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B.A. Economics
B.A. Part -1
Paper - 1st (Microeconomics)
Topic - **Ricardian Theory of Rent**

<u>Ricardian Theory of Rent</u>

David Ricardo *was a brilliant 19th century economist of England who propounded a systematic theory of rent which is in many ways the basis of the modern concept of rent. Ricardo defined rent as ; " Rent is that portion of Earth which is paid to the land lord for the use of the original and indestructible power of the soil " It should be noticed that land rent, According to Ricardian definition, is a payment for the use of only land and is different from contractual rent which includes :*

- *According to Ricardo, marginal land earns so rent.*
- *In Ricardian Theory , rent is not price determining. In fact , in this theory rent is price determined , i.e; it is price that determines rent. To quote Ricardo,* ***" Corn is not high because a rent is paid , but a rent is paid because corn is high "***

<u>Assumptions of the Theory:</u>

The Ricardian theory of rent is based on the following assumptions:

1. Rent of land arises due to the differences in the fertility or situation of the different plots of land. It arises owing to the original and indestructible powers of the soil.

2. Ricardo assumes the operation of the law of diminishing marginal returns in the case of cultivation of land. As the different plots of land differ in fertility, the produce from the inferior plots of land diminishes though the total cost of production in each plot of land is the same.

3. Ricardo looks at the supply of land from the standpoint of the society as a whole.

4. In the Ricardian theory it is assumed that land, being a gift of nature, has no supply price and no cost of production. So rent is not a part of cost, and being so it does not and cannot enter into cost and price. This means that from society's point of view the entire return from land is a surplus earning.

<u>Reasons for Existence of Rent:</u>

According to Ricardo rent arises for two main reasons:

(1) Scarcity of land as a factor

(2) Differences in the fertility of the soil

Scarcity Rent:

Ricardo assumed that land had only one use—to grow corn. This meant that its supply was fixed, as shown in Figure 13.1. Hence the price of land was totally determined by the demand for land. In other words, all the price of a factor of production in perfectly inelastic supply is economic rent—it has no transfer earnings.

Thus, it was the high price of corn which caused an increase in the demand for land and a rise in its price, rather than the price of land pushing up the price of corn. However, this analysis depends on the assumption that land has only one use. In the real world a particular piece of land can be put to many different uses. This means its supply for any one use is elastic, so that it has transfer earnings.

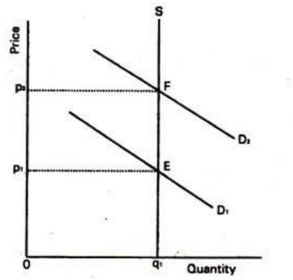

Fig. 13.1. Earnings of a Factor in Fixed Supply

Differential Rent :

According to Ricardo, rent of land arises because the different plots of land have different degree of productive power; some lands are more fertile than others. So there are different grades of land. The difference between the produce of the superior lands and that of the inferior lands is rent—what is called differential rent. Let us illustrate the Ricardian concept of differential rent.

Differential Rent on account of differences in the fertility of soil:

Ricardo assumes that the different grades of lands are cultivated gradually in descending order—the first grade land being cultivated at first, then the second grade, after that the third grade and so on. With the increase in population and with the consequent increase in the demand for agricultural produce, inferior grades of lands are cultivated, creating a surplus or rent for the superior grades. This is illustrated in Table 13.1.

Table 13.1: ***Calculation of Differential Rent***

Grade of Land (the same size)	Total Produce and its Value	Cost of Production	Rent	Status of land
1st	40 kg×Rs. 5 = Rs. 200	Rs. 100	Rs. 100	Above-marginal Land
2nd	30 kg×Rs. 5 = Rs. 150	"	Rs. 50	"
3rd	20 kg×Rs. 5 = Rs. 100	"	Nil	Marginal (or No Rent) Land
4th	15 kg.×Rs. 5 = Rs. 75	"	Rs. –25	Below-marginal Land

Table 13.1 shows the position of 3 different plots of land of equal size. The total cost is the same for each plot of land. Let us assume that the order of cultivation reaches the third stage when all the three plots of land of different grades are cultivated and the market price has come to the level of Rs. 5 per kg of wheat.
The first grade land, being the most fertile, produces 40 kg, the second grade 70 kg and the third grade land, being less fertile, only 20 kg. So, the first grade land earns a surplus or rent of Rs. 100, the second grade a rent of Rs. 50 and the third one earns no surplus. The first two plots are called the intra-marginal and the third one is the marginal (or no-rent) land. This simple example shows how the differences in the fertility of the different plots of land create rent for the superior plots of lands.

The concept of differential rent arising due to differences in the fertility of different plots of land (illustrated in Fig. 13.2.)

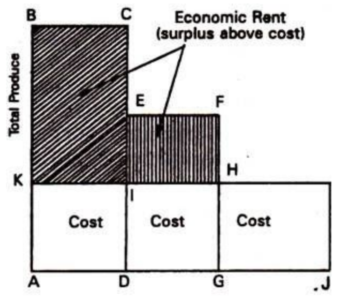

Fig. 13.2. Differential Rent

Here, AD, DG and GJ are three separate plots of land of the same size, but of difference in fertility. The total produce of AD is ABCD, that of DG is DEFG and that of GJ is GHIJ. The first and second plots of land generate a surplus shows by the shaded area, which represents the rent of the first two plots of land. Since the third plot GJ has no surplus it is marginal land or no-rent land. Grade 4 (below-marginal) land will not be cultivated, because rent is negative (Rs. 25 in this example).

Rent and Cost (Price):

Another interesting question is whether rent is price-determined or price is rent- determined. Land is a free gift of nature and, therefore, its cost of production is zero. To Ricardo, price can never be rent-determined; rather the converse is true, because rent is viewed as a pure surplus.

The higher the price, the larger will be the rent. So rent depends on price but price is not determined by rent. Therefore price is high not because rent is paid but rent is paid because price is high. Rent is thus price-determined, not price-determining.

Paul Samuelson generalizes this viewpoint when he says:

"Whether rent is or is not a price-determining cost depends upon the viewpoint."

Criticisms :

(i) No Original and Indestructible Power

(ii) Wrong Assumption of 'No Rent Land'

(iii) Rent Enters Into Price

(iv) Wrong Assumption of Perfect Competition

(v) All Lands are Equally Fertile

(vi) Historically Wrong

(vii) Neglect of Scarcity Principle