THEORIES OF RENT

[Academic Script]

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RICARDIAN THEORY OF RENT

Introduction

Ricardo has discussed this theory in the year 1817 in his book "Principles of Political Economy and Taxation"
Over a period of years many different theories are developed to explain why rent arises but the Ricardian theory is the first modern theory to explain determination of rent.
Ricardo has considered rent as a peculiarity of land i.e. rent arises to only one factor of production and that is land because it is fertile.

Definition of Rent according to Ricardo

Ricardo has defined rent in the following way.
Rent is that portion of the produce of the earth which is paid to the landlord for the use of the original and indestructible powers of the soil.

Explanation of the theory

Following is the explanation given by Ricardo to explain this theory of rent.
According to Ricardo, rent is a differential surplus which arises from the fact that different plots of land are different in fertility as well as other aspects like climate, situation etc. the more fertile and better situated land enjoys an advantage over the less fertile and less favorably situated land. If land is fertile, similar amount of labor and capital gives more out put as compared to less fertile or inferior land.

This difference in output between superior land and inferior land is considered as rent.

Reason for emergence of Rent

According to Ricardo differences in fertility of land is the main reason for emergence of rent. If all lands were equally fertile rent would not have arisen. So the major reason why rent arises is the difference in fertility.

Illustration

With the help of the following schedule we can understand the basic explanation of the Ricardian theory of Rent.

Explanation of the schedule

In the schedule we can see that A,B and C plots of land earn economic rent to the extent of Rs. 7,500, Rs. 5,500 and Rs. 3,000 respectively. Plot D does not get any rent. A,B and C plots of land enjoy rent which is the difference between total income and total cost of production. Plot D does not get any rent because its income is just sufficient to cover its cost of production. Plot D is considered as a marginal land according to Ricardo. Land A,B and C earn positive rent so they are called as super marginal land.

Explanation with the help of a diagram

In this diagram we can see that there are different plots of land i.e. A,B,C and D. A,B and C are superior land so they get rent due to their fertility. Land D is a marginal land so it gets only cost of cultivation. Rectangles with line show cost of cultivation. Blank rectangles show the amount of rent.

ASSUMPTIONS OF THE THEORY

This theory is based on the following assumptions.

1. From the view point of the society supply of land is perfectly inelastic i.e. supply of land is permanently fixed.
2. Land has no alternative uses. It can be used only for the production of corn.
3. Different plots of land has different fertility.
4. There is perfect completion in the market for land and corn.
5. Method of production is fixed.
6. Every plot of land is subject to the law of Diminishing Marginal Returns.

LIMITATIONS OF THE THEORY

This theory is criticized on the following grounds.

1. According to Ricardo land has indestructible powers but today due to modern inventions and innovations it has become possible to destroy the indestructible powers of Land.
2. According to Ricardo most fertile land is cultivated first but in reality land which is easily accessible is cultivated first.
3. Modern writers are of the different opinion. According to modern writers rent is available because of scarcity of land. Even if all lands are equally fertile they will get rent due to scarcity.

4. Modern writers have criticized the concept of marginal land. According to them its difficult to find such land.
5. Modern writers are of the opinion that price includes rent.
6. According to modern writers land is available to all the other factors of production including land due to scarcity.
7. According to modern writers many assumptions of Ricardian theory are unrealistic.

MODERN THEORY OF RENT

Introduction

Modern writers like Stonier, Hague, Mrs. Robinson have contributed in the development of the modern theory of rent. According to these writers rent is available to any factor of production including land, if it scarce.
Let us discuss various aspects of this theory in detail.

Definition of rent according to modern writers

According to modern writers rent is the excess of income which a factor of production gets over and above its transfer earning or minimum supply price.

With the help of the equation we can understand the concept of rent.
In the given equation Present earning is that earning which is offered to a factor of production.

Transfer earning of a factor is the minimum price which has to be paid to that factor to remain in its present occupation. This minimum price must be equal to what it can earn in alternative occupation.
Difference between the two is RENT

Explanation of the theory

In order to understand the theory we need to consider three types of supply elasticity of a factor.

1. Perfectly elastic supply
2. Perfectly inelastic supply.
3. Supply of factor is less than perfectly elastic

Let us discuss them to understand rent.

1. Perfectly elastic supply

If a supply of a factor is perfectly elastic, rent will not arise because whatever is paid to this factor will be of the nature of transfer earnings.

When the supply of a factor is perfectly elastic it means that any number of unit of that factors are easily available at the prevailing market price for example peon/laborer. If the demand for the factor units increases the employer can get the additional unit at the current market price. He need not pay more to obtain additional units. Thus all the factor units will be getting an income equal to their minimum supply price. So there is no rent.

To understand the same we can use a diagram.

It is seen in the above diagram that the supply of labor is perfectly elastic. At ware rate of Rs. 50 per day at point E demand and supply of labor are equal and total wages earned by labor are Rs. 2000(50*40).

This is transfer earning of labor. If the wage rates are less than Rs. 50 per day, the laborers will move to other alternative occupations. At the same time they do not get more than Rs. 50 because supply of labor is perfectly elastic. Therefore they cannot earn any rent.

2. Perfectly inelastic supply

Perfectly inelastic supply of factor means that its supply remains fixed irrespective of changes in its price for example an astronaut. If there is an increase in demand for this factor or decrease in demand there will be a change in price but not in supply. When the supply of a factor is perfectly inelastic, the same amount of the factor unit will be supplied at different prices. The factor has no alternative occupation and therefore its transfer earning is zero. As a result whatever is earned by a factor is rent, there is no transfer earning.

We can use a diagram to understand the same.

In this diagram we can see that the supply of land is fixed. Therefore minimum supply price of land is zero. Point E is equilibrium at which demand for land equals supply of land.

Total income=100 acres * Rs. 50 = Rs. 5000.

Transfer earning is zero, therefore Rs. 5000 is rent.

3. Supply of factor is less than perfectly elastic

When the supply of a factor of production is less than perfectly elastic, the units of the factor that have the lowest supply price will be used first. So long as these units are available, there will be no rent. As soon as the demand increases beyond a point it becomes necessary to employ high priced units of a factor. Therefore rent will arise on those units of a factor whose supply price is lower. In a competitive market, they will be able to demand the same market price a s is received by new units. For example a teacher or a lecturer.

We can use a diagram to understand the same.
in the above figure E is the equilibrium point at which demand for labor equals supply of labor. Equilibrium wage rate is Rs. 70. But before this point there were laborers who worked at Rs. 40 per day. When demand for labor increases and it is not possible to get additional laborers below Rs. 70, previous batch of laborers get a rent of Rs. 30 (70-40). This is because of the relative scarcity of labor and not because of more efficiency of additional laborers.

In this diagram rent is ABE. Which we can find by deducting transfer earning i.e. BOTE from Total wages i.e. OETA.

Assumptions

Modern theory of rent is based on the following assumptions.

1. There is perfect competition in the market.

2. Rent is available due to scarcity of a factor.

3. All factors will get rent.

4. different land has same productivity or fertility.

By discussing all these aspects of the modern theory of rent we can now understand the grounds on which the theory is developed.

QUASI RENT

Introduction

The concept of quasi rent was first given by Dr. Marshall. It refers to short term temporary surplus earnings of manmade factors of production

Definition of Quasi Rent according to Dr. Marshall

Quasi rent is only a temporary surplus which is enjoyed by the owner of the capital equipment in the short run due to increase in the demand for it and which will disappear in the long run due to increase in the supply of capital equipment in response to the increased demand Dr. Marshall calls it Quasi rent.

Difference between rent and quasi rent

with the help of the following points we can understand the difference between rent and quasi rent which will be helpful to understand the concept of quasi rent clearly.

1. Rent is a permanent phenomenon.

Quasi rent is a temporary phenomenon.

2. Rent accrues to land and other free gifts of nature, whose supply is fixed in the short as well as in the long run.

Quasi rent accrues to factors whose supply is inelastic in the short run, but elastic in the long run.

3. Rent is a payment to induce the owners to offer their factors in the market.

Quasi rent is not a payment to induce a factor to enter into the market.

4. Rent does enter into price.

Quasi rent does not enter into the cost and it is price determined.

5. Rent is the result of a differential surplus.

Quasi rent is the result of the relative short term scarcity of a factor in relation to its demand.

6. Rent is a differential surplus of super-marginal land over marginal land.

Quasi rent is an extra income over the normal earnings.

These points clarify the difference between rent and quasi rent.

Explanation of Quasi rent

The concept of quasi rent as discussed earlier is developed by Dr. Marshall. He calls it a quasi rent because of two reasons.

1. it is of rent nature due to limited supply.
2. limited supply is not permanent but temporary.

The supply of machinery, building etc is fixed in the short period. Now if their demand increases, their supply cannot be increased in the short period. The result is that the owners of machinery, building etc starts getting higher earnings(surplus over their normal income).

But in the long run supply of machines, building etc can be increased to meet the increase in demand. As a result of the increase in the supply of such factor their surplus earnings will be completed away and they will just earn enough to maintain them in running order and provide only normal returns to the factor. Therefore in the long run quasi rent disappears.

Reason for emergence of Quasi Rent

Quasi rent emerges because of any factor which has a limited supply as compared to its demand in the economy in the short run. We all know that the supply of the factor cannot be increased in the short run. So for some limited time the factor of production gets extra earnings in the short run which is considered as a quasi rent and its available to the factor of production due to its scarcity in short run.

In the long run it is possible to increase the supply of the factor in accordance with the demand because the supply is perfectly elastic. As a result of this additional gain which was available to the factor of production becomes zero in the long run.

As this gain is available for a short time it is considered as quasi rent.

Explanation with the help of the diagram

In the diagram short run supply of machine is fixed at OS. given the demand DD, e is the equilibrium point at which demand for machines equal supply of machines therefore OP or SE is normal income of machines. Now demand increases from DD to D1D1, supply being fixed, price of machine increases from P to P1 or e to e1, e1 is new equilibrium. Eeq or pp1 is the surplus income earn by a machine due to its scarcity. In the long run, supply of machines will increase, so that supply curves becomes ss1. It intersects the new demand curve at e2. So once again price of machine falls from p1 to p. extra income pp1e1e which was earned by machine is known as quasi rent, so disappeared in the long run with increase in its supply.