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B.A. Economics
B.A. Part - I
Topic : Modern Theory Of Rent

Modern Theory of Rent

Modern Theory of Rent does not confine itself to the Determination of the reward of only land as a factor of production. Rent according to the modern sense can arise in respect of any factor of production. It is a surplus payment in excess of transfer earnings of that factor factor. ***Transfer earnings means the amount of money which any particular unit of a factor could earn in its next best alternative use.*** *In other words, economics rent in such a case is the difference between the present earnings and transfer earnings. In* ***Joan Robinson's*** *words ,* ***" The essence of the conception of rent is the conception of a surplus earned by a particular part of a factor of production over and above the minimum earnings necessary to induce it to it's work."***

How Economic Rent Arises?

Now the question is how economic rent arises. Economic rent is the sense of surplus over transfer earnings will arise when the supply of the factor units is less ***than perfectly elastic or not perfectly elastic.*** *From the point of view of elasticity of supply, there are three possibilities:*

- *When the supply is perfectly elastic*
- *When it is less than perfectly elastic , and*
- *When it is inelastic.*

- ***When the supply of factors units is perfectly elastic***

In this case,there will be no surplus or economic rent and the actual earnings and transfer earnings will be equal.when the supply of a factor is perfectly elastic, it means that at a given price ,or remuneration the entrepreneur can engage or employ any number of the factor units. It is obvious that,when the factor units are available at a minimum price or transfer earnings,their equilibrium price will be equal to that minimum price at which the present earnings are equal to the transfer earnings. Thus,no factor units in such a situation will be able to earn more than its transfer earnings. That is, there will be no rent or surplus earnings.

This is shown in Figure 184 given below. In this figure, the supply of the factor of production SS is perfectly elastic and is, therefore, shown as a horizontal straight line. This means that all factor units are available at the given price OS or in other words , the transfer earnings of each factor unit are also equal to OS. DD is the demand curve. The two curves intersect at P . OM is the quantity of the factor used The price determined is OS . The total earnings are

OSPM . But since transfer earnings are equal to the actual earnings, they are also equal to OSPM. There is no surplus and hence no rent.

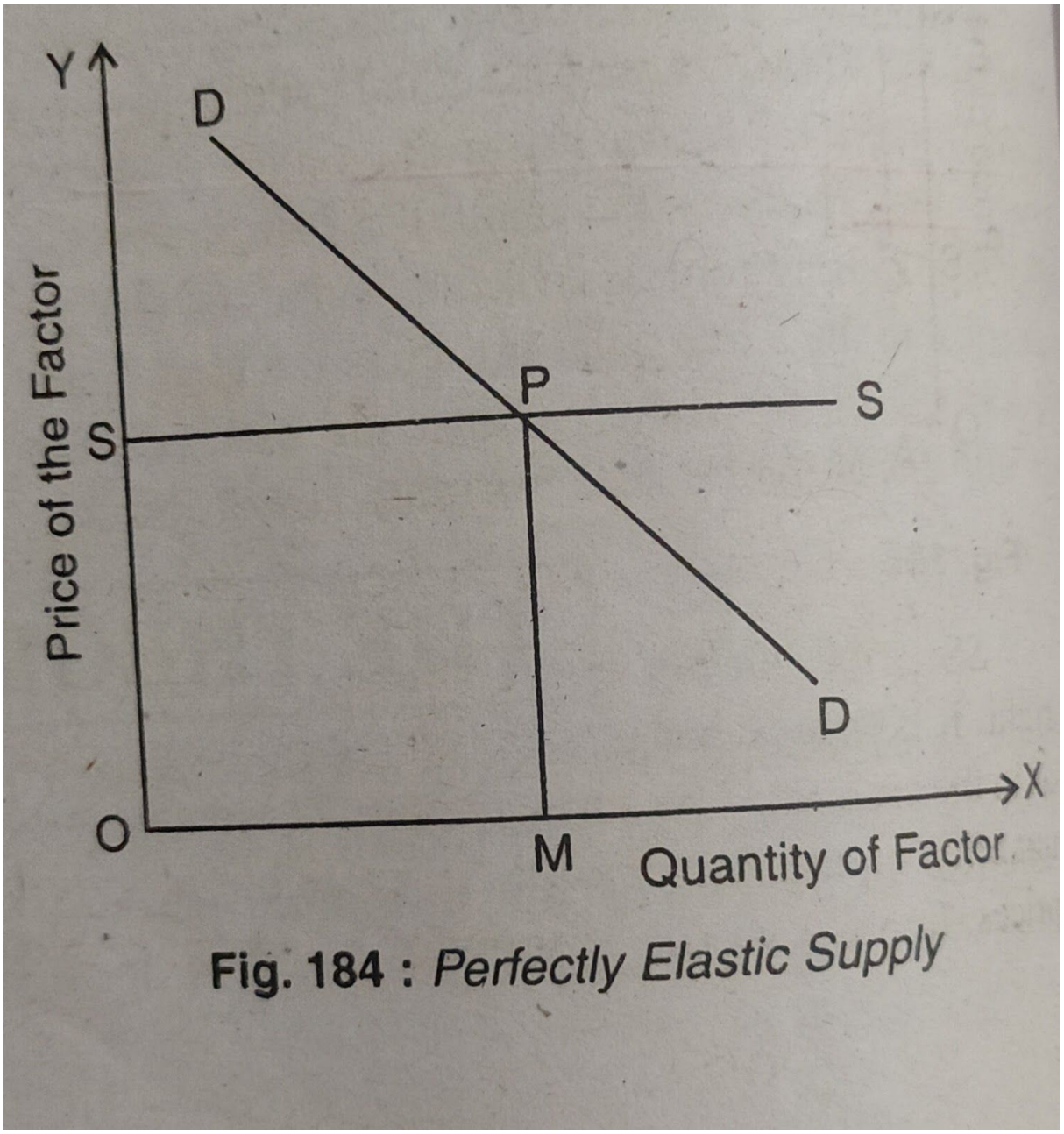

Fig. 184 : *Perfectly Elastic Supply*

If this firm does not pay the price OS, the factor units will be shifted to some other use and earn there as much, because present earnings are equal to transfer earnings. Thus, it is clear that if the supply of factor units is perfectly elastic for a particular use or industry , then no factor unit can earn surplus or economic rent.

b) Less than Perfectly Elastic Supply

Now let us take a case when the supply is less than perfectly elastic, i.e; it is some what elastic. This means that the transfer earnings of all the factor units are not equal, As, in some industry or use, the price of the factor increases, more and more of the factor units will

offer their services to this industry in use. Suppose that in a particular industry or use, a factor unit can earn Rs. 200 p.m. It is obvious that only such units of the factor will offer their services to this industry whose price in other alternative occupations is less than Rs. 200 or in other words the transfer earnings are less than the present earnings. In this manner , as the price paid for a factor in a particular industry or occupation increases, the supply of the factor will increases, the supply of the factor will increase if the transfer earnings are less. It is clear that the supply of a factor of production depends on its earnings. This is shown in the figure 185.

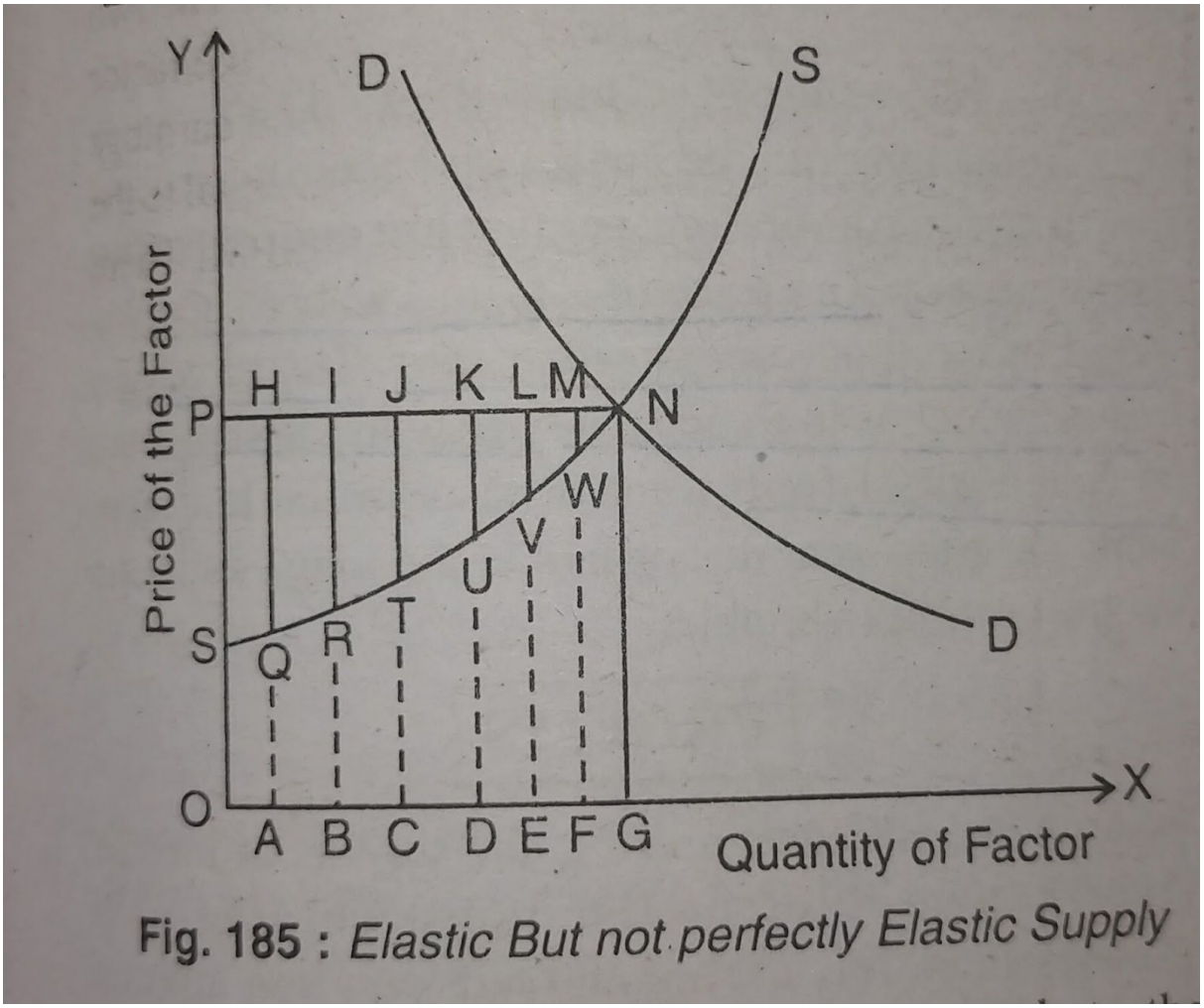

Fig. 185 : *Elastic But not perfectly Elastic Supply*

SS is the supply curve sloping upwards to the right. It is somewhat elastic but not perfectly elastic as in the case (a). The supply curve SS indicates what quantity of the factor will be available at various prices. In other words, it shows the transfer earnings of different factor units. Thus, the transfer earnings of a unit of the factor, is AQ whereas the price is OP. Therefore, surplus or rent, is HQ . In the same manner , the other units earn surplus or rent.It is assumed that all factor units are equally useful for this industry. Hence,the price of all factor units in the industry will be the same. The supply curve cuts DD demand curve at N. In this case, OG is the quantity of the factor used. The rent or price per unit is OP=(GN).by the transfer earnings of each factor unit as less than the price OP. All units except the last G unit are earnings more than their transfer earnings. Economic rent or surplus will be different for

different units because the transfer earnings are different , although the price is the same. The total earnings are OGNP. But the transfer earnings are OGNS. Hence,

Economic Rent = OGNP - OGNS = PNS

c) Absolute Inelastic Supply

Now we come to a case when the supply of a factor is absolutely Inelastic . The obvious example of this case is the supply of land for the community as a whole. We know that land for the community is fixed and it can not be increased or decreased whatever the price offered. High price will not increase it or low price will not decrease it. That is why it is said that land has no supply price.

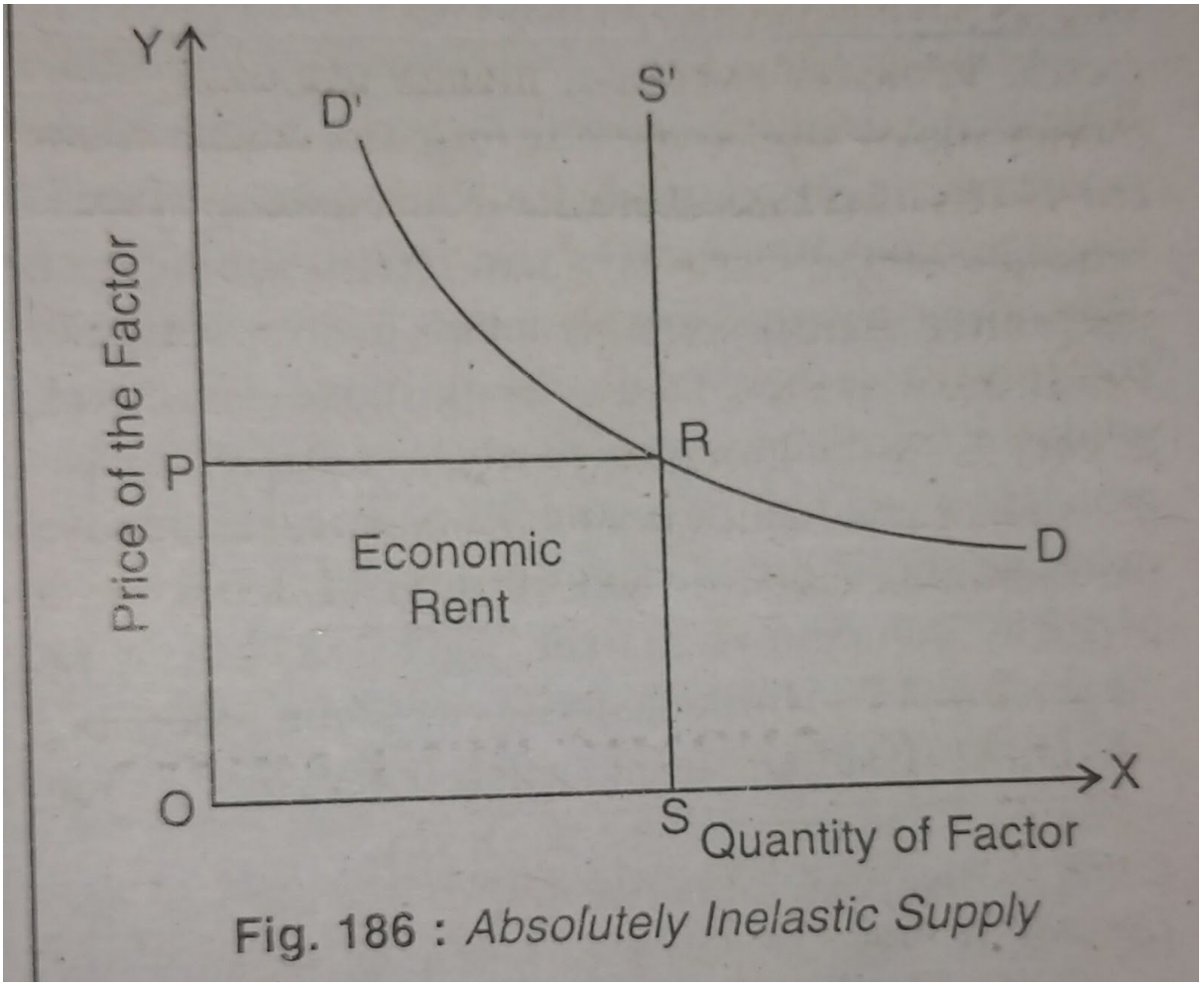

Fig. 186 : *Absolutely Inelastic Supply*

In the above given graph; the supply curve SS shows an absolutely Inelastic Supply which represents the supply of land for the community as a whole. Since the supply is fixed, the supply curve SS' is a vertical straight line . This means that from the point of view of the community as a whole, the transfer earnings are zero, since the land can not be transferred to any place. In the figure; DD' is the demand curve for the whole land , The supply curve SS' and the demand curve DD' intersect at R. In equilibrium the price of land or rent is determined at OP and the total earnings of the land are equal to OPRS area . Since in this situation the transfer earnings of the land are zero, the entire earnings of land , i,.e; OPRS is

rent. Thus, it is clear that in this case the supply of factor is absolutely inelastic ,its earnings are rent.

Conclusion :

We may conclude that rent arises when the supply of a factor is less than perfectly elastic.