Normal Value

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1. The Marshallian Concept of Normality

In his preface to the first edition of the *Principles*, Marshall ([1890] 1961) set himself the task of elucidating the permanent and the essential behind the transitory appearance of things. Before his eyes, Victorian England was growing in population, technical knowledge, technical accomplishment, literacy and breadth of suffrage. Its industrial methods and commercial arrangements were fast changing. Yet this rapid evolution, Marshall seems to assume, was explicable by some permanent logic of human existence. It was this constant and permanent something that he tried to elucidate. And he found in the concept of the "normal" that which enables static analysis to be applied to an ever-changing reality. This concept is, perhaps, the most difficult in all of Marshall's book : "in the present book normal action is taken to be that which may *be expected*, under certain conditions, from the members of an industrial group; and no attempt is made to exclude the influence of any motives, the action of which is regular, merely because they are altruistic. If the book has any special character of its own, that may perhaps be said to lie in the prominence which it gives to this and other applications of the Principle of Continuity." (*ibid.*, p. vi). *Natura non facit saltum*. It is this phrase in the *Principles* which stands out as an appeal to the gradualness of change and as a measure of ascribing to it permanent and discoverable causes. Within this framework (the *continuous* character of evolutionary change), Marshall speaks of the "normal".

The normal, with regard to price, daily or yearly quantities supplied, quantities of resources employed in a given industry and so on, is the result of two different processes (technological and market) each with its own time-scale. There must be enough time for the technological process of *adaptation* to occur and there must be the prospect of the altered circumstances of demand or supply continuing long enough to make the result worthwhile. The fulfilment of both these pre-conditions spawns the long period, allowing the full adaptation of both processes which can be discerned by the businessman, or perhaps the analyst himself. The prospect of the altered circumstances continuing is routinely assumed in standard theory, even for short period analysis. Marshall does not routinely assume it; indeed the prospect of a reversal encourages firms to restrain their price rises when demand expands

and to keep price above marginal cost when it contracts; the context, of course, is of a firm that is concerned to expand its trading connections, the context to which most of Marshall's discussions of normality refer.

Moreover, the normal is what would come about given *ceteris paribus* conditions which, in fact, cannot be preserved. If time for adaptation is prescribed by the analyst as shorter than might be eventually needed, or if the duration of the new circumstances is assumed to be limited, then there will be a "normal" adaptation in respect of these restricted opportunities. The normal is relative to the opportunities. Insisting on the continuity of change, Marshall shows how it can be split into stages, each having its own unity and rationale. The changes in value, which we may regard as normal if we are thinking of changes from hour to hour on a Produce Exchange, do no more than indicate the current variations with regard to the year's history. And normal values with reference to the year's history are but current values relative to the history of the century. For time is "absolutely continuous: Nature knows no absolute partition of time into long periods and short; but the two shade into one another by imperceptible graduation, and what is a short period for one problem, is a long period for another" (Marshall, *ibid.*, p. vii). Despite the absence of any partition between "normal" and "current" value in real time, there is a logical difference between this pair of concepts in a given period of time.

2. The Normal Value, the Market Value, and the Average Value

As there is no sharp division between that which is normal and that which is provisionally disregarded as abnormal, there is also no sharp division between normal values and current, market or occasional values. The latter "are those values in which the accidents of the moment exert a preponderating influence; while normal values are those which would be ultimately attained, if the economic conditions under view had time to work out undisturbed their full effect. But there is no impassable gulf between these two; they shade into one another by continuous gradation" (*ibid,* p. vii). Interpreted in this way, the concept of "normal" goes back to Adam Smith's idea of "natural" value. In fact, for Marshall, the concept of normal value is the real meaning of that much quoted and much "misunderstood" doctrine of Adam Smith and other economists that the normal or "natural" value of a commodity is that which economic forces tend to bring about in the *long run*. It is the average value which economic forces would bring about *if* the general conditions of life were *stationary for a run of time* long enough to enable them all to work out their full effect. But we cannot foresee the future perfectly. The unexpected may happen and existing tendencies may be disturbed before they have had time to accomplish what appears now to be realised. The fact that the general

conditions of life are not stationary is the source of many of the difficulties that are met with in applying economic doctrines to practical problems (*ibid.*, pp. 347-8). That explains why, for Marshall, the normal price is generally not equivalent to average price.

In a rigidly stationary state in which supply could be perfectly adjusted to demand in every particular, the normal costs of production, the marginal costs, and the average costs (inclusive of rent) would be the same, for long periods and for short. However, in a non-stationary world, the distinction between average price and normal price is essential: "An average may be taken of the prices of any set of sales extending over a day or a week or any other time: or it may be the average of sales at any time in many markets; or it may be the average of many such averages. But the conditions which are normal for any one set of sales are not likely to be exactly those which are normal for others: and therefore it is only by accident that an average price will be a normal price; that is, the price which any one set of conditions tends to produce. In a stationary state alone, as we have just seen, the term normal always means the same thing: there, but only there, 'average price' and 'normal price' are convertible terms" (*ibid,* p.372). Since “normal” is not equivalent to “average”, we can conclude that the consequences of normal behaviour must be the subject of thought-experiments; econometrics is of dubious relevance to the appraisal of such theories.

Normal does not mean competitive, at least not in the modern sense of perfect competition. This is Marshall’s position in the *Principles*, but as Whitaker (1975, pp. 70-73) and Raffaelli (2003, p. 41) rightly note, Marshall’s stand on normality was radically different in the *Economics of Industry* (1879). He was previously arguing that normal values were brought by free competition (Marshall and Marshall, 1879, p. 148), despite the passive resistances of ignorance, prejudices, custom, etc. (Ibid, p. vii). Hence, normal meant competitive. But, according to the author of the *Principles***,** market and normal prices alike are brought about by a "multitude of influences of which some rest on a moral basis and some on a physical; of which some are competitive and some are not. It is to the persistence of the influences considered, and the time allowed for them to work out their effects that we refer when contrasting market and normal price, and again when contrasting the narrower and the broader use of the term normal price" (*ibid.*, p. 347-8). Meanwhile, although the normal price is determined by factors which are not solely competitive, for Marshall, the normal usually implies a good deal of competition. In fact, the normal price is based on some kind of "expectation", conventions and the attitudes of producers and consumers. The "normal" has many dimensions, not only those related to competitive market forces but also those which lie outside the market and determine the structure of the market.

Normal price, contrary to market price, has a regulatory effect, as a sort of gravitational force around which fluctuates the accidental, phenomenal force of market price. This kind of "gravity force" should be clearly distinguished from neo-Ricardian centres of gravitation in which expectation does not play a major role. For Marshall, the normal price is the price whose expectation will just suffice to maintain the existing *aggregate* amount of production, albeit with some firms growing and increasing their output, and others shrinking and reducing theirs. The normal reveals the general feature and gives a sense to "aggregate" by defining the particular general conditions underlining an order not only in its *competitive* market aspects, but also in its *non-competitive* dimensions.

3. Normal Value and Supply

According to Marshall, we have to represent the normal demand value and supply value as functions both of the amount normally produced and of the time period relative to which that amount is normal. An important difference between the demand curve and the supply curve resides in the fact that the former is based solely on the fundamental psychological law of diminishing returns, while the latter can be subject to the law of increasing returns. However, the law of increasing returns only applies in the long run. As a general rule, the shorter the period we are considering, the greater the influence of demand on value will be; and the longer the period, the more important the influence of cost of production on value will be (*ibid.*, p. 349). Thus, in the long run, supply has the overriding role in determining the normal value. Being subject to increasing returns, the conditions of normal supply are less definite as compared with normal demand (*ibid.*, p. 342).

The general meaning of the term normal supply value is always the same whether the period to which it refers is short or long, but there are great differences in detail. In every case, reference is made to a certain given rate of aggregate production; that is, to the production of a certain aggregate amount daily or annually. In every case, the normal value is that which meets the expectation of people with regard to the compensation which they claim in order to consider it worthwhile to produce that aggregate amount. In every case, the cost of production is marginal, *viz*. it is the cost of production of those goods which are on the margin of not being produced at all, and which would not be produced if the price to be had for them was expected to be lower (*ibid.*, p. 373). When the term normal is taken to relate to *short* periods of a few months or a year, supply means broadly that which can be produced for the price in question with the existing stock of plant, personal and impersonal, in the given time. When the term normal refers to *long* periods of several years, supply means that which can be produced by plant, which itself can be profitably produced and applied within the given time.

Finally, there are very gradual or *secular* movements of normal value, caused by the gradual growth of knowledge, of population and of capital, and the changing conditions of demand and supply from one generation to another. A theoretically perfect long period must give time enough to enable not only the factors of production of the commodity to be *adjusted* to the demand, but also the factors of production of those factors of production to be adjusted, and so on. And this, when carried to its logical conclusion, will be found to involve the supposition of a stationary state of industry, in which the requirements of a future age can be anticipated beforehand (*ibid.*, p. 379). This "theoretically perfect long period", with its stringent requirement either for rational expectations or the limitation of contingencies, would prevent Marshall (or anyone else) from analysing change. In such a setting, normal would be equivalent to average.

According to Marshall, the long period during which the true normal value is formed can be explicated as the period in which "the normal action of economic forces has time to work itself out more fully; in which, therefore, temporary scarcity of skilled labour, or of any other of the agents of production, can be remedied; and in which those economies that normally result from an increase in the scale of production... have time to develop themselves. The expenses of a representative firm, managed with normal ability and having normal access to the internal and external economies of production on a large scale, may be taken as a standard for estimating normal expenses of production..." (*ibid*, p. 497). In the light of this definition of true normal value under the law of increasing returns, Marshall can revert once again to the distinction between average values and normal values, since the distinction becomes particularly clear in a non-stationary state marked by the internal and external economies of production. In other words, this very distinction reveals that the normal value belongs to economic dynamics (Vahabi, 1998).

4. *Ex ante* or *Ex post* Visions of the Normality Concept

The Marshallian concept of normality is based on the contradictory, or at least ambiguous, combination of an *ex ante* perspective of expectation formation and an *ex post* vision of time as viewed by an observer. According to Shackle, the Marshallian long-period supply curve combines both viewpoints: "Marshall shows us the long period from two viewpoints, that of the businessman who stands, as it were, upon the calendar axis and looks, by imaginative construction based on suggestions offered by the past and the present, *along* it to future dates, and that of the detached and knowledgeable observer who stands outside the participant's axis and can view all its distinct dates as co-valid" (Shackle, 1972, p. 289).

It is not evident that the two viewpoints are reconciled in Marshall's work (Vahabi, 1998). There are two reasons for this. *First*, the objective of the normal as a theoretical construction is the appraisal of regularity in ongoing economic changes under the *ceteris paribus* hypothesis. *Second*, contrary to Shackle's conception of time, Marshall contends: "The explanation of the past and the prediction of the future are not different operations, but the same worked in opposite directions, the one from effect to cause, the other from cause to effect" (Marshall, Appendix C, p. 773). The symmetry of prediction and explanation obtains only in an idealised world, where the data on which reason is to work are complete and certain for either purposes, or the data assumed to be non-changing or "undisturbed". For, as Shackle argues in his criticism of Marshall's induction and deduction procedures (Shackle, 1972, pp. 345-353), this symmetry assumes that the selection of data has already been performed, in a manner which is guaranteed (whence and by whom remain obscure) to be correct. This is why one cannot be as categorical as Reisman (1986, p. 48) in claiming that "The economics of Alfred Marshall is the economics of the *ex ante*, not the *ex post*."

Although the Marshallian concept of the normal embraces the two viewpoints (*ex ante* and *ex post*), the reconciliation of the two is not achieved (Robertson, 1956; Harcourt, 1996, Vahabi, 1998). There remains a tension between two possible interpretations of the normal. It may be interpreted as the businessman's action-scheme as one out of all possibilities open to him, which he selects on the basis of what he expects might occur over the relevant time period. That is the interpretation attached to this concept by Shackle and advocated also by Keynes (1936) especially in Chapters 12 and 17 regarding the relevance of "conventional judgments" or businessmen's guesses on the asset valuation. From an *ex ante* viewpoint of normal values, "prices are convention" (Shackle, 1989, p. 267). Dardi's recent contribution stresses the idea that Marshall's normal equilibrium is based on an "*epistemic consensus* which current events leave unchallenged" (2003, p. 86).

However, it may also be interpreted as the regulatory mechanism of a changing system in some given calendar interval as seen by an economist or an outside observer *ex post*. "Regulatory mechanism" refers to some kind of "order" or a tendency to equilibrium in a changing economic system. In this second version, the concept "normal" would be *predictive*. The development of this version of the normal has been accomplished by Janos Kornai. For Kornai, any economic system is marked by certain "intrinsic regularities" that constitute the *normal* state of a system and as such can be considered as a sort of equilibrium. Equilibrium in this broad sense, is an "objective reality", a "tendency", which can be justified *if* "there exist, in fact, *such internal forces and regulatory mechanisms which drive the system back to*

equilibrium, if it has departed from it" (Kornai, 1983, p. 150). In Kornai's conception, abstract economic systems have a normal state, or, regarding their dynamics, a normal path. The mechanism of control by norms channels the system back towards the normal state or the normal path, should its actual state differ from that corresponding to the norm. Like Marshall, Kornai calls the normal state the "long-term equilibrium" of the system (Kornai, 1981, p. 29).

In contrast to Marshall's interpretation of normal value, Kornai defines normal value as "nothing else but the statistical average of the actor behaviour. Depending on the nature of the control process, an average either constant or regularly moving over time" (Kornai, 1981, p. 27). For Marshall, normal value is only identical with average value if the general conditions of life are stationary for a long enough period to enable economic forces to work out their full effect. Nonetheless, as a general rule, normal value diverges from average value since the general conditions of life are not stationary, and because supply demonstrates increasing returns. Kornai's definition of normal value is diametrically opposed to Marshall's. He considers normal values as unconditionally synonymous with average values (Kornai, 1981, p. 129).

In summary, while Marshall's theory and intuition concerning the normal value has been developed by Shackle's and Kornai's contributions, the problem of combining *ex ante* versus *ex post* viewpoints has not yet been solved satisfactorily. Further exploration of "normal" as a key concept in the historical analysis of institutional change is a challenging task for economists. In this respect, Marshall's *Principles* are as relevant as ever.

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