Market

Meaning :- The term 'market' refers to the whole region in which buyers and sellers of a commodity are close in contact to effect purchase and sale of a commodity

Forms of Market

- Perfect Competition
- Imperfect Competition
  - (i) Monopoly
  - (ii) Monopolistic Competion
  - (iii) Oligopoly.

Q. Write of definition of perfect Competition.

Ans Perfect Competition :- Perfect Competition is the market situation in which buyers and sellers operate freely and a commodity sells at a uniform price

OR

It is the market in which a very large

number of firms produce homogeneous goods and sell them at a uniform price.

Features of Perfect Competition

1) Very large number of buyers and sellers:

The number of buyers and sellers is so large that none of them can't influence the prevailing price in the market. Each buyer and seller buys or sells a very insignificant proportion of total supply of the commodity in the market. This shows ineffectiveness of seller & buyer in influencing the price. In fact, the price of a comm. is determined by the aggregate demand & the aggregate supply in the whole industry.

ii) Homogeneous Product :-
Product sold in the perfect mkt. are homogeneous i.e. they are identical in all respects like quality, color, size, weight, design etc. They are perfect substitutes of one another. The products sold by diff. firms in the mkt. are equal in the eyes of the buyers. Since, a buyer can't distinguish b/w the products of one firm & that of another, he becomes indifferent as to the firms from which he buys.

iii) Free entry & exit of firms :-
Buyers & sellers are free to enter or leave the market or industry at any time they like. New firms induced by large profits can enter the industry whereas losses make the inefficient firms to leave the industry.

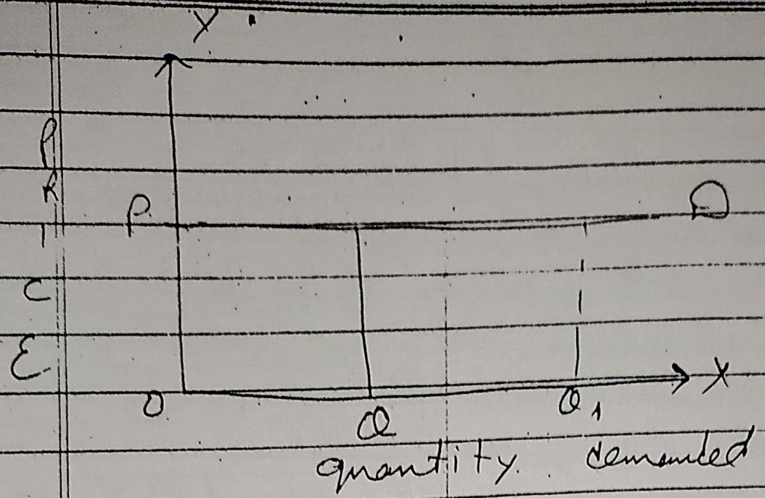
In case of abnormal profit at the profit - max. level of output, new firms will be attracted to the industry. This will lead to an inc. in supply leading to fall in price & profit. Thus, the entry process of firms will continue till there are no abnormal profits. On the contrary, if there are losses due to low price, some firms will quit the industry leading to fall in supply. As a result, the price will rise lessening the losses. Thus, the exit process of firms will continue till there are no losses. Hence, free entry & exit imply zero normal profit.

IV) Perfect Knowledge :-
The buyers & sellers have perfect knowledge about the prices & cost prevailing in diff. parts of the market. All sellers have equal access to technology & input with the result that all firms have same per unit cost. Clearly, this leads to an emergence of uniform price of the product.

V) Perfect Mobility :-
~~Perfect Mobility~~ There is a perfect mobility of goods & factors of prodn without any obstruction. The factors are free to enter in an industry if considered profitable & leave the industry when remuneration is inadequate.

VI) Absence of Transport Cost :-
~~As~~ In perfect comp., it is assumed that there is no transport cost for consumers who may buy from any firm. This ensures existence of a single uniform price of the product.

VII) Demand (AR) Curve is perfectly elastic & ll to x-axis :-
In the perfect comp., the dd curve facing an individual seller is, horizontal in shape & ll to x-axis. The reason is that the price is determined by the industry & the firm has no option but to accept it. It may sell as many units of the comm. as it wishes at the price given by the industry.



(viii) Firm is price-taker & industry is price-maker :-
In PC, the price is determined by the industry & all the firms accept it.

Q. Write the definition of monopoly & explain its features.
Ans. 'Mono' literally means 'one', 'poly' means 'seller' & so 'monopoly' means 'one seller'.

DEFINITION
Monopoly is a market situation where there is a single firm selling the comm. & there is no close substitute of the comm. sold by the monopolists. It is very difficult for a new firm to enter the monopoly market.

FEATURES OF MONOPOLY

1) Single Seller of the comm. :-
There is only one seller / producer of the comm. in the market. As a result, the monopoly firm has full control over the supply of the comm. The monopolist may be an individual, a firm, a grp. of firms or a govt. corp. or even govt. itself.

ii) **Absence of close substitutes of the product:-**

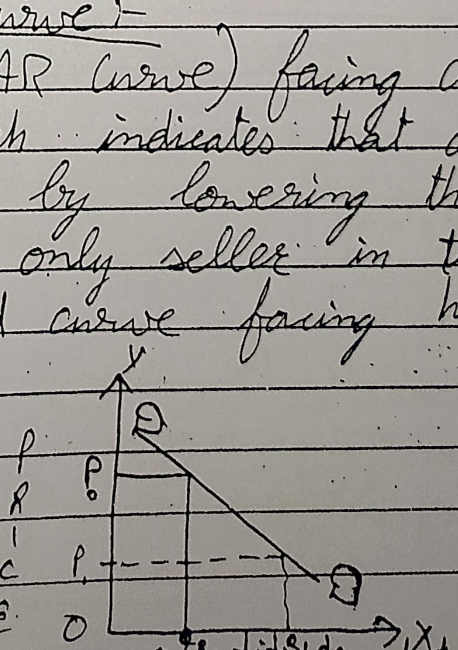
The product sold by the monopolist has no close substitute ~~Through~~ Though some substitutes of the product may be available yet they are not close substitutes in the sense ~~such~~ that such substitutes are not identical to the product. As a result, the consumer will have to buy the comm. from the monopolist or go without it.

iii) **Difficult entry of a new firm:-**

The monopolist controls the ~~mkt~~ situation in such a way that it becomes very difficult for a new firm to enter the monopoly mkt. & compete with the monopolist by producing a homogeneous or identical product. The monopolist tries his utmost to block the entry of a new firm. This barrier can be economic, institutional or artificial in ~~&~~ nature. As a result, a monopoly firm earns abnormal profit in the long run due to blocked entry of new firms.

iv). **-vely Sloped Demand Curve:-**

The Demand Curve (or ~~of~~ AR Curve) facing a monopolist is -vely sloped which indicates that a monopolist can sell more only by lowering the price. Since monopolist is the only seller in the market, therefore, the demand curve facing him is the market demand curve.



v) Price - maker with constraint:-
A monopoly firm is the only seller & has no competitor, ∴ it can fix the price partially. It has substantial influence over the price of his product by manipulating its supply. It is because of this position, the monopolist is said to be a price - maker.

vi) Price - discrimination :-
Unlike uniform price at which a product is sold in perfect competition, a monopolist can charge diff. prices for his product from diff. persons & in diff. market areas.

Types of Price discrimination:-
i) ~~Price~~ Acc. to Person
ii) Acc. to Place
iii) Acc. to Use
iv) Acc. to Time

MONOPOLISTIC COMPETITION

Monopolistic Competition refers to a mkt. situation in which there are many firms which sell closely related but differentiated products. For eg:- Mkts. of products like toothpastes, shoes, cycles, TV sets etc. are eg. of monopolistic competition.

FEATURES

i) Large no. of firms :-
The no. of firms selling similar product is fairly large but not very large as in perfect comp., each supplying a small %age of total supply of the product. As a result, firms are in a position to influence marginally the price of their product due to their brand names. For instance, among toothpastes of diff. brands, Colgate toothpaste sells at a comparatively higher price.

ii) Product differentiation :-
This is the most imp feature of monopolistic comp. Differentiated products are variants of a diff. comm. Products are closely related but not identical or homogeneous. Each firm produces a unique brand of the same product which can be differentiated from brands of other firms. Products are not the same but are closely similar to each other. They are not ~~homo~~ homogeneous, they can be differentiated from each other on the basis of brand name, shape, colour, quality etc. For instance, toilet soaps like lux, hamam, pears, lifebuoy etc. belong to this category

iii) Free entry and exit of firms :-

New firms can enter the market if found profitable. Similarly, inefficient firms already operating in the market are free to quit the market if they incur losses. It is because of this feature that like perfect competition, monopolistic competition also gives rise to normal profit. Free entry & exit imply that abnormal profit is driven to zero.

iv) Selling Costs :-

Selling costs are the expenses which are incurred for promoting sales or for inducing customers to buy the good of a particular brand. These include the cost of advertisement through newspapers, TV and radio, free sampling, show windows, salaries of salesman & costs on other sales promotion activities. These costs — also called advertisement costs - are undertaken to increase the demand for a product or to persuade buyers to buy the product of the firm in preference to others.

v) Demand Curve :-

The demand curve or AR Curve faced by a firm is -vely sloped i.e. downward sloping because the firm can sell more only by lowering the price of its product. The dd curve in monopolis-tic competition is highly elastic due to availability of close substitutes.

OLIGOPOLY :

It is that form of imperfect competition where a few big firms compete for their homogeneous product like cement or differentiated products like cars. There is interdependence of firms with regard to price-output decision. Mostly prices are stable. Here, entry of a new firm in the industry is quite difficult.

FEATURES

i) **A few firms :-**

There are a few firms controlling the market where each firm produces a substantial part of total output of the industry. The no. of firms is so small that each seller knows that he can influence the price by his own action & that he can provoke rival firms to react.

ii) **Interdependence :-**

There is interdependence of firms in case of price-output decision as no firm can take such independent decision. Interdependence means that actions of one firm affect actions of other firms.

iii) **Selling Costs :-**

Heavy selling & advertisement costs are incurred to promote sales.

iv) Price rigidity :-
Mostly prices are stable since no firm dares to change the price for fear of by rival firms. Firms generally keep prices at similar levels to avoid a price war.

v) Indeterminate demand curve :-
No firm can be certain of demand for its product due to unsure reaction of rival firms & ∴ dd curve for its product is indeterminate

vi) Group behaviour :-
Group behaviour in the form of collective decision by firms is common. This is the main cause of price rigidity.

vii) Homogeneous or differentiated product :-
The product may be ~~hom~~ homogeneous ~~or~~ like steel or differentiated like cars.

viii) Difficult Entry :-
Entry of new firms in the industry is difficult. Hence, in the long run, firms continue to earn abnormal profits.

Q Define Cartel.
Ans A Cartel is a group of firms which jointly sets output and price so as to exercise monopoly power.
e.g. OPEC [Organisation of Petroleum Exporting Companies]

DIFFERENCE B/W :-

I. PERFECT COMPETITION & MONOPOLY

	PERFECT COMPETITION	MONOPOLY
1.	A very large no. of sellers of product	A single seller (firm) of product.
2.	Products are homogeneous	Product has no close substitute.
3.	Free entry + exit of firms	Very difficult entry of a new firm.
4.	Firm is the price taker, not the price maker. It has no market power.	Firm is the price maker not the price taker. It has market power.
5.	Price is uniform in the market. Price = MC	Due to price discrimination, price is not uniform. Price > MC
6.	AR + MR Curve is a straight line parallel to X-axis. AR = MR.	AR + MR Curves are downward sloping from left to right. MR is less than AR.
7.	In the long run, the firm earns only normal profit.	In the long run, the firm manages to earn abnormal profit.
8.	A firm has its supply curve on the basis of its given price.	There is no ss curve since firm decides its output + price.

III. MONOPOLY & MONOPOLISTIC COMPETITION

	MONOPOLY	MONOPOLISTIC
1.	There is a single firm (or producer).	There are many firms.
2.	Product has no close substitute	Product has many close substitutes.
3.	Entry of new firm is very difficult.	Entry of new firm in the mkt. is free.
4.	Price discrimination is possible.	Price discrimination by a firm is not possible.
5.	Selling Costs are almost nil.	Heavy selling costs are incurred.
6.	dd curve (AR Curve) is downward sloping but less elastic than that in monopolistic competition.	dd ~~cu~~ curve is downward sloping but more elastic (quite flat) than the one in monopoly.

II. PERFECT COMPETITION & MONOPOLISTIC

	PERFECT COMPETITION	MONOPOLISTIC
1.	A very large no. of sellers. No seller can influence price & supply.	No. of sellers is fairly large but each seller has some control over price & supply
2.	Products are homogeneous.	Products are differentiated.
3.	No selling costs for promoting sales.	Significant selling costs through various forms of advertisements.
4.	Firm is only the price taker i.e. firm can't influence price.	Firm has ltd. control over price through product differentiation
5.	Demand (or AR) curve of a firm is straight line parallel to x-axis.	Demand (or AR) curve of a firm is downward sloping curve from left to right.
6.	Buyers & sellers are presumed to have perfect knowledge of mkt. condn.	Lack of perfect knowledge since product differentiation influences taste & preference
7.	There is perfect competition among sellers.	Both competitive & monopoly elements are present.

Tools of Monetary Policy

1. Quantitative Methods

Quantitative methods affect of the volume of credit in the economy. These methods include the following :

(a) **Bank Rate :** The bank rate is the traditional method of credit control used by a central bank. *The bank rate is the rate at which the central bank lends money to commercial banks or rediscounts the approved first class bills of exchange and government securities held by the commercial banks.* Changes in bank rate affect the money supply in the economy.

Increase in Bank Rate

During inflation (i.e., a state of rising of prices), to control the volume of credit, central bank raises its bank rate. It will increase the cost of borrowing by banks. An increase in the bank rate will then cause the banks to raise the rates of interest at which they lend. This will discourage businessmen and others to borrow from them, leading to reduction in the volume of credit and money supply.

Decrease in Bank Rate

During deflation (i.e., a state of falling of prices), central bank reduces the bank rate. Borrowing from the central bank by commercial banks becomes cheaper. Commercial banks also reduce their lending rates. Businessmen are encouraged to borrow more leading to expansion of credit and hence money supply. Output, employment, income and aggregate demand start rising.

Box 6.1 : Bank Rate, Repo Rate and Reverse Repo Rate

Bank Rate

Bank rate refers to the rate of interest at which country's central bank lends money to member banks for a long period as a lender of the last resort.

Repo rate

Repo rate (short form of re-purchase option) refers to the market rate of interest at which central bank lends money to banks for short period. Commercial banks get loans from central bank by selling securities to the latter. However, this is a conditional loan. The condition is that banks will repurchase their securities after a fixed time period at a pre-determined price. There is no such condition in case of bank rate. **The RBI has replaced bank rate with repo rate to influence the availability of credit and rate of interest in the country**.

Reverse Repo Rate

Reverse repo rate is the rate of interest at which the RBI borrows from commercial banks for short period. This is done by selling government bonds to banks. The banks utilise the reverse repo rate facility to deposit their short term excess funds with the RBI and earn interest on it.

(b) Open market operations : *Open market operations (OMO) refer to the buying and selling of government securities (like National Saving Certificates (NSCs)) by the central bank from/to the public and banks.* OMO are used to influence money supply in the country. It does not matter whether the securities are bought and sold to the public or banks, money ultimately is deposited in or transferred from the banks. Suppose people buy securities, they will withdraw their money from the banks. And when they sell the government securities the money so obtained is deposited in banks.

Sale of Securities

During the period of excess demand or inflation, the central bank starts selling government securities in the market. As a result, the cash resources of commercial banks are reduced and they are not in position to lend more to the businessmen. This reduces the volume of credit and money suppiy in the economy. The level of aggregate demand starts falling.

Purchase of Securities

During deficient demand or deflation, the central bank starts purchasing securities from the open market. Consequently, the excess reserves of commercial banks increase and they give more loans and advances. Thus, when credit is to be expanded the central bank buys the government securities from the market.

(c) **Legal reserve requirements :** Commercial banks are required to maintain reserves on two accounts. One cash reserve ratio and other statutory liquidity ratio.

(i) **Cash reserve ratio (CRR):** It refers to the minimum percentage of total demand and time deposits to be kept by commercial banks with the central bank. A change in CRR affects the power of commercial banks to create the credit.

Increase in CRR

An increase in CRR reduces the excess reserves of commercial banks and limits their lending power. In other words, the reserves of commercial banks are reduced and they give less credit. CRR is raised during excess demand or inflation. The volume of aggregate demand will decrease.

Decrease in CRR

During the period of deflation (or deficient demand) the central bank decreases the cash reserve ratio. A decrease in CRR has the effect of increasing the banks excess reserves and thus increases their lending ability. Banks now give more credit. Thus when credit or money supply is to be expanded, CRR is reduced.

(ii) **Statutory liquidity ratio (SLR) :** SLR is another component of legal reserve requirements. It refers to the minimum percentage of net demand and time deposits which commercial banks are required to maintain with themselves. SLR is maintained in the form of cash or other liquid assets. Change in SLR affects the availability of credit.

Increase in SLR

The central bank increases the SLR during the period of excess demand (or inflation). An increase in the SLR, reduces the amount of excess reserves of the banks. This reduces their lending ability to give credit. As a result, the bank lend less. Thus, the volume of aggregate demand will decrease.

Decrease in SLR

The central bank reduces the SLR during the period of deflation when the level of aggregate demand is low. A decrease in the SLR, increases excess reserves of the banks and thus increase their ability to give credit. In other words, the reserves of commercial banks are raised and they give more credit.

2. Qualitative Methods

These methods direct or restrict the flow of credit to specific areas of economic activities, that is, who should get more credit or who should get less credit. These methods are also called **selective methods** which include the following :

(a) **Regulation of consumer's credit :** Under this method, the credit given to durable consumer goods is controlled. Durable consumer goods (like motor cars, houses, computers etc.) are purchased under *'Hire Purchase System'* and payment is made in installments. In times of inflation, consumer's credit is reduced and in times of deflation, credit is expanded. For checking inflation, hire purchase system is made limited. Down payment (difference of money or margin money) is increased and maximum repayment period is reduced. On the other hand, the central bank reduces the amount of down payment and raises the maximum repayment period during the period of deflation.

(b) Regulation of margin requirements : *Margin requirement refer to the difference between the amount of loan granted and the value of security offered for the loan.* Margin is necessary because if a bank gives a loan equal to the full value of security, then bank will suffer a loss in case of fall in price of security. The central bank influences the availability of bank credit by changing this margin requirement. For example, suppose for a given house the central bank allows only 70 per cent of the value of a house to be given as a loan. The margin requirement in this case would be 30%. If flow of credit is to be expanded, this margin may be reduced to 20%. Now people will be more willing to purchase a house, as they would get 80% loan of the mortgaged property.

(c) Credit rationing : Rationing of credit is another instrument of selective credit control. It aims at limiting the maximum (ceiling) amount of bank loans and advances. Rationing of credit may take the following two forms :

(i) the central bank may fix the maximum amount of loans and advances which can be given by a commercial bank.

(ii) the central bank may fix the maximum ratio of loans and advances of a commercial bank to its total deposits.

(d) Moral suasion : Under this method, the central bank adopts the policy of persuasion and pressure on the commercial banks in order to get them to fall in line with its policy. The central bank frequently announces its policy and urges the commercial banks to adopt it. This is exercised through letters, discussions and directives to the banks. The member banks generally do not ignore the advice of the central bank.