

Factors of production essay sample

[Economics](#)



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There are two categories of factors of production: tangible resources including capital, land and natural resources; and non-tangible resources including labor, knowledge and entrepreneurship. In factor markets the buyer and seller pattern is opposite to the goods markets; in goods markets firms sell and households buy, but in factor markets firms buy and households sell. Households provide the labor; their savings flows into the financial markets and finances physical capital; they own the land and they are the entrepreneurs. The expenditures of the households are financed by the income they earn by selling the factors of production (Gwartney and Skipton, 2015).

Firms weigh the cost versus productivity of acquiring each unit of a factor of production; they expand use of a factor only so long as it is profitable to do so. The factor markets are driven by supply and demand just as any other market. However, there are few differences in the motivation of the sellers and buyers in the factor markets from those in the goods markets, the most obvious of which is the motivation of buyers. In a goods market the buyers want the goods based on utility.

Buyers in factor markets do not gain benefit from acquiring a factor of production; it is a means to an end and not the end itself. They gain a benefit only if the factor of production adds to their profit; therefore the demand for a factor of production is a derived demand – it is determined by consumer demand for the final good. When supply for a particular good or service increases, the derived demand for the factors of production needed for producing that good also increases. Derived demand acts a means to strengthen the consumer side of the factors market, a firm is directed to <https://assignbuster.com/factors-of-production-essay-sample/>

produce goods as per the consumer's needs and thus gives the power of choice to the customer (Gwartney and Skipton, 2015).

Land

The term land is used in economics to refer to acreage and the natural resources contained therein. Thus coal, oil, metal ores, subterranean water reservoirs, etc. are all examples of land. The payment for land is economic rent, which is considered any payment above that necessary because nature provided the resources without any need for compensation. When property rights are poorly defined or regulations make a resource non-tradable, waste will result because the resource will often be directed toward less valuable uses (Gwartney and Skipton, 2015). The supply of land in nature is essentially perfectly inelastic – independent of the going market price. No matter how expensive land becomes nature will not produce another few thousand acres and the same is true for the minerals and fossil fuels contained within the land.

Economic rent serves only an allocative function – the size of the economic rent determines how we use a resource, what purposes we budget or allocate it to, not a production function. The best use of land by any firm depends on various factors associated with it, like the location of the land or the price of a building or a land (Gwartney and Skipton, 2015). Rent control is one of the biggest obstacles in the efficient use of land or buildings. Rent regulation is imposed as limitation on price increases. The nature of rent control is that it begins with, at most, minor effects because it doesn't bind until the equilibrium rent increases.

Thus, the cost of rent control tends to be in the future, and ill effects worsen over time. A candidate who runs on a rent-control platform appeals to a large portion of the voters as there are more renters than landlords. Rent ceilings, cause haphazard and arbitrary allocation of space, inefficient use of space, retardation of new construction and indefinite continuance of rent ceilings, or subsidization of new construction and a future depression in residential building (Lewis and McAfee, 2013).

Capital and labor

Non-human capital like the physical capital (equipment or machinery) and financial capital (money and liquid assets) work hand in hand with the human capital (skills and experience of the workers). A firm needs all three in order to be successful. Financial capital lies behind the other two – the firm must raise financial capital in order to fund physical investment or labor training. Financial planning is the key aspect of a successful economy. Firms can increase capital by issuing preferred stocks to buyers and employees, borrow from banks or issue bonds. Issuing stock involves selling off ownership of the company to the public and becoming responsible to a board of directors and the shareholders.

If a firm is successful, they pay out the dividends to the shareholders' and reinvest the profits for expansion of the company. Issuing and placing stock is expensive, it requires the expertise of investment bankers and attorneys, and entails compliance with reporting requirements to shareholders and government agencies, such as the federal Securities and Exchange Commission (Leitner, 2007). The other aspect of capital is human capital; according to Heckman, the only way an economy can make the best use of <https://assignbuster.com/factors-of-production-essay-sample/>

its capital is by investing in activities that bear long term profits. Training the young unskilled workers will have a higher rate of return than adults past a certain age and below a certain skill level. So, private firms have higher profits because they train the younger population which has a longer life span to reap their profits.

On the contrary, the government training programs that provide training to any age group or skill level primarily because of political agendas have lower profits and tend to always depend on the taxpayers money to bail them out in case of any financial crisis (Heckman, 1998). Greater skills also facilitate worker mobility across occupations and regions to venture into newer job openings, this helps in reallocation of resources to a more productive task (Heckman, 2003). More than 135 million Americans form the workforce of the country. For any economy to function well, the performance of its labor force plays a vital role. In any market, productivity is the offspring of progress; so, any firm will progress only if their productivity is high and in order for them to have a maximum profits, workers are required be satisfied.

Today's workplace acknowledges facilities like safety, protection against occupational accidents, flexible working hours and telecommuting as a mantra for keeping the employees satisfied (Cox and Alm, FRB 2000). In the job market, every job has its own perks and downsides, it is up to a worker to decide, what he or she is ready to trade-off. Different types of jobs are more or less attractive to prospective employees. The employers compensate more for undesirable aspects of the job and compensate less when the job has desirable aspects. Employees who want to earn more wages, take up the less desirable jobs and vice versa. Employment that is more attractive to <https://assignbuster.com/factors-of-production-essay-sample/>

prospective employees can pay a lower wage; employment that is less attractive to potential workers must pay a higher wage, this difference in wages based on risk, physical effort, legal liability, prestige of the job, desirability of job location and local cost of living is known as differential compensation.

Higher wages are a lucrative incentive that attracts laborers to work towards increasing the productivity of any firm. There is a class of workers which gets paid the least hourly wages, so the political parties with an intention of increasing their vote bank are advocating a raise in the minimum wage; however this formula is causing unemployment among the least-skilled members of the society. The higher the wages are, the higher the costs of production are resulting in higher prices. Due to which smaller quantities of goods and services are demanded and the number of workers employed in producing them. Thus, the result of this ill policy by the government is higher rate of unemployment, so the government should not meddle with the wages and let the market take its own course to decide the wages based on skills and experience of the workers (Reisman, 2014). Entrepreneurship

Entrepreneurship is the ability to recognize an economic opportunity and to organize the other factors of production to exploit that opportunity (Formaini, 2001). There can be both private and political entrepreneurs. Private entrepreneurship has to do with change. Political entrepreneurs may pertain to change too, but it may also relate to preservation of status quo – protecting privilege, budgets or status. The major difference though is the reward that private and political entrepreneurs receive for successful entrepreneurship. In the private market the entrepreneur receives what is <https://assignbuster.com/factors-of-production-essay-sample/>

left over after the other factors are paid off which is the profit where as in the political market, the rewards vary. For the political actors – elected politicians, appointed officials or lobbyists' rewards may include campaign contributions, credit claims, praise, avoidance of criticism, and vote maximization (Simmons, 2011). Some business ventures are inherently higher risk than others.

Entrepreneurs will not engage in high risk ventures unless the potential profit is commensurately larger. When something very important is being risked – a large sum of money, personal safety, etc. – most people are very risk averse. Consequently, the payoff would have to be fairly large to induce most people to risk the money involved in a business investment. While entrepreneurs are more likely to be risk seekers than the general public, they too must see some larger payoff in order to engage in ventures that are high risk (Gwartney and Skipton, 2015). The innovator of a new product, a new production technology or a new service may be able to enjoy extra profit if the innovation increases sales and price or lowers production costs.

A company can string together a series of short run economic profits and, theoretically, make constant positive economic profit. The 3M Company (Minnesota Mining and Manufacturing) ran positive economic profits most years in a competitive industry by constant innovation. They developed scotch tape that didn't yellow, that was transparent and later two sided; they developed envelopes that had security weaves as well as those that had flavored glue. Their greatest success during this time period was the Post-it note (A century of innovation, the 3M story).

Knowledge and Politics

According to Hayek, the central issue for economics is division of knowledge within a society. A modern economy with an advanced division of labor requires cooperation of millions of individual actors. Given that an individual actor can only know the particulars of a small part of the economy, the coordination of economic activities is a critical issue (Hayek, 1945).

Furthermore, Hayek states that to overcome the problem of knowledge division, price mechanism helps in filling up the rift created by lack of information among individuals. Since knowledge is dispersed throughout an economy, it is impossible for policymakers and law makers to successfully steer an economy in a direction that ensures the maximization of profits (Hayek, 1973). People turn to government to get what they cannot get from markets, such as protection from environmental hazards like pollution.

While government can shift the cost of services from one person to another, there is no assurance that it will improve efficiency. The central planner has insufficient information to direct the economy and efforts to do so will do more damage than good. Resources will be used more productively if directed by market forces. Incentives exert a major impact on how government works and that political incentives will often result in government failure and impede the adoption of sound policies (Gwartney and Skipton, 2015). Regulation or central control is a two-way edged sword – it can generate adverse as well as positive results. For example the California electricity deregulation debacle in the year 2000-2001.

Energy deregulation policy froze or capped the price of energy that the major energy distributors could charge. Deregulation did not encourage new

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producers to create more power and drive down prices. Instead, with increasing demand for electricity, the producers of energy charged more for electricity. The producers used moments of spike energy production to inflate the price of energy which eventually led energy producers to shut down plants to increase prices. All these consequences resulted from the lack of control during reduced supply of electricity; market actors took undue advantage of the same and withheld power from the market (Navarro and Shames, 2003).

To sum it all up, the best use of all the factors of production for economic growth is when all the factors are used collectively, making the best possible use of one of the factors will not serve the purpose. The market or firm should be allowed to run its own courses to decide price ceilings or come to decisions regarding supply and demand. Intervention by policymakers for their own ulterior motives leads to imbalance in the economic growth.

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