Introduction To Theory Of Factor Pricing

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Introduction:

- The theory of factor pricing deals with the prices paid for factor services (land, labour, capital, entrepreneur) and received by the sellers of factor services. It deals with wage rate, interest rate specific rent and profit.
- In short theory of factor pricing studies how rent of land, wages of labour interest on capital and profit of entrepreneur is determined.

Why factor pricing is not studied along with product pricing:

- Theory of factor pricing deals with determination of prices of services of different factors of production, whereas theory of value deals with the determination of prices of goods produced. In both the theories prices are determined by the intersection of demand and supply curves. Therefore a question arises that why a separate study of factor pricing?
- This is because of the fact that the nature of demand and supply of factors and that of commodities. The difference in nature of demand and supply are as follows:

Difference in demand of factors and commodities: There are three main differences in the demand for factors and commodities.
These are:

- **Derived Demand:**Factors are demanded to produce commodities to satisfy consumer’s demand. Thus demand for factors is derived demand which is derived from the demand of commodities in the production of which it is used. For example demand for bricks, cement iron etc. is derived from the demand for a building.
- **Joint Demand:** Demand for factors is joint demand i.e. more than one factor is needed jointly to produce the commodity. For example one factor (labour) alone cannot produce apple. It is the outcome of efforts of Land, labour, capital and entrepreneur jointly.
- **Dependability:** The demand for factors depends upon their marginal productivities, while the demand for commodities depends upon their marginal utilities

Difference in supply of factors and commodities: There are two factors of difference between supply of factors and commodities:

Cost of production:

- Supply of commodities depends on its cost of production. But land has no cost of production to an economy. Also it is not possible to estimate the cost of production of labour.
- According to Modern economists supply of factors depend on their opportunity cost.

Relationship between price and supply

- There is positive relationship between price and supply of commodities, but there is no definite relation between price and supply of factors. Thus due to these differences, there is need for a separate theory for factor pricing.