Factor of production

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Factors of Production – Land and Its Characteristics – Theories of Rent

THEORY OF PRODUCTION

- In theory of production ,it is assumed that the entrepreneur aims at maximizing his profits.

MEANING OF PRODUCTION:

- Production is the opposite of consumption
- It is creation of utilities, i.e., Production is the creation goods and services
- Production is the process of transformation of inputs into outputs

FACTORS OF PRODUCTION

- LAND
- LABOUR
- CAPITAL
- ENTERPRENEUR

LAND

- Marshall defined land as

“The materials and forces which nature gives freely for man’s aid in land and water , in air and light and heat “

- In other words ,land stands for

“All natural resources , which yield an income or have an exchange value”

CHARACTERISTICS OF LAND

LAND AS A FACTOR OF PRODUCTION HAS THE FOLLOWING CHARACTERISTIC FEATURES:

- Land is fixed quantity.
- Land has original and Indestructible properties
- Land lacks mobility in the geographical sense
- Land differs in fertility

THEORIES OF RENT

RENT

Rent is only a payment for the use of land

THEORIES OF RENT:

1.Ricardian theory of Rent

2.Modern Theory of Rent

RICARDIAN THEORY OF RENT

David Ricardo defined rent as

"That portion of the produce of the earth

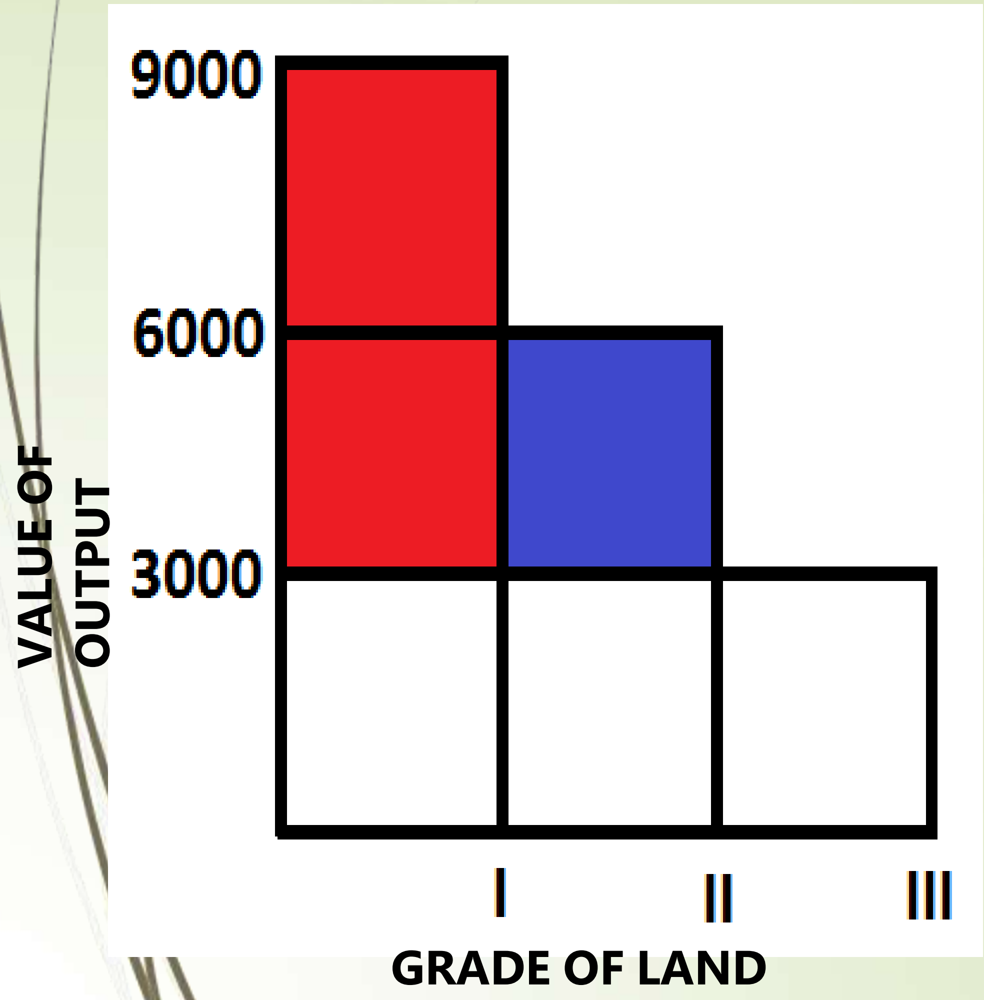
Which is paid to the land lord for the use of original and indestructible powers of the soil"

- Ricardian rent is also known as Pure rent.

The Ricardian theory of rent is based on the following assumptions:

- Land differs in fertility
- The most fertile lands are limited in supply

Example for theory of rent



- In the diagram if a farmer spent rupees 3000 each , for cultivation in three grades of land , namely , I ,II and III Then he will not get any rent for grade III land .But he will get rupees 6000 and rs 3000 from **grade –I** and grade – II land , respectively over the cost of cultivation. The first and second grade lands will yield rent and **third grade** land **will not yield any rent** .such lands which will not yield any rent are called **"Marginal land".**
- **Value of output=Quantity * Price**
- **So if the price of produce is high , rent will be high**
- Thus ,rent does not form a part of the cost of production .Rent is the earnings over and above the cost of production of the marginal land , but the marginal land gas no rent .

Modern theory of Rent

According to the modern theory of rent,

" The rent of a factor , from the point of view of any industry , is the difference between its actual earnings and Transfer earnings "

Rent = Present Earnings – Transfer Earningsr

Transfer earning refers

"To the amount of money , which a factor of production could earn in its next best paid use (opportunity cost)"

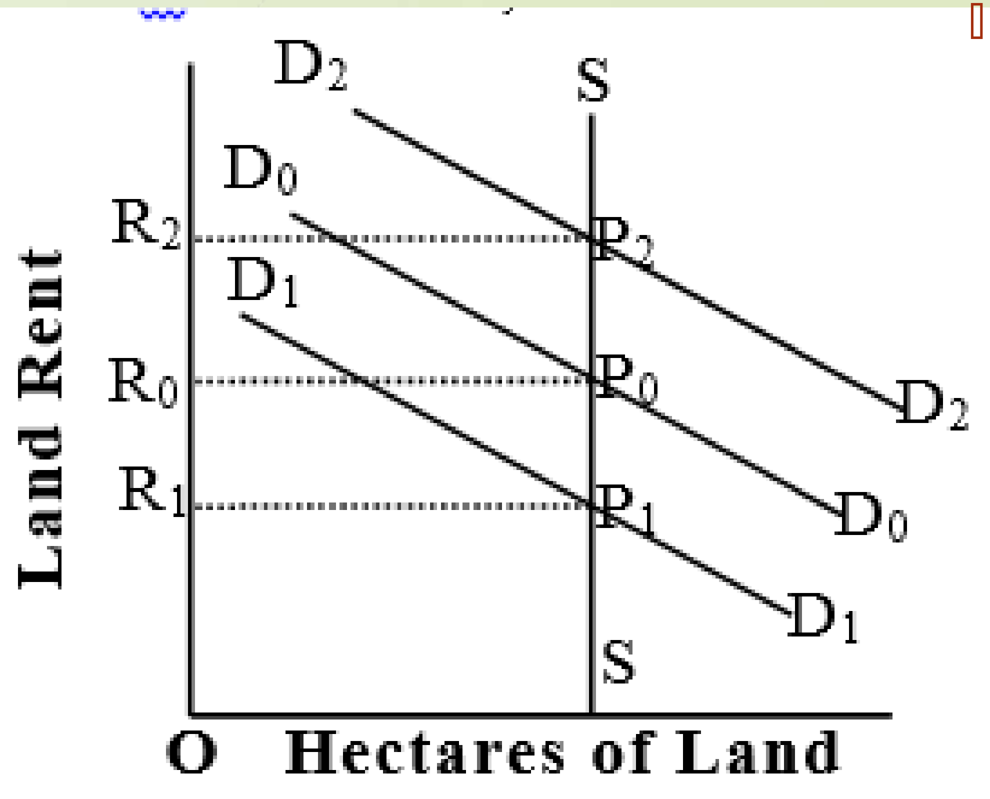
Modern theory of rent

For example ,

An hectare of land under cotton cultivation yields an income Of Rs 10,000 , If the same area is put into its next best use ,namely , Paddy cultivation , it earns an income of Rs 7000 , then it is transfer earning(opportunity cost).Then , the rent of that hectare of land is (Rs 3000)(Rs 10000 Rs – Rs 7000).

According to modern theory of rent, In the sense of surplus , arises when the supply of land is less than perfectively elastic. From the point of view of elastic of supply , there are three possibilities.

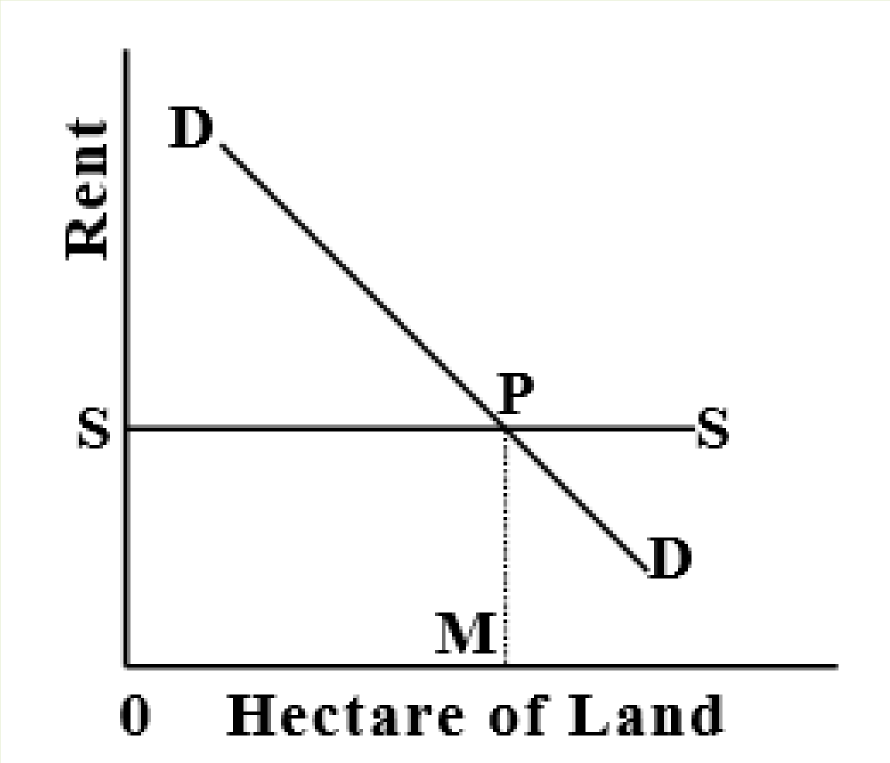
1. PERFECTLY INELASTIC



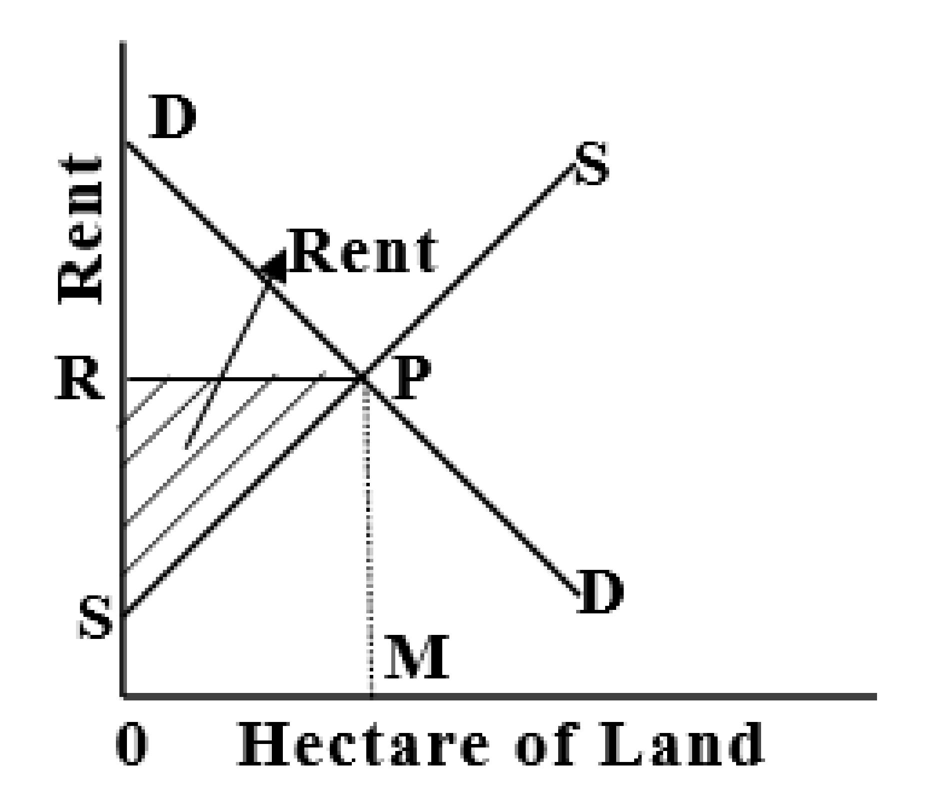
- supply of land is perfectly inelastic. The interaction of demand and supply of land determines its rent. If demand for land increases from D_0 to D_2, Then, the rent also increases from R_0 to R_2. Similarly, if the demand for land decreases from D_0 to D_1, then, the rent decreases to R_1. Here, the transfer earnings will be zero, because the land cannot be transferred to any other use; the supply of total land area is also fixed and it has only one use. In this case, the entire income from land is surplus and hence, it is called rent.

2.PERFECTLY ELASTIC

- The supply of land may be perfectly elastic to an individual farmer. In that case, it will be represented by a horizontal straight line. If any factor has a perfectly elastic supply, it will earn no surplus or reward. Hence, in this case, the actual earnings and the transfer earnings would be the same and there would be no surplus (rent). However, in real life, no factor has a perfectly elastic supply.



RELATIVELY INELASTIC



- The supply of land may fall between two extremes, i.e., it may be elastic, but not perfectly elastic. In this case, a part of income from land is rent (in the sense of surplus over transfer earnings), and remaining part is not rent.

QUASI RENT

- Quasi rent is the earning of capital equipments such as machineries, buildings etc., which are inelastic in supply, in short run.
- According to Marshall,

"The quasi rent is only a temporary surplus, which is enjoyed by the owner of the capital equipments in the short run".

THANK YOU TO ALL