SUBJECT : ECONOMICS
CLASS : 2nd SEMESTER (REGULAR)

Factor Pricing in Competitive Market:

Factor Pricing is similiar to commodity pricing, i.e. demand = supply. The input which are used in the process of production are known as factors of production. The four main factors of production are land, labour, Capital and Organisation which are purchased and sold in the market. But generally we explain the market for labour, however the theory is for all 'productive factor.'

Demand for labour:

The assumptions for demand for labour are as follows:

1. A single commodity, is produced. The price of X is P_x.
2. The goal of firm is profit maximisation.
3. Labour market is perfectly competitive. Hence in the given wage rate (W) market supply curve is horizontal.
4. Production function is increasing at a decreasing rate i.e. the marginal product of labour is decreasing.
5. A firm will hire labour up to that point at which the last unit will contribute as much as to total cost as to total revenue.

$$\text{In revenue} = P_x\, MP_L = VMP_L$$

$$\text{In cost} = \text{Wage}(W)$$

$$\text{For equilibrium } VMP_L = W$$

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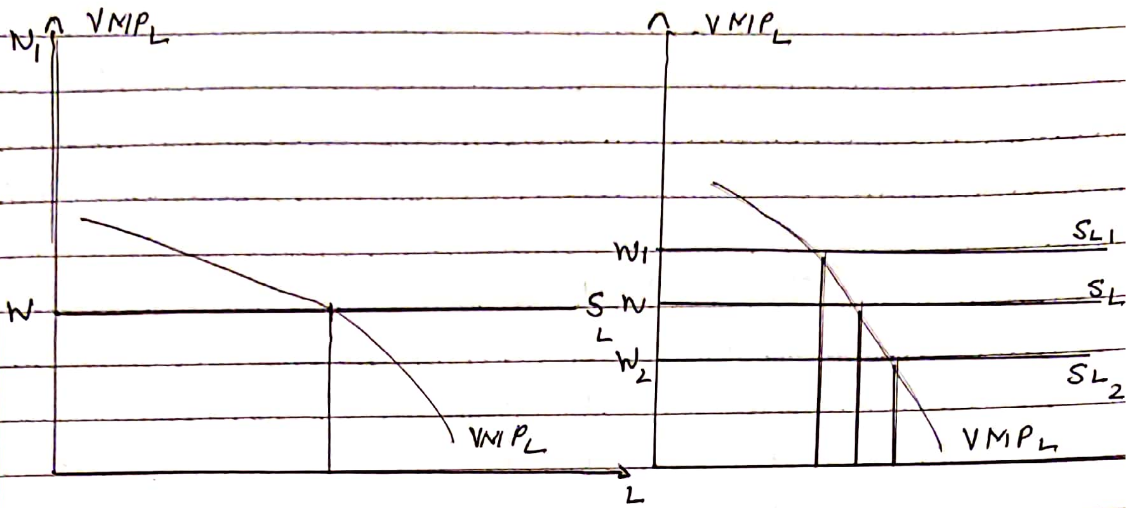
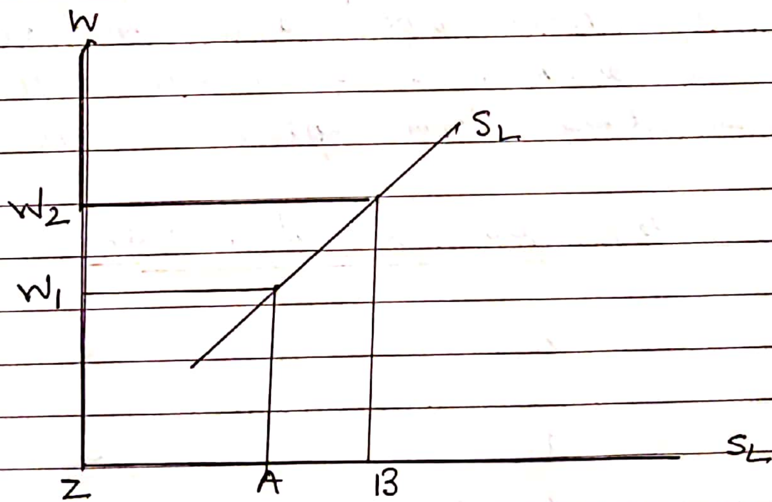
Demand for Labour:



Labour Supply:

The labour supply curve is derived by Indifference curve approach. The individual supply curve can be derived in the diagram given below.



Backward Bending Supply Curve:

The individual supply curve maybe backward bending i.e. after a certain wage level further increase in wage rate reduces individual labour supply. This is because when wage increases income also increases. In this situation people generally want some entertainment or similar things.

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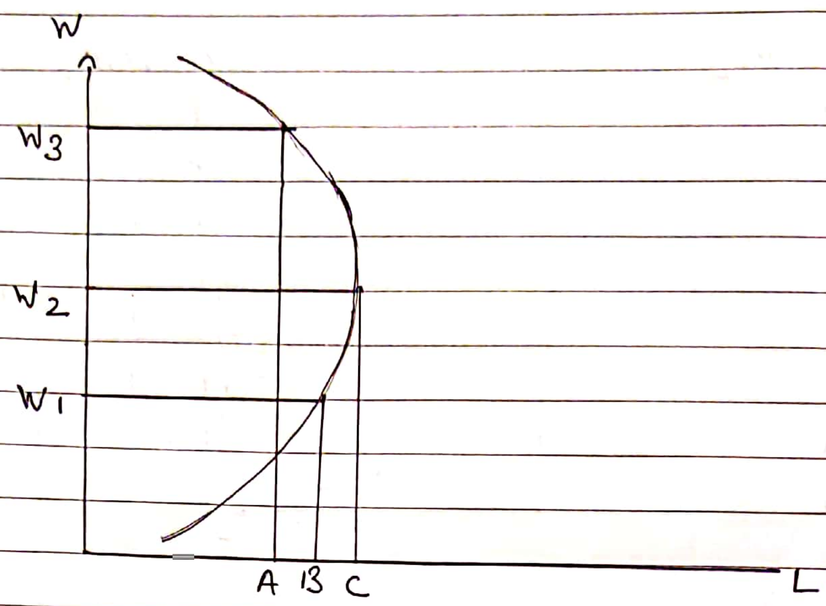
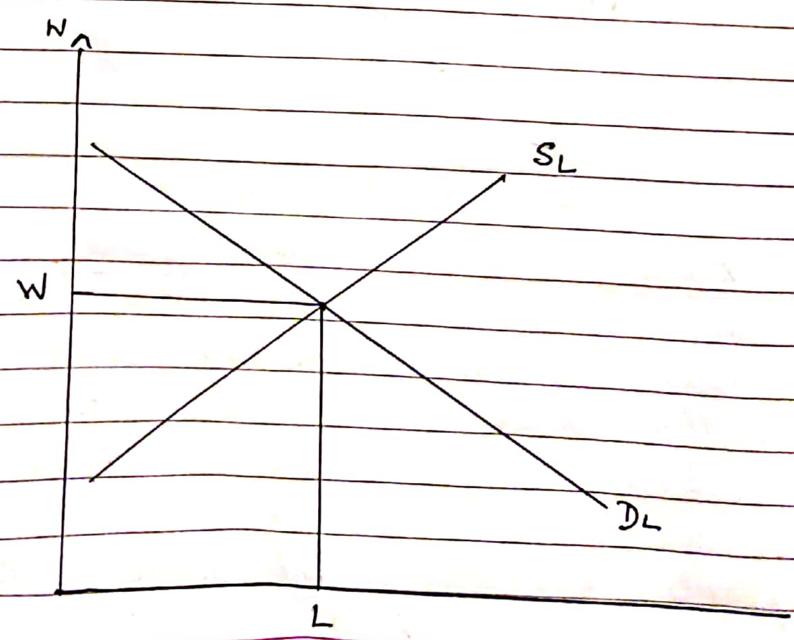
Backward bending Supply Curve.



Market Supply of labour:

The market supply labour curve however in the long run is not backward sloping because if some people at a very high wage rate do not wish to work, young people will then undertake their place.

Determination of Wage Rate:



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Pricing of Fixed Factor (Land and Capital)

The pricing of land and capital is very much different from that of labour. Labour cannot only be purchased but land and capital can either be purchased or rented in. If they are rented than the same theory of labour will apply, but if they are purchased then both the current and the expected value of marginal product will be considered.

Theory of Economic Rent:

This theory explain the pricing of factors whose factor is fixed in the long run. The fixed factors do not have marginal product.

ECONOMIC RENT = PRESENT EARNINGS – OPPORTUNITY COST (i.e. payments in excess of its opportunity cost)

THEORY OF ECONOMIC RENT

Example:

PRESENT INCOME OF LAND (Rs)	OPPT. COST (Rs)	RENT = Surplus over OC (Rs)
1000	100	0
1000	0	1000
1000	700	300
1000	1200	– 200

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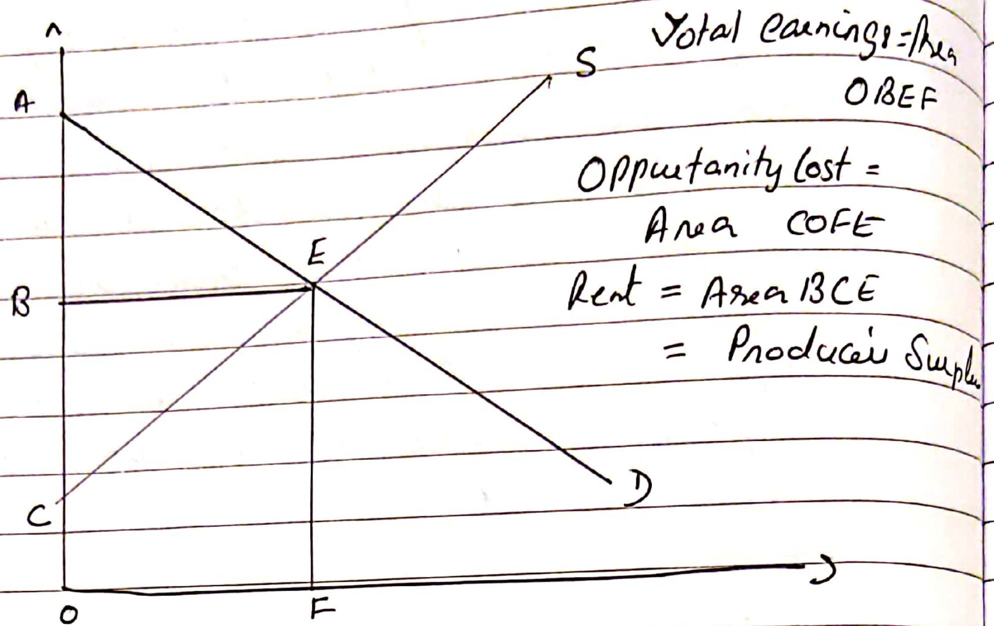
THEORY OF ECONOMIC RENT :

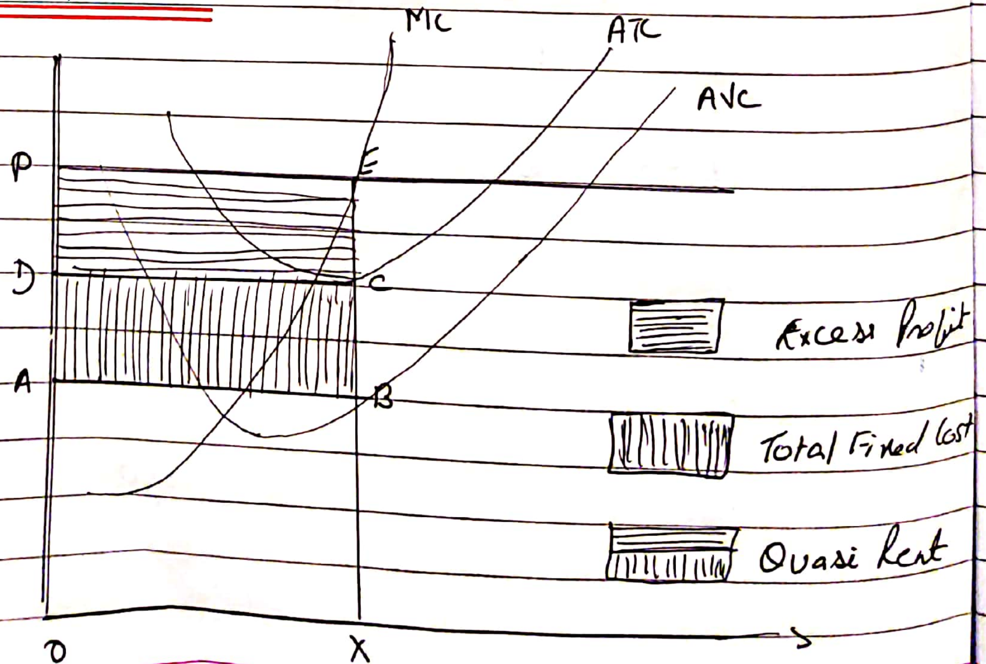


QUASI RENT :

Those factors which have inelastic supply in the short run are the fixed factors. The payments which are made to an input in the short run is called quasi-rent.

Quasi Rent = TR − TVC

Quasi Rent :



Profit:

The reward for entrepreneurship which is a residual income is profit. Profit is generally classified into two categories:

(a) Normal Profit
(b) Super Normal Profit

The super normal profit in the long run is obtained in the perfectly competitive market. The super normal profit is generally the outcome of

1) Risk taking behaviour
2) Imperfect Market
3) Innovation

Profit and Innovation:

Innovation is the use of new machines and finding new ~~so~~ source of raw materials, finding new materials, new techniques of selling and distribution etc. Innovation reduces cost and increases profit.

Innovation —> Profit —> Innovation

Profit and Risk:

Producers generally invest based on future cost, price and demand. But, since future is not certain, so there is risk. If only one can predict the future correctly then there will be profit. Hence, profit is a ~~rewarding~~ reward for risk taking.

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