

# **LECTURE 2**

## **FACTORS OF PRODUCTION**



# Introduction

This topic aims at getting the student to understand what is required in the agricultural production process.

It introduces the concepts of factors of production, the questions facing the peasant farmer as an entrepreneur and the production function

In other words it introduces the student to the concept of production economics or the theory of the firm

# **What is a factor of production?**

A factor of production is anything that contributes directly to production of a given output such as seed, fertilizer, etc.

The volume of production is determined by the level of factors of production used.

It is often difficult to draw a clear distinction between the contribution of one factor of production and another.

But there are some noticeable differences between one factor and another which help economists to make some value judgement and make recommendations.

The universally accepted factors of production are:

## **1. Land**

This refers to natural characteristics of a given area of land.

It includes; land itself, mineral deposits, lakes, rivers, forests, climate, etc.

It excludes such man made features as terraces, irrigation furrows, roads, etc.

It is important to note that the supply of land as a production unit can be expanded by use of capital.

For example; irrigation of arid land, drainage of swamps, application of manure or fertilizers to infertile soils, etc.

Such application of capital for improvement of land makes it rather difficult to make a definite distinction between the two factors.

## **2. Labour**

Labour is an important factor of production.

It enables the effective utilization of the other factors of production.

Land needs to be cultivated, seeds need to be applied to soil, a tractor needs to be driven in order to plough the land, etc.=this has to be done by labour

A farmer is not interested in mere numbers of people but in real productivity, i.e. it is how work is performed rather than the size of the labour force that counts

In a country, population figures are not enough to determine the size of the labour force because not all people are economically active, i.e. are able to work.

Age and sex distribution would be a better indicator of the labour available.

While statistics of manpower employed or trained in various skills and activities is even a more accurate indicator of the labour available in a country.



### **3. Capital**

All man made assets that help land and labour to produce e.g. machinery, roads, buildings, permanent improvements on land such as fencing, terraces, irrigation, furrows, etc. are called capital.

Money itself, including stocks and shares and bank deposits, is capital only in as far it can be used to acquire real assets.

Money is usually referred to as liquid capital because it can be used in the acquisition of any form of real capital asset which can be used in the production process

Often capital can be further classified into:

- a) Liquid capital-money
- b) Operating or working capital-raw material for production normally used up in the production process and
- c) Fixed capital or durable capital-producer goods not used up in the production process but are subjected to depreciation and in time need to be replaced

## **4. Management**

Management is the process of decision making.

Decision making is very different from production in the form of labour.

A peasant farmer uses his knowledge and judgement to make decision on how to combine his given resources of land, family labour and capital to produce commodities for family consumption.

This managerial process makes the difference in output between farmers with similar conditions.

## EXHIBIT 1-1

RESOURCE CLASSIFICATION. We can arbitrarily classify resources, or factors of production, into those that are natural, human, and manufactured. We have denoted specific names within those three classifications.

Natural  
Resources

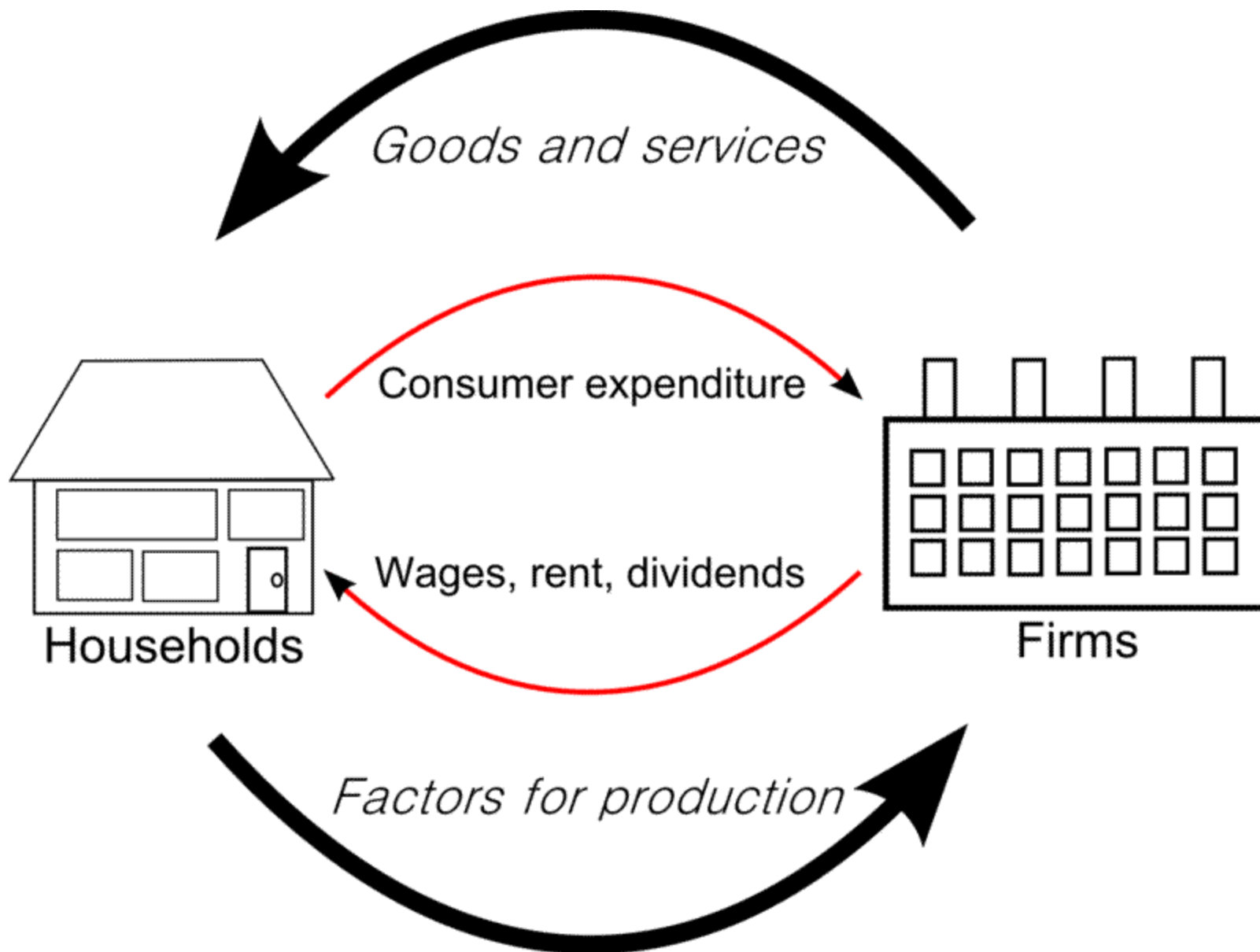
Human  
Resources

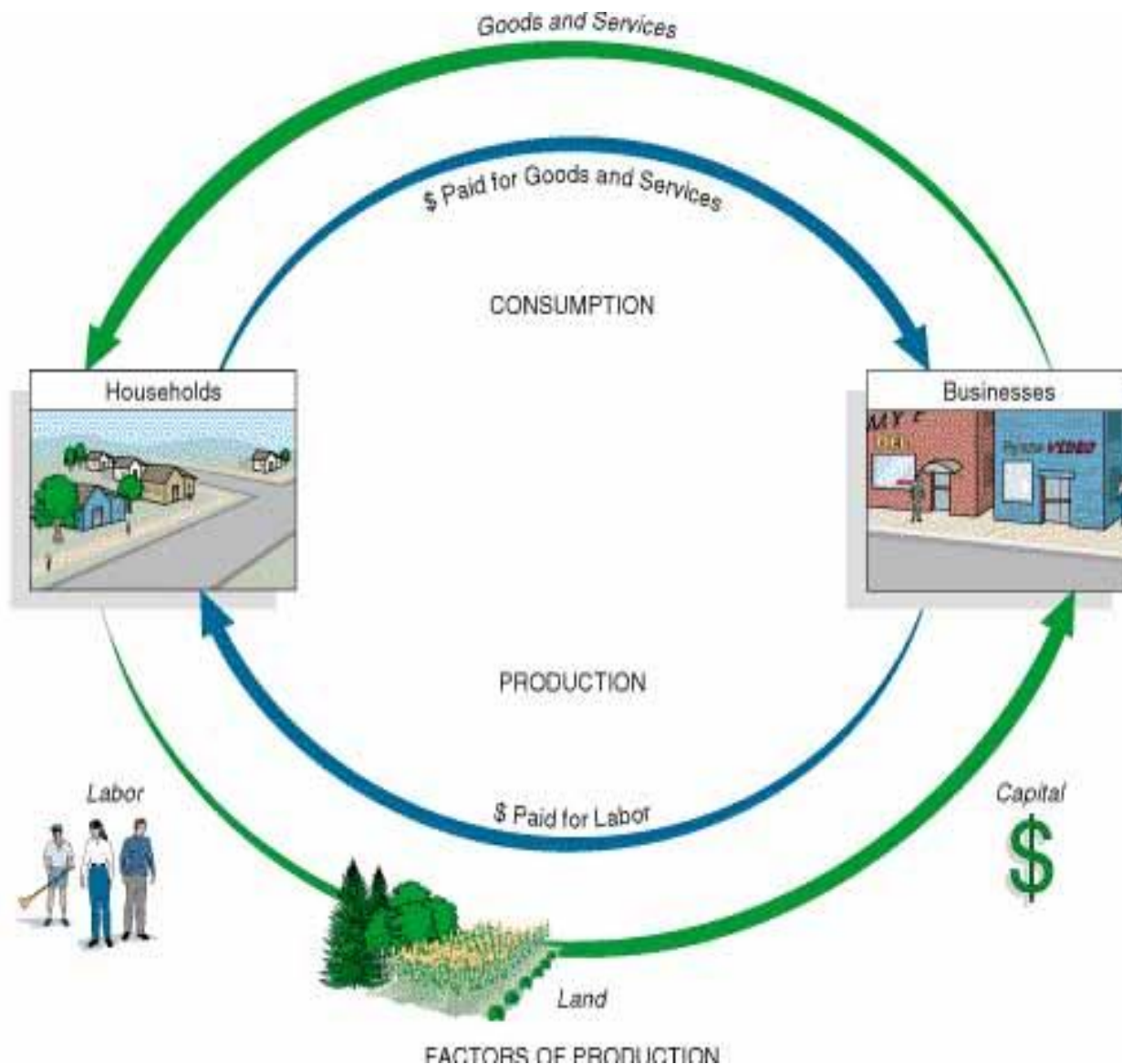
Manufactured  
Resources

Land

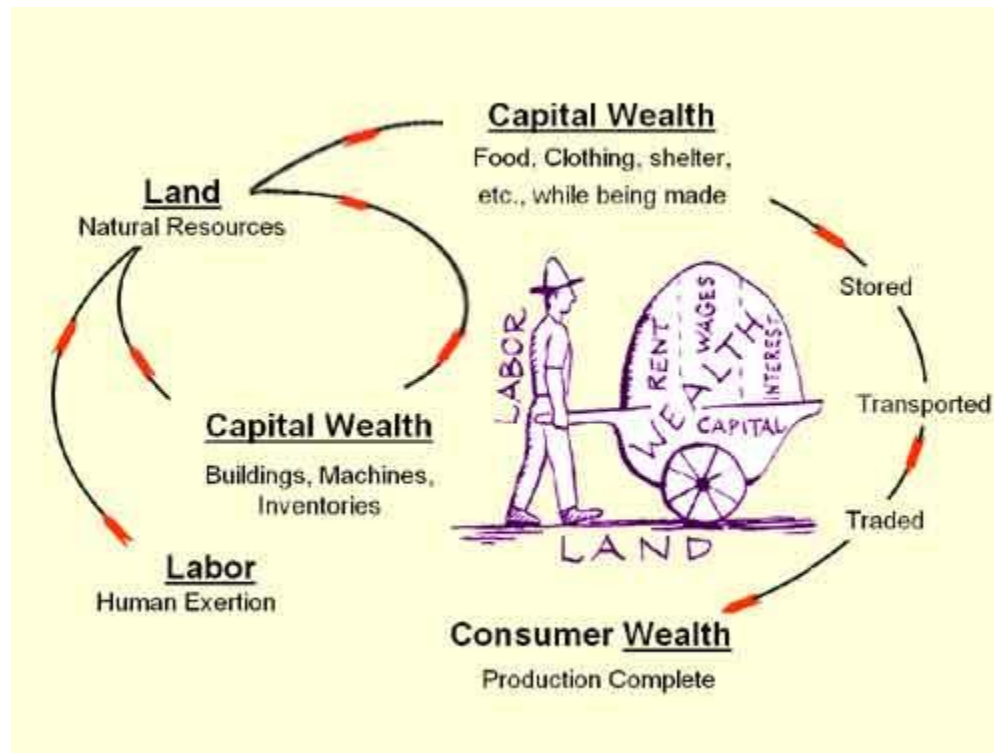
Labor and  
Entrepreneurship

Capital





- Land (meaning natural resources), labor and capital are the three elements constituting the "factors of production." Economic activity involves the circular flow of money and products.



# PRODUCTION

Three factors of production, land, labor and capital, don't always mean what we think they do:



**Land**

Not just real estate.

All resources, such as mined minerals, native plants and animals.



**Labor**

Not just physical strength.

All human endeavors, such as mental abilities.



**Capital**

Not just money.

All human creations that help produce wealth, such as a car used as a taxi.



# ***Background Questions***

1. Briefly define each factor of production.
2. Why are the factors interdependent? Explain.
3. What is wealth/asset? Give an example.
4. Why is land considered a passive factor of production?
5. How do capital and labor differ from land?
6. Why is it important to understand how terms are used in different contexts?