<u>Wages,Interest &Rent</u>

Dr.Alok Kumar

Class-M.A.Sem-II

Factor prices

The optimal price for the factor of production is determined by the demand and supply of factor of production.

Distribution of national income is determined by factor payments (factor prices). Factor payments include rent, wages, interest and profit. The prices for factor of production depends upon demand and supply of that particular factor of production. Assume that the factors of production in the economy are fixed and hence the factor supply curve is vertical. Equilibrium of factor payments is determined by the intersection of the downwardsloping factor demand curve and the vertical supply curve. The optimal factor payments are determined through their respective markets i.e. the market clearing prices of the factors of production. There are three major factor of production Land, Labor, Capital.

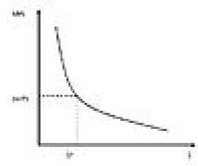
Labor market

As one knows that the firm will hire only the optimal amount of labor that will maximize profit, this optimal quantity of labor depends upon the marginal product of labor (MPL). The marginal product of labor is defined as the extra unit of output that the firm produces from hiring one extra unit of labor.

$$MPL=F(K,L+1)-F(K,L)$$

The above equation states that Marginal Product of labor is the difference of output produced from one extra unit of labor and the output produced from original quantity of labor. This production function has the function of **diminishing marginal product** which means that the marginal product of labor decreases as the amount of labor increases,and as the amount of labor increases the production function becomes flatter i.e. **diminishing marginal product**.

Optimal wages for Labor



The optimal demand for labor force is determined where marginal product equals real wage rate.

The demand for labor is dependent on the theory of marginal product of labor, which means that the firm compares the extra revenue earned from increased production that results from the added labor which ultimately leads to the higher spending on wages.