

ISAS Background Brief

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Institute of South Asian Studies
Hon Sui Sen Memorial Library Building
1 Hon Sui Sen Drive (117588)
Tel: 68746179 Fax: 67767505
Email: isaspt@nus.edu.sg
Website: www.isas.nus.edu.sg



SINGAPORE-INDIA CECA DIALOGUE: ISSUES AND OPTIONS

Dr. S. Narayan¹

INTRODUCTION

The Comprehensive Economic Cooperation Agreement (CECA) between Singapore and India has been over two years in the cooking. On a recent visit to Singapore in March 2005, the Indian Finance Minister, P. Chidambaram, expressed confidence that most of the issues have been resolved 'but for one or two issues like the space to be allowed for banks and certain clauses in the double taxation agreement'. He felt that the agreement was ready to be signed soon. The 'almost there' position has been reached several times earlier in previous negotiations for this agreement, and there is skepticism whether this time as well, the optimism is justified.

Relations between India and Singapore have been on the upswing for over a decade, and the concept of a comprehensive agreement rose out of discussions between the Indian Prime Minister Atal Bihari Vajpayee and the Singapore Prime Minister Mr. Goh Chok Tong at a meeting in August 2002. A joint study group was set up to make recommendations on the framework of the CECA to the respective Prime Ministers, indicating the seriousness of intent. The study group, after a series of deliberations lasting several months, made its recommendations to the Prime Ministers in its report in April 2003. *Inter alia*², the group recommended that the CECA should be structured as an integrated package of agreements between India and Singapore including:

¹ The author is a Visiting Senior Research Fellow at the Institute of South Asian Studies. The views expressed do not necessarily represent those of the Institute.

² India Singapore Comprehensive Economic Cooperation Agreement, Ministry of External Affairs, New Delhi, India, April 8 2003.

- a Free Trade Agreement, which would include, trade in goods and services and investment;
- a bilateral agreement on investment promotion, protection and cooperation;
- an improved double taxation avoidance agreement;
- a more liberal Air Services agreement ; and,
- a work programme for economic cooperation covering areas outlined in the joint study report, including the creation of the India- Singapore fund, and the setting up of a second India Centre in Singapore and Tourism Cooperation.

The report included the establishment of regular consultation mechanism, which would serve to clarify issues of interpretation and also serve as a vehicle for both governments to review the CECA in order to enhance the agreement and ensure that it remains relevant to the needs of both countries. Both governments, accepting the road map of the report, commenced negotiations with a target to complete these negotiations within 12 to 18 months.

TRADE POLICIES

At this point of time, there is considerable difference in the trade policies of the two countries. Singapore's trade policy objectives are to contribute to the strengthening of a free, open and stable international trading system and to develop Singapore into an international trading centre. Singapore has been pursuing free trade in goods; and import licensing and control provisions are maintained primarily to discharge Singapore's obligations under international commitments on account of public health, environmental and security considerations. Singapore does not impose any duty on exports, and export control measures are also primarily related to these safety considerations.

In WTO agreements, Singapore has accepted bound rates on 69% of its tariff lines, and its applied rates in respect of a majority of tariff lines are lower than the bound rates. The import weighted tariff rates are less than 5%. Singapore is a member of a number of regional trading arrangements, the most comprehensive being AFTA. ASEAN agreements provide for mutual, reduced, preferential tariffs, removal of quantitative barriers and reduction of all non-tariff barriers within the region. The industrial co-operation agreement provides for free treatment to products of cross border companies that enter into strategic alliances.

There is also a framework agreement on services with a vision to move forward to realize a free trade area in services. Other economic integration measures include food security, co-operation in areas of infrastructure like energy and transport and promotion of e-commerce. Free trade has been the basis of

the trade, economic and external policies of this country. In FTAs, therefore, the country would attempt to maximize its access to investment, trade and to markets, with the bilateral trading partner.

On the other hand, trade policies in India bear the imprint of certain historicity. Post independence, concerns over external exploitation and an import substitution model of development effectively kept Indian trade away from world markets for several decades. This has changed considerably over the last decade and a half. Trade as a percentage of GDP has risen from around 21% in 1991-92 to over 33% in 2002-3, an impressive increase of over 50% in this period. Tariff rates have been reduced substantially over this period. GDP growth has been 5.7%, compounded since 1984. Economic reforms of the last fifteen years have resulted in a buoyant economy, reduction in poverty, and significant strengths in the services sector, notably software. Its share in world trade, however, is still only around 0.9%, and the internal reforms agenda has only marginally been driven by the agenda for trade reforms—a significant difference between the policies of the two countries.

In WTO negotiations³, India was often perceived to be a reluctant assenter and the term ‘incremental unilateralism’ has been used to describe the Indian liberalization strategy over the last decade. According to this analysis, liberalisation has almost entirely been driven by decisions taken on a unilateral basis. Neither WTO commitments nor bilateral agreements would therefore be able to pressurise the process beyond a pace comfortable to all factions in India.

Trade reform cannot proceed in isolation, and in India, it has not been the flag-bearer of the reform process. India’s strategy in trade negotiations has always centred around the preservation of policy space. It has been commented that no matter how good an idea is for bilateral negotiations, India would likely change if the internal political environment at any point of time requires such a move⁴. It is also argued that this has resulted in a stop-go approach to reforms – whilst many of the reforms are still in their infancy.

Consequently, it is argued that India is unlikely to make significant alterations to the strategy of incremental unilateralism, for two main reasons. First, it has served India fairly well so far. Second, the slow moving, opportunistic nature of the reform process has provided the right blend of progress and conservatism to ensure that politics remains manageable. Trade agreements are therefore unlikely to assume a greater role in the reform process than they have occupied until now.

³ Lawrence Robert. Z & Chaddha Rajesh, Should a US-India FTA be part of India’s Trade strategy? India Policy Forum, 2004.

⁴ Alves, Philip, Understanding Indian Trade Policy: Implications for the India-SACU Agreement, South African Institute of International Affairs, SAIIA Trade Report 5, November 2004.

At the same time, there is also evidence that the Ministry of Commerce and Industry (MOCI) in India is concerned that India has only a few strategic trading partners, and thus may be in a weaker position relative to other emerging economies. The Medium Term Export Strategy document provides some insights into its policy. While seeking multilateral as well as regional cooperation, the MOCI is specifically interested in widening the scope for trade in services, particularly in IT and related industries. Investments and joint ventures are also on the list, though there is still wariness about foreign ownership.

India has signed bilateral agreements only with developing countries so far, and only Thailand can be considered outside that group so far. The agreement with Singapore is therefore important not just from the point of view of increased market access, but from a political point of view as well.

POLITICAL ECONOMY

It is important to bear in mind that the CECA initiative arose out of interactions at the Prime Ministerial level, that the report of the joint study group was submitted to the Prime Ministers; and that subsequent monitoring, at least in India, was at the level of the Prime Minister's office. India⁵ believes that India's "Look East" policy and its economic liberalisation efforts coincided with Singapore's regionalisation strategy of investing in emerging economies, providing a common ground for co-operation. India sets great store by the bilateral agreements on General Economic Co-operation and Co-operation (GECC) in shipping, tourism, civil aviation, information technology, science, and technology that have been signed between India and Singapore.

On the international front, Singapore has played a leading role in ensuring India's inclusion in ASEAN, first as Sectoral Dialogue Partner (Singapore, 1992) and then as Full Dialogue Partner (Bangkok, December 1995), which in turn ensured India's membership in the ARF. Singapore has also supported India's participation in the APEC Working Groups and India's candidatures in other multilateral fora, including UN organisations. Singapore has also been jointly engaged in naval exercises with India, and has facilitated India's participation in the East Asian summit next year. These are currently important considerations for India.

It may be important to recognize that the agreement therefore has political and symbolic significance for India and it is also unlikely that an agreement with deep commitments or broad coverage would be of particular interest to them.

⁵ Indian High Commission: Political Relations between India and Singapore. For more information, see www.embassyofindia.com.

For Singapore, past experiences in China had illustrated that success of ethnicity-based businesses cannot be taken for granted. There was a need to diversify market opportunities outside the ASEAN and China markets, and suddenly the entire world was waking up to the opportunities in India. Notwithstanding past disappointments, it was evident that several businesspersons from Singapore were able to make money in India. India's financial markets were transparent enough to attract international funds. Most importantly, from a political standpoint, there was recognition of the increasing warmth of the Sino-India relationship, and of the need and importance of reaching out to each other in trade relations.

As a result, both sides approached the negotiations with slightly different agendas. Singapore needed market access at preferential tariffs and facility for quick investments and rewards in the financial markets. It was clear even early in the negotiations (and this position remains), that benefits to Singapore from this agreement would be immediate and tangible, whereas they would be somewhat fuzziier for India. It was as a counterbalance that India sought the creation of an India fund – which did not eventually find favor in Singapore and had to be dropped.

The differences in the agenda surfaced during the negotiations. The Indian side, led by the Ministry of Commerce, was looking at trade related issues, and not at the political and strategic issues that were at the back of the considerations of the Prime Minister's office and of the foreign office (in the earlier Indian government, until May 2004, these two were synonymous). The change in government led to the initial distancing of the new Prime Minister's office from the deliberations, resulting in an impasse for some months. After a few months, there was a review at the Prime Minister's level and the parameters of the negotiations were again clarified, and there has been significant progress since then.

NEGOTIATIONS – ISSUES AND OPTIONS

The current state of the negotiations, the opportunities and obstacles, has to be examined against this backdrop. There were five important areas where differences threatened the conclusion of the negotiations.

Trade in Goods

The first of these related to the list of goods to be covered under the FTA. The assumption of the Singapore side that all goods would be covered but for a negative list was not acceptable to the Indian side, who wanted to proceed initially with a positive list of goods to be covered, a strategy that should have been expected, given the historicity described earlier. There were also concerns over the Rules of

Origin (ROO) ⁶. Tariff barriers in India were much higher than in Singapore and there was need to address the concerns of local industry on rerouting of imports. Indian imports have had to face this issue repeatedly over the years, with the memories of the rupee rouble trade and the Foreign Exchange Regulation Acts still fresh.

With all trading partners, India has been insisting on change of classification based rules of origin. For Singapore, as it found in its negotiations with the USA, these issues could have excluded a substantial quantity of exports, as forwarding, repackaging and re-routing are an integral part of its trade. During negotiations, it therefore rejected India's proposal for simultaneous application of all the three ROO criteria for these items, saying they are "sensitive" as far as Singapore's economy is concerned.

The three criteria of rules of origin are: fixed level of minimum value addition in the relevant country, change of tariff heading (CTH) at the 4-6 digit level as per the WTO's harmonised system (HS) code (defining the product) and specifications of the kind of value addition. These criteria are inter-related. For example, a CTH could, in practice, require an obligatory degree of value addition.

Singapore made a strong case for product-specific relaxation of the ROO criteria for over 480 items of trade in sectors including chemicals, petrochemicals, food processing, electronics and automobiles. Singapore, agreed to a 40% domestic value addition and a CTH at 4-digit level for the generic ROO criteria for the FTA with India, In addition it proposed a special dispensation for the 480-odd items, indicating willingness to comply with any of the three ROO criteria for these items, instead of complying with all the three criteria.

India, on the other hand, stuck to the three criteria formula, which the country has generally maintained for all free trade pacts and CECA being negotiated. India considered it crucial to have full compliance with ROO criteria because of Singapore's large exposure to transit trade.

Singapore would have been more comfortable with a percentage based estimation of value addition. This⁷ was not an issue that the Indian side would have conceded – and when the Singapore side gave a list of over 400 items for exemption from ROO norms, there was frustration on the Indian side. It required a review at the ministerial level to get the process going again.

It is important to understand at this point, that Singapore needs to be pragmatic about these. The policy of incrementality that India follows will enable the list to be added to in future; at present, the

⁶ Bhattacharya, B & DE, Prithwis K, AFTA and India's relative tariff disadvantage, Foreign Trade Review, Vol.35, No.4., Jan-Mar.2001, New Delhi

⁷ Singapore Ceca hits a roadblock, www.bilaterals.org, 11 November, 2004.

MOCI has to balance indigenous industry interest with the FTA. It is understood that some consensus has been reached, and it should not be allowed to slip away.

Investment

The second major issue relates to investments. Given that FDI policy in India provides for different ceiling in different sectors, there has been no serious attempt on either side to carve out a preferential regime for Singapore. The focus has been more on the double taxation type of arrangements, and in particular replication of the investment arrangements that India has with Mauritius. This agreement was a matter of some public criticism and controversy for several years before it was settled by the Supreme Court of India last year. Investments out of Mauritius are covered by a double taxation avoidance treaty, and in addition, there is a facility for exemption from capital gains tax for investments out of Mauritius. Since income tax in Mauritius is nil, this means that profits of all investments from Mauritius into India become tax free in both the countries. There has been apprehension that this facility has been misused by funds and individuals alike, and, under Indian pressure, Mauritius agreed to amend its laws providing access to information to origin of funds to the Indian authorities, to check such misuse. In the FTA with India, Singapore wants Mauritius type tax exemption facility, but cannot reciprocate, due to national laws, on issues of revealing source information about funds, except to the extent that it is bound by international obligations.

The grant of Mauritius-type facility for Singapore investments is no longer a major issue, given the double taxation avoidance agreement and that capital gains tax on long-term gains has been since reduced substantially in India (zero for long-term gains and 10% for short-term gains). It is the clause on information sharing that both sides are not able to swallow. It is important to recognize that Singapore cannot change its national laws in this regard, given the size and scope of its financial sector, and this is a matter that India should move to early closing, on terms suggested by Singapore.

Banking

The next issue relates to access to banking facilities in India. Branches of Indian public sector banks have a presence in Singapore, and Singapore banks want approvals for opening branches in India. The policy of the Reserve Bank of India (RBI) is restrictive and only a certain number of branches of foreign banks are licensed to be opened every year. Therefore, RBI finds it difficult, under its regulations to relax this for Singapore alone.

One way out of this impasse would be for Singapore to indicate the number of branches it would like in India over a period of time (say five years) and the finance ministry to agree, on behalf of the RBI,

to a phasing of these openings. Within five years, it is expected that the banking sector reforms in India would be quite advanced, and the issue could be revisited thereafter.

Information Sharing

Yet another outstanding matter appears to be the sharing of trade information. Singapore has been sensitive about sharing trade related information on origin and destination of goods to-and-fro India, the number of Indian companies doing business here, etc. It is important to recognise that India has a huge tax avoidance problem; and cross-border movement of funds that are not legitimised by RBI procedures. There is also the problem of undervaluation and overvaluation of goods that affects customs revenues. There must be some indication on willingness to cooperate, on a case by case basis, by Singapore. It has been the experience that such cases get referred to only sporadically and rarely exceed a dozen in number. It is important that the Singapore side provides some comfort on this.

Services

Finally there is the issue of services. There was an initial attempt to list categories and numbers of services that has been given up. For some reason, India is not bringing to the fore its demand for opening up and reciprocity of services, but the fact that little has been offered from the Singapore side will continue to be an irritant. For the moment, both sides have agreed to look at this later, but it is important that these commitments are adhered to, sooner rather than later.

CONCLUSION

It is evident that Singapore needs this agreement, not only for market access and for creating trade and investment avenues for growth, but also as a necessary corollary to the developments in the region, including the Chinese strategies. On the Indian side, the agreement would fit in with her political priorities at two levels: her interest in terms of the broader international context, and with her need to build alliances with other developing countries post Cancun.

Political considerations do not last for ever, and other strategies and interests may take over after some time. It is important for both sides to recognize that incremental convergence is perhaps the most appropriate solution, and for both sides to conclude these outstanding issues early with a clear commitment to revisit the other areas in a specified period of time.

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