India's Supermarket Move Shows its Tired Government has Run Out of Ideas

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India's ruling coalition has been rocked after its second-largest partner withdrew this week. The latest round of political instability comes about because Prime Minister Manmohan Singh announced a number of economic measures without consulting his allies. The announcements – that diesel prices were to be raised, and that India's retail and domestic aviation sectors were to be opened up to overseas companies such as Tesco – were the government's attempt to woo back foreign investors who had become cynical about India's growth prospects.

The opposition parties protested against these measures with a nationwide strike today. More damaging for the government is the decision of the Trinamool Congress, headed by the chief minister of West Bengal, Mamata Banerjee to pull out of the government, with its ministers to resign on Friday.

The popular anger against the rise in diesel prices is easy to understand – Indian prices of this essential fuel are already among the highest in the world. This increase will affect all other prices, raising farmers' costs and causing already high food prices to soar. If the government is really concerned with controlling inflation, this is a foolish and unjust measure, bound to cause further inflation without delivering much in public savings.

What makes opening up the retail sector to western supermarkets so controversial? Most other sectors are already open to foreign investors to varying degrees, but the proposals to allow foreign investment in this area have evoked strong responses on both sides and generated massive public debate. The government argues that this move will benefit consumers by bringing down food and other prices as well as help farmers and other small suppliers. (An unstated motive is that it will bring in more capital from large corporations eyeing the potentially huge Indian market.) But these arguments can all be challenged.

The international evidence suggests that the greater market power of large supermarket chains actually leads to higher marketing margins and exploitation of small producers. This is true even in rich countries: a European parliament declaration in 2008 stated that "evidence from across the EU suggests large supermarkets are abusing their buying power to force down prices paid to suppliers to unsustainable levels and impose unfair conditions upon them". In the United States, marketing margins for major food items has increased rapidly in the last two decades, and the shares received by farmers fell for most crops and dairy products.

Nor will food inflation be brought down by this measure – certainly not immediately, or even in the medium term. Distribution margins in India are quite low precisely because the various levels are so highly competitive – and if they are to be improved, that is best done through public investment in cold storage and efficient transport, as well as by encouraging co-operatives.

The employment impact is likely to be very negative. The retail trade in India employs about 40 million – mostly very small-scale traders who are largely self-employed, who would not be able to compete with large organised corporations. It has been estimated that one Walmart can displace up to 1,400 small stores, costing around 5,000 jobs. Since Indian growth has been mostly jobless already, this is obviously a huge concern.

So the hue and cry about opening up retail trade in India is hardly surprising. What is more surprising is the government's insistence on pushing through this relatively minor "reform" barely a month after it had promised parliament it would do so only by consensus. The entire episode speaks of a tired regime that has run out of ideas.

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