



Q1. What are the four factors of production and what are the remunerations to each of these called?

Ans: The four factors of production are:

- i. Land- It denotes the natural resources like air, water, soil, etc. The payment that is paid by the firms to acquire these services is called rent.
 - ii. Labour- It refers to the physical and mental effort required to do a work. For example, engineer, manager, worker, etc. The payment made to the labour in exchange of his/her services is called as wage.
 - iii. Capital- It refers to the monetary investments and physical and tangible investments like machinery, buildings, technology, tools, etc, which assists in production process. The payment received in exchange of these services is called interest.
 - iv. Entrepreneur- It refers to the individual who undertakes the risk to organise the production process. Entrepreneurs are the risk takers and often are the innovators of new techniques. They receive profit in exchange of their entrepreneurship.
- The remunerations paid to the factors of productions are called factor payments or factor incomes. These are the aggregation of rent, wage, interest and profit.

Q2. Why should the aggregate final expenditure of an economy be equal to the aggregate factor payments? Explain.

Ans: In a two sector economy, consisting of households and firms, the only way in which the households can dispose their income is on the goods and services produced by the firms. The factors of production use their remuneration to purchase goods and services. Thus, the income will come back to the producers in the form of sales' revenue. So, there is no difference between the amount that firms distribute in the form of factor payments and consumption expenditure incurred by the households. The same process continues year after year. However, if there has been any leakage in the form of savings, imports or taxes, then there arises a difference between the aggregate consumption expenditure and aggregate factor payments. In the case of some leakage, the households will spend less than their factor incomes. Consequently, the firms will receive lesser amount in the form of revenue, which will reduce the production level and employment level. This process will continue in every successive round and production and employment levels will continue to drop. Thus, the equality between the aggregate consumption expenditure and the aggregate factor payments is very necessary for the smooth functioning of the economy.

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