistently accounted for roughly one third of global outward FDI: 32.6 percent of global FDI in other countries in 2023³⁶.

The geographic distribution of this stock underscores both the EU's global reach and the scope for reallocation towards India. The US absorbed 28.7 percent of total EU FDI stocks abroad, followed by 19.5 percent for the UK, while Asian economies together accounted for only 12.2 percent of the EU total. India's share of the EU's outward stock thus remains a small fraction of what flows to comparably sized markets – a gap that is striking given that the EU's outward FDI is more widely distributed across developed and emerging economies than its inward investment, indicating that European capital does reach emerging markets when conditions permit³⁷.

The EU's dominance in FDI is particularly significant in manufacturing, where European multinationals in automotive, chemicals, specialised machinery, pharmaceuticals and advanced industrials are among the most technologically sophisticated and globally integrated firms in the world. European manufacturing investment also has distinctive characteristics that differentiate it from other sources of capital: it tends to be patient rather than opportunistic, anchored in decades-long commitments to production sites; it brings embedded R&D and process engineering rather than mere assembly; and it typically arrives with an ecosystem of specialised suppliers – notably Germany's 'Mittelstand' of hidden champions in machine tools and components – alongside established traditions of vocational training and workforce upgrading. Consequently, European manufacturing FDI represents precisely the type of investment India needs: long-term, technology-intensive and integrated into global supply chains, capable of generating not only jobs but also the technology diffusion, supplier development and export linkages that have so far eluded India's manufacturing sector.

36 Eurostat, 'World direct investment patterns', *Statistics Explained*, January 2026, European Commission, https://ec.europa.eu/eurostat/statistics-explained/index.php?title=World_direct_investment_patterns.

37 Eurostat, 'Foreign direct investment – stocks', *Statistics Explained*, January 2026, European Commission, https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Foreign_direct_investment_-_stocks.

5.2 The China retreat and the India opportunity

The strategic calculus for European investors has significantly shifted since 2021. As García-Herrero *et al* (2025) document, based on nearly a decade of EU Chamber of Commerce in China survey data, business sentiment among EU firms in China has declined to historically low levels. Respondents report falling profits, negative growth expectations, increasing regulatory discrimination in favour of domestic Chinese competitors and reduced reinvestment plans. Compounding geopolitical risks are deflationary pressures, weak domestic consumer demand and intensifying competition from state-subsidised Chinese firms in sectors previously dominated by Europeans. Consequently, there seems to be a conviction among businesses that the China model is no longer viable for European multinationals, necessitating the reallocation of capital away from China. This reallocation creates a natural opportunity for India. This is not only because India offers a low-cost production base but, more crucially, India offers access to one of the world's largest and fastest-growing consumer markets. At the same time, high unemployment among young and educated workers – around 45 percent in the 15-24 age group and 15 percent among graduates, against an overall rate of roughly 8 percent – combined with the substantial annual influx of young entrants into the labour force, enhances India's attractiveness as a prospective hub for manufacturing, akin to the role China played from the 1990s to 2010s (García-Herrero and Sengupta, 2026).

Despite India's strong economic fundamentals and its rapid growth, its share of the EU's outward FDI stock falls significantly short of its potential. This underperformance is partly due to the challenges of regulatory and bureaucratic complexity and Indian authorities' insistence on maintaining the current investment environment, as highlighted in section 3. Capital is deterred not only by operational hurdles but also by the absence of a modern, balanced investment protection framework. There seems to be a fundamental difference between the EU and India over dispute settlement mechanisms, a central obstacle in the current IPA negotiations. Consequently, while India is the EU's fastest-growing major FDI destination in recent years, absolute investment volumes from the EU remain modest compared to those going to the US, UK or China, and in comparison to the size of the Indian market.

6 EU-India economic relations and what to expect from the free trade agreement and beyond

6.1 What the EU-India free trade agreement brings to the table

The EU-India FTA represents India's most comprehensive trade deal in recent years. Regarding goods, India has committed to eliminating or reducing tariffs on 92.1 percent of its tariff lines, covering 97.5 percent of EU goods exports by value, with 49.6 percent of these seeing immediate duty elimination and the remainder phased out over five to ten years. In return, the EU has committed to eliminating or reducing tariffs on over 96 percent of its tariff lines covering EU imports from India, with 70.4 percent of tariff lines – covering 90.7 percent of India's exports by value – receiving immediate duty elimination upon entry into force, concentrated in labour-intensive sectors such as textiles, leather, footwear and gems and jewellery.

In services, the agreement surpasses India's existing commitments under the WTO's General Agreement on Trade in Services (GATS)³⁸. It introduces provisions on domestic regulation, transparency in licensing procedures and commitments for the temporary movement of professionals – elements new to India's trade agreements. These are intended to facilitate greater market access for European service providers in sectors like IT, professional services and financial services, while simultaneously creating opportunities for Indian professionals in the European market.

The FTA also includes dedicated chapters on digital trade, intellectual property rights, trade and sustainable development. These chapters generally align with standards in the EU's other recent trade agreements, addressing issues such as intellectual property protection, regulatory transparency, data flows, copyright and patent protection, labour standards and environmental commitments. While their scope is more limited than in some EU agreements with developed economies – the digital charter also lacks commitments on data flows and the non-application of duties on e-commerce – they nonetheless introduce new dynamics into the EU-India trade relationship. It is worth noting that the agreement does not include commitments on government procurement or investment market access in the manufacturing sector.

Overall, the agreement is projected to yield economic benefits for both parties through increased trade and supply chain integration. Nevertheless, the full economic impact will hinge on the FTA's effective implementation, the swift conclusion of the separate IPA currently under negotiation and businesses' capacity to leverage the new market access opportunities.

38 The General Agreement on Trade in Services (GATS), operates on a positive-list basis, meaning that signatory countries are only bound by commitments they explicitly schedule. GATS is the principal multilateral reference point against which services chapters in bilateral and regional trade agreements – including the EU-India FTA – are typically benchmarked. For more information, see the World Trade Organization's website, undated, 'General Agreement on Trade in Services', https://www.wto.org/english/tratop_e/serv_e/gatsintr_e.htm.

6.2 The missing piece: the EU-India Investment Protection Agreement

EU-India IPA negotiations began in parallel with the FTA discussions in June 2022 and were intentionally sequenced separately³⁹. However, they remained unfinished as of the FTA's conclusion in January 2026. The significance of this schism is amplified by India's unilateral BIT terminations between 2016 and 2024 and the restrictive nature of its 2015 Model BIT⁴⁰. The India-EFTA Trade and Economic Partnership⁴¹, which entered into force in October 2025, serves as a cautionary precedent. It contains no investment protection provisions, instead relying on a 'desk model' of government-to-government consultations to address investor concerns.

While this is only meant to be a temporary solution, the ongoing negotiations for an India-EU Investment Protection Agreement (IPA) are proving difficult. The focus is on reconciling the two contrasting approaches to resolving investment disputes. India strongly advocates for the 'Exhaustion of Local Remedies' (ELR) approach⁴², which would require foreign investors to first pursue claims through Indian courts or administrative bodies before appealing to international dispute resolution mechanisms. Conversely, the EU would, in principle, prefer a modern 'Investment Court System' (ICS), in other words, an investor-to-state mechanism granting investors more direct access to an international forum, though this avoids concerns about the lack of legitimacy of traditional investor-state dispute settlement mechanisms. And yet, the Commission also faces its own problems with the ICS model as it necessitates ratification by EU countries. This process has historically presented political and procedural difficulties, as in the case of EU-Canada Comprehensive Economic and Trade Agreement (CETA) which was approved in 2016 and is not yet fully in force as some EU countries have not yet ratified it. Such practical constraints make a pragmatic compromise more likely, namely a state-to-state dispute settlement system.

A well-designed IPA, complementing the recent FTA, could be decisive in unlocking the potential of the EU-India partnership. As García Bercero and Sapir (2025) argue, a modern investment framework would not only safeguard existing investments but also stimulate greater export-oriented manufacturing in India. This would enable European firms to serve India's expanding domestic market while simultaneously using it as a

39 See the European Parliament announcement of 20 June 2026, 'EU - India FTA, IPA/BIT and GI agreement In "A global Europe: Leveraging our power and partnerships"', <https://www.europarl.europa.eu/legislative-train>.

40 Prakash Pillai and Perry Wong, 'India-EU Free Trade Agreement: An Unfinished Treaty', *Insight*, 24 February 2026, Clyde & Co, <https://www.clydeco.com/en/insights/2026/02/india-eu-free-trade-agreement-an-unfinished-treaty>.

41 The European Free Trade Association (EFTA) is a regional intergovernmental organisation comprising four non-EU European states: Iceland, Liechtenstein, Norway, and Switzerland. In March 2024, the EFTA states concluded a landmark trade and economic partnership agreement with India – notably the first such agreement to include a binding investment facilitation commitment, under which EFTA members pledged to encourage \$100 billion in investment into India over 15 years. See European Commission news article of 10 April 2024, 'EFTA – India: Trade and Economic Partnership Agreement', https://intellectual-property-helpdesk.ec.europa.eu/news-events/news/efta-india-trade-and-economic-partnership-agreement-2024-04-10_en.

42 Exhaustion of Local Remedies (ELR) is a legal principle requiring foreign investors to pursue all available remedies through the host country's domestic courts before resorting to international arbitration. In the EU-India context, a proposed '3-year ELR window' would cap this requirement at three years, after which investors could escalate unresolved disputes to international arbitration.

competitive export platform for South Asia, Southeast Asia and sub-Saharan Africa.

Several European multinationals, especially in healthcare, industrial equipment and renewable energy, have already successfully adopted this dual-market strategy. By establishing local manufacturing and service operations in India, they reduce costs, enhance responsiveness to local demand and build regional supply chains. However, scaling this model for a broader range of European firms is hindered by the current investment protection environment. Regulatory uncertainty, weak dispute resolution mechanisms and the absence of a comprehensive bilateral investment agreement continue to limit the willingness of many companies – especially mid-sized European manufacturers – to commit to larger, longer-term investments.

The ongoing IPA negotiations are more than a technical legal exercise; they are central to determining if European firms can fully capitalise on India's emergence as both a major consumer market and a strategic production and export hub. Without significant progress on investor protection and regulatory predictability, the full economic potential of the EU-India partnership is likely to remain unrealised.

7 Conclusions

This paper has advanced a single, integrated argument: while the EU-India FTA is welcome and significant, it leaves unaddressed one of the most consequential dimensions of the bilateral economic relationship – the urgent need to substantially increase manufacturing FDI into India by establishing the legal infrastructure necessary to make such investment possible at scale. India's FDI performance is profoundly weaker than China's, particularly in manufacturing, despite its large market size and underutilised human-capital potential. FDI plays a vital role in technology spillovers and knowledge transfers which, in turn, are essential for building a strong innovation ecosystem, but this has not gained momentum in India. The EU, as India's largest foreign investor and the world's largest source of outward FDI, is uniquely positioned to help India address this challenge and, in turn, diversify away from China.

The innovation data presented underscores a critical asymmetry. In China, foreign firms innovate at rates comparable to leading domestic firms – reflecting deep supply-chain integration, strong intellectual property protection and decades of accumulated industrial ecosystem development which have supported high returns on FDI. In contrast, both foreign and domestic firms in India innovate at negligible rates, and the FDI that has arrived has been predominantly market-seeking rather than technology-bearing. Closing this gap requires creating the conditions under which multinationals feel confident expanding their production capacities, innovating and eventually locating high-value manufacturing in India – all of which would enable India to better integrate into global value chains. Legal certainty for investors is a prerequisite for this shift. The EU-India FTA creates the trade architecture; the IPA must now provide the investment foundation.

India's employment challenge ranks among the most urgent economic policy issues facing any major economy today. With more than ten million young people entering the

labour market each year in an economy where manufacturing stagnates at 15 percent to 17 percent of GDP and formal employment is dominated by skill-intensive services, this represents a social and political challenge of enormous proportions. Manufacturing FDI – with its associated supply-chain linkages and direct job creation – offers the channel through which India can most rapidly expand formal manufacturing employment.

The structural barriers to manufacturing FDI in India are substantial, especially labour market rigidities, protectionist trade policies, the collapse of bilateral investment treaty protection and regulatory complexity. A strong IPA cannot resolve all these issues. However, by restoring internationally enforceable legal certainty for European investors, it addresses what is arguably the most binding constraint: the risk premium that currently makes Indian manufacturing investments appear uncompetitive relative to alternatives.

Europe, for its part, possesses the capital, technology and – due to growing pressure to diversify supply chains away from concentrated dependence on China – the strategic motivation to invest. EU investors have compelling reasons to invest in India, where investment returns exceed those of most current EU investment destinations.

Hence, concluding the IPA must be the next priority on the EU-India agenda. It is a project that India's demographic pressures make urgent and that Europe's search for resilient, trusted partners makes strategic. Neither side can afford to wait.

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