Factor Pricing

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.

The theory of factor pricing is also called theory of distribution. The distribution may be either functional or personal. The personal distribution is concerned with the distribution of national income among various factors of production which is unequally distributed. On the other hand, the functional distribution is concerned with the remuneration paid to various factors of production in an act of production.

The factors of production, viz., land, labour, capital, entrepreneur and organisation are paid in the form of rent, wages, interest, profit and salary. Thus, the theory of functional distribution is called the theory of factor pricing.

Thus, Theories under factor Pricing are:

1. Theories of wage
2. Theories of rent
3. Theories of Interest
4. Theories of Profit

Theories of Wages:

Some of the most important theories of wages are as follows: 1. Wages Fund Theory 2. Subsistence Theory 3. The Surplus Value Theory of Wages 4. Residual Claimant Theory 5. Marginal Productivity Theory 6. The Bargaining Theory of Wages 7. Behavioural Theories of Wages.

1. Wages Fund Theory: This theory was developed by Adam Smith (1723-1790). His theory was based on the basic assumption that workers are paid wages out of a pre-determined fund of wealth. This fund, he called, wages fund created as a result of savings. According to Adam Smith, the demand for labour and rate of wages depend on the size of the wages fund. Accordingly, if the wages fund is large, wages would be high and vice versa.

2. Subsistence Theory: This theory was propounded by David Recardo (1772-1823). According to this theory, “The labourers are paid to enable them to subsist and perpetuate the race without increase or diminution”. This payment is also called as ‘subsistence wages’. The basic assumption of this theory is that if workers are paid wages more than subsistence level, workers’ number will increase and, as a result wages will come down to the subsistence level. On the contrary, if workers are paid less than subsistence wages, the number of workers will decrease as a result of starvation death; malnutrition, disease etc. and many would not marry. Then, wage rates would again go up to subsistence level. Since wage rate tends to be at, subsistence level at all cases, that is why this theory is also known as ‘Iron Law of Wages’. The subsistence wages refers to minimum wages.

3. The Surplus Value Theory of Wages: This theory was developed by Karl Marx (1849-1883). This theory is based on the basic assumption that like other article, labour is also an article which could be purchased on payment of its price i e wages. This payment, according to Karl Marx, is at subsistence level which is less than in proportion to time labour takes to produce items. The surplus, according to him, goes to the owner. Karl Marx is well known for his advocation in the favour of labour.

4. Residual Claimant Theory: This theory owes its development to Francis A. Walker (1840-1897). According to Walker, there are four factors of production or business activity, viz., land, labour, capital, and entrepreneurship. He views that once all other three factors are rewarded what remains left is paid as wages to workers. Thus, according to this theory, worker is the residual claimant.

5. Marginal Productivity Theory: This theory was propounded by Phillips Henry Wick-steed (England) and John Bates Clark of U.S.A. According to this theory, wages is determined based on the production contributed by the last worker, i.e. marginal worker. His/her production is called ‘marginal production’.

6. The Bargaining Theory of Wages: John Davidson was the propounder of this theory. According to this theory, the fixation of wages depends on the bargaining power of workers/trade unions and of employers. If workers are stronger in bargaining process, then wages tends to be high. In case, employer plays a stronger role, then wages tends to be low.

7. Behavioural Theories of Wages: Based on research studies and action programmes conducted, some behavioural scientists have also developed theories of wages. Their theories are based on elements like employee’s acceptance to a wage level, the prevalent internal wage structure, employee’s consideration on money or’ wages and salaries as motivators.