MODULE II MARKET STRUCTURE 9

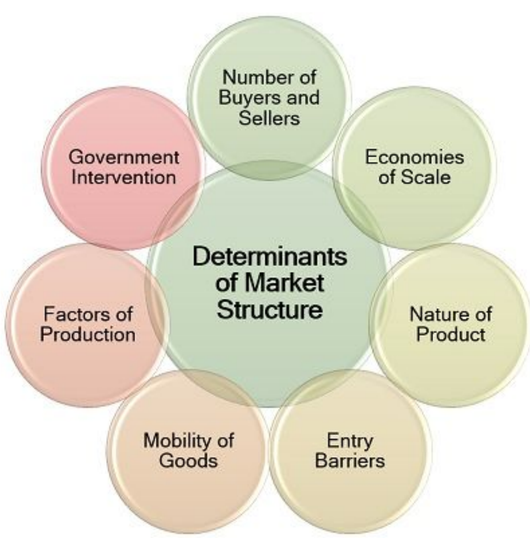
Perfect Competition – Imperfect Competition: Monopoly – Monopolistic – Oligopolistic Strategy, Cartels, Cournot Kinked Demand and Price Leadership – Measurement of economic concentration – Policy against monopoly and restrictive trade practices – Competition Law – Pricing Practices: Objectives – Determinants – Pricing Methods – Government Policies and Pricing.

Meaning and Functions of Market

In ordinary parlance, the word 'market' means a place where buyers and sellers assemble to buy and sell goods and services. But in Economics, the word market does not refer to a particular place where goods and services are bought and sold but it refers to a social relation or a social institution between buyers and sellers of a product. In fact, it is a whole set of conditions under which buyers and sellers come in contact for the purpose of exchange. Market performs two essential functions – firstly, it bridges the gap between production and consumption and secondly it determines the price.

Determinants of Market Structure

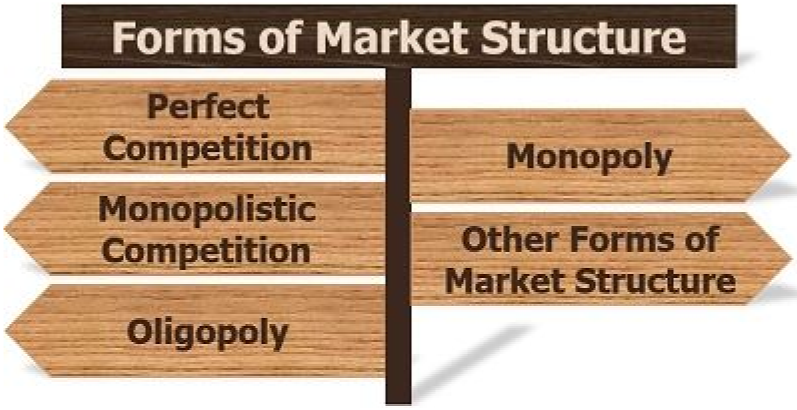
The market type for any product or service is decided by the following factors:



- **Number of Sellers**: The number of firms selling a particular product on the market, determines the level of competition, ultimately choosing the structure of the market for that specific product.
- **Number of Buyers**: Buyers decide the demand for a particular product. A monopsony market has multiple sellers and a single buyer who influences the price of the product.
- **Economies of Scale**: The size of the firm or the level of production contributes to a market structure. If the output is done on such a large scale that it fulfils the market demand solely, it may create a monopoly market.
- **Nature of Product**: The product features determines the type of market structure to which it belongs. If the products offered by different sellers are homogeneous, it lies in a perfect competition market. If it is unique and has no other substitute, it creates a monopoly in the market.
- **Entry Barriers**: The profitability of a product invites the sellers to enter such markets. The market runs on the rule 'survival of the fittest' where weak firms exit and strong ones survive. There are some public utility service markets which run on monopoly by the government like post offices, railways, water supply, etc.
- **The mobility of Goods**: Easy transportation of goods from production place to the market ensures uniform prices by different sellers.
- **Government Intervention**: Some markets are indirectly controlled by the government. The government either imposes heavy taxes or makes the business license mandatory to restrict the entry of firms.

Forms of Market

Markets have been classified by the economists on the basis of certain elements like competition, nature of the commodity, number of sellers, time period, etc. Hence, a thorough understanding of this concept is required. Based on the above determinants, the market structure can be classified into four broad categories.



Perfect Competition

It is a market in which many sellers are present to sell the same kind of products at the same market price to a large number of buyers.

For Example; the farmers' market can be seen as the most common examples of a perfect competition market. Here, all the sellers are engaged in selling identical products at a single price.

Monopoly

The market which is solely occupied by a single seller offering products which have no other competitive product is known as a monopoly market.

For Example; Reliance Jio is ruling the Indian telecom industry solely because of its affordable plans and idea of a digital revolution.

Monopolistic Competition

A market where a large number of sellers trade in differentiated products to meet the requirement of many buyers is known as a monopolistic competition market.

It is a combination of perfect competition and monopoly and depicts the real market situation of the present era.

For Example; a company producing cooking oil has a differentiated product which it has to sell at a competitive or reasonable price to the buyers.

Oligopoly

Oligopoly is a market where there is a limited number of sellers who are engaged in selling similar or distinct products. The firms that deal in identical products are termed under homogeneous oligopoly.

Whereas, the firms which deal in products that differ in one or the other way from its substitute, lies under the heterogeneous oligopoly.

For Example; the cement industry is a homogeneous oligopoly market. However, the firms manufacturing mobile phones are stated under heterogeneous oligopoly market.

Other Forms of Market Structure

Other than the above-market types, there are some other forms of the market too. These are classified as follows:

Duopoly: In a duopoly, the market is majorly captured by two sellers who work unanimously. They are competitors but together decides the price of a product.

For Example; Once, the brands like Apple and Microsoft formed a duopoly market for personal computers.

Monopsony: A monopsony market is just the opposite of the monopoly market. There is a single buyer in a monopsony market who has the power to influence the price of the product. It is most commonly seen in labour markets.

For Example; country towns are well-known examples of a monopsony market. One of these is Minto city, British Columbia, where most of the localities are involved in gold mining activities

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.

The best example of a cartel today is the Organization of Petroleum Exporting Countries, otherwise known as OPEC, which comprises 12 oil-producing nations that supply 60% of all oil traded internationally. Prices are maintained by restricting each country of the OPEC cartel to a specific production allocation. The OPEC cartel is largely responsible for the large fluctuations in gasoline prices that occurred in the United States since 1973, although recently, speculation in the commodity markets has also increased volatility.

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 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.

Price Leadership Model

In many industries, there is a dominant firm in an oligopoly, and the other firms often follow the dominant firm in price changes, which can be viewed as a type of implicit price collusion. Hence, the dominant firm also becomes the price leader. Since most firms have been in the business for a number of years, they can observe how their competitors react to changes in the industry, allowing them to reach an understanding of how their competitors will react to any price changes. Firms in an oligopoly do not often change prices, certainly not for minor changes in costs, but they will change prices if cost changes are substantial. Indeed, if there is a general price increase in the inputs of an industry, then all firms will surely increase their prices. Increasing price of inputs, of course, helps to protect the industries from antitrust prosecutions since they have a reasonable basis for increasing the price of their products that is not related to restricting competition. Oftentimes, the price leader will communicate the need to raise prices through press releases, trade publications, and speeches by major executives, especially when announcing quarterly earnings. There are many times when a price leader will limit price increases to discourage the entrance of new competitors — a practice called limit pricing. This will be particularly true if the economies of scale are not that steep, since high prices can allow the entrance of new competitors who will be able to survive on a small market share.

Measurement of Economic Concentration

The economic concentration refers to the extent to which a market is taken up by producers within a given industry. It is an important element of the market structure which plays a dominant role in determining the behavior of a firm in the market. It means the situation when an industry or market is controlled by a number of leading producers who are exclusively or at least very largely engaged in that industry. Basically, it is caused by the oligopolistic structure of industries. The two variables that are of relevance in determining such situation are i) the number of firms in the industry ii) relative size of distribution. For example, concentration in the ownership of the industry, concentration of decision making power and concentration of the firms in a particular location or region, etc., all being elements of market concentration may have considerable impact on the market performance of the firms such as profitability, price cost margin, growth, technological progress and content. Industrial concentration also is promoted by barriers to entry, which make it difficult for new firms to displace established firms. Barriers to entry are erected by government-conferred privileges such as patents, copyrights and trademarks, exclusive franchises, and licensing requirements. Existing firms may possess other advantages over newcomers, including lower costs and brand loyalty, which make entry more difficult.

These links are important to understand because all of them are very much relevant from the point of view of decision making and regulation of industries.

The market concentration ratio measures the combined market share of all the top firms in the industry. 'Market Share' is used as a reference here in the formulae. It could be sales, employment statistics, number of people using a company's services, number of outlets etc. The value of top firms or top 'n' firms may be three or maximum five. If the top firms keep on gaining market share, then we say that the industry has become highly concentrated. To understand market concentration, let's first understand 'concentration'. Concentration within an industry can be defined as the degree at which a small number of firms make up for the total production in the market. If the concentration is low, it simply means that top 'n' firms are not influencing the market production and the industry is considered to be highly competitive. On the other hand, if the concentration is high, it means that top 'n' firms influence the production or services provided in the market the industry then is said to be oligopolistic or monopolistic.

The most common measure to calculate the market concentration is the Herfindahl-Hirschman Index (HHI). This index is calculated by adding the square root of the percentage market share of each individual firm in the industry. For example, in a market consisting of only five firms with shares of 30%, 30%, 20%,20% and 20%, the Herfindahl Index would be 3000 (900 + 900+ 400+ 400+400). The index may rise as high as 10,000 if the market has a monopoly. But, lower the index is, more competitive the market becomes. The indicator could become zero for the perfect competition.

Policy against Monopoly and Restrictive Trade Practices: Monopolistic and Restrictive Trade Practices Act,1969

The Monopolistic and Restrictive Trade Practices Legislation (MRTP) was implemented in 1969. This law was designed to ensure that the economic system's operation does not result in the concentration of economic power in the hands of a few. Therefore, ensure that monopolies are controlled and that monopolistic and restrictive business practices are prohibited. It was later repealed and replaced by the Competition Act, 2002 but it still was the first legislation in India regulating the market.

The Monopolistic and Restrictive Trade Practices Act, 1969, was enacted:

1. To ensure that the operation of the economic system does not result in the concentration of economic power in hands of a few,
2. To provide for the control of monopolies, and
3. To prohibit monopolistic and restrictive trade practices.

The MRTP Act extends to the whole of India except Jammu and Kashmir.

Definition of Monopolistic Trade Practice

The act defines the Monopolistic Trade Practice as "Such practice indicates misuse of one's power to abuse the market in terms of production and sales of goods and services.

- Firms involved in monopolistic trade practice tries to eliminate competition from the market.
- Then they take advantage of their monopoly and charge unreasonably high prices.
- They also deteriorate the product quality, limit technical development, prevent competition and adopt unfair trade practices"

Definition of Unfair Trade Practice

The act defines Unfair Trade Practice as

- False representation and misleading advertisement of goods and services.
- Falsely representing second-hand goods as new.
- Misleading representation regarding usefulness, need, quality, standard, style etc of goods and services.
- False claims or representation regarding price of goods and services.
- Giving false facts regarding sponsorship, affiliation etc. of goods and services.
- Giving false guarantee or warranty on goods and services without adequate tests.

Definition of Restrictive Trade Practice

The act defines Restrictive Trade Practice as "The traders, in order to maximize their profits and to gain power in the market, often indulge in activities that **tend to block the flow of capital** into production. Such traders also bring in conditions of delivery to affect the flow of supplies leading to unjustified costs."

Unless the Central Government otherwise directs, this act shall not apply to:

1. Any undertaking owned or controlled by the Government Company,
2. Any undertaking owned or controlled by the Government,
3. Any undertaking owned or controlled by a corporation (not being a company established by or under any Central, Provincial or State Act,
4. Any trade union or other association of workmen or employees formed for their reasonable protection as such workmen or employees,
5. Any undertaking engaged in an industry, the management of which has been taken over by any person or body of persons under powers by the Central Government,
6. Any undertaking owned by a co-operative society formed and registered under any Central, Provincial, or State Act,
7. Any financial institution.

Conclusion

MRTP Act also allows for the establishment of the Commission of MRTP which is to be a regulatory authority to deal with the offences under the MRTP Act. During its enactment, the MRTP Act is the first legislation that addressed competition law problems in India and it seemed to be perfect legislation to catch the defaulting companies.

However, with the wave of globalization that came to post the 1991 reforms the whole scenario in the country changed. A need for modification in the existing MRTP Act to keep pace with the rapidly changing economic scenario arose and so it was repealed and replaced by the Competition Act, 2002.

Competition Law

Competition law is the body of legislation intended to prevent market distortion caused by anti-competitive practices on the part of businesses. In the United States, Canada and the European Union, competition law is also known as Antitrust law.

The purpose of competition law is ensuring a fair marketplace for consumers and producers by prohibiting unethical practices designed to garner greater market share than what could be realized through honest competition. The effects of anti-competitive practices include not just difficulty for smaller companies entering or succeeding in a market, but also higher consumer prices, poorer service and less innovation.

Anti-competitive practices include, among many other examples: Predatory pricing, which involves a monopoly or oligopoly charging an exorbitant price for something that the consumer has little choice other than to purchase; price fixing, which involves collusion between would-be competitors to set similar prices for products; bid rigging, which involves colluding to select the winner of a contract in advance; and dumping, which involves selling a product at such a low price that smaller companies are unable to compete and may be forced out of the market. Although specific legislation varies from one country to another, those practices are generally prohibited by competition law.

The Competition Act of 2002 came into effect on 20 May 2009, repealing the Monopolies and Restrictive Trade Practices Act, 1969. It was passed in December 2002, and the act came into force on 14 January 2003.

Objective and Scope of Competition Act 2002

The Competition Act is legislation that seeks to ensure that the interests of consumers are protected against anti-competitive practices, promote and sustain market competition, protect consumers' interests, and ensure the freedom of trade is carried out by other participants in markets in India. The act applies throughout India and has replaced the Monopolies and Restrictive Trade Practices Act (MRTP Act), 1969.

The Competition Act is based on three pillars of competition law; Competition Commission of India (CCI), Competition Appellate Tribunal (COMPAT) and, most importantly, the National Competition Policy (NCP).

The main objective behind enacting this act is to ensure that market competition works effectively and that consumers get access to a wider range of products at competitive prices. A customer, be it an individual, a collective group, or an entire nation, are all affected by these competition laws through a variety of channels.

- **Better Quality**

Competition law forces companies to increase their product quality and productivity, so as to attract customers, which eventually provides them with an advantage over their competitors in the market.

- **More Choices**

A Strong Competition policy is a catalyst to promote social inclusion and reduce inequalities as it tends to provide different customers with alternate options of the same product, commensurate with a specific customer's needs and affordability factor.

- **Low Prices for all**

The simplest and perhaps the most sought after way for a company to attain a higher market share is to offer a better product or service at a better price. A competitive market forces companies to push down prices in order to maintain their stand in the marketplace.

- **Promotes Innovation**

Competition law provides a sense of positive motivation to smaller and less prominent companies to constantly undergo product design innovations and changes so as to be at par with the competitive rivals that have established a monopoly in the respective sector.

Salient Features

The following are the features of the Competition Act:

1. Anti-Agreements: Any individual or enterprises shall not deal in production supply or distribution that may cause a negative impact regarding competition in India. Any existence of such agreements is considered illegal.

2. Abuse of dominant position: In the event, an enterprise or an associated individual, it is found to indulge in practices that are unfair or discriminatory in nature shall be considered an abuse of dominant position. If a party is found to be in abuse of its position, then they will be subjected to an investigation from the concerned authorities.

3. **Combinations:** As per the act a combination is defined as terms which lead to acquisitions or mergers. But should such combinations cross the limits as put forth by the Act, then the parties involved would be under the scrutiny of the Competition Commission of India.

4. Competition Commission of India: The Competition Commission of India is an independent body with the powers to enter into contracts and should the contracts be broken they can sue the parties involved. The Commission consists of a maximum of six members who are tasked with sustaining and promoting the interests of consumers in order to foster an ideal environment for economic competition. The other function of the Commission is to advise the Government of India regarding competition in the economy and create public awareness on the same issue.

5. Appeal: Any person aggrieved by any decision or order of the Commission may file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Commission. No appeal shall lie against any decision or order of the Commission made with the consent of the parties.

6. **Penalty:**

If any person fails to comply with the orders or directions of the Commission shall be punishable with fine which may extend to 1 lakh for each day during which such noncompliance occurs, subject to a maximum of 10 crores. If any person does not comply with the orders or directions issued, or fails to pay the fine imposed under this section, he shall be punishable with imprisonment for a term which will extend to three years, or with fine which may extend to 25 crores or with both. Section 44 provides that if any person, being a party to a combination makes a statement which is false in any material particular or knowing it to be false or omits to state any material particular knowing it to be material, such person shall be liable to a penalty which shall not be less than 50 lakhs but which may extend to 1 crore.

Difference Between MRTP Act and Competition Act

The Monopolies and Restrictive Trade Practices (MRTP) Act was a law in India that aimed to prevent monopolies and restrict unfair trade practices. It was repealed in 1991 and replaced by the Competition Act. The Competition Act is a more comprehensive law that aims to prevent practices that have an adverse effect on competition in India and promote and sustain competition in markets. It also establishes the Competition Commission of India, which is responsible for enforcing the Act.

MRTP Act (Monopolies and Restrictive Trade Practices Act)	**Competition Act, 2002**
The MRTP Act is a legislation that was established in 1969 with the primary objective of curbing monopolistic practices and promoting competition in the Indian market.	The Competition Act, 2002 is a legislation that was established in 2002 with the primary objective of promoting and protecting competition in the Indian market.
The MRTP Act is regulated by the Ministry of Corporate Affairs.	The Competition Act, 2002 is regulated by the Competition Commission of India (CCI).
The MRTP Act has provisions for the regulation of monopolies and the prevention of restrictive trade practices.	The Competition Act, 2002 has provisions for the prevention of anti-competitive agreements, the regulation of combinations (mergers and acquisitions), and the prevention of abuse of dominant position.
Penalties for non-compliance under the MRTP Act include fines and imprisonment.	Penalties for non-compliance under the Competition Act, 2002 include fines and penalties for individuals and companies.
The MRTP Act is not applicable to certain sectors like agriculture, small-scale industries and services.	The Competition Act, 2002 applies to all sectors of the economy.

The MRTP Act does not have provision for leniency policy.	The Competition Act, 2002 has provision for leniency policy.
The MRTP Act does not have provision for settlement of cases.	The Competition Act, 2002 has provision for settlement of cases.

Pricing Policy

Pricing policy refers to the policy of setting the price of the product or products and the policy of setting the price of the product or products and services by the management after taking into consideration various internal and external factors, forces and its own business objectives. The various internal factors that need to be taken into account are objectives of the firm, cost of production, quality of the product, scale of production, efficient management of resources, advertisement and sales promotion policies, wage policy, product life cycle, etc.

On the other hand, the external factors that needs to be taken into account are demand and supply and their determinants, degree of competition, size of the market, the goodwill, name and fame and reputation of a firm, availability of substitutes, government policy, bargaining power of customers, etc. fixing prices are the most important aspect of managerial decision making because market price charged by the company affects the present and future production plans, distribution, marketing, etc. hence, a firm has to charge the most reasonable and acceptable price to the customers. There is no a standard formula or equations in Economics to fix the best possible price for a product. The dynamic and changing nature of the economy forces a firm to raise and reduce prices continuously. Thus, prices fluctuate over a period of time.

Pricing Methods

Pricing is the most important policy followed by a producer or a firm because it earns revenue to the seller. The right price of a product is one which keeps all stakeholders happy, consumers feel happy that they got value for their money, sellers are happy because they could sell the desired volume and shareholders are satisfied that they earned higher profits. Firms pursue a number of objectives while setting the price of their products. A business or a firm can use a variety of pricing strategies keeping the objectives in mind when selling a product or service. The price can be set to maximize profitability for each unit sold or from the market overall. It can be used to defend an existing market from new entrants, to increase market share within a market or to enter a new market. Businesses may benefit from lowering or raising prices, depending on the needs and behaviors of customers and clients in the particular market. Finding the right pricing strategy is an important element in running a successful business.

Different Pricing Methods in Practice

Cost Plus Pricing Method: According to this method, the price is set to cover the costs of material, labour, overheads and a certain percentage of profit. Costs to be includes in the price are normally actual costs, expected costs or standard costs. Actual costs are costs actually incurred in the production period. Expected costs are based on the forecasts of production and prices. Standard costs are based on the forecasts made on the basis of the assumption that the efficiency, sales, prices, etc. will be normal.

For example, let us say, a producer produces 10 units of product X. he estimates the overhead costs, labour costs and material costs to be suppose Rs. 10, Rs. 10 and Rs. 5 and profit markup is 12% of costs. The price of the product X will be Rs. 10+10+5+3=Rs.28.

Premium Pricing

Premium pricing strategy establishes a price higher than the competitors. It's a strategy that can be effectively used when there is something unique about the product or when the product is first to market and the business has a distinct competitive advantage. Premium pricing can be a good strategy for companies entering the market with a new market and hoping to maximize revenue during the early stages of the product life cycle.

Penetration Pricing

A penetration pricing strategy is designed to capture market share by entering the market with a low price relative to the competition to attract buyers. The idea is that the business will be able to raise awareness and get people to try the product. Even though penetration pricing may initially create a loss for the company, the hope is that it will help to generate word-of-mouth and create awareness amid a crowded market category. . Under this approach, a product is widely promoted and its introductory price is kept comparatively low. Eg. Razor manufacturers often use this strategy.

Price Skimming

Businesses that have a significant competitive advantage can enter the market with a price skimming strategy designed to gain maximum revenue advantage before other competitors begin offering similar products or product alternatives. An approach under which a producer sets a high price for a new high-end product (such as an expensive perfume) or a uniquely differentiated technical product (such as advanced software). Its objective is to obtain maximum revenue from the market before substitutes products appear. After that is accomplished, the producer can lower the price drastically to capture the low- end buyers and to thwart the copycat competitors. Sometimes, they may not lower the price because of (i) brand image already created (ii) need not increase the price in the long run while the competitors may, when costs increase.

Psychological Pricing

Psychological pricing strategy is commonly used by marketers in the prices they establish for their products. For instance, Rs. 99 is psychologically "less" in the minds of consumers than Rs. 100. It's a minor distinction that can make a big difference.

Peak Load Pricing:

This is a kind of price discrimination in which consumers are segregated on the basis of time segments; different prices are charged for the same facility used at different points of time by the same consumers. The time zone is divided into peak load and off peak load, consumers using the product at peak load time pay a higher price and users at off peak period pay a lower price. Ex: BSNL, Airlines provide various discounts on tickets purchased at different points of time.

Administered Pricing Policy:

An administered price is in general a price which is either set (fixed) by legal statute or by a standard procedure formulated as an official policy, instead of being determined directly by supply costs and market demand. The government generally adopts this by intervening in the market mechanism and administering. Controlling the prices of the goods, especially essential goods, to make it available to the common man. Rationing (public distribution system) is a type of administered pricing policy adopted in India.

Bundle Pricing Policy:

It is a strategy whereby a seller bundles together many different goods/items being sold and offers the entire bundle at a single price. E.g. Various plans in a cell phone; value meals in a restaurant, etc.

Going Rate Pricing: this is a pricing strategy adopted when most of the players do not indulge in separate pricing but prefer to follow the prevailing market price. Normally, price is fixed by the dominant firm and the other firms accept its leadership and follow that price. The success of this strategy is dependent on the fact that most of the firms do not want to enter into a price war kind of situation. Mention can be made of the same prices followed by packaged drinking water, soft drinks or pasteurized milk packets.

No Profit-No Loss Pricing:

Some Government enterprises have been required and directed by law or by Memorandum and Articles of Association to follow a "no profit no loss price" policy. The Hindustan Insecticides have been following this rule. These corporations have been marketing their products on no profit no loss basis.

Differential Pricing: Under this method the same product is sold at different prices to different customers, in different places and at different periods. For instance, a cinema house charges different rates for different categories of seats. Telephone authorities charge less for trunk calls at night than during day. This method is also called discriminatory pricing or price discrimination.

Monopoly Pricing: Monopolistic conditions exist where a product is sold exclusively by one producer or a seller. When a new product moves to the market, its price is monopoly price there no problem is no competition or no substitute. Monopoly price will maximize the profits, as there is no pricing problem.

Dual Pricing: This is a system adopted by the government of charging lower prices to poor sections and higher prices to richer class of the society. Originally started with the price of steel, dual pricing was extended to many other essential goods such as major food grains, sugar, edible oils and cheaper varieties of cotton cloth.

International Price discrimination and Dumping: Normally firms do not charge same price in the international market as in the domestic market simply because the market conditions are not similar. The international price is either higher than domestic price or lower depending upon the market forces. At the same time, companies may be charging be charging different prices in different countries using discriminatory pricing strategies. The firm may segregate its market on the basis of that particular country's paying capacity and price elasticity of demand. One very common form of such pricing is called dumping which is aimed at gaining monopoly in a foreign country or at disposing of excess inventory in order to avoid reduction in home price and thereby help in reduction in producer's income. Dumping is often referred to as a pricing which is below the fair value of the product.

Government Policies and Pricing

The equilibrium price of a commodity is determined by the free play of the forces of demand and supply of the commodity without any intervention of the government. But sometimes the price so determined is very high when there is shortage of some commodity in the market. In such a situation some consumers cannot afford to buy the commodity due to its high price. So in order to protect the interest of consumers the government has to fix the price of the commodity which is generally lower than the equilibrium price. In the same way when there is bumper crop of food grains, the price of food grains is determined at a lower level. At this price the farmers are unable to meet their cost of production even. So, the farmers are badly affected due to heavy fall in price. In such cases the government fixes the price of food grains which is higher than the equilibrium price in order to protect the interest of producers specially farmers. So, sometimes the government does not allow free play of the forces of demand and supply for determination of price of some commodities in order to protect the interest of consumers or producers. Government can fix the price of the commodity either below the equilibrium price or above the equilibrium price. Such a price is called administered price (Government determined price). Administered price may be in the form of: (i) Control Price (ii) Support Price (iii) Token Price (iv) Dual Price

- **Control Price:** In order to protect the interest of consumer's government fixes the maximum price of the commodity. This maximum price is generally lower than the equilibrium price. This is called control price or ceiling price. This price is fixed by the government because poor people cannot afford to buy the commodity at equilibrium price. This situation arises when the production of a commodity is less than its demand. As the price of the commodity fixed by the government is less than the equilibrium price, it may create excess demand of the commodity which means the buyers are willing to buy more than what the sellers are willing to sell. In India government has a control price or ceiling price of the commodities which it considers essential for the masses. For examples some goods such as wheat, rice, sugar, kerosene oil etc. have a control price. Due to excess demand for the commodity at ceiling price government resorts to rationing. Rationing means fixing of quota per head per unit of time. Due to excess demand of the commodity at ceiling price the problem of black marketing may also arise. Black marketing is a situation in which the seller illegally charges the price of the commodity which is much higher than the control price.

- **Support Price**: Sometimes, in order to protect the interests of producers specially farmers, government fixes the minimum price of the commodity which has to be paid to the producers. This price is generally higher than the equilibrium price. This problem arises when the producers do not cover even their cost of production at equilibrium price. This price fixed by government to safe guard the interests of producers, is called support price. It may create the situation of excess supply of the commodity. It means the sellers are willing to sell more than what the buyers are willing to buy. In India low price of food grains such as wheat, rice etc. adversely affects the farmers. They may lose their interest in producing food grains. This may result in acute shortage of food grains. Therefore, the system of support price is usually followed in case of agricultural products. The system of support prices assures the farmers that they will be able to sell their products at least at this price. In case of excess supply of the commodity at support price government is ready to purchase any quantity of the commodity to make buffer stock of the commodity.

- **Token Price:** There are some goods and services which are considered necessary for the existence of life e. g. medical services, health services and education services. Poor people may not afford those services. This will increase the problem of poverty. In order to avoid that, the government reduces the price of services which are necessary. That reduced price is called token price. For example: Tuition fees in schools and medical expenses in hospitals are below the market price. They are fixed at Token price. Token price is charged in order to prevent the wasteful use of these services otherwise these services are misused. Also, there are some Private Charitable institutions providing goods and services to the poor people at Token price (much below the market price).

- **Dual Price:** As explained earlier in this lesson that price control may lead to the shortage of the commodity because sellers are not willing to supply adequate quantity of the commodity at the price fixed by the government as the price is lower than the equilibrium price. This may also lead to black marketing of the commodity. To avoid this situation government adopts dual price policy under this policy a part of the production of the good is sold at control price through fair price shops and the remaining part is sold at prevailing market price which is determined by the forces of demand and supply. At this market price any quantity of the commodity can be bought. For example, government sells wheat, rice and sugar to BPL (Below poverty line) card holder at control price through fair price shops and the producers are also allowed to sell their remaining production at equilibrium price in open market.

Effect of Taxes and Subsidies on Market Price

Government imposes various types of taxes on production and sales of the commodities and also on the imports of raw material etc. in the form of excise duty, sales tax and import duty respectively. These taxes are paid to the government by producers, sellers and importer of these commodities. The producers, sellers and importers of these commodities recover them from the buyers of these commodities. So these taxes increase the market price of the commodities. If the government increases the rate of these taxes, the market price of the commodities will also increase. On the other hand, government gives subsidy to the producers to sell some goods at a lower price in order to make the commodity available to the common men at a reasonable price. Thus an increase in subsidy leads to decrease in market price of the commodity. For example, government gives subsidy on kerosene oil, cooking gas etc.

PUBLIC DISTRIBUTION SYSTEM (PDS) Poor people cannot afford to buy even the essential commodities at their market price. To help these people, one of the methods adopted in India is public distribution system under this system essential commodities like wheat, rice, sugar etc. are made available to the common man at cheaper rate through fair price shops called ration shops. These commodities are sold through an identification paper called ration card. Following are the essential elements of public distribution system in India. 1. Subsidy:

Government gives subsidies on the commodities sold through public distribution system. Therefore, the prices of the commodities sold under this system are relatively lower. 2. Fixed quantity (Rationing): Government fixes the quantity (quota) per head per unit of time on the basis of minimum requirement of a person. Every household is issued a ration card mentioning the number of persons in the family. Every household can buy the fixed quantity of the commodity according to the number of persons in the family from the fair price shops. 3. Fair price shops (FPS): Government sells these commodities through fair price shops popularly known as ration shops. These shops are opened in all parts of the country. The government supplies these commodities to the owner of these shops according to the number of ration cards registered with each shop. The owner of these shops is paid a commission on their total sales.

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