Modern Theory of Rent

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From the elasticity point of view there are three possibilities.

i.e.,

(i) Supply of factor of production is perfectly elastic.

(ii) Supply of factor of production is perfectly inelastic.

(iii) Supply of factor of production is less than perfectly elastic.

(i) When Supply is Perfectly Elastic:

When change in demand at existing rate is followed by corresponding change in supply, then the supply is said to be perfectly elastic i.e., such a factor is not scarce. At the existing rate, any amount of that factor is available. Therefore, its actual earning and transfer earning will be equal.

Actual Earning = Transfer Earning Rent

= Actual Earning – Transfer Earning

= Zero (0)

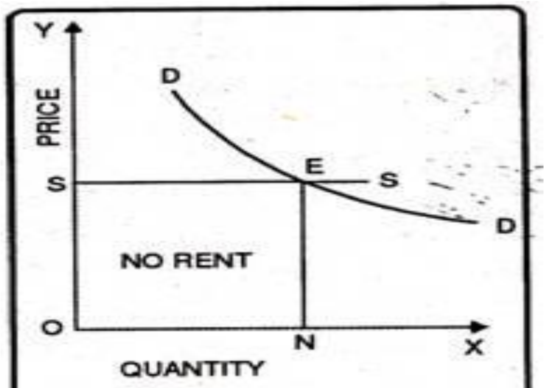

Fig. 6.

In Fig 6., the supply curve of the factor of production is represented by SS which is horizontal straight line. It means all factors are available at price OS. DD is the demand curve.

The demand and supply curves intersect each other at point E. ON is the quantity of the factor used and price is OS. The total earnings are OSEN.

Since, transfer earnings are equal to actual earnings i.e., OSEN, there is no surplus and, thus, no rent. If this firm does not pay the price, the factor units will be shifted to other uses and earn there as much, because present earnings equate the transfer earnings. In this way, we may conclude that if the supply is perfectly elastic, then there exists no surplus and hence no economic rent.

(ii) When the Supply is Inelastic:

Inelastic supply of a factor indicates that any increase or decrease in demand is not followed by the supply. In such a case, transfer earning will be zero and the difference between actual earning and transfer earning will be equal to actual earning. Therefore, all the actual earning will be called rent.

Rent = Actual Earning (Since Transfer Earning is Zero)

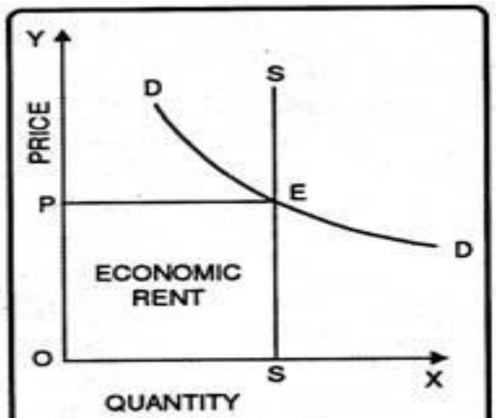

Fig. 7.

In Figure 7, SS is perfectly inelastic supply curve of land which indicates that if price of land falls to zero even then supply remains OS. It means the transfer earnings of land are zero.

DD is the demand curve. As both the demand and supply curves intersect each other at point E, price OP is determined. Since transfer earnings are zero, the total earnings (OSEP) represent the economic rent.

(iii) When the supply is Less than Perfectly Elastic:

Less than perfectly elastic supply means that the transfer earnings of all the factor units are not equal. Mrs. Joan Robinson used the concept of 'Transfer Earnings' to explain the amount of rent earned by a factor unit in a particular use. She defines transfer earnings as the price which is necessary to retain a given unit of a factor in a certain industry.

This can be shown with the help of following table 2:

Table 2

Demand for Labour	Actual Earning	Transfer Earning	Rent
20	20	20	20–20 = 0
35	25	20	25–20 = 5
40	30	20	30–10 = 10

The above table shows that when demand for labourer is 20, their transfer earning and actual earnings are equal. Therefore, Rs. 20 is the minimum wage rate below which there will be no supply of labour. Now, if demand for labourer increases to 35 but supply does not increase to the same ratio, wage rate will rise. As a result, actual earning of labourer will rise to 25 while transfer earning will be Rs. 20 per labourer. Similarly, if the demand for labourer increases to

40 but supply does not rise, wage rate of labourer will further rise. Actual earning will go up to Rs. 30 per labourer. Thus, every labourer will earn rent equal to Rs. 10.

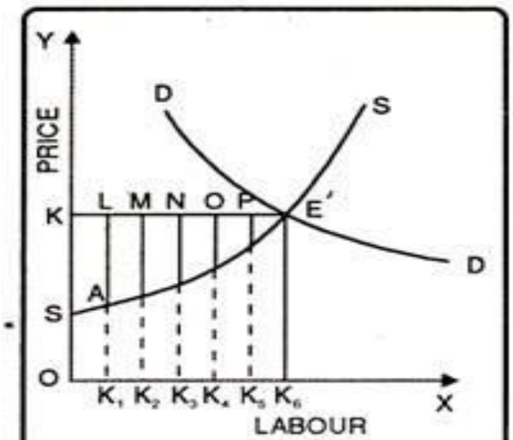

Fig. 8.

In Fig. 8 labour has been measured on X-axis and price on Y-axis. SS is the somewhat elastic but not perfectly elastic supply curve indicating that what quantity of the factor will be available at various prices. The transfer earning of X1 unit of factor is AK1 while the price is OK.

Thus the surplus or rent is AL. In the same fashion, the other unit earns surplus or rent. The transfer earnings of each factor units are less than the price. All units except the last unit Kg are earning profits which are more than their transfer earnings i.e., they are earning economic rent. The total earnings are OK6E' K and the transfer earnings are OK6E'. If we take away the transfer earnings, we get KE'S as surplus or rent.