India and the World

Perspectives from Northern Europe on India in world affairs. Issued on a regular basis by the Project for Nordic-India Relations at the Swedish Institute of International Affairs (UI). For previous issues please visit www.ui.se/english/research/asia/pnir

#15 2024-02-06

Taking stock of economic cooperation between the EU and India

Optimism is fading on getting a trade agreement in place between the EU and India before the general elections in India this spring, and elections for the European Parliament in June. A post-election deal is however still viable, and negotiations are expected to pick up pace later this year. There is political will from both sides to move forward.

This political will is due partly to the commercial opportunities, but also because deeper economic cooperation would contribute to both parties' strategic goals. Accelerated economic cooperation with the EU underpinned by trade and investment deals, would help India in moving closer to the goal of becoming a developed country by 2047, catching up with China economically, and build an economic foundation for becoming a leading power. It would also enhance India's digital and green transitions, and further integrate the Indian economy into Global Value Chains (GVCs). Moving closer economically to India – already a strategic partner – would enhance the EU's economic security by reducing dependencies on China, as well as providing significant business opportunities for European industry.

The negotiations for a trade deal continues at a slower pace, with the sixth round concluded in Brussels in October and November 2023. The seventh round is to be held in New Delhi; dates are yet to be confirmed. There is some progress in the talks. A report from the EU Commission of the outcome of the sixth round points towards "good progress" on, for example, Customs and Trade facilitation, Digital Trade, Good Regulatory Practices, and Dispute Settlement. Yet the report cautions that "there is still a need for significant work on the main substantive issues where the Parties' respective positions diverge".

As it stands today, economic cooperation between the EU and India is far from reaching its potential. A recent report from the Confederation of Swedish Enterprise details the extent to which a much more mature trade relationship would benefit both parties. While there is growth in certain sectors of the EU's merchandise export to India, exports overall have stagnated in recent years. As a share of the EU's merchandise exports, India accounts for only 1.9%, compared to, for example, China, which accounts for 10.2%. The share of EU exports to India has been consistent since 2007. When looking at it from the perspective of India's overall imports, the report concludes, the EU's share of India's imports is in decline, exhibiting opportunities lost. The trend in the EU's service exports to India, however, is positive. In sectors like IT-, and transport services, the growth in exports from the EU is significant.

India's share in the EU's merchandise import basket has been parked around 2%, the report finds. This share is projected to grow, especially with a trade agreement in place. To compare, China's share of the EU's merchandise imports stands at 22%. Again, services perform better in EU-India trade, and there is growth in the EU's imports of telecommunication and IT services, as well as "other services", from India. In these sectors, India's share of the EU's imports is just over 3%, surpassing China but being clearly dwarfed by the United States. India's export of services to the EU is expected to grow if a trade agreement is reached.

India's economy will undoubtedly continue to grow and is projected to become the world's third largest within this decade. Yet, GDP per capita will remain relatively low. For India to reach its development goal for 2047, the economy must grow at around 8-9% a year for decades. Some observers suggest that given the relatively low growth in India's agricultural sector, manufacturing sectors will need to perform exceedingly well, reaching growth targets around 10% annually (e.g. R. Mohan, 2022). India's demographics could be an asset when pursuing these levels of growth in manufacturing sectors, as over a hundred million people will enter the labour force in the coming decade. Others argue that instead of prioritising low-skilled manufacturing and assembly where global competition from East and South East Asia is high, India should pursue a novel path of growth through innovation and embedded and direct services, where India has comparative advantages (R. Rajan and R. Lamba, 2023).

It is not clear, however, whether the demand from domestic industries and consumers can drive such expansion in either manufacturing or services. Further integration of India's industrial base and innovative environments into GVCs, would be helpful in this regard, as it would increase production and value addition to meet external demand. This, in turn, requires fundamentals such as infrastructure, skilled labour, but also research and development facilities, to be in place.

Today, however, India's contribution to international trade is relatively small, as India accounts for about 2% of global merchandise trade and 4% of trade in services. The share of exports of India's GDP is just below 20%, as compared to over 30% in China during its trade-driven growth takeoff earlier this century. An EU-India FTA would further opportunities for improving on those figures, hence contributing in substantial ways to New Delhi's vision of "Make in India – for the world". This would be a boon when trying to accomplish the dramatic level and longevity of growth needed to meet the 2047 development target.

India's growth has historically had a bedrock in domestic household and public savings, with additional contributions from FDI. With current rather low levels of domestic private corporate investments and falling levels of household savings, India stands to gain from continuously increased levels of FDI. In 2022 India was in fact the third largest recipient of FDI in the world for so-called green field investments, according to the UN body UNCTAD. While the US and UK being the largest sources of FDI into India, the EU's share in India's stock is increasing. There is, however, plenty of scope for improvement: India only captures 1% of the EU's outward FDI stocks; India's investments in Europe currently make up 0.1% of the EU's inward FDI stocks, according to the report from the Confederation of Swedish Enterprise. So far European FDI has mostly been directed towards investments for production for India's domestic market, rather than manufacturing for global markets, but investment into export-oriented activities in India could increase with, for example, a more conducive tariff environment.

The most significant outstanding issues in the negotiations on an EU-India FTA are chapters regarding sustainability, environment, and labour provisions. India has historically been suspicious of the EU using FTAs to impose structural change in partner countries. Also, there are clear differences in perspectives on what sustainability means in practice. It is often perceived in India that the EU's emphasis on sustainability implies hidden protectionist measures. DG Trade has its job cut out in explaining for Indian counterparts what the EU perspective on sustainability entails.

Furthermore, the insistence on the EU's side on extensive civil society consultations as part of the FTA process raises concerns in New Delhi. India's objection to civil society involvement partly stems from the experience of having encountered how special interests, including rival corporations, can set up front organisations that then intervene into processes with motivated positions.

The next few years are likely to be crucial in creating the trade and investment links that determine future patterns of economic growth. Attempts to move supply chains away from mainland China and increase economic security are underway across the world. This process will be aided greatly by closer economic integration between the EU and India. An ambitious trade and investment protection agreement would also divert value chains to India and the EU which might otherwise go to other geographies.

From a strategic point of view as well, the EU-India strategic partnership needs a new economic component, which could only really be achieved through an FTA. Given the uncertainties for global trade in an era of accentuated geopolitics, it would clearly be to the benefit of both parties economically and strategically.

Dr Henrik Chetan Aspengren
Senior Analyst and Project Lead, UI
Henrik.aspengren@ui.se
+46(0)708986797

Mihir Swarup Sharma
Director, ORF
Mihir.swarup.sharma@orfonline.org