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Topic: Time Element in Market

Significance of Time Element or Importance of Time in the Determination of Value:

The time factor has a very great importance in the theory of value.

The element of time occupies a pivotal place in the Marshallian theory of value. According to the traditional value theory, the forces of demand and supply determine the price.

The position of supply is greatly influenced by the element of time taken into consideration.

Here time refers to the operational time period pertaining to economic action and forces at work. Functionally, the supply of a commodity relates to this operational time involved regarding adaptations of firms in their production activity. Supply is thus adjusted in relation to the changing demand in view of the time span given for such adjustment.

It is well known that both demand and supply like the two blades of scissors, exert their influence on the determination of value. But their relative importance depends on the period of time given to the forces of supply to adjust themselves to the changes in demand.

In Marshall's words—"As a general rule the shorter the period which we are considering the greater must be the share of our attention which is given to the influence of demand on value; and longer the period the more important will be the influence of the cost of production on value. The actual value at any time, the 'market value' as it is often called, is often more influenced by passing events and

by causes whose action is fitful and short-lived, than by those which work persistently. But in the long periods these fitful and irregular causes in large measure efface one another's influence, so that in the long-run persistent causes dominate value completely".

Marshall has given such a great importance to the time element in the theory of value and has divided the pricing of products into four time periods:

1. Very Short Period or Market Period

2. Short Period

3. Long Period

4. Secular Period or Very Long Period

1. Very Short Period or Market Period:

Market period is a very short period in which supply being fixed, price is determined by demand. The time period is of a few days or weeks in which the supply of a commodity can be increased out of a given stock to meet the demand. This is possible for durable goods. The time period for perishable commodities is only a day. In reality market price is that price which is determined by the forces of demand and supply in the market at a point of time. The determination of market price is explained separately for perishable and durable commodities.

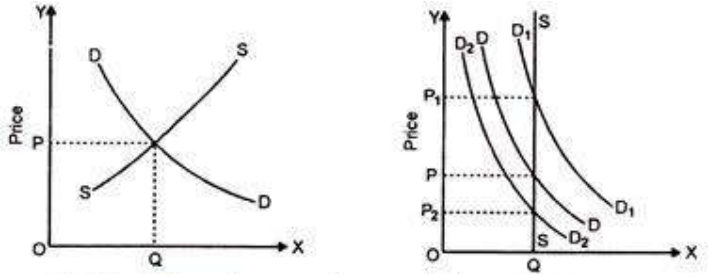
In case of Perishable Commodities like milk, vegetable, fish etc. the price is influenced by its demand. Supply has no influence on price because it is fixed. Therefore the price of a perishable commodity rises with the increase in its demand and falls with the decrease in its demand.

In case of durable commodities which can be kept in stock; when the price of commodity increases with the increase in its demand, its supply can be increased out of the given stock. Such commodities are cloth, wheat, tea etc. They have two price levels.

First a minimum price below which a seller will not sell his commodity. This is known as the reserve price.

Second, a minimum price at which the seller will be prepared to sell the entire quantity of his commodity.

Thus, the very short period price or for brevity the market price is determined by the interaction of market period demand and supply as shown in figures given below:



In the figure (A) the SS supply curve is a vertical straight line, representing perfectly inelastic supply. DD is the demand curve. The intersection between these two curves determines the equilibrium price OP at which demand equal to supply (OQ).

Supply being fixed during the market period, the equilibrium price—the market period price tends to be solely governed by the changes in demand condition. Evidently as demand increases, the market price rises correspondingly and when demand decreases, the price also decreases to that extent. The point is clarified in figure (B).

A shift in the demand curve from DD to D_1D_1 means an increase in demand, along with it the new equilibrium price rises from OP to OP_1. Similarly, if there is decrease in demand as represented by the curve D_2D_2; the new price is also set at OP_2 level.

2. Short Period Market Price:

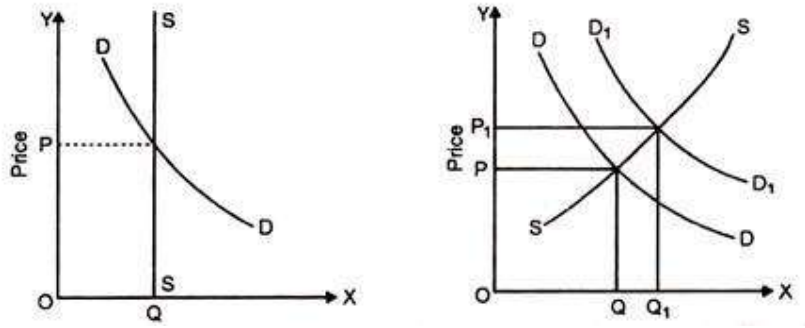
The short period market price is that functional time period price during which the size of the firm and its plant cannot be altered, thus a set of fixed factors remains unchanged in its production function and more output can be produced only by increasing the inputs of variable components under the given state of technology.

Thus, during the short period, the stock of a given commodity can be increased but to a limited extent by an intensive use of the given production plant. As such the supply curves of the existing firms will tend to be relatively inelastic. Therefore, the supply curve of industry will be relatively inelastic.

The short period price is thus determined by the interaction of the forces of short-run demand and supply. In graphical terms, the short-period equilibrium price is determined at the point of intersection between short-run demand curve and short-run supply curve as shown in figure given below in (C) and (D).

In figure (C) SS is the short-run market demand curve which has a steeper slope, indicating relatively inelastic supply. DD is the short run market demand curve.

OP is the equilibrium price, at which OQ is the quality of demand as well as supply. The short-run price is also described as ‘sub-normal price.’



At this price, the industry may not be in equilibrium, as some efficient firms might be earning super-normal profits, which may attract the entry of new firms. Again, some inefficient firms might be incurring losses, yet they continue in business in the hope of improvement in the market situation in the long run.

In the short-run price determination also, demand forces tend to have a greater impact as compared to the supply forces. Thus, when the short-run demand increases, there is some variation in supply in the process of adjustment but the adjustment being imperfect and much less than the market requirement, the equilibrium price tends to rise.

However, the rise in the short-run price is not of the same range as in the case of the market period price; since there is some adjustment due to a degree of variation in supply. The point may be elucidated as in figure (D). With a shift in the demand curve from DD, D_1D_1 the short period equilibrium price rises from OP to OP_1 and the new equilibrium quantity of demand and supply is OQ_1.