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FDI in retailing and inflation: The case of India

by
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India's food price inflation is a major driving factor behind the country's overall accelerating inflation over the past few years. Agricultural food prices in particular have risen recently: over the past year vegetables have become costlier by 18%, pulses by 14%, milk by 10%, and eggs, meat and fish by 12%. The rise in fruit prices was, however, relatively smaller (5%), and the same happened for cereals (3%).[1] This price escalation is largely due to an inefficient supply chain in agriculture.[2] Some of the supply side constraints have been identified: poor agricultural productivity, lack of corporate involvement in agriculture, ceilings on landholding size, existence of middlemen, hoarding, and, more importantly, insufficient cold storage facilities and transportation infrastructure. Around 50% of fresh produce in India rots and goes to waste between the farm gate and the market because of inadequate cold storage facilities and a poor distribution network.[3] These factors unfavorably affect agricultural supply, create a supply-demand gap and help raise food prices.

Controlling food price inflation has become an urgent policy objective for India because of the regressive tax that inflation imposes, since food occupies a massive share in the consumption basket of a significant section of the Indian population. Moreover, persistent and spiraling food

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[1] "Wholesale price indices for primary articles and fuel & power in India (Base: 2004-05 = 100) review for the week ended 12th November, 2011 (21 Kartika, 1933 Saka)," Press Information Bureau, Ministry of Commerce, Government of India.

[2] Duvvuri Subbarao, "Factors that drive India food inflation and policy measures to combat it," *CommodityOnline*, November 24, 2011.

[3] BBC.com, "India MPs in uproar over retail reform plan," 25 November 2011, available at: http://www.bbc.co.uk/news/world-asia-india-15885004.

inflation also threatens the macroeconomic stability of the country and the potential for high and sustained economic growth in the future. With the clear objective of curbing inflation, the Indian Cabinet approved 51% foreign direct investment (FDI) in multi-brand retail on November 24, 2011[4] after intense deliberations at different levels that extended over a year. The policy comes with some riders to protect the interests of neighborhood stores, farmers and small and medium-sized enterprises. If effectively implemented, such FDI has the potential to:

- bring in foreign capital, technology and managerial expertise of big international retailers;
- develop an efficient linkage between the back-end supply chain and the front-end via capital investment and technological inputs;
- create a proper farm-to-fork infrastructure through direct purchase from farmers and the resultant control of intermediaries;
- bring about efficient movement of produce through the reduction of transit costs;
- minimize the prevailing wastage of fresh produce[5] through improving and adding upon the existing cold storage facilities, transport infrastructure, warehousing technology, and food processing facilities;
- help raise farm productivity through the application of contract farming;
- increase agricultural production, reduce intermediate costs, render remunerative prices to farmers for their produce and eventually lower final food prices to consumers, thus integrating retailers into the value chain; and
- create employment in small and medium-size industries and back-end infrastructure.[6]

Despite the regulatory provisions to ensure domestic competition and protect the domestic retail industry and farmers, the policy has received stiff opposition. Concerns include the possibility of monopoly power of foreign entrants over both farmers and consumers, predatory pricing strategies of the entrants, manipulation of prices for the entrants' own benefit and a fall in income, employment and the eventual destruction of the unorganized indigenous retail sector dominated by small family-run outlets.[7]

But it is important to remember that other countries like Argentina, Brazil, Chile, China, Indonesia, Malaysia, Russia, Singapore, and Thailand have allowed 100% FDI in multi-brand retail since the 1990s and many of them have had encouraging experiences. China, for one, permitted FDI in retail as early as 1992. It has since attracted huge investments in the retail sector without affecting either small retailers or domestic retail chains. Since 2004, the number of small outlets rose from 1.9 million to over 2.5 million in China. Employment in the retail and wholesale sectors increased from 28 million to 54 million from 1992 to 2001.[8] In Indonesia, even after ten years of opening FDI in multi-brand retail, 90% of the business remains with small traders.[9]

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[4] "India Inc welcomes FDI in multi-brand retail," *Business Today, India Today Group*, November 24, 2011.
[5] "FDI in multi-brand retail trading," KPMG, Audit Committee Institute (2010).
[6] "FDI in multi-brand retail will create 10 million jobs: Anand Sharma," *The Times of India*, November 26, 2011.
[7] "FDI in multi-brand retail: Industry lauds decision," *India Today*, November 25, 2011.
[8] "Foreign direct investment (FDI) in multi-brand retail trading," Department of Industrial Policy and Promotion Discussion Paper, Government of India (2010).
[9] "FDI in multi-brand retail will create 10 million jobs: Anand Sharma," op. cit.

Favorable experiences of other emerging markets suggest that the appropriate implementation of FDI in multi-brand food retailing, with effective checks designed to protect indigenous small and medium-size enterprises, will eventually alleviate the supply-side impediments to agricultural production. It will transform the way perishable agricultural produce is acquired, stored, preserved, and marketed -- and thus help control India's persistent food inflation.

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The Vale Columbia Center on Sustainable International Investment (VCC – www.vcc.columbia.edu), led by Dr. Karl P. Sauvant, is a joint center of Columbia Law School and The Earth Institute at Columbia University. It seeks to be a leader on issues related to foreign direct investment (FDI) in the global economy. VCC focuses on the analysis and teaching of the implications of FDI for public policy and international investment law.

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