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The big picture on FDI in retail PREMIUM

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India's FDI inflows have improved since 2005, perhaps at China's expense. In this context, the expected FDI inflows from retail are not significant. However, retail FDI can lead to FDI flows in other sectors and improve our BoP situation.

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Foreign direct investment (FDI) in the retail sector has been at the epicentre of national debate. Much has been said on India possibly losing out on investment by sending a wrong policy signal. But do we really need to get so worked up?

INDIA AS FDI DESTINATION

Considering the anticipated level of inflows on account of FDI in retail, there may not be much reason to worry. During 2000, India attracted significantly lower FDI ($3.5 billion) than many other South-East Asian

countries, such as South Korea ($10. 5 billion), Thailand ($6 billion) and Malaysia ($5 billion).

However, an interesting pattern has started to emerge since 2005. FDI inflow into India increased by leaps and bounds, from $7.6 billion in 2005, to $35 billion in 2009. FDI flow in the whole of East Asia and the Pacific remained more or less constant during this period — $104 billion in 2005 and $102 billion in 2009.

For China, the figure is $79 billion in 2005, and around $78 billion in 2009. In 2000, India's share among middle-income countries, in terms of attracting FDI, was only 2.4 per cent, compared with China's 26 per cent. In 2009, China's share fell to 22 per cent, whereas India's share increased to 10 per cent *(Global Development Finance: Country and Summary Data 2011)* . India's gain has been at the cost of China losing out in terms of being a favourable FDI destination.

CHINA'S PROBLEMS

India has outdone China due to the high inflation rate in the latter country. Wages of migrant workers, land, property rents and power prices, have all registered an increase in China.

Measured as a year-on-year basis as of November 2010, labour costs went up by 21 per cent, and the home prices across 70 cities in China went up by 7.7 per cent. Property prices have also been on the rise, despite the government having ownership rights over land — indicating a real-estate bubble.

What is evident from data is also being witnessed in reality. Multinationals such as Ford and Hyundai are shifting their manufacturing base from China to India. During the early part of last fiscal, India exported 2,30,000 cars, vans, sports utility vehicles, and trucks — a growth of 18 per cent, whereas Chinese exports have tumbled 60 per cent to 1,65,000 units. Perhaps due to these reasons, Nokia and Lotte, are setting up their manufacturing base in India.

It is no surprise, therefore, that India has attracted, on an average, an annual FDI inflow of $20.4 billion per annum between 2006 and 2009.

The estimated inflow from FDI in retail, of $3 billion over the next five years, seems modest in comparison. To get a sense of proportion, the Reserve Bank of India generally uses this sum of money daily in the foreign exchange market.

Even so, there are reasons to be concerned if FDI in retail were to be stalled in the long run. So, what are the problem areas?

SUPPLY LOGISTICS

FDI in retail will bring down inflation by investing in supply chain logistics, that is, by investing in transport and refrigerated storage necessary for perishable items. Typically, if a farmer were to sell his produce, he needs to bring it to the local market where he usually auctions it to the retailer, who, in turn, will sell to the final consumers.

This process of auctioning in the *mandi* (central market) is facilitated by the middleman, who charges a commission from the farmers. Add to this the cost of bringing the agricultural produce to the local market; the price difference between what the farmers get and what the consumers pay is what society loses out due to inefficiency.

By investing in supply chain logistics, the players in multi-brand retail will reduce the cost, and bring down inflation. They will procure the produce directly from the farmers, keep it in their storage, and transport it directly to their retail outlet. It is worthy to note that there is a huge investment involved to get the supply chain logistics in place — something that FDI in retail promises.

Those who have been arguing that the local *kirana* and the marginal farmers may be hurt — the former losing out on business, and the latter not getting the right price – are not right. Currently, the local *kirana* , and retail outlets such as Reliance Fresh, Tata-Tesco, and Spencer, to name a few, are co-existing comfortably with each other.

Marginal farmers also stand to gain. Recent evidence suggests that marginal farmers who have entered into contracts with Pepsi India have on average realised double the price in comparison with the local *mandi* and the local *mahajan* (in absence of the local *mandi*). This is an eye-opener for those suggesting that multinationals will squeeze the farmers by not offering them the right price.

Experience from around the globe suggests that the local *kirana* needs to worry from the spread of e-commerce, and not the presence of corporates in the retail sector. India badly needs corporatisation of the agriculture sector to even out distribution of income. The ITC and Pepsi examples have shown that, in their best interest, corporates directly get in touch with the farmers, and give them the necessary information on how to increase crop output and productivity.

It is to be noted that the agriculture sector receives minuscule investment, while supporting the livelihoods of around 55 per cent of the population.

RIGHT POLICY SIGNAL

The UPA government also stands to gain substantially by sending the right policy signal. Moreover, FDI in retail can bring in forms of FDI, at a time when our trade figures aren't doing really well. The trade deficit for April-October, 2011-12, was estimated at $94 billion, which was higher than the deficit of around $85 billion during April-October, 2010-11.

India's credit-worthiness can improve, with more FDI inflow resulting from reforms. International rating agencies usually look at total foreign exchange reserves and the FDI inflow as a criteria for rating any country.

Tailpiece: Mamata Banerjee is smart, and is playing her cards right. She has already got Rs 8,750 crore, out of her demand for Rs 19,000 crore as part of the Bengal package.

Who knows, she might actually give in if the UPA government meets her demand.

(The author is Associate Professor, IFMR. The views are personal.)