UNIT – V

Factor pricing

Rent · Wages · Interest · Profit

Explanatory Lecture Slides

Micro Economics · Major-5 · Semester IV

MICRO ECONOMICS

LEARNING OBJECTIVES

Topics covered in this unit

- **01** Explain Ricardian and modern rent
- **02** Theories of wages
- **03** Theories of interest (especially Keynes)
- **04** Theories of profit
- **05** Place marginal-productivity theory
- **06** Hook labour, land and money law

UNIT V · SYLLABUS MAP

How this unit is organised

01	02	03	04	05	06
Rent	Quasi-rent	Wages	Interest	Profit	MFP theory

Ricardian rent

Rent is the surplus of a superior land over the margin of cultivation. Land’s supply is fixed; rent is price-determined, not price-determining.

- ‘Corn is not high because a rent is paid; a rent is paid because corn is high.’
- Differential rent. Criticisms: land is not fixed in use; fertility is not the only difference (location — von Thünen).

Ricardian rent

RICARDO

- Differential surplus.
- Price-determined.

MODERN

- Any factor in inelastic supply can earn rent.

Quasi-rent (Marshall)

The short-run surplus of a machine (fixed supply today, reproducible tomorrow). In the long run it is normal return; in the short run it looks like rent.

- A 6-mark that shows you know time. Quasi-rent can be negative (a stranded plant).

Quasi-rent (Marshall)

SHORT RUN

- Machine is like land.

LONG RUN

- It can be reproduced; rent vanishes into cost.

Wages

Subsistence (Malthus/Ricardo), residual, bargaining (Webb), modern: MRP of labour in a competitive market; monopsony if one employer.

- Collective bargaining and a minimum-wage statute are the legal bargains against a pure MRP story.
- Real v money wages. Efficiency-wage: pay more to get more (optional).

Wages

COMPETITIVE

- $w = MRP_L$.

REAL WORLD

- Union.
- Code on Wages.
- Monopsony town.

Interest — Keynes’s liquidity preference

Interest is the price of parting with liquidity, not a prize for waiting (against classical abstinence). Motives: transactions, precaution, speculation. Liquidity trap: LP curve flat, monetary policy weak.

- Classical: S and I determine r. Loanable funds: a hybrid. Keynes: M and LP determine r, then I and multiplier determine Y.
- A 16-mark of this paper. Diagram-in-words: L1 + L2 against M.

Interest — Keynes's liquidity preference

MOTIVES

- Transactions.
- Precaution.
- Speculation.

TRAP

- r so low that cash and bonds are substitutes; extra M is hoarded.

Profit

Clark (marginal product of the entrepreneur), Schumpeter (innovation), Knight (uncertainty — uninsurable risk), residual.

- Accounting profit v economic profit (the latter after opportunity cost of own capital).
- A 10-mark: three theories, one criticism each. Knight is the one a lawyer likes: courts deal in uncertainty, insurers in risk.

Profit

KNIGHT

- Uncertainty ≠ risk.

SCHUMPETER

- Profit is the prize of a new combination, eaten by imitation.

Marginal-productivity theory of distribution

Each factor is paid its MRP under competition. Elegant; weak where markets are not competitive, information is poor, or bargaining power is unequal.

- The unit’s closing theory. Add: it does not justify the existing distribution as ‘just’ (Joan Robinson’s criticism).

Marginal-productivity theory of distribution

HOLDS IF

- Competition.
- Known MP.
- Mobile factors.

FAILS IF

- Monopsony.
- Caste/gender barriers.
- Firm-specific skills.

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LANDMARK AUTHORITIES

Cases a KSLU answer should name

CASE

K.T. Plantation

(2011) 9 SCC 1

Land’s rent and the State’s taking — Art. 300A sits on Ricardian land.

CASE

Sanjit Roy

(1983) 1 SCC 525

A wage below the floor is not a ‘market wage’ the State may pay.

CASE

Swiss Ribbons

(2019) 4 SCC 17

Profit and loss are supposed to end in an insolvency process — Knight’s uncertainty with a statute.

STATUTE / SECTION MAP

Provisions & materials to quote

Art. 300A	Land and the legal right that rent sits on.
Code on Wages 2019	A statutory floor against a pure MRP wage.
RBI Act / T-Bills	The money-market face of the interest rate.
IDA / IR Code	Bargaining theory of wages in a statute.
IBC 2016	Where residual profit (and loss) is finally allocated.

WRITE IT IN THE HALL

10 / 16-mark frames from this unit

Q1 Examine the Ricardian theory of rent. What is quasi-rent?

Q2 Explain the bargaining / marginal-productivity theory of wages.

Q3 Explain Keynes's liquidity-preference theory of interest.

Q4 Examine Knight's / Schumpeter's theory of profit.

BEFORE YOU CLOSE THE FILE

Unit recap

1. Rent: a surplus of the inelastic factor; quasi-rent is its short-run cousin.
2. Wages: MRP as a start; statute and union as the rest.
3. Interest (Keynes): price of liquidity; name the trap.
4. Profit: Knight’s uncertainty, Schumpeter’s innovation.
5. MFP theory is a competitive benchmark, not a theory of justice.