The factors of production are resources that are the building blocks of the economy; they are what people use to produce goods and services. Economists divide the factors of production into four categories: land, labor, capital, and entrepreneurship.

The first factor of production is land, but this includes any natural resource used to produce goods and services. This includes not just land, but anything that comes from the land. Some common land or natural resources are water, oil, copper, natural gas, coal, and forests. Land resources are the raw materials in the production process. These resources can be renewable, such as forests, or nonrenewable, such as oil or natural gas. The income that resource owners earn in return for land resources is called rent.

The second factor of production is labor. Labor is the effort that people contribute to the production of goods and services. Labor resources include the work done by the waiter who brings your food at a local restaurant as well as the engineer who designed the bus that transports you to school. It includes an artist's creation of a painting as well as the work of the pilot flying the airplane overhead. If you have ever been paid for a job, you have contributed labor resources to the production of goods or services. The income earned by labor resources is called wages and is the largest source of income for most people.

The third factor of production is capital. Think of capital as the machinery, tools, and buildings humans use to produce goods and services. Some common examples of capital include hammers, forklifts, conveyer belts, computers, and delivery vans. Capital differs based on the worker and the type of work being done. For example, a doctor may use a stethoscope and an examination room to provide medical services. Your teacher may use textbooks, desks, and a whiteboard to produce education services. The income earned by owners of capital resources is interest.

The fourth factor of production is entrepreneurship. An entrepreneur is a person who combines the other factors of production — land, labor, and capital — to earn a profit. The most successful entrepreneurs are innovators who find new ways to produce goods and services or who develop new goods and services to bring to market. Without the entrepreneur combining land, labor, and capital in new ways, many of the innovations we see around us would not exist. Think of the entrepreneurship of Henry Ford or Bill Gates. Entrepreneurs are a vital engine of economic growth helping to build some of the largest firms in the world as well as some of the small businesses in your neighborhood. Entrepreneurs thrive in economies where they have the freedom to start businesses and buy resources freely. The payment to entrepreneurship is profit.

You will notice that I did not include money as a factor of production. You might ask, isn't money a type of capital? Money is not capital as economists define capital because it is not a productive resource. While money can be used to buy capital, it is the capital good (things such as machinery and tools) that is used to produce goods and services. When was the last time you saw a carpenter pounding a nail with a five dollar bill or a warehouse foreman lifting a pallet with a 20 dollar bill? Money merely facilitates trade, but it is not in itself a productive resource.

Remember, goods and services are scarce because the factors of production used to produce them are scarce. In case you have forgotten, scarcity is described as limited quantities of resources to meet unlimited wants. Consider a pair of denim blue jeans. The denim is made of cotton, grown on the land. The land and water used to grow the cotton is limited and could have been used to grow a variety of different crops. The workers who cut and sewed the denim in the factory are limited labor resources who could have been producing other goods or services in the economy. The machines and the factory used to produce the jeans are limited capital resources that could have been used to produce other goods. This scarcity of resources means that producing some goods and services leaves other goods and services unproduced.

It's time to test your knowledge with a little game I like to call, Name That Resource. I will say the name of an item and you will identify it as one of the four possible resources that form the factors of production: land, labor, capital, or entrepreneurship.

- Coal ... land
- Forklift ... capital
- Factory ... capital
- Oil ... land
- Michael Dell ... entrepreneur

It's time to wrap things up, but before we go, always remember that the four factors of production — land, labor, capital, and entrepreneurship — are scarce resources that form the building blocks of the economy.

-Federal Reserve Bank of St. Louis, “Factors of Production: The Economic Lowdown Podcast series, Episode 2” (Undated) excerpt.