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CECA Implementation: A First Look

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Introduction

The Comprehensive Economic Cooperation Agreement (CECA) was signed between India and Singapore on 29 June 2005 to promote trade and investments between the two countries. For the first time, India has signed an all-encompassing economic pact with any country so as to benefit from gains through trade and investment flows in areas of mutual interest. This is also the first time that India has notified a Free Trade Agreement (FTA) under Article XXIV of the General Agreement on Tariffs and Trade (GATT). While, the Agreements relating to goods and services are in accordance with the provisions under the World Trade Organization (WTO), the Agreement on financial services goes beyond the WTO commitments for both India and Singapore.

The idea for a comprehensive economic agreement between India and Singapore developed from discussions between the then Prime Minister of India Atal Behari Vajpayee and the then Prime Minister of Singapore Goh Chok Tong in August 2002. A joint study group was set up to draft the working of the CECA and it submitted a report in April 2003 that recommended an integrated package of agreements between India and Singapore including free trade in goods and services and investments.

The CECA is a classic example of proving that the disparity in size does not matter when it comes to economic cooperation. Despite the asymmetry between two partners, since Singapore is a city-state and India, a sub-continental country, the CECA holds promises for both the countries. On the one hand, Singapore is expected to serve as a gateway for India to access the vibrant markets of East and Southeast Asia. On the other hand, India is likely to provide Singapore with its expertise and skill in high-technology areas like IT, electronics and pharmaceuticals, besides being a large market. Even though there is a requirement for value addition according to the rules-of-origin provisions, the strategic advantage to India from being a part of the East Asia architecture will outweigh the trade-related handicaps, if any.

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Key Provisions

Singapore is a highly trade-dependent economy with a strategic location within the Association of South East Asian Nations (ASEAN) offering a combined market of over 500 million people. Its trade to gross domestic product (GDP) ratio at over 300 percent is the highest in the world. Free trade is a key tenet of the foreign economic policy of Singapore. Since Singapore is a free port and offers entry for all Indian products at zero duty, it will help to build supply chains by taking advantage of Singapore as a trading and entrepot hub for regions in East and South-east Asia. The agreement has built in safeguards providing rules of origin that require a minimum value addition of 40 percent to ensure that only the goods, which are actually manufactured in Singapore and India, benefit under the CECA. On the part of India, custom duties on 506 products, accounting for 80 percent of total imports from Singapore, were scrapped from 1 August 2005. These include duties on electronics, electrical instrumentation, pharmaceuticals and publishing products. In addition to this, duties would be eliminated in phases by 10, 25, 50, 75 and 100 per cent on 2,202 tariff lines by 1 April 1, 2009 and on another 2,407 lines also by 1 August 2009. A negative list comprising 6,551 tariff lines has been retained mostly for agricultural and textile items with no duty concessions. Singapore will also grant duty free access to Indian beer. The product until now attracted US$ 0.8 per litre.

Further, the CECA incorporates a double taxation agreement in order to avoid double taxation of income in India and Singapore. India has amended the Double Taxation Avoidance (DTA) Agreement of 1994 to provide for sharing of information and improved tax treatment on the lines of a similar treaty with Mauritius wherein Singaporean firms can invest in India without paying capital gains tax on profits earned there. Accordingly, capital gains earned by a Singapore resident from the sale of shares in India will be liable to tax only in Singapore and since Singapore does not impose capital gains tax, residents of Singapore will face no such taxes for investments in India.

As a part of the Agreement on financial services, India has granted three major Singapore banks – Development Bank of Singapore (DBS), Overseas Chinese Banking Corporation (OCBC) and United Overseas Bank (UOB) – the right to establish wholly-owned subsidiaries in India. These banks will be accorded “national treatment” equivalent to Indian banks by giving them the operational and functional autonomy of setting up new branches subject to adherence of prudential norms as mandated by the Reserve Bank of India (RBI).

Reciprocally, Indian banks, such as the State Bank of India (SBI) that is a public sector bank and the Industrial Credit and Investment Corporation of India (ICICI) that is the country’s largest private sector bank, will qualify for national treatment in Singapore. This would allow them facilities for retail banking like electronic fund transfer and setting up of automated teller machines (ATMs) and clearances rather than just corporate banking. Both the banks have submitted an application to the Monetary Authority of Singapore (MAS), Singapore’s central bank, to seek licences that would allow them to offer services from 25 premises, including branches and ATMs.

Interestingly, at the recently held 6th India-European Union Summit, Chief Executive of Standard Chartered Bank group Mervyn Davies made a plea for an agreement on the lines of the CECA between India and the European Union after witnessing the success of banking operations of Singaporean banks in India.

Some Early Effects

Trade

A study of destinations for India's exports shows that developing economies are fast emerging as important destinations in an environment of rising South-South trade. According to the *RBI Bulletin* (November 2005), Latin America has emerged as the fastest growing region for India's exports during April-August 2005, followed by Africa, East Asia and the European Union. Countries like Singapore, China, Korea, Hong Kong, Netherlands, France and the United Kingdom have become the major markets for India's exports.

Table 1: Destination of India's Exports (April-August) (US $ million)

Group/Country	(1) 2003-04	(2) 2004-05	(3) 2005-06 P	Percentage variation (2)/(1)	Percentage variation (3)/(2)
E.U.	5014.2	6215.8	7890.6	24.0	26.9
Canada	282.5	321.4	363.5	13.8	13.1
U.S.A.	4224.3	5254.2	6003.4	24.4	14.3
Australia	215.5	255.4	306.4	18.5	20.0
Japan	656.3	703.6	881.9	7.2	25.4
Latin America	517.1	680.0	1236.4	31.5	81.8
OPEC	3007.4	4580.8	5077.0	52.3	10.8
Russia	274.8	235.5	257.9	-14.3	9.5
Bangladesh	651.3	572.2	587.7	-12.1	2.7
Maldives	10.9	15.8	26.0	45.6	64.3
Nepal	235.2	331.3	251.7	40.9	-24.0
Pakistan	58.8	210.2	240.5	257.2	14.5
Sri Lanka	517.6	483.6	795.8	-6.6	64.6
China	753.9	1264.2	2017.2	67.7	59.6
Hong Kong	1146.2	1375.3	1805.9	20.0	31.3
Malaysia	312.4	440.1	374.4	40.9	-14.9
Singapore	546.8	1380.0	2313.0	152.4	67.6
South Korea	227.9	368.2	569.2	61.5	54.6
Thailand	266.1	292.5	380.0	9.9	29.9
Africa	1109.6	1425.1	2118.9	28.4	48.7

Source: *Reserve Bank of India Bulletin*, November 2005.
Note: P- Provisional

Table 1 clearly shows the tilt in Indian exports towards Singapore, having more than doubled from 2003-04 to 2004-05. The CECA negotiations during this period could have generated awareness about the potential of Singapore as a trading partner. In 2005-06, Singapore has become the fourth largest market for India's exports, after the European Union, the United States and OPEC. In fact, in the category of manufactured goods, engineering goods, led by transport equipments, metals and manufactures, machinery and parts and chemicals, were the key drivers of export growth during April-May 2005. Exports of transport equipments, accounting for about one-fourth of the expansion in manufacturing exports, was propelled by demand from France and Italy in Europe and Singapore, Korea and Thailand in East Asia.

Figure 1: India's Trade with Singapore (US $ million)

Figure 1, taken from the *RBI Bulletin* (September 2005), depicts the surge in India's exports to Singapore, which have accelerated from about US$1 billion during the mid-1990s to US$3.8 billion in 2004-05. During April-May 2005-06, India's exports to Singapore posted a growth of 88 percent on year-on-year basis, the highest growth among India's major trading partners. The prime movers for the recent surge in exports have been petroleum products, engineering goods, gems and jewellery and chemical products, accounting for 44.7, 19.7, 14.8 and 6.5 percent of India's total exports to Singapore in 2004-05, respectively.

Table 2: Sources of India's Imports (April-August) (US $ million)

Group/ Country	(1) 2003-04	(2) 2004-05	(3) 2005-06 P	Percentage variation (2)/(1)	Percentage variation (3)/(2)
E.U.	5422.7	6394.9	8448.3	17.9	32.1
Canada	225.8	204.7	292.3	-9.4	42.8
U.S.A.	1817.5	2184.0	2760.1	20.2	26.4
Australia	749.6	1281.8	1965.6	71.0	53.3
Japan	911.8	1068.9	1249.3	17.2	16.9
Latin America	549.0	628.7	825.3	14.5	31.3
OPEC	1766.0	3209.9	4883.0	81.8	52.1
Russia	340.8	456.8	761.2	34.1	66.6
Bangladesh	29.6	16.0	29.4	-46.0	84.4
Maldives	0.1	0.2	0.6	-	-
Nepal	85.9	136.4	141.6	58.8	3.8
Pakistan	27.4	29.9	58.0	9.2	93.8
Sri Lanka	51.4	94.0	191.4	83.0	103.6
China	1408.5	2405.4	3476.5	70.8	44.5
Hong Kong	549.4	593.7	837.5	8.1	41.1
Malaysia	743.1	795.9	881.2	7.1	10.7
Singapore	634.7	896.3	1100.0	41.2	22.7

South Korea	918.8	1147.7	1471.5	24.9	28.2
Thailand	226.9	280.2	434.9	23.5	55.2
Africa	1454.2	1278.0	1768.9	-12.1	38.4

Source: *Reserve Bank of India Bulletin*, November 2005.
Note: P- Provisional

The gains in trade are two-way since India has also become an important trading partner for Singapore. In 2004, India was the twelfth largest destination for Singapore's exports and fourteenth largest source of Singapore's imports. Table 2 shows the steady increase in Singaporean exports to India (or Indian imports from Singapore) after the decision to cut down duties on imports by India. However, a glance at Table 3 shows that India is still behind other countries regarding the non-oil domestic exports (NODX) from Singapore. In 2005, Singapore's foreign trade (including exports and imports) increased by 14 percent amounting to $ 716 billion and it was Indonesia that improved its ranking by elbowing out Japan from the list of top five trading partners. Similarly, China displaced Malaysia to become the third largest NODX market. In fact, China and Hong Kong taken together represent a larger market than the United States, accounting for 16.5 percent of the total NODX against 14.4 percent of the US. It could reflect the fact that many American firms are basing their manufacturing facilities in China and thus the increased demand for Singaporean imports. The surge in NODX was mainly on account of a jump in shipments of non-electronic items like pharmaceuticals to the European Union and the United States and petrochemicals to China, Malaysia, Thailand and Hong Kong. According to International Enterprise (IE) Singapore, Singapore's total trade is expected to grow between 8-10 percent in 2006 fuelled by the robust demand for semi-conductors and the high growth in South-east Asia, China and India. Table 3 shows, regions such as South Asia, Middle East, South America, Eastern Europe, Africa and Central Asia, shared only 14.5 percent of the market for NODX from Singapore. Thus, undoubtedly, there is a great scope for improving this figure for South Asia, in general and India, in particular.

Table 3: Singapore's top trading partners for NODX

Market	Value in 2005 (S $ billion)	Share in 2005	Share in 2004	Ranking in 2005
World	**154.7**	**100.0**	**100.0**	-
EU	29.1	18.8	19.2	1
US	22.2	14.4	15.8	2
China	15.0	9.7	8.2	3 (4)
Malaysia	13.5	8.7	8.6	4 (3)
Indonesia	11.9	7.7	7.1	5 (7)
Hong Kong	10.5	6.8	7.3	6
Japan	10.4	6.7	7.4	7 (5)
Taiwan	7.6	4.9	4.5	8
Thailand	6.9	4.4	3.9	9
South Korea	5.2	3.3	3.3	10
Others∗	22.4	14.5	14.6	-
Top 10	**132.3**	**85.5**	**85.4**	-

Source: International Enterprise, Singapore (2006).
Notes: ∗Include South and Central Asia, Middle East, South America, Eastern Europe and Africa. The numbers in brackets refer to NODX ranking in 2004.

Investment

As regards foreign direct investment (FDI), Table 3 shows that India is fast emerging as a favoured destination for Singapore investors. In just the first eight months of 2005, FDI from Singapore trebled compared to that for the whole of 2004. It is possible that the promise and eventual realization of the CECA may have stimulated investments from Singapore to India.

Table 4: Country-wise Break-up of India's FDI Inflows (US $ million)

Country	2001 (Jan-Dec)	2002 (Jan-Dec)	2003 (Jan-Dec)	2004 (Jan-Dec)	2005 (Jan-Aug)
Mauritius	28925.30	18466.06	25859.33	46162.14	45847.52
U.S.A.	49215.30	20511.22	19040	29791.68	16707.82
Japan	7352.74	7408.49	4343.86	537.44	4439.71
Netherlands	36935.71	5523.57	11618.83	2279.26	3445.92
U.K.	49942.45	18043.58	8628.97	6585.36	8239.36
Germany	4138.91	2531.45	3624.98	7274.88	2059.89
France	6798.08	6228.72	1642.51	5289.3	1042.62
South Korea	667.57	290.29	1128.62	1227.14	564.62
Singapore	3798.70	3721.62	1680.46	2855.01	7264.23
Malaysia	1057.96	3723.36	2202.06	375.26	91.64
Hong Kong	429.16	169.79	124.15	1105.43	602.11

Source: Government of India, Ministry of Commerce, Secretariat of Industrial Assistance, *SIA Newsletter*, various issues.

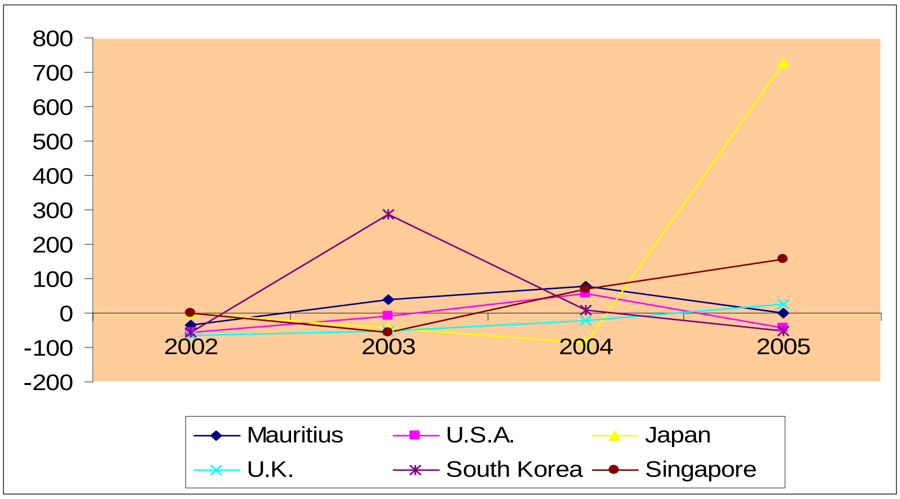
A look at Figure 3 shows how the growth rates in FDI behaved for major investors in India. Of the six major investor-countries, only Japan, Singapore and U.K. show rising trends, while the United States, Mauritius and South Korea show a declining trend. Particularly, in the area of infrastructure, Singaporean companies have made significant investments in the Software Technology Park in Bangalore, Tuticorin port in Tamil Nadu and telecommunications. In fact, recently the Government of Singapore Investment Corp Real Estate (GIC RE), the Republic’s real estate investment arm that manages a tenth of GIC’s more than US$100 billion of foreign reserves, announced that it would expand into India and Brazil to hedge against the risk of falling property prices in the US. According to property consultancy Knight Frank, the net yield on office property in India is around 11 percent, which is among the highest in Asia. In fact, India is looking towards Singapore and Japan to develop its Special Economic Zones (SEZ) by setting up factories and industrial parks.

During the last four decades, Singapore has transformed itself from a small trading entrepot to a global business hub with a strong manufacturing base in electronics, chemical and biomedical products together with a well-developed services sector. Thus, it can provide funds for research and development in these areas where funds are lacking in India despite the presence of skilled manpower. In this era of science and technology, both the countries will be able to embark on a higher growth path by entering into joint ventures and R&D alliances to compete in world markets.

Recently, the Asia President of Flextronics, a Nasdaq-listed provider of electronics manufacturing services (EMS), outlined the company’s expansion plans for India owing to its booming technology and telecom industries coupled with a low cost structure. The company has based its plans on a study carried out by iSuppli, an electronics research firm, which shows that the EMS market in India is expected to grow at 21 percent annually from US$774 million in 2004 to US$2 billion in 2009. Similarly, Tata Consultancy Services (TCS), Asia's biggest information technology (IT) services provider, is planning to set up a development centre in Singapore to provide financial solutions and products.

Thus, India wants to exploit the potential of Singapore as a regional financial hub as well as an investment hub for FDI into India. Japan is one country that has great potential in terms of investments into India via Singapore under the CECA. Even the possible next prime minister of Japan, Shinzo Abe, has declared that Japan should boost ties with India. In pursuance of this goal, Singapore has recently announced that it will send a delegation to Japan in early 2006 to tap their companies for leveraging the CECA. Singapore wants to draw out Japanese companies to set up production facilities on its shores for exports to India.

Figure 2: Annual Growth Rate of FDI for Major Investors in India (%)



Source: Author's own calculations based on Table 3.

Tourism

Both India and Singapore have pledged to improve air connectivity between the two countries to support the expansion of tourism, trade and investments. There is a provision in the CECA to review and enhance air service linkages through the bilateral Air Services Agreement. By all accounts, tourism seems to be on a high-growth trajectory. According to the Singapore Tourism Board (STB), in 2005, tourists from India traveling to Singapore outnumbered those from Malaysia, placing India at fifth place after Indonesia, China, Australia and Japan among tourism markets. Tourism is a highly labour-intensive industry and citizens of both the countries can gain from it.

Education

As regards the cooperation on education, there have been several achievements. Numerous memorandum of understanding (MoUs) have been signed by Singaporean educational institutes and the Indian Institutes of Technology (IITs). IIT Mumbai and NUS recently signed a joint graduate engineering program. This is a first significant alliance by any IIT with a foreign university and is expected to yield 40 M.Sc. and eight PhD graduates annually. On a recent visit to India, Senior Minister Goh Chok Tong invited the Indian Institute of

Management (IIM) at Ahmedabad to expand its student-exchange programme with NUS and also offer short-duration management programmes in Singapore for students at Insead and Singapore Management University. Further, Singapore has agreed to recognize 129 professional degrees offered by the University Grants Commission in India but there has been little progress on this front. Recently, during the visit of the President of India to Singapore, it was agreed that a NUS College would be set up in collaboration with the Indian Institute of Science (IISc) in Bangalore.

Issues and Concerns

<u>Rules of Origin</u>

India's main concern seems to be the rules of origin that determines the percentage of value addition (40 percent in this case) entitled to discounted tariffs for exports from the original country, Singapore, to the importing country, India. As per CECA requirements, India will eliminate import duties on about 2,400 products on a fast-track basis, which include a whole range of farm-related products, engineering imports, scrap, chemicals, insecticides, fungicides, pharmaceuticals and the like. On the other side, although tariffs have been reduced, Singapore exporters feel that the imposition of Additional Duties (AD) and Special Additional Duties (SAD) on imports of components and parts into India belies the notion of a level playing field for exporters vis-à-vis the domestic players.

The fear is that about 4,000 multinational corporations (MNCs) that operate out of Singapore could use the CECA as a conduit to swamp the Indian market with their products at lower tariffs. India also wants more banking licenses. Recently, the RBI barred Temasek Holdings from further increasing its stake in ICICI Bank by claiming that Temasek and other Singaporean investors like GIC and MAS were "related entities" and their combined holding was above the stipulated 10 percent. This happened despite the fact that the CECA specifies that Temasek and GIC have independent operations and do not act in concert.

<u>Stricter DTA</u>

Further, observers say that the CECA-inspired investments from Singapore to India have remained below the optimum potential. One reason for this is the tax situation in Singapore. While the big Singapore investors continue to be interested in India after the CECA, only a handful of Singapore small manufacturing enterprises (SMEs) wish to set up shop in India. According to Leena Pinsler of Rajah & Tann, there were many foreign investors from the United States and Japan who earlier wanted to use Singapore as the springboard for their investments in preference to Mauritius but are no longer interested after getting professional advice that the tax situation in Mauritius is better than Singapore. Two foreign funds wanting to invest US$1.5 billion in India specifically wanted to locate in Singapore but chose Mauritius instead. Another Singapore fund that wants to raise about US$250 million to invest in India also made the decision to locate in Mauritius. This is because gains for funds are treated as business profits and not capital gains and are thus subject to 20 percent tax. Further, although India's DTA with Singapore is modelled on the lines of the existing treaty with Mauritius, the latter has free unchallenged residency rules. In order to restrict the tax benefit only to *bona fide* Singapore businesses, the CECA requires a minimum threshold and proof of actual operations to be eligible for beneficial treatment. Thus, a tax resident will not be entitled to the capital gains exemption if its operations are motivated primarily to take advantage of the benefits of the DTA.

Further, a conduit company with negligible business activities in Singapore is disallowed from enjoying the exemption from capital gains tax. Indian companies may not be able to engage in round-tripping of investments through Mauritius and other tax havens such as Bermuda and the British Virgin Islands since safeguards have been built into the Singapore treaty.

Furthermore, it is learnt that foreign investors prefer to locate their manufacturing operations, for goods destined for the Indian market, in Thailand both because of the cheaper cost of operation as well as the looser rules-of-origin in the Indo-Thai treaty which will nevertheless benefit from the Indian tariff reductions.

Educational Tie-Ups

The CECA provides for the setting up of a Joint Committee on Education, comprising representatives from the government and private sectors, to focus on education. As part of the agreement, a ministerial meeting for a review of the CECA within a year of the date of entry into force has to take place and this is an opportune time to take another look at some of the provisions for greater trade and investment.

Summary

To sum up, it has to be recognised that India needs FDI, particularly for the development of the poor states like Bihar, Uttar Pradesh, Rajasthan and Orissa. It was indeed a momentous event when Orissa, one of the poorest states of India, bagged the country's largest FDI from South Korea's Pohang Steel Company to invest $12 billion for exploiting its rich iron-ore resources. The project will get the status of a SEZ and give a boost to the economy of this neglected region with the establishment of a steel plant, a port a power plant and a township. The project is expected to generate direct and indirect employment in the state as well as the tax revenues for both the Centre and state. Thus, initiatives such as the CECA to attract FDI are a step in the right direction and must be followed up with greater political will.

From the point of view of Singapore, the CECA provides an avenue for gainful employment of funds and the availability of skilled manpower at competitive costs. Singapore should look at India as a new area to tap for investments since it has large market with great potential. It is important to bear in mind that even though "FTAs do not make good politics", they are the way ahead for greater development and prosperity. This is becoming increasingly recognised by political leaders in India and Singapore.

Recently, India's Prime Minister Manmohan Singh and Singapore's Senior Minister Goh Chok Tong have agreed for a meeting to review the CECA implementation. They also discussed other areas of bilateral cooperation like civil aviation and township planning. Thus, Singapore has a catalytic role in promoting faster reforms in India and at the same time wants to benefit from the high growth in India. In the final analysis, the best course for the CECA is to learn from past mistakes and charter new territories. This thinking is evident from the statement of India's Commerce and Industry Minister that "we hope they (Changi Airport) will participate in future projects", even after the last-minute withdrawal of Changi Airport from the multi-billion dollar project for upgrading New Delhi's airport. In the final analysis, the future looks bright with the recent launch of the India chapter of the Singapore India Partnership Foundation.

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