Unit 3

Market Structure

A market is defined as the sum total of all the buyers and sellers in the area or region under consideration. The area may be the countries, regions, states, or cities.

The value, cost and price of items traded are as per forces of supply and demand in a market. The market may be a physical entity, or may be virtual. It may be local or global, perfect and imperfect.

These kinds of market structures necessarily refer to the degree of competition in a market. Other components of market structures are the nature of product & services, a number of the seller, numbers of consumers, economics scale (types of market in economics).

Types Of Market:

Market structure refers to the nature and degree of competition in the market for goods and services. The structures of market both for goods market and service (factor) market are determined by the nature of competition prevailing in a particular market.

Determinants:

There are a number of determinants of market structure for a particular good.

They are:

(1) The number and nature of sellers.

(2) The number and nature of buyers.

(3) The nature of the product.

(4) The conditions of entry into and exit from the market.

(5) Economies of scale.

Perfect Competition

In a perfect competition market structure, there are a large number of buyers and sellers. All the sellers of the market are small sellers in competition with each other. There is no one big seller with any significant influence on the market. So all the firms in such a market are price takers.

There are certain assumptions when discussing the perfect competition. This is the reason a perfect competition market is pretty much a theoretical concept. These assumptions are as follows,

- The products on the market are homogeneous, i.e. they are completely identical
- All firms only have the motive of profit maximization
- There is free entry and exit from the market, i.e. there are no barriers
- And there is no concept of consumer preference.
- Consumers have perfect knowledge about the market and are well aware of any changes in the market. Consumers indulge in rational decision making.
- All the factors of production, viz. labour, capital, etc, have perfect mobility in the market and are not hindered by any market factors or market forces.
- No government intervention
- No transportation costs

- Each firm earns normal profits and no firms can earn super-normal profits.

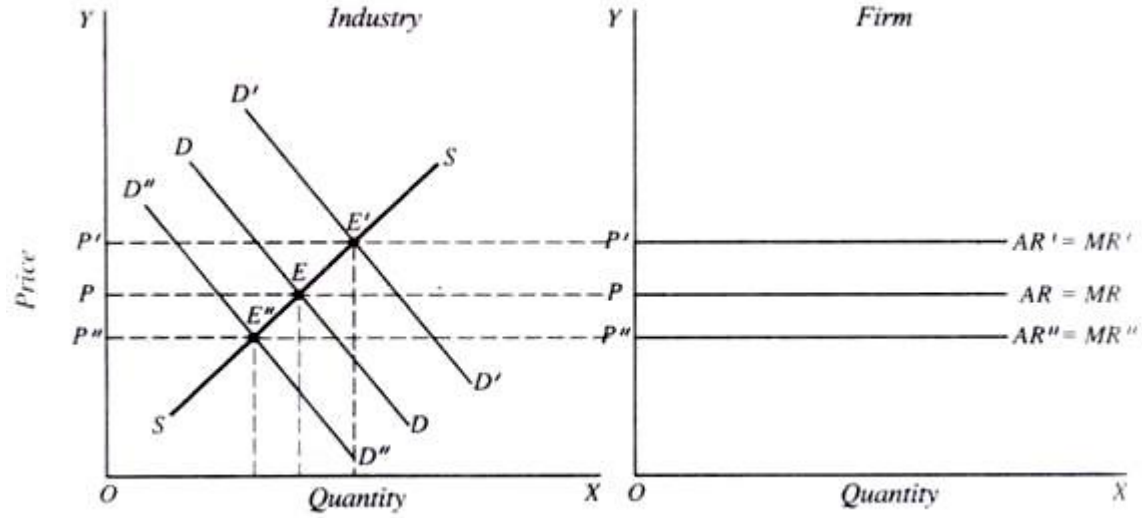


Fig. 23.1 *Demand Curve facing an Individual Firm*

To begin with, demand curve DD and supply curve SS intersect at point E and determine price OP. Now, the firm, having no influence over the price, will take the price OP as given and therefore average-marginal revenue curve facing it will be a horizontal straight line at the level of OP.

When the demand increases and as a result the price rises to OP', the firm will now confront average-marginal revenue curve at the level of OP'. And if the demand decreases and price falls to OP" the firm's average-marginal revenue curve will shift below to the level of OP"

The fourth condition, namely, free entry and free exit, ensures that the firm will make only normal profits in the long run. On the one hand, super-normal profits will disappear by the entry of new firms in the industry and, on the other, losses will disappear as a result of some firms leaving the industry

The short run and the long run

In the short run, the number of firms is fixed. Depending on its costs and revenue, a firm might be making large profits, small profits, no profits or a loss; and in the short run, it may continue to do so.

In the long run, however, the level of profits affects entry and exit form the industry. if profits are high, new firms will be attracted into the industry, whereas if losses are being made, firms will leave.

Supernormal profit is any profit above normal profit. If supernormal profits are made, new firms will be attracted into the industry in the long run. Thus whether the industry expands or contracts in the long run will depend on the rate of profit. Naturally, since the time a firm takes to set up in business varies from industry to industry, the length of time before the long run is reached also varies from industry to industry.

Thereby, in the short-run, it may be possible for an individual firm to make supernormal profit. This situation is shown in the diagram below, as the price (average revenue) is above the average cost (AC). As fewer firms had happened to enter in the period of high profits, the actual price of a given output would be higher.

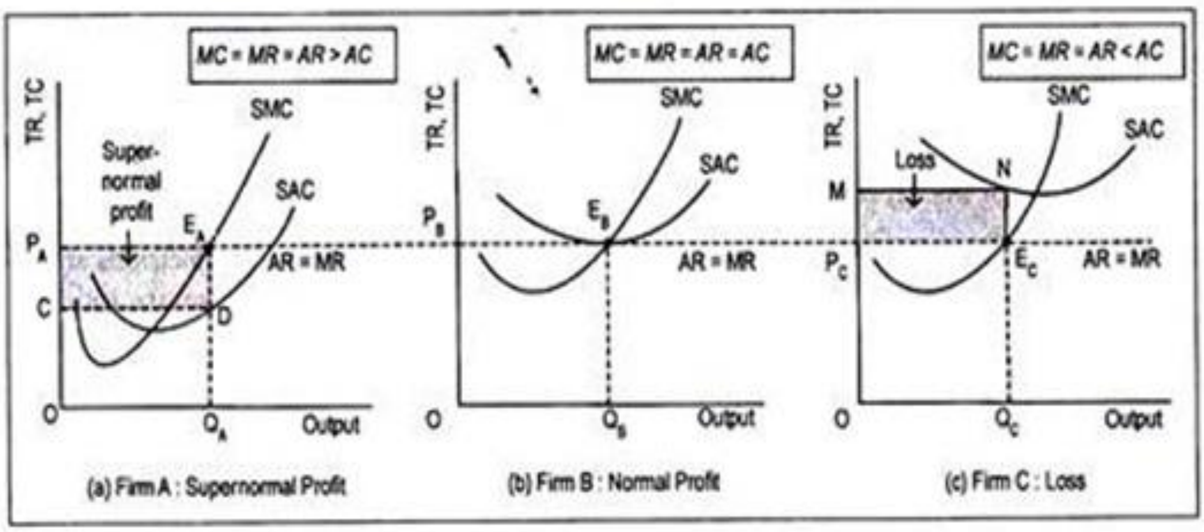


Fig. 4.3: Short Run Equilibrium of Firm

Monopoly Market:

Monopoly is a market situation in which there is only one seller of a product with barriers to entry of others. The product has no close substitutes. The cross elasticity of demand with every other product is very low. This means that no other firms produce a similar product. According to D. Salvatore, "Monopoly is the form of market organisation in which there is a single firm selling a commodity for which there are no close substitutes." Thus the monopoly firm is itself an industry and the monopolist faces the industry demand curve.

The demand curve for his product is, therefore, relatively stable and slopes downward to the right, given the tastes, and incomes of his customers. It means that more of the product can be sold at a lower price than at a higher price. He is a price-maker who can set the price to his maximum advantage. However, it does not mean that he can set both price and output. He can do either of the two things. His price is determined by his demand curve, once he selects his output level. Or, once he sets the price for his product, his output is determined by what consumers will take at that price. In any situation, the ultimate aim of the monopolist is to have maximum profits.

The main features of monopoly are as follows:

1. Under monopoly, there is one producer or seller of a particular product and there is no difference between a firm and an industry. Under monopoly a firm itself is an industry.

2. A monopoly may be individual proprietorship or partnership or joint stock company or a cooperative society or a government company.

3. A monopolist has full control on the supply of a product. Hence, the elasticity of demand for a monopolist’s product is zero.

4. There is no close substitute of a monopolist’s product in the market. Hence, under monopoly, the cross elasticity of demand for a monopoly product with some other good is very low.

5. There are restrictions on the entry of other firms in the area of monopoly product.

6. A monopolist can influence the price of a product. He is a price-maker, not a price-taker.

7. Pure monopoly is not found in the real world.

8. Monopolist cannot determine both the price and quantity of a product simultaneously.

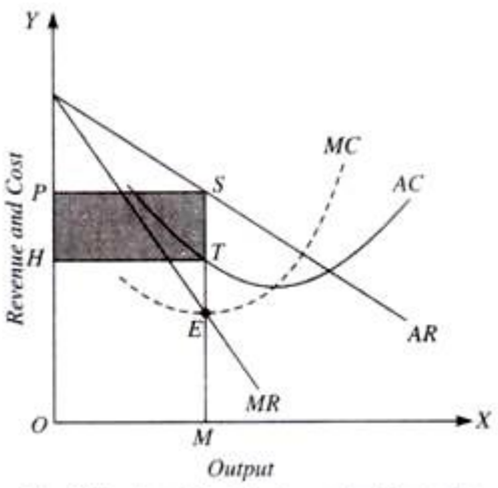
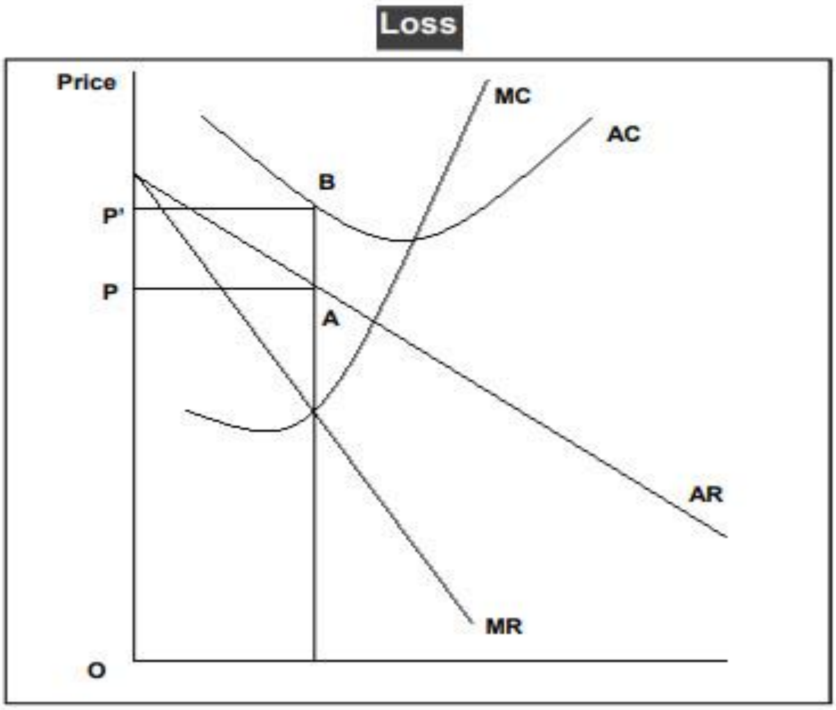


Fig. 26.3. *Firm's Equilibrium under Monopoly: Maximisation of Profits*

In Fig. 26.3, marginal revenue is equal to marginal cost at OM level of output. The firm will be earning maximum profits and will therefore be in equilibrium when it is producing and selling OM quantity of the product. If he increases his output beyond OM, marginal revenue will be less than marginal cost, that is, additional units beyond OM will add more to cost than to revenue.

Therefore, the monopolist will be incurring loss on the additional units beyond OM and will thus be reducing his total profits by producing more than OM. Thus he is in equilibrium at OM level of output at which marginal cost equals marginal revenue (MC = MR).

It will be seen from the AR curve in Fig. 26.3 that he will be getting the price MS or OP by selling OM quantity of output. The total profits earned by him are equal to the area HTSP. There is here a significant difference between monopoly and perfect competition.



Oligopoly:

Oligopoly is a market situation in which there are a few firms selling homogeneous or differentiated products. It is difficult to pinpoint the number of firms in 'competition among the few.' With only a few firms in the market, the action of one firm is likely to affect the others. An oligopoly industry produces either a homogeneous product or heterogeneous products.

The former is called pure or perfect oligopoly and the latter is called imperfect or differentiated oligopoly. Pure oligopoly is found primarily among producers of such industrial products as aluminium, cement, copper, steel, zinc, etc. Imperfect oligopoly is found among producers of such consumer goods as automobiles, cigarettes, soaps and detergents, TVs, rubber tyres, refrigerators, typewriters, etc.

DUOPOLY is a special case of oligopoly, in which there are exactly two sellers. Under duopoly, it is assumed that the product sold by the two firms is homogeneous and there is no substitute for it. Examples where two companies control a large proportion of a market are: (i) Pepsi and Coca-Cola in the soft drink market.

Characteristics of Oligopoly

Now that the Oligopoly definition is clear, it's time to look at the characteristics of Oligopoly:

Few firms

Under Oligopoly, there are a few large firms although the exact number of firms is undefined. Also, there is severe competition since each firm produces a significant portion of the total output.

Barriers to Entry

Under Oligopoly, a firm can earn super-normal profits in the long run as there are barriers to entry like patents, licenses, control over crucial raw materials, etc. These barriers prevent the entry of new firms into the industry.

Non-Price Competition

Firms try to avoid price competition due to the fear of price wars in Oligopoly and hence depend on non-price methods like advertising, after sales services, warranties, etc. This ensures that firms can influence demand and build brand recognition.

Interdependence

Under Oligopoly, since a few firms hold a significant share in the total output of the industry, each firm is affected by the price and output decisions of rival firms. Therefore, there is a lot of interdependence among firms in an oligopoly. Hence, a firm takes into account the action and reaction of its competing firms while determining its price and output levels.

Nature of the Product

Under oligopoly, the products of the firms are either homogeneous or differentiated.

Selling Costs

Since firms try to avoid price competition and there is a huge interdependence among firms, selling costs are highly important for competing against rival firms for a larger market share.

No unique pattern of pricing behaviour

Under Oligopoly, firms want to act independently and earn maximum profits on one hand and cooperate with rivals to remove uncertainty on the other hand.

Depending on their motives, situations in real-life can vary making predicting the pattern of pricing behaviour among firms impossible. The firms can compete or collude with other firms which can lead to different pricing situations.

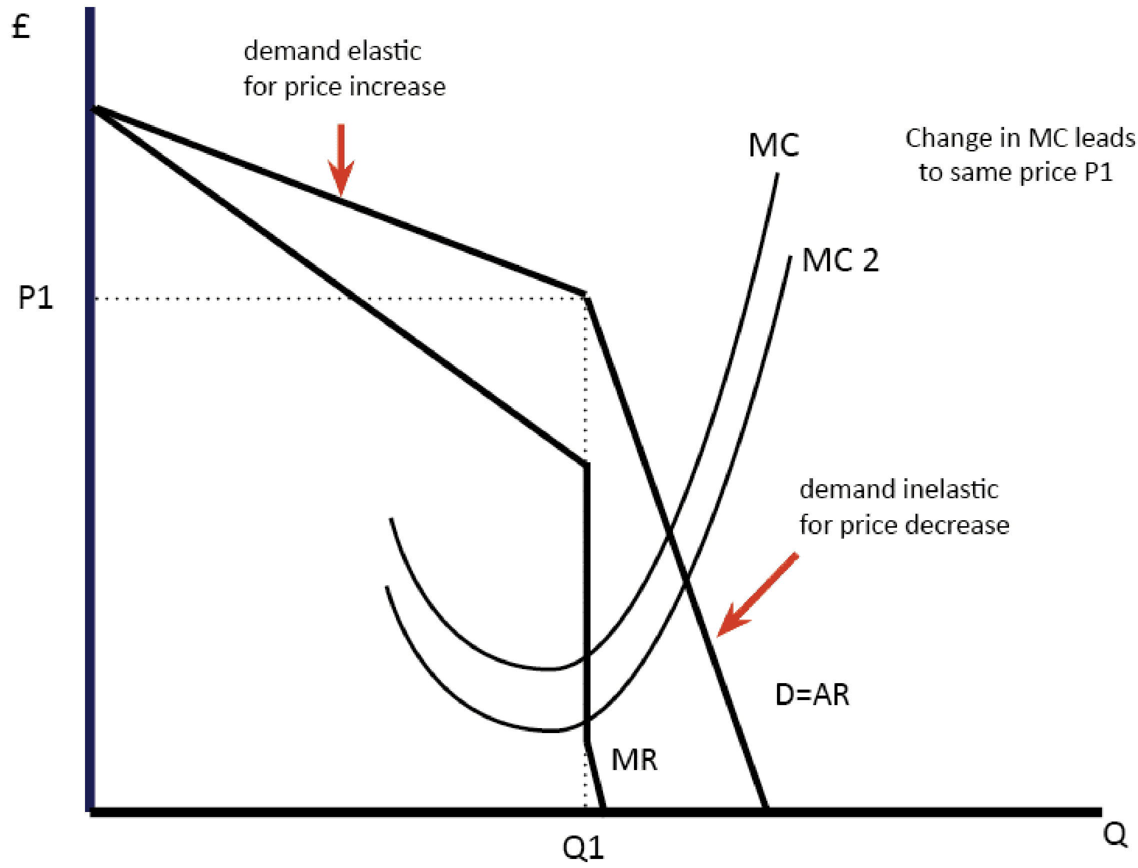
Kinked-Demand Theory

Consider a firm in an oligopoly that wants to change its price. How will the other firms react? There are 2 possibilities: they can either match the price changes or ignore them. But what the other firms will actually do will probably depend on the direction of the price change. If one firm raises its price, the others probably will not follow, since that will allow them to take market share from the price changer. This makes the demand curve more elastic, since as the firm raises its price, then many of its customers will buy from the other firms, lowering the revenue of the higher-priced firm.

If the firm lowers its price, then the other firms would surely follow, to prevent any loss of market share. This part of the demand curve is much more inelastic, since all the firms are acting in concert. This creates a kink in the demand curve, where the change in demand goes from very elastic at higher prices to inelastic at lower prices. Since the marginal revenue curve depends on prices, the marginal revenue curve is also kinked. At lower prices, the marginal revenue curve drops downward creating a gap. The marginal cost curves of both scenarios will intersect the same quantity being produced by the oligopoly, represented by the vertical line in the graph; therefore, there is no change in quantity produced as prices are lowered, as long as the change in marginal cost is within the marginal revenue gap.

The **kinked-demand curve** explains why firms in an oligopoly resist changes to price. If one of them raises the price, then it will lose market share to the others. If it lowers its price, then the other firms will match the lower price, causing all the firms to earn less profit.

Critics of the kinked-demand model point out that while the model explains why oligopolies maintain pricing, it doesn't explain how its products were initially priced. The other thing it doesn't explain is that when the economy changes significantly, especially when there is high inflation, then the firms of an oligopoly do change prices often. In some cases, oligopolistic firms may engage in a **price war**, where each firm charges a successfully lower price to gain market share.



Contestable Market Model

The contestable market model is an oligopolistic model based on barriers to entry and barriers to exit that determine the firm's price and output. If the barriers are high, then the oligopolist will set higher prices. On the other hand, if the barriers are low, then the oligopolist will set low prices to prevent new firms from entering the industry or to promote the exit of its competitors.

Cartel Model

Sometimes firms in an oligopoly try to form a cartel by agreeing to fix prices or to divide the market among themselves, or to restrict competition some other way. The primary characteristic of the Cartel Model is collusion among the oligopolistic firms to fix prices or restrict competition so that they can earn monopoly profits**.**

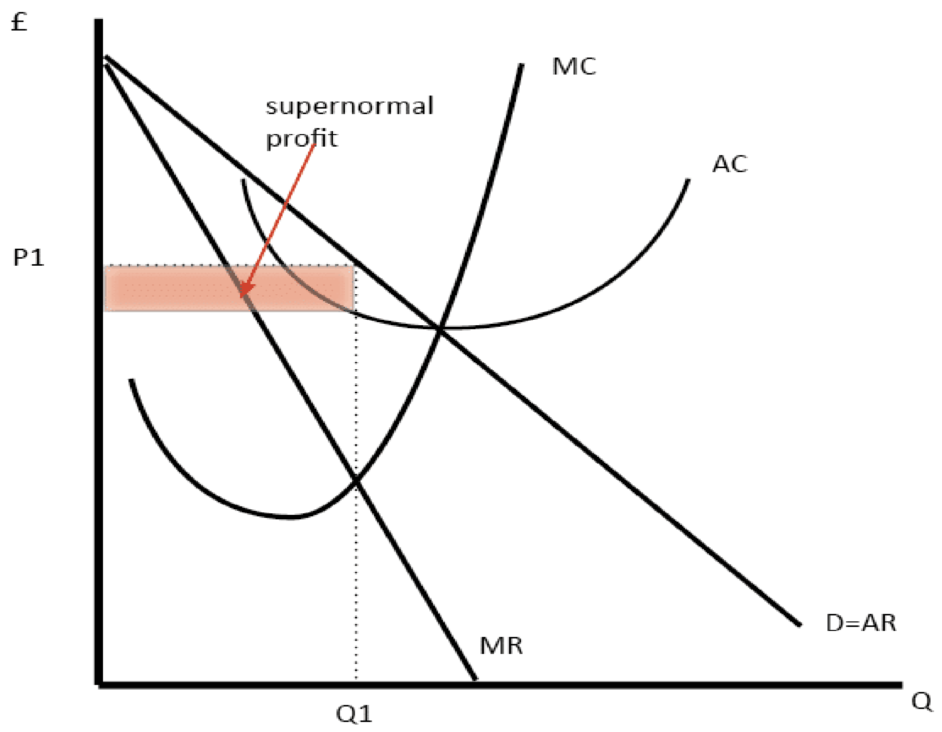
If the dominant firms in an oligopoly can successfully collude to fix prices, then they can be certain of each other's output, which will allow to maximize their profits by producing that quantity of output where marginal revenue = marginal cost, just as it would be for a monopoly. However, if any of the firms cheat, then a price war may ensue, lowering the profits of all firms, and maybe even causing them to operate at a loss. In most modern economies, collusion is generally against the law, however there are certain countries that engage in collusion to maximize their profits from their natural resources.

Monopolistic Competition:

Monopolistic competition is a market structure which combines elements of monopoly and competitive markets. Essentially a monopolistic competitive market is one with freedom of entry and exit, but firms can differentiate their products. Therefore, they have an inelastic demand curve and so they can set prices. However, because there is freedom of entry, supernormal profits will encourage more firms to enter the market leading to normal profits in the long term.

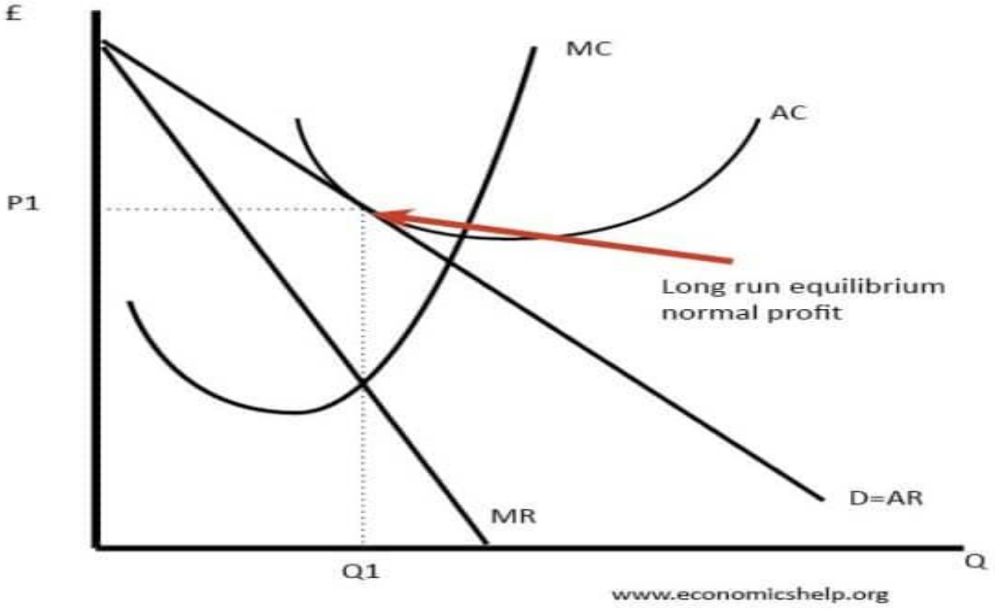
A monopolistic competitive industry has the following features:

- Many firms.
- Freedom of entry and exit.
- Firms produce differentiated products.
- Firms have price inelastic demand; they are price makers because the good is highly differentiated
- Firms make normal profits in the long run but could make supernormal profits in the short term
- Firms are allocatively and productively inefficient.



In the short run, the diagram for monopolistic competition is the same as for a monopoly.

The firm maximises profit where MR=MC. This is at output Q1 and price P1, leading to supernormal profit.



Demand curve shifts to the left due to new firms entering the market.

In the long-run, supernormal profit encourages new firms to enter. This reduces demand for existing firms and leads to normal profit.

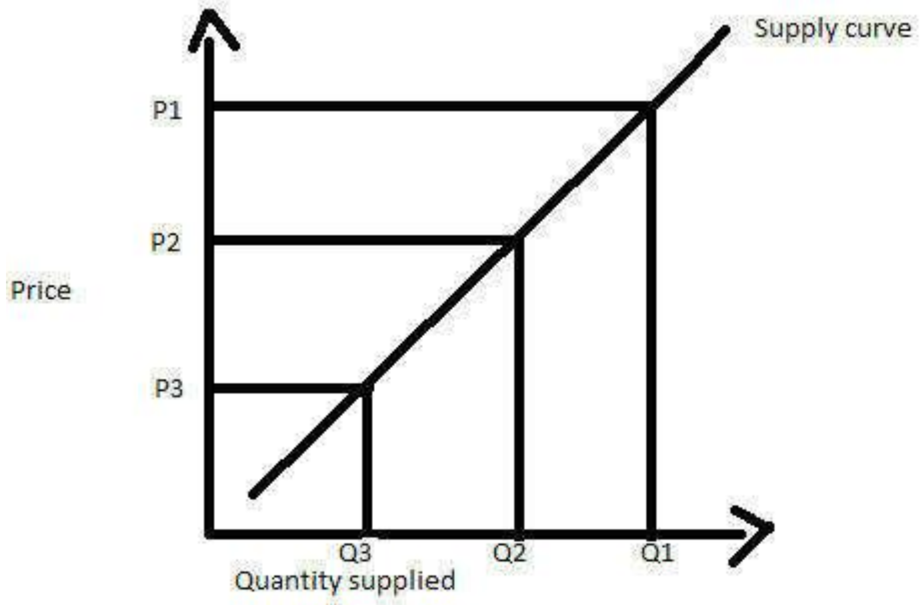
- In the short run **supernormal profits** are possible, but in the long run new firms are attracted into the industry, because of low **barriers to entry**, good knowledge and an opportunity to differentiate.

  Examples:

  Restaurants – restaurants compete on quality of food as much as price. Product differentiation is a key element of the business. There are relatively low barriers to entry in setting up a new restaurant.
  Hairdressers. A service which will give firms a reputation for the quality of their hair-cutting.

Clothing. Designer label clothes are about the brand and product differentiation

Supply:



The above diagram shows the supply curve that is upward sloping (positive relation between the price and the quantity supplied). When the price of the good was at P3, suppliers were supplying Q3 quantity. As the price starts rising, the quantity supplied also starts rising.

Law of supply

States that other factors remaining constant, price and quantity supplied of a good are directly related to each other. In other words, when the price paid by buyers for a good rises, then suppliers increase the supply of that good in the market.

What are the limitations and factors affecting the Law of Supply?

The overarching relationship is between price and quantity, and applies only if all other factors remain constant. There are other factors that can affect the quantity supplied of a given. The following are some of the more common factors:

- Cost of Production – When there are changes in the cost of raw materials or labour to produce a unit of supply, the volume will change as well, assuming the selling price remains the same. The variable cost affecting profit margins is a big factor in targeting the quantity to produce.
- Technological Changes – Advancement in technology can boost the efficiency with which units are produced, lessening the cost of production. This then has a similar effect to that outlined under "Cost of Production".
- Taxes – The imposition of taxes in the production of goods limits profitability. If a producer is required to remit a portion of sales as tax, then the producer will be less inclined to increase supply.
- Legislations – Certain regulatory laws or quotas may be put in place that limit the quantity of a given product that can be produced. For example, in the energy industry, carbon offsets limit the amount certain companies can supply.
- Periods of Uncertainty – In situations of higher business risk, producers may be inclined to reduce supplies so that they can offload older inventory. During war or civil unrest, for example, producers are more than eager to sell, even possibly at a lower price.

The formula for calculating the point elasticity of supply is:

Es= (Dq/Dp)×(P/Q)

Here Dq/Dp is the slope of the supply curve.

Perfectly Inelastic Supply

A service or commodity has a perfectly inelastic supply if a given quantity of it can be supplied whatever might be the price. The elasticity of supply for such a service or commodity is zero. A perfectly inelastic supply curve is a straight line parallel to the Y-axis.

Unitary Elastic

For a commodity with a unit elasticity of supply, the change in quantity supplied of a commodity is exactly equal to the change in its price. In other words, the change in both price and supply of the commodity are proportionately equal to each other.

Perfectly Elastic supply

A commodity with a perfectly elastic supply has an infinite elasticity. In such a case the supply becomes zero with even a slight fall in the price and becomes infinite with a slight rise in price. This is indicative of the fact that the suppliers of such a commodity are willing to supply any quantity of the commodity at a higher price. A perfectly elastic supply curve is a straight line parallel to the X-axis.

Role of Demand & Supply in Price Determination

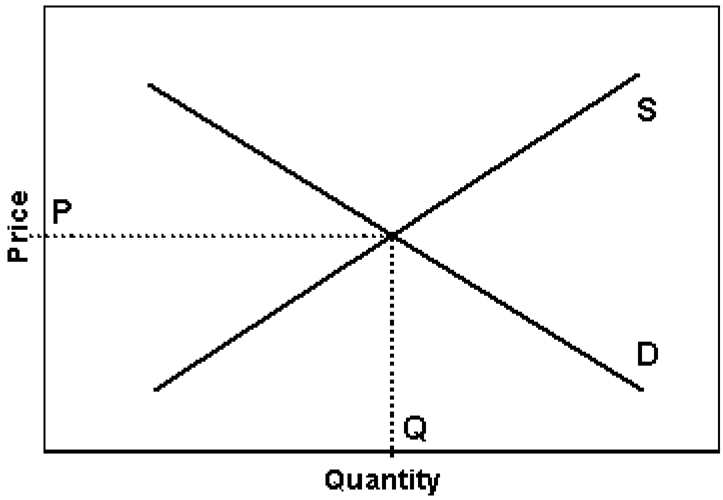
Price is dependent on the interaction between demand and supply components of a market. Demand and supply represent the willingness of consumers and producers to engage in buying and selling. An exchange of a product takes place when buyers and sellers can agree upon a price.

Equilibrium price

When a product exchange occurs, the agreed upon price is called an equilibrium price, or a market clearing price. Graphically, this price occurs at the intersection of demand and supply as presented.

Both buyers and sellers are willing to exchange the quantity Q at the price P. At this point, supply and demand are in balance. Price determination depends equally on demand and supply.

Figure 1. Price Equilibrium



At any price below P, the quantity demanded is greater than the quantity supplied. In such a situation, consumers would clamour for a product that producers would not be willing to supply; a shortage would exist. In this event, consumers would choose to pay a higher price in order to get the product they want, while producers would be encouraged by a higher price to bring more of the product onto the market.

The end result is a rise in price, to P, where supply and demand are in balance. Similarly, if a price above P were chosen arbitrarily, the market would be in surplus with too much supply relative to demand. If that were to happen, producers would be willing to take a lower price in order to sell, and consumers would be induced by lower prices to increase their purchases. Only when the price falls would balance be restored.

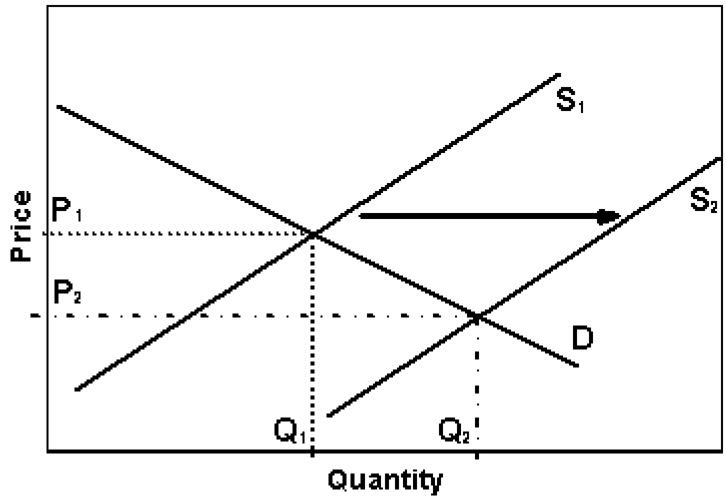
A market price is not necessarily a fair price, it is merely an outcome. It does not guarantee total satisfaction on the part of buyer and seller. Typically, some assumptions about the behaviour of buyers and sellers are made, which add a sense of reason to a market price. For example, buyers are expected to be self-interested and, although they may not have perfect knowledge, at least they will try to look out for their own interests. Meanwhile, sellers are considered to be profit maximizers. This assumption limits their willingness to sell to within a price range, high to low, where they can stay in business.

The four basic laws of supply and demand are:

1. If demand increases and supply remains unchanged, then it leads to higher equilibrium price and higher quantity.
2. If demand decreases and supply remains unchanged, then it leads to lower equilibrium price and lower quantity.
3. If supply increases and demand remains unchanged, then it leads to lower equilibrium price and higher quantity.
4. If supply decreases and demand remains unchanged, then it leads to higher equilibrium price and lower quantity.

When a bumper crop develops, supply shifts outward and downward, shown as S2 in Image 2, more product is available over the full range of prices. With no immediate change in consumers' willingness to buy crops, there is a movement along the demand curve to a new equilibrium. Consumers will buy more but only at a lower price. How much the price must fall to induce consumers to purchase the greater supply depends upon the elasticity of demand

Figure 2. Movement Along Demand Curve



In Image 2, price falls from P1 to P2 if a bumper crop is produced. If the demand curve in this example was more vertical (more inelastic), the price-quantity adjustments needed to bring about a new equilibrium between demand and the new supply would be different

Unit -4

An economy is the large set of inter-related production, consumption, and exchange activities that aid in determining how scarce resources are allocated. The production, consumption, and distribution of goods and services are used to fulfill the needs of those living and operating within the economy, which is also referred to as an economic system.

Indian Economy

Some features of Indian economy are given below:

1. **Low per Capita Income:** India's per capita income is very less as compare to developed countries. As per the estimates of the Central Statistics Office (CSO), the per capita net national income of the country at current prices for the year 2015-16 is estimated to attain the level of Rs. 93231/-. The per capita net national income at constant prices (2011-12) for the year 2015-16 is estimated to attain the level of Rs. 77, 431/-.

2. **Agriculture Based Economy:** Agriculture and allied sectors provide around 14.2% of Indian GDP while 53% of total Indian population is based on the agriculture sector. In 2004, nearly 58 per cent of the total working population of our country was engaged in agriculture and allied activities and was contributing about 21.0 per cent of the total national income.In most of the countries of Asia, Middle East and Africa, from two-thirds to four- fifths of their total population are solely dependent on agriculture. In most of the developed countries like U.K., U.S.A. and Japan, the percentage of active population engaged in agriculture ranges between 1 to 5 per cent.

3. **Over population:** in every decade Indian population get increased by about 20% . During the 2001-11 population increased by 17.6%. Currently India is adding the total population of Australia every year. India is the possessor of around 17.5% population of the whole world.

4. **Income Disparities:** a report released by Credit Suisse revealed that the richest 1% Indians owned 53% of the country's wealth, while the share of the top 10% was 76.30%. To put it differently, in a manner that conveys the political economy of this stunning statistic, 90% of India owns less than a quarter of the country's wealth.

5. **Lack of Capital Formation:** Rate of capital formation is low because of lower level of income. Gross domestic capital formation was 23.3% in

1993-94 increased upto the level as 38.1% in 2007-08 but declined upto 34.8% in 2012-13. Capital deficiency is one of the characteristic features of the Indian economy. Both the amount of capital available per head and the present rate of capital formation in India is very low. Consumption of crude steel and energy are the two important indicators of low capital per head in the under-developed countries like India. Moreover, this low level of capital formation in India is also due to weakness of the inducement of invest and also due to low propensity and capacity to save. As per Colin Clark's estimate, in order to maintain the same standard of living, India requires at least 14 per cent level of gross capital formation. To achieve a higher rate of economic growth and to improve the standard of living, a still higher rate of capital formation is very much required in India. In India the rate of saving as per cent of GDP has gradually increased from 14.2 per cent in 1965-66 to 30.6 per cent in 2013-14 which is moderately high in comparison to that of 30 per cent in Japan, 23 per cent in Germany, 15 per cent in U.K. and 17 per cent in USA.

6. **Backwardness of Infrastructural Development:** As per an recent study, 25% of Indian families don't have reach of electricity and 97 million peoples don't have reach of safe drinking water and 840 million people in India don't have sanitation services. India needs 100 million dollar for infrastructural development upto 2025.

7. **Market Imperfections:** Indian economy doesn't have good mobility from one place to other which hinders the optimum utilization of resources. These market imperfections create the fluctuations in the price of commodities every year.

8. **Low level of technology:** Prevalence of low level of technology is one of the important characteristics of an underdeveloped economy like India. The economy of our country is thus suffering from technological backwardness. Obsolete techniques of production are largely being applied in both the agricultural and industrial sectors of our country.

Sophisticated modern technology is being applied in productive units at a very limited scale as it is very much expensive. Moreover, it is very much difficult to adopt modern technology in Indian productive system with its untrained, illiterate and unskilled labour.

9. **Under-utilisation of natural resources:** In respect of natural endowments India is considered as a very rich country. Various types of natural resources, viz., land, water, minerals, forest and power resources are available in sufficient quantity in the various parts of the country. But due to its various inherent problems like inaccessible region, primitive techniques, shortage of capital and small extent of the market such huge resources remained largely under-utilised. A huge quantity of mineral and forest resources of India still remains largely unexplored. Until recently, India was not in position to develop even 5 per cent of total hydropower potential of the country.

10. **Lack of infrastructure:** Lack of infrastructural facilities is one of the serious problems from which the Indian economy has been suffering till today. These infrastructural facilities include transportation and communication facilities, electricity generation and distribution, banking and credit facilities, economic organisation, health and educational institutes etc.

11. **Low level of living:** The standard of living of Indian people in general is considered as very low. Nearly 25 to 40 per cent of the population in India suffers from malnutrition. The average protein content in the Indian diet is about 49 grams only per day in comparison to that of more than double the level in the developed countries of the world.

12. **Poor quality of human capital:** Indian economy is suffering from its poor quality of human capital. Mass illiteracy is the root of this problem and illiteracy at the same time is retarding the process of economic growth of our country. As per 2001 census, 65.3 per cent of the total

population of India is literate and the rest 34.7 per cent still remains illiterate.

13. **Inadequate development of economic organisation:** Poor economic organisation is another important characteristic of the Indian economy. For attaining economic development at a satisfactory rate certain institutions are very much essential. As for example, for mobilisation of savings and to meet other financial needs, more particularly in the rural (areas, development of certain financial institutions are very much essential. In India the development of financial institutions is still inadequate in the rural areas. There is the urgent need to develop certain credit agencies for advancing loan to small farmers on easy terms as well as to provide long term and medium term loan to industries.

14. **Existence of chronic unemployment and under-employment:** Rapid growth of population coupled with inadequate growth of secondary and tertiary occupations are responsible for the occurrence of chronic unemployment and under-employment problem in our country. In India, unemployment is structural one, unlike in developed countries, which is of cyclical type. Here unemployment in India is the result of deficiency of capital. Indian industries are not getting adequate amount of capital for its necessary expansion so as to absorb the entire surplus labour force into it.

15. **Inequality in the distribution of wealth:** Another important characteristic of the Indian economy is the mal-distribution of wealth: The report of the Reserve Bank of India reveals that nearly 20 per cent of the households owing less than Rs 1000 worth of assets possess only 0.7 per cent of the total assets. Moreover, 51 per cent of the households owing less than Rs 5000 worth of assets possessed barely 8 per cent of the total assets. Lastly, the top four per cent households possessing assets worth more than Rs 50,000 held more than 31 per cent of the total assets.

India – A Mixed Economy – Explained!

In a mixed economy, private and public sectors go side by side. The government directs economic activity in some socially important areas of the economy, the rest being left to the price mechanism to operate.

Before Independence, Indian economy was a 'laissez faire' economy. But post-independence, country adopted the mixed economy system.

(i) Coexistence of Public and Private Sectors:

The coexistence of large public sector with big private sector has transformed the economy into a mixed one. Industrial policies of 1948 and 1956 formulated by the Indian government have made the provision of such coexistence. Some basic and heavy industries are being run under the public sector. However, with the liberalisation of Indian economy, the scope of private sector has further enhanced.

(ii) Planned Development:

India had a poor industrial base at the time of Independence. A long period of economic stagnation under British rule had weakened the Indian Economy. Hence 5-year plans have been adjusted along with the Directive Principles of State Policy to rebuild the rural economy and lay foundations of industrial and scientific progress.

Economic Planning:

In Mixed economy, the Government adopts the instrument of economic planning. This is necessary for the public sector enterprises which have to work according to some plan and to achieve certain pre-determined objectives.

In the same way, the Private Sector cannot be left to develop in its own way. To ensure a co-ordinated and fast economic development the programmes of both the sector are drawn in such a way that growth in one complements the growth in the other

(iii) Role of Public Sector:

It has played an important role in the development of Indian economy. It increased the pace of economic growth and reduced disparities of income and wealth.

It seriously acts in the following areas, like:

(a) Development of infrastructure;

(b) Establishment of basic and heavy industries;

(c) Dispersing industries in several backward regions; and

(d) Imperative role in trading and marketing activities, including international trade.

(v) Private Sector:

It includes not only organised industry, but agriculture, small industry, trade and great deal of activity in housing and construction. Private sector provides employment to three-fourths of our manpower. To control the private industrial units. Industries Development and Regulation Act and Monopolies and Restrictive Trade Practices Act are already set up in India.

(vi) Combination Between Public and Private Sector:

The second Five Year Plan and pointed out that both the sectors have to function jointly. In fact a high level of public investment it infrastructures and key industries is a precondition for development in the private sector.

Measures like the Industries (Development and Regulation) Act of 1951, MRTP Act of 1969, nationalisation of major commercial banks, takeover of some sick industrial units, successive developmental plans, etc., have no doubt strengthened the base of India's mixed economy.

Privatization:

It means a transfer of ownership, management, and control of public sector enterprises to the private sector. Privatization occurs when a government-owned business, operation, or property becomes owned by a private, non-government party. Privatization is considered to bring more efficiency and objectivity to the company, something that a government company is not concerned about. India went for privatization in the historic reforms budget of 1991, also known as 'New Economic Policy or LPG policy'.

- Privatization describes the process by which a piece of property or business goes from being owned by the government to being privately owned.
- It generally helps governments save money and increase efficiency, where private companies can move goods quicker and more efficiently.

Potential benefits of privatisation

1. Improved efficiency

The main argument for privatisation is that private companies have a profit incentive to cut costs and be more efficient. If you work for a government run industry managers do not usually share in any profits. However, a private firm is interested in making a profit, and so it is more likely to cut costs and be efficient. Since privatisation, companies such as BT, and British Airways have shown degrees of improved efficiency and higher profitability.

2. Lack of political interference

It is argued governments make poor economic managers. They are motivated by political pressures rather than sound economic and business sense. For example, a state enterprise may employ surplus workers which is inefficient. The government may be reluctant to get rid of the workers because of the negative publicity involved in job losses. Therefore, state-owned enterprises often employ too many workers increasing inefficiency.

3. INCREASE FLEXIBILITY

Privatization gives state officials greater flexibility to meet program needs. Officials can replace the private firm if it isn't meeting contract standards, cut back on service, add to service during peak periods, or downsize as needed.

4. Shareholders

It is argued that a private firm has pressure from shareholders to perform efficiently. If the firm is inefficient then the firm could be subject to a takeover. A state-owned firm doesn't have this pressure and so it is easier for them to be inefficient.

5. Increased competition

Often privatisation of state-owned monopolies occurs alongside deregulation – i.e. policies to allow more firms to enter the industry and increase the competitiveness of the market. It is this increase in competition that can be the greatest spur to improvements in efficiency. For example, there is now more competition in telecoms and distribution of gas and electricity.

- However, privatisation doesn't necessarily increase competition; it depends on the nature of the market. E.g. there is no competition in tap water because it is a natural monopoly. There is also very little competition within the rail industry.

6. Government will raise revenue from the sale

Selling state-owned assets to the private sector raised significant sums for the UK government in the 1980s. However, this is a one-off benefit. It also means we lose out on future dividends from the profits of public companies.

7. IMPROVE SERVICE QUALITY

Service quality is not assured, however, by privatization. Contracts must be well-designed with performance standards that create incentives for high quality service. Furthermore, diligent monitoring of the contractor's performance through customer surveys and on-site inspections must also be performed by government in its oversight role.

Disadvantages

Opponents of privatization claim that privatization is simply a scheme to divert taxpayer dollars to create long-term revenue streams and profits for corporations. The Public Interest, a resource center dedicated to "ensuring that public contracts with private entities are transparent, fair, well-managed, and effectively monitored," as well as meeting the needs of the community, lists a number of potential drawbacks to privatization.

- Private sector focuses more on profit maximization and less on social objectives unlike public sector that initiates socially viable adjustments in case of emergencies and criticalities.

• There is lack of transparency in private sector and stakeholders do not get the complete information about the functionality of the enterprise.

• Privatization has provided the unnecessary support to the corruption and illegitimate ways of accomplishments of licenses and business deals amongst the government and private bidders. Lobbying and bribery are the common issues tarnishing the practical applicability of privatization.

• Privatization loses the mission with which the enterprise was established and profit maximization agenda encourages malpractices like production of lower quality products, elevating the hidden indirect costs, price escalation etc.

• Privatization results in high employee turnover and a lot of investment is required to train the lesser-qualified staff and even making the existing manpower of PSU abreast with the latest business practices.

• There can be a conflict of interest amongst stakeholders and the management of the buyer private company and initial resistance to change can hamper the performance of the enterprise .

• Privatization escalates price inflation in general as privatized enterprises do not enjoy government subsidies after the deal and the burden of this inflation affects the common man.

<u>Globalisation</u> we mean opening up of the economy for world market by attaining international competitiveness. Thus the globalisation of the economy simply indicates interaction of the country relating to production, trading and financial transactions with the developed industrialized countries of the world.

Accordingly, the term globalisation has four parameters:

(a) Permitting free flow of goods by removing or reducing trade barriers between the countries,

(b) Creating environment for flow of capital between the countries,

(c) Allowing free flow in technology transfer and

(d) Creating environment for free movement of labour between the countries of the world. Thus taking the entire world as global village, all the four components are equally important for attaining a smooth path for globalisation.

Advantages of Globalisation:

The following are some of the important advantages of globalisation for a developing country like India:

(i) Globalisation helps to boost the long run average growth rate of the economy of the country through:

(a) Improvement in the allocative efficiency of resources;

(b) Increase in labour productivity; and

(c) Reduction in capital-output ratio.

(ii) Globalisation paves the way for removing inefficiency in production system. Prolonged protective scenario in the absence of globalisation makes the production system careless about cost effectiveness which can be attained by following the policy of globalisation.

(iii) Globalisation attracts entry of foreign capital along with foreign updated technology which improves the quality of production.

(iv) Globalisation usually restructure production and trade pattern favouring labour-intensive goods and labour-intensive techniques as well as expansion of trade in services.

(v) In a globalized scenario, domestic industries of developing country become conscious about price reduction and quality improvement to their products so as to face foreign competition.

(vi) Globalisation discourages uneconomic import substitution and favour cheaper imports of capital goods which reduces capital-output ratio in manufacturing industries. Cost effectiveness and price reduction of manufactured commodities will improve the terms of trade in favour of agriculture.

(vii) Globalisation facilitates consumer goods industries to expand faster to meet growing demand for these consumer goods which would result faster expansion of employment opportunities over a period of time. This would result trickle down effect to reduce the proportion of population living below the poverty line

(viii) Globalisation enhances the efficiency of the banking insurance and financial sectors with the opening up to those areas to foreign capital, foreign banks and insurance companies.

Disadvantages of Globalisation:

The following are some of these disadvantages:

(i) Globalisation paves the way for redistribution of economic power at the world level leading to domination by economically powerful nations over the poor nations.

(ii) Globalisation usually results greater increase in imports than increase in exports leading to growing trade deficit and balance of payments problem.

(iii) Although globalisation promote the idea that technological change and increase in productivity would lead to more jobs and higher wages but during the last few years, such technological changes occurring in some developing countries have resulted more loss of jobs than they have created leading to fall in employment growth rates.

(iv) Globalisation has alerted the village and small scale industries and sounded death-knell to it as they cannot withstand the competition arising from well organized MNCs.

(v) Globalisation has been showing down the process to poverty reduction in some developing and underdeveloped countries of the world and thereby enhances the problem of inequality.

(vi) Globalisation is also posing as a threat to agriculture in developing and underdeveloped countries of the world. As with the WTO trading provisions, agricultural commodities market of poor and developing countries will be flooded farm goods from countries at a rate much lower than that indigenous farm products leading to a death-blow to many farmers.

(vii) Implementation of globalisation principle becoming harder in many industrially developed democratic countries to ask its people to bear the pains and uncertainties of structural adjustment with the hope of getting benefits in future.

Banking Fundamentals

Banking fundamentals refer to the concepts and principles relating to the practice of banking. Banking is an industry that deals with credit facilities, storage for cash, investments, and other financial transactions. The banking industry is one of the key drivers of most economies because it channels funds to borrowers with productive investments.

Banks perform a myriad of functions, including deposits and withdrawals, currency exchange, forex trading, and wealth management. Also, they act as a link between depositors and borrowers, and they use the funds deposited by their customers to provide credit facilities to people who want to borrow.

Banks make money by charging an interest rate on loans, where they profit by charging a higher interest rate than the interest rate they pay on customer deposits. However, they must comply with the regulations set by the central bank or national government

Objectives of Bank:

1. To establish as an institution for maximizing profits and to conduct overall economic activities.

2. To collect savings or idle money from the public at a lower rate of interests and lend these public money at a higher rate of interests.

3. To create propensity of savings amongst the people.

4. To motivate people for investing money with a view to bringing solvency in them .

5. To create money against money as an alternative for enhancing supply of money.

6. To build up capital through savings.

7. To expedite investments.

8. To extend services to the customers.

9. To maintain economic stability by means of controlling money market.

10. To extend co-operation and advices to the Govt. on economic issues.

11. To assist the Govt. for trade& business and socio-economic development.

12. To issue and control notes and currency as a central bank.

13. To maintain and control exchange rates as a central bank.

Functions of Commercial Banks

The primary functions of a commercial bank are as follows:

1. Accepting Deposits

Commercial banks accept deposits from people, businesses, and other entities in the form of:

- **Savings deposits** – The commercial bank accepts small deposits, from households or persons, in order to encourage savings in the economy.
- **Time deposits** – The bank accepts deposits for a fixed time and carries a higher rate of interest as compared to savings deposits.
- **Current deposits** – These accounts do not offer any interest. Further, most current accounts offer overdrafts up to a pre-specified limit. The bank, therefore, undertakes the obligation of paying all cheques against deposits subject to the availability of sufficient funds in the account.

2. Lending of Funds

Another important activity is lending funds to customers in the form of loans and advances, cash credit, overdraft and discounting of bills, etc.

Loans are advances that a bank extends to his customers with or without security for a specified time and at an agreed rate of interest. Further, the bank credits the loan amount in the customers' account which he withdraws as per his needs.

Functions of Commercial Banks

Commercial banks are authorized to provide a variety of financial services which includes loans, savings accounts, etc. In this article, we will talk about various functions that a commercial bank performs.

Broadly speaking, the functions are of two categories – primary and secondary.

Primary Functions of Commercial Banks

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Under the cash credit facility, the bank offers its customers a facility to borrow cash up to a certain limit against the security of goods. Further, an overdraft is an arrangement that a bank offers to customers wherein a temporary facility is offered to overdraw from the current account without any security.

The limit is pre-specified. Additionally, banks also discount and purchase bills. In both of these cases, a bank credits the amount of the bill in the customer's account after deducting discounts and commissions. Subsequently, this amount is recovered from the debtors on the maturity of the instrument.

Secondary Functions of Commercial Banks

The secondary functions of a commercial bank are as follows:

Bank as an Agent

A bank acts as an agent to its customers for various services like:

- Collecting bills, draft, cheques, etc.
- Paying the insurance premium, rent, loan installments, etc.
- Working as a representative of a customer for purchasing or redeeming securities, etc. in the stock exchange.
- Acting as an executor, administrator, or trustee of the estate of a customer
- Also, preparing income tax returns, claiming tax refunds, etc.

Functions of Central Bank of India

1. Issue of Currency:

The central bank is given the sole monopoly of issuing currency in order to secure control over volume of currency and credit. These notes circulate throughout the country as legal tender money. It has to keep a reserve in the form of gold and foreign securities as per statutory rules against the notes issued by it.

It may be noted that RBI issues all currency notes in India except one rupee note. Again, it is under the directions of RBI that one rupee notes and small coins are issued by government mints. Remember, the central government of a country is usually authorised to borrow money from the central bank.

2. Banker to Government:

Central bank functions as a banker to the government—both central and state governments. It carries out all banking business of the government. Government keeps their cash balances in the current account with the central bank. Similarly, central bank accepts receipts and makes payment on behalf of the governments.

3. Banker's Bank and Supervisor:

(i) It is the custodian of their cash reserves. Banks of the country are required to keep a certain percentage of their deposits with the central bank; and in this way the central bank is the ultimate holder of the cash reserves of commercial banks, (ii) Central bank is lender of last resort. Whenever banks are short of funds, they can take loans from the central bank and get their trade bills discounted. The central bank is a source of great strength to the banking system, (iii) It acts as a bank of central clearance, settlements and transfers. Its moral persuasion is usually very effective so far as commercial banks are concerned.

4. Controller of Credit and Money Supply:

Central bank controls credit and money supply through its monetary policy which consists of two parts—currency and credit. Central bank has monopoly of issuing notes (except one-rupee notes, one-rupee coins and the small coins issued by the government) and thereby can control the volume of currency.

The main objective of credit control function of central bank is price stability along with full employment (level of output).

5. Lender of Last Resort:

When commercial banks have exhausted all resources to supplement their funds at times of liquidity crisis, they approach central bank as a last resort. As lender of last resort, central bank guarantees solvency and provides financial accommodation to commercial banks (i) by rediscounting their eligible securities and bills of exchange and (ii) by providing loans against their securities. This saves banks from possible failure and banking system from a possible breakdown. On the other hand, central bank, by providing temporary financial accommodation, saves the financial structure of the country from collapse.

6. Exchange Control:

Another duty of a central bank is to see that the external value of currency is maintained. For instance, in India, the Reserve Bank of India takes steps to ensure external value of a rupee. It adopts suitable measures to attain this object. The exchange control system is one such measure.

7. Custodian of Foreign Exchange or Balances:

It has been mentioned above that a central bank is the custodian of foreign exchange reserves and nation's gold. It keeps a close watch on external value of its currency and undertakes exchange management control. All the foreign currency received by the citizens has to be deposited with the central bank; and if citizens want to make payment in foreign currency, they have to apply to the central bank.

8. Collection and Publication of Data:

It has also been entrusted with the task of collection and compilation of statistical information relating to banking and other financial sectors of the economy.

BASIS FOR COMPARISON	CENTRAL BANK	COMMERCIAL BANK
Meaning	The bank which looks after the monetary system of the country is known as Central Bank.	The establishment, which provides banking services to the public is known as Commercial Bank.
What is it?	It is a banker to the banks and the government of the country.	It is the banker to the citizens of the nation.
Governing Statute	Reserve Bank of India Act, 1934.	Banking Regulation Act, 1949.
Ownership	Public	Public or Private
Profit motive	It does not exist for making profit for its owners	It exist for making profit for its owners.
Monetary Authority	It is the supreme monetary authority with wide powers.	No such authority.
Objective	Public welfare and economic development.	Earning Profits
Money supply	Ultimate source of money supply in the economy.	No such function is performed by it.
Right to print and issue currency notes	Yes	No

BASIS FOR COMPARISON	CENTRAL BANK	COMMERCIAL BANK
Deals with	Banks and Governments	General Public
How many banks are there?	Only one	Many