Factors of Production- CAPITAL

4TH SEM, HONS, CC-9
PREPARED BY DR SURAJIT LET

(3) Capital:

Capital, the third agent or factor is the result of past labour and it is used to produce more goods. Capital has, therefore, been defined as 'produced means of production.' It is a man-made resource. In a board sense, any product of labour-and-land which is reserved for use in future production is capital.

To put it more clearly, capital is that part of wealth which is not used for the purpose of consumption but is utilised in the process of production. Tools and machinery, bullocks and ploughs, seeds and fertilizers, etc. are examples of capital. We have already identified certain things described as capital in our discussion on producers' goods.

Even in ancient times, capital was created for producing food, hunting animals and for the transportation of goods. At that stage capital goods consisted of simple tools and implements. Even in the least developed countries some capital is used. In such countries people make use of simple ploughs, axes, bows and arrows, and leather bags to carry water.

It may be pointed out in this context that the same article may, at one time, be a consumption good and, at another time, capital, depending on the use to which it is put. Thus, if a doctor goes out in his motor car to examine a patient he is using his car as capital. But if he goes out for a joy ride in his motor car, he is using it as a consumption good. Similarly, when coal is used in a factory, it is capital, but when coal is used as domestic fuel, it is a consumption good.

Economists use the term capital to mean goods used for further production. In the business world, however, capital is always expressed in terms of money. If a businessman is asked, "What is your capital?" he will always mention a sum of money. But money is not capital because money, by itself, cannot produce anything.

The business-person thinks of money as capital because he can easily convert money into real resources like tools, machines and raw materials, and use these resources for the production of goods. Also capital is measured in terms of money. So the amount of resources used or possessed by a business-person is conveniently expressed as a sum of money.

Classification of Capital:

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Capital can be classified in two broad categories that which is used up in the course of production and that which is not.

Fixed and Circulating Capital:
Fixed capital means durable capital like tools, machinery and factory buildings, which can be used for a long time. Things like raw materials, seeds and fuel, which can be used only once in production are called circulating capital. Circulating capital refers to funds embodied in stocks and work-in- progress or other current assets as opposed to fixed assets. It is also called working capital.

Two Features of Capital:
Two important features of capital are:
Firstly, it entails a sacrifice, since resources are devoted to making non-consumable capital goods instead of goods for immediate consumption. Secondly, it enhances the productivity of the other factors, viz., land and labour.

In fact, it is this enhanced productivity which represents the reward for the sacrifice involved in creating capital. Hence we can predict that new capital is only created so long as its productivity is at least sufficient to compensate those who make the sacrifices involved in its creation. These two features may now be discussed in detail.

Capital Formation:
People use capital goods like machines, equipment, etc. because capital goods are the creators of other goods. But this is not the whole truth. People use capital for another important reason to produce goods with less effort and lower costs than would be the case if labour were not assisted by capital. But in order to use capital goods people must first produce them. This calls for a sacrifice of current consumption.

When people use their labour to produce capital goods like textile producing machines, they can use the same labour for producing consumer goods like textiles. As Stanlake has put it “The opportunity cost of the capital goods is the potential output of consumer goods which has to be foregone in order to produce that capital, the production of capital demands abstinence from current consumption.”

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Factors Affecting Capital Formation:

The creation of capital depends on two things:

(a) Savings and (b) a diversion of resources (from the production of consumption goods to meet current needs to the production of capital goods to meet future needs). Saving is the difference between current income and current consumption. In other words, it is the act of foregoing current consumption.

It means that resources otherwise used to produce consumer goods are set aside for producing capital goods. If people choose not to buy some consumer goods, with some part of their current income, they refrain from buying (utilising) the services of the factors required to make those goods.

These factors might, therefore, remain idle. But these savings may be borrowed and utilised by business firms (entrepreneurs) to finance the construction of capital goods. This is the second step—the diversion of resources for the production of consumer goods to the production of capital (producers) goods. It may be noted that savings make possible capital accumulation. It does not cause it.

In short, capital formation depends on savings, which, in its turn, depends on two things:

(1) The capacity to save and

(2) The desire to save.

The capacity to save depends on income and the existence of savings institutions like banks, insurance companies, post offices, stock exchanges, etc. If income is low, savings will also be low. Even if income is high savings will be low in the absence of the above-mentioned savings institutions.

The desire to save depends on

(1) the rate of interest and (2) stability in the value of money (i.e., the rate of inflation).

If the rate of interest is high people will be eager to save more by curtailing their current consumption. People will also be eager to save more if they expect that there will exist reasonable price stability in the economy in future.

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Mobility of Capital:

Capital is both geographically and occupationally mobile. However, a certain portion of a nation's capital stock which consists of such things as railway networks, blast furnaces and shipyards are highly specialised equipment and are virtually immobile in the geographical sense. It is physically possible to dismantle them and move them to different sites or locations, but the cost of doing so will be so great that it will not be economically feasible to do so.

Such equipment are not even occupationally mobile. Each such equipment can only be used for a specific purpose. Many buildings however, can be put to better uses. Many of the old buildings used as cinema house or god-owns in northern area of Calcutta have been dismantled and converted into multi-storeyed buildings.

Some capital equipment is mobile in both the geographical and occupational sense. Examples of such capital equipment are electric motors, machine tools, hand tools, typewriters, and lorries. Such equipment can be used effectively in a wide variety of industries and are capable of moving from one location to another at very little cost.

Return:

The earning of capital, i.e., the price that has to be paid for it, is known as interest. If it stated as percentage of the principal, representing the sum paid by a borrower who needs finance to purchase a piece of capital equipment.