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MSP HIKE MUST BE SUPPLEMENTED WITH PRICE DEFICIENCY SCHEME: INFLATION IMPACT ONLY IF PROCUREMENT HAPPENS

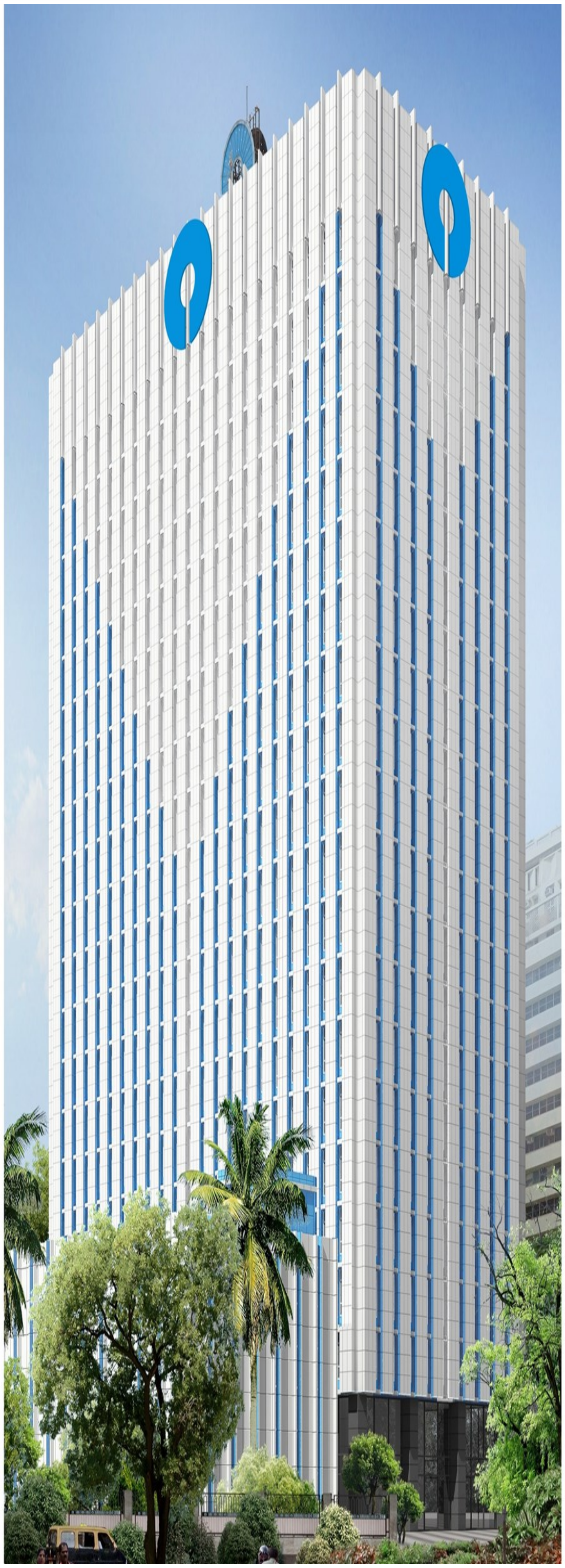
The Government decision to hike the minimum support price (MSP) of 14 Kharif (summer sown) crops is a welcome step to address farmer's distress in India. Importantly, out of 14 crops, 7 crops witnessed hike of more that 20% compared to last year.

The immediate fallout of the announcement is an inflation impact. Various estimates placed inflation impact between 50-100 bps on CPI, while fiscal impact would be in the range of 0.2% to 0.4% of GDP. However we believe, such estimated inflation impact could just be a statistical artefact and will only transpire if there is procurement by Government. It is well known that when the public agency starts procuring the crops at MSP, it ensures a convergence between market prices and MSP and thereby impacting inflation. For the statistically minded, our estimate suggest that, post announcement of MSP with 150% hike in cost of production, the CPI inflation could increase by 73 bps and this could materialize in one or two quarter but purely subject to procurement by the Government/State Government.

Interestingly, historical trends suggest that with no Government procurement, market prices have often fallen below MSP due to demand-supply dynamics. For example, in FY18 NAFED could procure only 6% of overall pulses and oilseed production. To make the MSP effective, it is thus absolutely imperative that the Government needs to either procure/ supplement through price differential scheme /PDS.

We recommend a PDS where farmers should have the right to sell at Mandis at MSP and if the market price is less than MSP, the gap between MSP and market price should be reimbursed to the farmer.

Our estimates show, the Government may require an additional Rs 10,000 crore / 6 bps of GDP, if they were to implement such a scheme, for Pulses and Sunflower, which is showing the maximum decline in prices and has no proper procurement mechanism. For Cereals (Wheat, Paddy, Ragi, Maize, Bajra) which are largely procured by both Central and State Government, one should continue to procure at MSP of 1.5x cost of production.



MSP INCREASED

- The Government decision to hike the minimum support price (MSP) of 14 Kharif (summer sown) crops for the 2018-19 marketing season, as it was promised in Union Budget 2018-19 (to fix MSP at 1.5 times of the cost of production) is a welcome step to address farmer's distress in India. Importantly, out of 14 crops, seven crops witnessed hike of more that 20% compared to last year.
- Just after the Government's decision, plethora of research reports released estimating its impact on inflation and fiscal deficit. Various estimates placed inflation impact between 50-100 bps on CPI, while fiscal impact would be in the range of 0.2% to 0.4% of GDP.
- However we believe, such estimated inflation impact could just be a statistical artefact and will only transpire if there is procurement by Government. In fact, historical trends show that market prices actually declines post MSP announcement.

IMPACT ON INFLATION

- Analyzing the MSP hike for the past decade, we find similar increase happened in FY09 and FY13 also. In particular in FY09, the increase was maximum across most of the crops.
- Regarding the impact on inflation, it is a fact that inflation will increase post MSP increase with a time lag of 3-6 months. During FY09 and FY13, when the increase in MSP was significant, the impact on WPI inflation on cereals and pulses was quite visible. Except few cereals and pulses, a jump in WPI inflation was apparent post six month after MSP announcement.
- Our estimate suggest that, post announcement of MSP with 150% hike in cost of production, the CPI inflation could increase by 73 bps and this could materialize in one or two quarter subject to procurement by the Government/State Government. With procurement, the impact on inflation would be 73 bps whereas without procurement the impact could be much lower. It is well known that when the public agency starts procuring the crops at MSP, it ensures a convergence between market prices and MSP and thereby impacting inflation.
- With higher MSP, it also increases the procurement cost of the Government depending on the procurement amount and its coverage. In FY18 NAFED could procure only 6% of overall pulses and oilseed production. Similarly FCI procured wheat and rice around 45.71 million tonnes in FY17, less than 25% overall wheat and rice production in India.

Increase in MSP (% YoY)

Year	Paddy Common	Jowar-Hybrid	Bajra	Ragi	Maize	Arhar (Tur)	Moong	Urad	Cotton Long	Groundnut (in shell)	Soyabean Yellow	Sunflower Seed
2008-09	**34.2**	**40.0**	**40.0**	**52.5**	**35.5**	**29.0**	**48.2**	**48.2**	**47.8**	**35.5**	**32.4**	**46.7**
2009-10	5.0	0.0	0.0	0.0	0.0	15.0	9.5	0.0	0.0	0.0	0.0	0.0
2010-11	-4.8	4.8	4.8	5.5	4.8	52.2	33.0	34.9	0.0	9.5	3.6	6.1
2011-12	8.0	11.4	11.4	8.8	11.4	5.7	9.0	11.8	10.0	17.4	17.4	19.1
2012-13	**15.7**	**53.1**	**19.9**	**42.9**	**19.9**	**4.1**	**10.0**	**13.2**	**18.2**	**37.0**	**32.5**	**32.1**
2013-14	4.8	0.0	6.4	0.0	11.5	11.7	2.3	0.0	2.6	8.1	14.3	0.0
2014-15	3.8	2.0	0.0	3.3	0.0	1.2	2.2	1.2	1.3	0.0	0.0	1.4
2015-16	3.7	2.6	2.0	6.5	1.1	6.3	5.4	6.3	1.2	0.8	1.6	1.3
2016-17	4.3	3.5	4.3	4.5	3.0	9.2	7.7	8.1	1.5	4.7	6.7	3.9
2017-18	5.4	4.6	7.1	10.1	4.4	7.9	6.7	8.0	3.8	5.5	9.9	3.8
2018-19	**12.9**	**42.9**	**36.8**	**52.4**	**19.3**	**4.1**	**25.1**	**3.7**	**26.2**	**9.9**	**11.4**	**31.4**

Source: SBI Research

Impact of Increase in MSP on Cereals and Pulses WPI Inflation (%)

Items	2008-09			2012-13		
	MSP Increase (% YoY)	Jun-08	Jan-09	MSP Increase (% YoY)	Jun-12	Jan-13
Food Articles	-	7.0	14.4	-	10.9	12.3
Foodgrains	-	10.3	12.9	-	9.2	18.0
Cereals	-	12.3	12.2	-	6.6	18.6
Rice	34.2	13.7	15.5	15.7	7.5	17.8
Jowar	40.0	1.8	-1.9	53.1	-8.4	-9.8
Bajra	40.0	1.5	12.8	19.9	10.8	28.2
Maize	35.5	4.6	9.5	19.9	5.8	19.2
Ragi	52.5	4.8	13.6	42.9	16.4	44.2
Pulses	-	2.3	15.6	-	20.6	15.9
Arhar	29.0	11.8	14.2	4.1	1.0	7.9
Moong	48.2	-9.4	25.8	10.0	-5.7	19.6
Urad	48.2	-13.7	20.2	13.2	-16.5	-0.4

Source: SBI Research

Impact of incremental MSP on inflation assuming wholesale / market prices converge to MSP

Kharif Crops	MSP 2018-19	Average Wholesale Prices**	Growth (%)	Weight (%)	Inflation (in bps)
Paddy Common	1750	1999	-0.14	4.38	-
Jowar-Hybrid	2430	1997	0.18	0.23	4
Bajra	1950	1296	0.34	0.11	4
Ragi	2895	2000	0.31	0.05	2
Maize	1700	1252	0.26	0.06	2
Arhar	5675	4375	0.23	0.80	18
Moong	6975	3206	0.54	0.36	19
Urad	5600	4453	0.20	0.27	6
Groundnut	4890	3934	0.20	0.33	6
Sunflower Seed	5388	3279	0.39	0.30	12
Soyabean (Yellow)	3399	3427	-0.01	0.30	-
Sesamum	6249	6768	-0.08	0.01	-
Nigerseed	5877	4440	0.24	0.01	0.2
Cotton Medium	5150	4657	0.10	0.05	0.5
Total					**73**

Source: AGMRKET, CACP, SBI Research, **Average mandi Prices in March, April, May

WE SUGGEST A HYBRID SCHEME OF MSP INCREASE AND PRICE COMPENSATION SCHEME (PCS) TO ENSURE MAXIMUM BENEFIT TO FARMERS

- Now it has become a major challenges for the Government to keep both inflation and fiscal cost within its target level. Our suggestion could be like this: without a price differential scheme, the fixation of MSP by 1.5 times of cost of production will not bring much cheer among farmers until as market prices will stay below MSP. Historical trends suggest that with no Government procurement, market prices have often fallen below MSP due to demand-supply dynamics. To make the MSP effective, it is absolutely imperative that the Government needs to either procure/ supplement through price differential scheme.
- Presently, procurement is mostly limited to wheat and rice (with few pulses) and the procurement centers are highly concentrated to northern States of India. Considering high transportation cost, lack of storage infrastructure, the present procurement system is highly inefficient.
- Under this situation, we believe implementing a price differential scheme along with 1.5 times of MSP will boost farmers income and also will be less inflationary as the market price will determined by demand and supply factors. As our estimate suggest by implementing price differential scheme for 14 major crops at all India level, could cost the Government only Rs 32,000 crore. Our estimate shows, if this programme is only for Pulses and Sunflower, which is showing the maximum decline in prices and has no proper procurement mechanism, the total cost comes to around Rs 13,110 crores, an reasonable estimate. In fact, if states share the 40% of cost, the cost for Centre will be quite less (i.e. Rs 20,000 crore).
- The impact of MSP increase in Kharif crops to exchequer is estimated around Rs 15,000 crore (Rs 12,000 crore for rice and Rs 3,000 crore for remaining crops). We believe that Government's estimate of Rs 3,000 crore is an underestimate as post-MSP the market prices of many crops go down, with the absence of a effective procurement. Our estimates show, the Government may require an additional Rs 10,000 crore / 6bps of GDP. The enhanced revenues from GST (plus provision of Rs 1.5 lakh crore of food subsidy in FY19) may provide enough cushion to the Government and may not impact its fiscal deficit target.

SBI suggestion for Price Differential Scheme to accompany MSP

Scenario	Amount to be Paid
MSP based on 1.5 times of A2+FL costs as announced by Government	A
Sale price of farmer	B
If B> A	No benefit
If B less than A, then amount to be paid to farmer per quintal	A-B

Source: SBI Research

Movement of Prices post MSP of few Kharif Crops

Crops	MSP 2017-18	July'17	Oct'17	Nov'17	Dec'17
Jowar	1700	1896	1582	1788	1830
Maize	1425	1436	1351	1378	1332
Bajra	1425	1389	1221	1311	1249
Ragi	1900	2515	2255	2234	2210
Arhar	5450	4564	4691	4497	4688
Moong	5575	5152	5147	5121	5097
Urad	5400	5434	4782	4799	4682

Source: AGMARKET, SBI Research

IMPACT ON EXPORT COMPETITIVENESS

- The exports growth which was only 9.8% in FY18 will suffer where MSP has been hiked, the impact will be largely seen in rice and cotton.
- India accounts for almost one-third of the global rice trade and so far, it has exported around 14 million tonnes of rice in the current year. Although MSP covers just normal rice, it will push up price of basmati rice as well. In the case of cotton (raw cotton), India till now has low cost advantage compared to the global market but the increase in MSP will dampen the India's advantage.
- Interestingly, in this case also, if Government implements the price compensation scheme to paddy procurement, it will carry the burden of maintaining the stocks while allowing exporters to purchase from the markets.

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ABOUT US

The Economic Research Department (ERD) in SBI Corporate Centre is the successor to the Economic and Statistical Research Department (E&SRD). The latter came into being in 1956, immediately after the State Bank of India was formed, with the objective of "tendering technical advice to the management on economic and financial problems in which the Bank has interest and which required expert analysis".

After the first reorganization of the Bank, when specialized departments like Management Science, Management Information Systems, Planning and Market Segment Departments took over the statistical work of E&SRD, the Department was renamed as ERD.

However, with the ERD team now taking on multidimensional functionalities in the area of risk management , corporate analytics, strategy and so on, who knows, the time may have come to rename it again!

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