



## MSP and Food Inflation

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**The central government has increased the Minimum Support prices of 14 crops for the Kharif Marketing Season (KMS) for 2023-24. The MPC meeting held on 6-8 June 2023 rendered a line of caution as to the possible negative spillovers from an erratic monsoon affected by the El-Nino and possible effects of the same on food and consequently headline inflation. The report takes a look at the dynamics of the price increase vis-à-vis the crop situation.**

The Minimum Support Price (MSP) mechanism adopted by the central government is designed to help farmer incomes, especially in times of a surplus in crop production which are under the ambit of the scheme. At present there are 23 such commodities which are protected from sudden price decline. The efficacy of the scheme is debatable many a times due to the procedure and lags of government procedure and farmers prefer to sell it to the middle men at the best price on offer. The Minimum Support Prices are announced by the central government in advance to the sowing season which typically begins in the onset of monsoons i.e. by mid-June every year.

The Commission for Agricultural Costs and Prices (CACP) recommends the increment in MSP each year and it is for the central government to accept the recommendations of the CACP, both price and non-price(policy). CACP considers various factors before recommending the increase in MSP prices such as cost of production, the demand and supply situation, domestic and international prices, inter-crop parity, terms of trade between agriculture and non-agriculture sectors, rational utilization of land, water and other production resources, the likely impact of the price policy on the rest of the economy, and a minimum of 50 per cent as margin over the cost of production.

### **MSP & Food inflation**

The increment in MSP affects the headline inflation as the MSP is in effect a price floor for the particular crop. So, in times of a bumper crop harvest, when market mechanism would naturally lead to lower prices, the government steps in and buys the crop at a fixed price, thereby giving the farmer an avenue to sell at higher than the prevailing market price. If there is a shortage of the crop on the other hand, and prices inch up, then the MSP is irrelevant as the prevailing market prices will be much higher, and farmers will sell



at market price. This process, in practice is much complex with the hurdles of transportation, lack of storage, logistics, local politics. Since the agricultural developments affect farm incomes, GDP, and more pertinently headline inflation the recent increase in MSPs for various crops should garner attention.

For the Kharif Marketing Season 2023-24 the price increases in various crops are given below in comparison to the previous year's changes:

Crop	WPI Weight	CPI Weight	MSP Increase (%) in 2022-23	MSP Increase (%) in 2023-24
Rice	1.431	4.38	5.10%	7.00%
Jowar	0.068	0.23	8.44%	7.50%
Bajra	0.086	0.11	4.44%	6.38%
Maize	0.189	0.06	4.92%	6.52%
Ragi	0.007	0.05	5.95%	7.49%
Tur (Arhar)	0.129	0.80	4.76%	6.06%
Moong	0.071	0.35	6.60%	10.35%
Urad	0.092	0.27	4.76%	5.30%
Groundnut	0.269	0.28	5.41%	9.01%
	<b>2.342</b>	<b>6.517</b>		

Source: PIB, STCI PD Research

The effect on CPI inflation is second round in the sense that these increases will first affect the wholesale *mandi* prices since MSPs are applicable to raw farm produce. As per our estimates, WPI index should see an effect of ~15-20 basis points given the increase in major kharif crops. The second stage effects will be seen in CPI and these are not linear in nature. We would agree with the assessment of the RBI Deputy Governor Dr. M.D. Patra and we see the effect of these price increases of not more than 10-15 basis points on headline inflation. As per government policy the increase in MSP should be remunerative to the farmer, and the farmer should be able to get at least 50% over and above the cost of production. In line with this, the CACP has recommended a 7% increase on the MSP in Paddy, on average, i.e. considering the two types of paddy - common and grade A. This is likely to have an impact since rice has a larger weightage in both WPI and CPI. Moreover, second round effects of paddy are more since de-husking of paddy is the next stage and rice is then sold to the end user. Hence, even though the highest increase is for Moong at 10.4%, it will not have much effect due to its index weightage while paddy/rice will have



a maximum impact within food grains. Overall, effect on food inflation will be close to 40-50 basis points and on headline inflation will be close to 10-15 basis points.

**Outlook:** The international prices of rice have sparked a concern on domestic prices. International rice prices have been on the rise since two major rice producing countries i.e. Pakistan and China have faced adverse weather, and hence global supply has been tight. For India which is the second largest producer and the largest exporter of rice, a normal monsoon is predicted with a significant chance of the El Nino weather pattern forming adverse climate for crop production. This should keep rice prices under pressure and pose upside risks to headline inflation. Though MSP increase will bring more farmers towards paddy cultivation and the overall impact may in fact be favorable to rice price with supply being robust.

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