**Unit II**

**Introduction to Markets and Pricing Strategies Meaning:**

Market refers to a place or point at which buyers and sellers negotiate their exchange of well-defined products or services.

**Definition:**

According to Prof R. Chapman, “the term market refers not necessarily to a place but always to a commodity and the buyers and sellers who are in direct competition with one another”.

**Feature of Market**

1. **Area:** it is an area where buyers and sellers of the commodity must reside i.e., local, national, international.

2. **Commodity:** commodity is soul of market. Every market must have commodity to be purchased and sold.

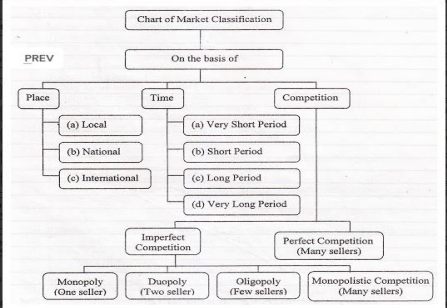
3. **Buyers and sellers:** Buyers and sellers directly or indirectly in the market is essential for conducting business transactions.

4. **Free competition:** Free competition among Buyers and sellers in the market.

**5. Price**

**6. Close contact between buyers and sellers.**

**Types of Markets:**

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**What is Perfect Competition?**

Perfect competition refers to a market structure where competition among the sellers and buyers is very large, all engaged buying and selling a homogeneous product, free entry/exit conditions and perfect knowledge of market at a time.

E.g.: fruit and vegetable market

**Features of perfect competition:**

(i) Large Number of buyers and sellers

(ii) Homogeneous Products or services

(iii) Freedom to enter or exit the market

(iv) Perfect information available to the buyers and sellers

(v) Perfect mobility of factors of production

(VI) Uniform price (Each firm is a price taker)

**What is Imperfect Competition?**

A competition is said to be imperfect when it is not perfect. In other words, when any or most of the above conditions do not exist in a given market it is referred to as an imperfect competition

Based on the number of buyers and sellers, the structure of market varies as below:

‘Poly’ refers to seller and ‘Psony’ refers to buyer.

Imperfect competition markets are classified as:

(a) Monopoly

(b) Monopolistic Competition

(c) Duopoly

(d) Oligopoly

(e) Monopsony

(f) Duopsony

(g) Oligopsony

**What is Monopoly?**

The term monopoly is derived from Greek words 'mono' which means single and 'poly' which means seller. So, monopoly is a market structure, where there only a single seller producing a product having no close substitutes.

Examples:

1. Indian Railways has monopoly in Railroad transportation. 2. State Electricity board has monopoly over generation and distribution of electricity in many of the states.

3. Hindustan Aeronautics Limited has monopoly over production of aircraft. 4. There is Government monopoly over production of **nuclear power**. **Characteristics / Features of Monopoly:**

1. A single seller has complete control over the supply of the commodity. 2. There are no close substitutes for the product.

3. There is no free entry and exit because of some restrictions. 4. Large no of buyers

5. Monopolist is a price maker.

6. Since there is a single firm, the firm and industry are one and same i.e. firm coincides the industry.

7. Monopoly firm faces downward sloping demand curve. It means he can sell more at lower price and vice versa. Therefore, elasticity of demand factor is very important for him.

8. Can decide either the price or quantity, not both

9. Monopoly may be created through statutory grant of special privileges such as licenses, permit, patent rights, and so on

**Classification / Kinds / Types of Monopoly:**

**1. Perfect Monopoly:** It is also called as absolute monopoly. In this case, there is only a single seller of product having no close substitute; not even remote one. There is absolutely zero level of competition. Such monopoly is practically very rare.

**2. Imperfect Monopoly:** It is also called as relative monopoly or simple or limited monopoly. It refers to a single seller market having no close substitute. It means in this market, a product may have a remote substitute. So, there is fear of competition to some extent e.g. Mobile (Cell phone) telecom industry (e.g. Vodafone) is having competition from fixed landline phone service industry (e.g. BSNL).

**3. Private Monopoly:** When production is owned, controlled and managed by the individual, or private body or private organization, it is called private monopoly. E.g. Tata, Reliance, Bajaj, etc. groups in India. Such type of monopoly is profit oriented.

**4. Public Monopoly:** When production is owned, controlled and managed by government, it is called public monopoly. It is welfare and service oriented. So, it is also called as 'Welfare Monopoly' e.g. Railways, Defence, etc. **5. Simple Monopoly:** Simple monopoly firm charges a uniform price or single price to all the customers. He operates in a single market.

**6. Discriminating Monopoly:** Such a monopoly firm charges different price to different customers for the same product. It prevails in more than one market. **7. Legal Monopoly:** When monopoly exists on account of trademarks, patents, copy rights, statutory regulation of government etc., it is called legal monopoly. Music industry is an example of legal monopoly.

**8. Natural Monopoly:** It emerges as a result of natural advantages like good location, abundant mineral resources, etc. e.g. Gulf countries are having monopoly in crude oil exploration activities because of plenty of natural oil resources.

**9. Technological Monopoly:** It emerges as a result of economies of large scale production, use of capital goods, new production methods, etc. E.g. engineering goods industry, automobile industry, software industry, etc.

**10. Joint Monopoly:** A number of business firms acquire monopoly position through amalgamation, cartels, syndicates, etc., it becomes joint monopoly. E.g. actually, pizza making firm and burger making firm are competitors of each other in fast food industry. But when they combine their business that leads to reduction in competition. So they can enjoy monopoly power in market.

**Monopolistic competition:**

It is market characterized by an admixture of the features of both monopoly and perfect competition. So it is defined as market setting in which a large no of sellers sell differentiated products.

Monopolistic competition has been introduced by American economist Professor. Edward Chamberlin, in his book 'Theory of Monopolistic Competition' published in 1933.

**Features of monopolistic competition:**

**1. Large Number of Sellers:** There are large numbers of sellers producing differentiated products. So, competition among them is very keen. Since number of sellers is large, each seller produces a very small part of market supply. So no seller is in a position to control price of product. Every firm is limited in its size.

**2. Product Differentiation:** It is one of the most important features of monopolistic competition. In perfect competition, products are homogeneous in nature. On the contrary, here, every producer tries to keep his product dissimilar than his rival's product in order to maintain his separate identity. This boosts up the competition in market. So, every firm acquires some monopoly power.

**3. Products offered are close substitutes**

**4. Freedom of Entry and Exit:** This feature leads to stiff competition in market. Free entry into the market enables new firms to come with close substitutes. Free entry or exit maintains normal profit in the market for a longer span of time. **5. Selling Cost:** It is a unique feature of monopolistic competition. In such type of market, due to product differentiation, every firm has to incur some additional expenditure in the form of selling cost. This cost includes sales promotion expenses, advertisement expenses, salaries of marketing staff, etc. **6. Absence of Interdependence:** Large numbers of firms are different in their size. Each firm has its own production and marketing policy. So no firm is influenced by other firm. All are independent.

**7. Two Dimensional Competition:** Monopolistic competition has two types of competition aspects viz.

Price competition i.e. firms compete with each other on the basis of price. Non price competition i.e. firms compete on the basis of brand, product quality advertisement.

**8. Concept of Group:** In place of Marshallian concept of industry, Chamberlin introduced the concept of Group under monopolistic competition. An industry means a number of firms producing identical product. A group means a number of firms producing differentiated products which are closely related.

**9. Falling Demand Curve:** In monopolistic competition, a firm is facing downward sloping demand curve i.e. elastic demand curve. It means one can sell more at lower price and vice versa.

**What is Duopoly?**

Duo means two; Poly means sellers.

If there are two sellers, duopoly is said to exist.

Sell homogeneous or heterogeneous product.

For example; let’s assume that we have only two soft drink manufacturing companies like Pepsi and Coke this market is said called Duopoly.

Basic facilities for satellite communication are presently provided by Mahanagar Telephone Limited (MTNL) and Videsh Sanchar Nigam Limited (VSNL). **Features of duopoly:**

. Two firms in the industry

· Strong control over price.

· Uses Non price competition to compete

· Very strong Barriers to entry

**What is Oligopoly?**

The term oligopoly is derived from two Greek words: ‘oligos’ means few and ‘pollen’ means to sell. Oligopoly is a market structure in which there are only a few sellers (but more than two) of the homogeneous or differentiated products. So, oligopoly lies in between monopolistic competition and monopoly.

The examples are the car manufacturing companies such as (Maruti-Suzuki, Hindustan Motors, Daewoo, Toyota and so on. )Newspapers such as (The Hindu, Indian Express etc.) telecom such as (Airtel, Idea, BSNL, Reliance) **Features of oligopoly:**

1. **Few firms:** there only few firms in the industry either homogeneous or differentiated products.

2. **Homogeneous or heterogeneous product:** sell the homogeneous or heterogeneous product.

3. **Interdependent:** as all forms are interdependent in their business policies about fixing the price and determination of output.

4. **Important role on advertising and selling costs:** advertising and selling costs have strategic importance to oligopoly firms.

5. **In determine demand curve:** due to interdependence, an oligopoly firm cannot make an accurate estimate of its sales because when one firm reduces price, the other firm also will make a cut in their prices. Therefore the demand curve of the firm is indeterminate.

6. **Price rigidity and price war:** in the oligopoly market and price war are common features. So the price of each firm unchanged.

7. **It is not easy to enter the industry**.

National income, GDP, GNP, NNP,NDP,Personal income, and GST:

**Define National Income and explain the various concept of National Income?**

**Answer**

In Macro Economics, National Income plays an important role. For the economic development of a country, the national income estimates are very important. The total market value of all goods and services produced in a country during a given period of time is called national income.

**Definitions**

**1.** According to Marshall, "Labour and capital of a country, acting on its natural resources produce annually a certain net aggregate of commodities material and immaterial, including services of all kinds" is called National Income.

**2.** According to A.C.Pigou, "National Income is that part of the objective dome of the community of course including the income derived from abroad which can be measured in money".

**Concepts of national income:** The following are the important concepts of national income

**1.** Gross National Product [GNP]

**2.** Gross Domestic Product [GDP]

**3.** Net National Product [NNP]

**4.** National Income or NNP at factor cost [NNPFC]

**5.** Personal Income [PI]

**6.** Disposable Personal Income [DPI]

**7.** Percapita Income [PCI]

**1. Gross National Product (GNP) at Market Prices:** Gross National Product at market prices is the current market value of all final goods and services produced in a country during a given period. GNP at market prices = C + I + G + (X- M) + Net factor income from abroad

C = Consumption

I = Investment

G = Government expenditure

X = Exports

M = Imports

In this concept production of goods and services must be made by the citizens of that country irrespective of where it is produced. **2. Gross Domestic Product (GDP) at Market Prices:** GDP is that part of the GNP that is produced within the country in a given period of time. In other words, it is the current market value of all final goods and services produced within the country in one particular year. In this concept it is essential that production of goods and services must take place within the country. Who produces, it is not the criteria for completing GDP.

If net factor income from abraod are deducted from GNP, we get GDP. GDP = GNP = Net factor income from abroad [NFIA]

**3. Net National Product [NNP] at market prices:** For the production of goods and services, capital goods like machines and tools are used. Depreciation is very common on capital goods. If depreciation is deducted from GNP, we get the NNP.

NNp at market prices = GNP at market prices – Depreciation **4. National Income or NNP at factor cost:** It is the total incomes received by the four factors of production in the form of rent, wages, interest and profits in an economy during a given period of time. The NNP is not available for distribution among the factors of production. The amounts of indirect taxes paid by the firms are going to the government and not to the factors of production. Therefore this amount has to be deducted from NNPMP; similarly the government gives subsidies to firms for production of certain types of goods and services that is a part of the production cost done by the government. Therefore this volume of subsidies has to be added to the NNPMP to get the National Income. In modem days the government sector is vastly enlarging and runs several industries and enterprises. The profits of the government do not go to the factors of production. So these profits has to be deducted from NNPMP to get NNFC or National income.

NNP at factor cost NNP at market prices - indirect taxes + subsidies - Profits of the Government owned firms.

NNP at factor cost NNP at market prices - Net Indirect taxes - Profits of the Government owned firms.

(\* Net Indirect Tax = Indirect taxes -subsidies)

**5. Personal Income [PI]:** Personal Income is the total incomes received by all persons or households in a country during a given period of time. The national income earned by factors of production is not totally available as personal income. If corporate taxes which are paid by firms, undistributed profits which firms may prefer to keep a part of their profits for expansion and social security contributions by salaried employees are deducted from NI at factor cost and transfer payments like pensions, unemployment allowances, scholarships etc, are added to the NI at factor cost. We get personal income.

Personal income (PI)

NI at factor cost – Corporate Taxes – undistributed Profits – social security contributions + transfer payments

**6. Disposable personal Income [DPI]:** Personal income is not totally available for spending. People have to pay various direct taxes like income tax, property tax etc. from their personal income. Therefore, disposable income is obtained by deducing the personal taxes from personal income. Generally disposable income is nothing but consumption and savings of an individual.

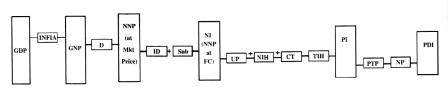
Disposable income Personal Income – Personal Taxes or Consumption + savings

**7. Percapita income:**

The percapita income is the average income of an individual in a country. If the national income is divided by total population, the percapita income is obtained. It is the best indicator of the average standard of living in a country.

National income Percapita IncomePopulation

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**Question No-2**

**Explain the various methods of calculating National Income?**

**Answer**

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**Measurement of National Income:**

There are three methods of measuring national income. **1.** Output method or product method

**2.** Expenditure method and

**3.** Incomes method

According to Cairn Cross, “National income can be looked in any one of the three ways, as the national income measured by adding up everybody’s income by adding up everybody’s output and by adding up the value of all things that people buy and adding in their savings”.

**1. Output method or product method:**

It is also known as inventory method or commodity service method. In this method we find the market value of all final goods and services produced in a country during a given period of time. The entire output of final goods and services are multiplied by their respective market prices to find out the gross national product.

NI = (P1Q1 + P2Q2 + ……….. PnQn) – Depreciation – Net Indirect taxes + NFIA

= GDP at MP – Depreciation – Net Indirect taxes + NFIA = NDP at MP – Net Indirect taxes + NFIA

= NDP at FC + NFIA

NI = NNP at FC

Where NI = National income

P = Price of the good or service

Q = Quantity of good or service produced

1,2………n = the various goods and services produced NFIA = Net Factor Income from Abroad

➢ Here we find out the value added in the different sectors like agriculture, government professionals, industry and service sectors. Hence it is also called “value added method”.

➢ For an individual unit, we taken the value of gross output and subtract the value of raw material, intermediary goods and services used by it and from this again we subtract the amount of depreciation to the Net Product or Value added by each unit.

➢ For the economy as a whole, first we combine the ‘value added’ by all the units in one sub sectors of a sector and finally to each sector then we get Net Domestic Product at factor cost. (NDPfc)

➢ Finally by adding the Net Factor Income from Abroad (NFIA) to the available NDPfc then we can get the NDPfc which is called as National Income of a country.

**Precautions:**

While calculating the National Income by this method, the following precautions should be taken into account.

**a)** Only final or finished goods should be taken into account. **b)** Unfinished goods and raw materials are excluded.

**c)** Double counting should be avoided.

**d)** Production for self-consumption should be included. **e)** Own account production of fixed assets by the government, enterprises and households will also be included.

**2. Expenditure method:**

In this method the expenditure on final goods and services by individuals, firms, government etc., is considered for estimating the national income. In this method we add the personal consumption expenditure of households, expenditure of the firms, government purchase of goods and services, net exports plus net factor income from abroad.

National Income (NI) = Expenditure of households (EH) + Expenditure of firms(EF) + Expenditure of government (EG) +Net exports + Net factor income from abroad.

**Precautions:**

While calculating the national income by this method, the following precautions should be taken into account.

**a)** Expenditure on financial assets that are produced and owned within the country should be excluded.

**b)** Expenditure on financial assets of foreign countries should be included.

**c)** Expenditure on raw materials, intermediate goods and services are excluded to avoid double counting.

**d)** Government expenditure on pensions, scholarships, unemployment allowance etc., should be excluded because these are transfer payments.

| Income from employment  + Income from self employment  + Gross trading profits of companies  + Gross trading surpluses of nationalized industries + Gross trading surpluses of general government enterprises + Rent  + Imputed charge for the consumption of non-traded capital |
| --- |
| = Total domestic income |
| - Stock appreciation  + Residual error |
| = Gross Domestic Product at factor cost |

**3. Incomes Method:**

In this method the incomes earned by all factors of production are added to get the national income of a country. The four factors of production receive incomes in the form of wages, rent, interest and profits. This is also National Income at factor cost.

NI = W + I +R + P + Net income from abroad.

NI = National Income W = Wages

I = Interest R = Rent P = Profits

**Precautions:**

While calculating the national income by this method, the following precautions should be taken into account.

**a)** Only net incomes should be taken into account.

**b)** Non-productive factor payments are excluded from national income.

**c)** Transfer payments are also excluded.

**d)** The undistributed profits are to be included in national income.

**Question No-3**

**Describe the components of National Income.**

**Answer**

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**Components of national income:**

There are five components of national income. They are **1.** Consumption (C)

**2.** Gross domestic investment (I)

**3.** Government expenditure (G)

**4.** Net foreign investment (X – M)

**5.** Net factor income from abroad

**1. Consumption (C):**

It is the total expenditure made by households on goods and services. It includes both durable and non durable goods like food grains, clothing, medical services etc., the level of consumption depends on the level of incomes.

**2. Gross domestic investment (I):**

It is the expenditure by firms on goods and services which are not for current consumption. It includes expenditure on capital goods like machinery, road ways, bridges etc., which will help in production of consumer goods in future.

**3. Government expenditure (G):**

It is the expenditure made by the government on infrastructural facilities for the use of the society. It also includes government expenditure on services like police, military and judicial services. **4. Net foreign investment (X – M):**

It is the income earned by a country through international trade. Every country exports certain volume of goods produced by it and import goods which are relatively cheaper in the international market or other countries.

The difference between the value of exports and imports is called Net foreign investment.

Net foreign investment = Exports (X) – Imports (M).

The Net foreign investment depends on the export-import policy of the government and the comparative price level of the goods in domestic and international markets.

**5. Net factor income from abroad:**

Some of the citizens of this country working in other countries may be sending remittances to this country. Likewise foreigners in one country may be sending their income abroad. Hence net factor income from abroad represents the difference between receipts and payments of the above type of factor incomes.

**Question No-4**

**Explain the importance of national income estimation. What are the difficulties in the computation of national income?**

**Answer**

**Importance of National income estimates:**

The importance of national income studies is growing because of several reasons. They are

**1.** The national income estimates or statistics are very important for preparing economic plans.

**2.** It is a very important tool for framing economic policies. **3.** It enables us to estimate the performance of each sector in the economy.

**4.** It is very useful in making budgetary allocations.

**5.** It gives us an idea of the standard of living in the country. **6.** It helps us to compare economic growth with other countries. **7.** It gives a clear picture of the level of utilization of natural resources in a country.

**8.** It is essential to calculate per capita income of a country and income inequalities.

**9.** It helps the government in macro-economic policy making. **10.** It will enable us to know the role of public and private sectors in the economy.

**Difficulties in the computation of National income:**

While calculating or measuring the national income of a country, the following problems may be arised:

**1.** In a developing country like India the non-monetized or barter economy is predominant. A large portion of agricultural output does not come to the market at all and is retained for barter purposes. But it is difficult to estimate the volume and value of goods which are exchanged under barter system.

**2.** Generally, a major part of production is from small enterprises. These enterprises may not record their production, sales, income, expenditure etc. For this reason, the national income gets reduced.

**3.** National Income is the money value of the final goods and services. But the sacrifices of the people, co-operation, favourable conditions of the nature are ignored in measuring national income.

**4.** To estimate the national income, the information relating to public expenditure, taxes, income etc are necessary. But, a comprehensive account may not be available.

**5.** In developing countries like India, there is no occupational specialisation. If a person is employed more than one occupation, income from all the occupations is not taken into account.

**6.** Sometimes the producer himself holds some part of the output for self consumption. This output is not shown in the national income account. **7.** While estimating the national income, the value of final goods should be taken into account. But it is difficult to find out which is final good (or) which is intermediary good. Hence we may commit double counting in the estimation of national income.

**8.** While estimating the value of services, it is difficult to estimate the value of services rendered by parents to the children.

Money: meaning functions and types

**Distinguish between different types of money.**

**Answer**

Different names are given to money on the basis of its value, the material used and its legal status. Thus, there are different types of money. They are:

**1.** Commodity money and representative money: On the basis of intrinsic value money possesses.

**a) Commodity money:** It includes metallic coins whose face value and intrinsic value are the same. It is also called full-bodied money. **b) Representative money:** It includes coins and paper money whose intrinsic value is less than their face value.

**2. Legal tender money and optional money:** On the basis of legality, money is divided into,

**a) Legal tender money:** It is the money which should be accepted as per law by everyone in payment for commodities and services. It is further divided into two. They are

➢ **Limited legal tender money:** It is that type of money which can't be forced to accept beyond a limit. The maximum limit is decided by government. .

➢ ii) **Unlimited legal tender money:** It is that type of money which can be accepted without any limit.

**b) Optional money:** It is non-legal tender money. Nobody bound by law to accept such money. However the public may generally accept it optionally.

Ex: Cheques, bills of exchange ... etc.,

**3. Metallic money and paper money:** On the basis of the material money is divided into two. They are

**a) Metallic money:** It is made up of metals such as silver, nickel, steel etc., All coins are metallic money.

**b) Paper money:** Money printed on paper is called paper money. Currency notes are paper money.

**4. Standard money and token money:**

**a) Standard money:** It is the money whose face value and intrinsic value are the same. The government adopts some precious metal as the standard. Ex : Gold coins in olden days.

**b) Token money:** It is the unit of currency whose face value is higher than the intrinsic value. It is not convertible. Ex : paper notes and coins.

**5. Credit money:** This is also called bank money. This is created by commercial banks. Credit money refers to the bank deposits that are repayable on demand. It can be transferred from one individual to the other through cheques.

TYPES OF BANKS

Meaning: “banking” means **the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise**

**Types of Banking**

The types of banks in India can be divided into the following categories – **1. Central Bank**

The central bank in this country is the Reserve Bank of India (RBI) which acts as the apex body for regulating and monitoring all other banks in the country. It also acts as a banker to the government in certain situations. RBI is instrumental in laying down the repo rate, reverse repo rate, cash reserve ratio, and statutory liquidity ratio.

**2. Commercial Bank**

Commercial banks perform the function for the public in terms of accepting profits or extending loans. These loans act as investments of the commercial banks intending to earn profit. Examples of commercial banks in India are the State Bank of India, United Bank of India, ICICI Bank, HDFC Bank, etc.

**3. Specialized Bank**

Specialized banks are formed with the specific goals of catering to a particular industry or sector. It may focus on export and import or provide financial services to some specific industries. An example of a specialized bank in India is Export-Import Bank.

**4. Cooperative Bank**

Cooperative banks in India are established under the State Cooperative Societies Act, providing easy credit to the members of the cooperative banks. One of the core functions of cooperative banks is to provide financial resources to the rural population at large. Examples of cooperative banks in India are – New India Cooperative Bank Limited, Ahmedabad Mercantile Co-operative Bank Ltd.

**What are the Types of Commercial Banks?**

There are four types of commercial banks in India. Those are – **1. Public Sector Banks**

Commercial banks in India where the government holds majority stakes in the bank (that is more than 50%) fall under the category of public sector banks.

Examples of public sector banks in India are – Bank of Baroda, Canara Bank, Punjab National Bank, etc.

**2. Private Sector Banks**

Commercial banks in India in which higher equity stakes are held by individual shareholders as opposed to the government fall under the category of private sector banks.

Apart from the shareholding structure, both public sector and private sector banks offer the same set of services. The aspects on which those are different involve charges that are imposed as well as the duration and description of the services that are provided.

Examples of such financial institutions in India are – HDFC Bank, Axis Bank, IndusInd Bank, ICICI Bank, etc.

**3. Small Finance Banks**

The objective of Small Finance Banks in India is to provide financial inclusion to less privileged sections of the economy, which ordinarily fails to gain access to financial institutions. Small Finance banks cover small and micro business units, marginal and small farmers, and various entities in the unorganized sector.

Examples of Small Finance Banks in India are – Janalakshmi Small Finance Bank, Equitas Small Finance Bank, Ujjivan Small Finance Bank, etc.

**4. Regional Rural Banks**

Regional Rural Banks in India have very specific mandates such as granting loans to marginal and small farmers cooperative societies, agricultural labourers along small entrepreneurs and artisans among others.

These banks were established according to the recommendations of the Narsimha Committee on Rural Credit. Examples of Regional Rural Banks in India – Kerala Gramin Bank, Pragathi Krishna Gramin Bank, etc.

Banking: Types, Functions

**Commercial Banks and Its Functions:**

The major functions of commercial banks include the following – • **Deposits**

One of the primary functions of commercial banks is to accept deposits from their customers, which can be both individuals or business entities. The deposits may be in the form of time deposits, savings deposits, and current deposits.

• **Lending**

The deposits that are taken by the commercial banks are further invested by way of granting loans to their customers. Banks derive profits in this manner. However, the lending of funds may take different forms such as cash credit, advances, discounting bills, overdraft, etc.

• **Remitting Funds**

Fund remittance, or money transfer in general vernacular, is also done by these commercial banks. Funds can be transferred in various modes such as IMPS, NEFT, RTGS, draft pay orders, etc., for specified commissions.

• **Cheque Facilities**

Cheque facilities provided by commercial banks also help in drawing funds. Money can be withdrawn both by the owner and the payee. The bearer cheques can be cashed immediately, but the crossed cheques can only be deposited in the account of the payee.

• **Services of General Utilities**

Banks provide general utility services too. For instance, traveller cheques are issued, locker facilities provide for safe custody, and facilities of credit and debit card services.

• **Services as Agent**

Commercial banks may also serve the role of agents to their customers by way of various services. Services may include a collection of cheques, drafts, and bills, insurance premium payment, trustee or executor or customers’ estate, etc.

**MONEYTARY POLICY AND FISCAL POLICY**

Monetary policy is the process by which the monetary authority of a country, generally central bank, controls the supply of money in the economy by its control over interest rates in order to maintain price

stability and achieve high economic growth.[1] In India, the central monetary authority is the Reserve Bank of India (RBI).

It is designed to maintain the price stability in the economy. Other objectives of the monetary policy of India, as stated by RBI, are:

**Price stability**

Price stability implies promoting economic development with considerable emphasis on price stability. The centre of focus is to facilitate the environment which is favourable to the architecture that enables the developmental projects to run swiftly while also maintaining reasonable price stability.

**Controlled expansion of bank credit**

One of the important functions of RBI is the controlled expansion of bank credit and money supply with special attention to seasonal requirement for credit without affecting the output.

**Promotion of fixed investment**

The aim here is to increase the productivity of investment by restraining non essential fixed investment.

**Promoting efficiency**

It tries to increase the efficiency in the financial system and tries to incorporate structural changes such as deregulating interest rates, easing operational constraints in the credit delivery system, introducing new money market instruments, etc.

FISCAL POLICY

Fiscal policy **deals with the taxation and expenditure decisions of the government**. Monetary policy, deals with the supply of money in the economy and the rate of interest. These are the main policy approaches used by economic managers to steer the broad aspects of the economy.

**Main objectives of Fiscal Policy in India:**

• **Economic growth:** Fiscal policy helps maintain the economy’s growth rate so that certain economic goals can be achieved.

• **Price stability:** It controls the price level of the country so that when the inflation is too high, prices can be regulated.

• **Full employment:** It aims to achieve full employment, or near full employment, as a tool to recover from low economic activity.

**Expansionary Fiscal Policy**

It involves all the actions taken by the government to invest more money back into the economy. Putting more money back into the economy creates more demand for services and products. It also expands the job opportunities and increases the profit for the people and government. In other words, it stimulates economic growth.

For example, the Indian government uses an expansionary fiscal policy to slow the reduction time of the business. It is also known as the recession. In this case, the government either spends more, cuts down the taxes, or does both of them. The main motive is to give more money to the hands of the consumers to allow them to spend more. It can result in a budget deficit. Therefore, the government should use this with caution.

**Contractionary Fiscal Policy**

Contractionary fiscal policy is the second type of fiscal policy, and it is normally used at the time of a boom in the economy. Sometimes expansion in the economy can also be dangerous, so in this case, the government tries to slow down the expansion so that it could not

become so intense. This type of fiscal policy helps make the growth of the economy manageable and controls inflation.

Sometimes, the government started collecting high taxes from the people and reducing the spending to move down the investment price and increase the rate of unemployment. This is done because the economy demands the unemployed workers for the businesses. So, in this case, the tax revenue generated is more than the government’s spending.

Concepts - CRR, Bank rate, repo rate

What is a Cash Reserve Ratio?

Cash Reserve Ratio (CRR) is a specific part of the total deposit that is held as a reserve by the commercial banks and is mandated by the Reserve Bank of India (RBI). This specific amount is held as a reserve in the form of cash or cash equivalent which is stored in the bank’s vault or is sent to the RBI. CRR ensures that the banks do not run out of money.

Cash Reserve Ratio in India is decided by the Monetary Policy Committee (MPC) under the periodic Monetary and Credit Policy. If the CRR is low, the liquidity with the bank increases, which in turn goes into investment and lending and vice-versa. Higher CRR creates a negative impact on the economy and also lowers the availability of loanable funds. As a result, it slows down the investment and reduces the supply of money in the economy.

To know about the Monetary Policy Committee, refer to the linked page.

Significance of CRR

CRR is an important tool of the Monetary Policy which provides the following benefits:

• CRR regulates the money supply and the level of inflation in the country.

• CRR ensures the security of the reserved amount as the specific amount of the bank’s deposit is stored with the Reserve Bank of India which can be readily available as per the need of the customers.

• CRR also has a major role to play during high inflation. During high inflation, the Reserve Bank of India increases the CRR rate to

reduce the amount of money that is available with the banks. This reduces the excess flow of money in the economy.

Repo Rate and Reverse Repo Rate

Repo rate can be defined as an amount of interest that is charged by the Reserve Bank of India while lending funds to the commercial banks. The word ‘Repo’ technically stands for ‘Repurchasing Option’ or ‘Repurchase Agreement’. Both the parties are required to sign an agreement of repurchasing which will state the repurchasing of the securities on a specific date at a predetermined price. The repo rate in India is controlled by the Reserve Bank of India.

Any changes in the repo rates can directly impact the economy. A decrease in the repo rates helps in improving the growth and economic development of the country. A decline in the repo rate can lead to the banks bringing down their lending rate which is beneficial for retail loan borrowers.

**Reverse Repo Rate**

The reverse repo rate is the rate of interest that is provided by the Reserve bank of India while borrowing money from the commercial banks. In other words, we can say that the reverse repo is the rate charged by the commercial banks in India to park their excess money with RBI for a short-term period. The current reverse repo rate in India as of May 2022 is 3.35%. Reverse repo rate is an important instrument of the monetary policy which control the money supply in the country.