An Attempt at Unifying the Marginal Principle and the Full Cost Principle

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The present article seeks to find a way of explaining, without contradictions, the price determination practice known as the full cost principle within the framework of the marginal principle. Although some economists have intuitively maintained that the union of these two principles is possible, none has so far offered any convincing explanations. The present article is an attempt to rectify the situation and offer a clear-cut explanation of the subject.

The conclusion is that "the existence of a strong tradition" that each firm is operating under the full cost principle can only be explained by accepting the simultaneous presence of the marginal principle designed for profit maximization. In order to fully explain the fact without any contraditions, however, it is necessary to work a realistic change to the hypothesis about the forms of the cost curve and the demand curve as generally presumed in orthodox theories. It is necessary, in other words, to accept that costs are not increasing and that the demand curve is bending or concave to the origin. The one reason for the bending demand curve is that the demand is unelastic for a short term. The other reason is that demand for individual firm becomes rapidly elastic at a critical region of price. The first reason is based on the fact that man's mode of living is more or less fixed for a short term, while the second reason is based on the possibility of competition with other firms, including potential ones.

The greater the degree of bending of the demand curve, the more acute a firm's intuitive belief that a clever selection of prices and output scales at the bending point (or area) will work in its best interest. The point (or area), as a matter of fact, becomes indifferent to that of profit maximization based on the marginal theory. The firm in question does not necessarily be aware of the marginal notion; it may only be aware of the fact that an acceptable com bination of prices and production scales under the restrictions imposed by competition and demand will naturally be narrowed down to a certain point (or area). What has been described as "traditional full cost price" by Hall and Hitch is nothing but the existence of this bending point in the demand curve. The kinded demand curve proposed by them does not offer the rationale for the existing point. The truth is not that demand curve is kinked at the existing point, but that the firm decides to operate at the bending area of demand curve.