Research Briefs

IN ECONOMIC POLICY

CATO INSTITUTE

July 2015 | Number 30

Retail Globalization and Household Welfare

Evidence from Mexico

By David Atkin, MIT and National Bureau of Economic Research; Benjamin Faber, University of California–Berkeley and National Bureau of Economic Research; and Marco Gonzalez-Navarro, University of Toronto

A radical transformation is occurring in the way households in developing countries source their consumption. A key driver of this so-called "supermarket revolution" has been the arrival of global retail chains, and this globalization has led to heated policy debates. Those against foreign retailers point to the large share of employment in the traditional retail sector, suggesting that global retail chains will drive down wages and employment in the domestic retail sector. Those in favor of foreign retailers emphasize the potential benefits to households from lower consumer prices.

Importantly, these debates have also led to stark differences in policies toward retail Foreign Direct Investment (FDI) across developing countries. Argentina, Brazil, Mexico, and most of Eastern Europe, for example, chose to liberalize retail FDI fully at the beginning of the 1990s; but India continues to restrict foreign retail entry, and Indonesia, Malaysia, and Thailand reimposed regulatory barriers on foreign retailers after initially allowing entry. These policy differences matter because retail is a key sector of the economy, on average accounting for 15–20 percent of employment, 10–15 percent of GDP, and more than 50 percent of household expenditure in developing countries.

Despite the rapid globalization of retail in the developing world and widespread policy interest, the existing literature has paid relatively little attention to this facet of international integration. Our research seeks to fill that gap by bringing together a new and rich collection of microdata to assess the consequences of retail FDI in Mexico.

Prior to the 1980s, retail FDI into Mexico had to be approved on a case-by-case basis, and it generally required at least 51 percent Mexican ownership. These restrictions were gradually relaxed in the 1980s, with foreign companies able to own up to 49 percent of a Mexican firm without explicit authorization. A 1993 FDI law allowed foreign firms full ownership rights and full freedom to repatriate profits; FDI was further protected under NAFTA's third-party dispute resolution mechanisms starting in 1994.

The first significant retail FDI into Mexico was Safeway's purchase of 49 percent of Casa Ley, a regional retailer in Northern Mexico. More transformative was Walmart's decision to enter the Mexican market in the early 1990s, as NAFTA was being negotiated. Walmart entered initially in a joint venture with the Mexican retailer Cifra, a chain from Mexico City with around 100 supermarket units at the

Editor, Jeffrey Miron, Harvard University and Cato Institute

time. In 1997, Walmart bought out Cifra and in 2000 changed the company name to Walmart de México (WALMEX). Unlike in the United States, WALMEX focused heavily on food retail and targeted relatively affluent Mexican consumers. In the ensuing years, WALMEX and its supermarket brands became the largest retail chain in Mexico and the largest employer, with over 210,000 workers in January 2014.

The expansion of Walmart and other foreign supermarket chains proceeded relatively slowly during the second half of the 1990s, predominantly serving the main metropolitan centers. The number of foreign supermarkets in Mexico expanded from 204 stores at the end of 1995 to 365 stores at the end of 2001. In both periods, foreign stores were strongly concentrated in the major cities. Between 2002 and 2014, the number of foreign supermarkets increased from 365 to 1,335. This period saw a large geographical expansion beyond large metropolitan cities into more remote corners of the country, and in particular, to smaller cities. In 2002, foreign stores were present in 96 municipalities; by 2014, they reached 461, covering the majority of urban areas in Mexico.

With this background, we address three central questions about the expansion of retail FDI in Mexico: What is the effect of retail FDI on average household welfare in the municipality of entry? What are the channels underlying this effect? And to what extent do the gains from retail FDI differ across the income distribution?

We combine data on all foreign-owned supermarket locations and opening dates over 2002–2014 with five additional datasets: monthly store-level consumer prices at the barcode-equivalent level; daily household-by-store level data on consumption quantities and prices at the barcode-equivalent level; store-level revenues, costs, and profits for the universe of urban retail establishments; quarterly worker-level incomes by occupation and sector; and household-level income shares by occupation and sector matched to consumption shares across products and store formats.

Our analysis breaks down the effect of retail FDI into six distinct effects. On the cost of living side, we distinguish between the effect on consumer prices at preexisting domestic retailers; the effect due to exit of domestic retailers; and the effect from consumers being able to shop at foreign stores, including different prices for preexisting products, new product variety, and different store amenities. The nominal income effect comprises a retail labor income effect (from employment in either traditional or modern retail), a retail profits effect for domestic store owners, and an indirect effect on other sources of household income from nonretail sectors of the local economy.

We find that foreign supermarket entry causes large and significant welfare gains for the average household equal to 6.2 percent of initial household income. The majority of this effect is driven by a significant reduction in the cost of living. While there is a 0.7 percent reduction in welfare due to exit of preexisting retailers, this is more than compensated by a 1.6 percent increase in welfare due to lower consumer prices charged by preexisting domestic stores and, most important, a 5.5 percent increase in welfare due to foreign supermarkets offering cheaper prices, new varieties, and different shopping amenities to consumers.

The large direct effect is consistent with the raw data: foreign retailers charge on average 12 percent lower prices for an identical barcode in the same location and month, offer five times the number of products compared to modern domestic stores, and capture on average more than one-third of household retail spending after entry. Just under half of this effect can be accounted for by the cheaper prices at foreign stores; the remainder results from gains in product and store variety and differences in amenities.

One of the most important findings is that the effects on nominal income pale in comparison to the reduction in the cost of living. We find no effect on average municipality-level household incomes or employment rates—the main concern for localities facing foreign retailer entry. We do, however, find evidence of store exit and adverse effects on domestic store profits, employment, and labor incomes for workers in the traditional retail sector. While these adverse income effects are sizable, they affect only a fraction of households and so are muted in the aggregate by reductions in the cost of living that benefit all households.

Finally, we quantify the distribution of the gains from retail FDI. While, on average, all household income groups experience significant gains from foreign entry, the richest income groups gain about 50 percent more than the poorest. The key driver is that richer

households substitute more than 50 percent of their retail consumption to foreign stores, while the poorest households substitute less than 15 percent. These differences imply that wealthier households in Mexico value the consumption choices at foreign stores significantly more than poorer households.

NOTE

This research brief is based on David Atkin, Benjamin Faber, and Marco Gonzalez-Navarro, "Retail Globalization and Household Welfare: Evidence from Mexico," National Bureau of Economic Research, Working Paper no. 21176, May 2015, http://www.nber.org/papers/w21176.