Dr.Alok Kumar Class-M.A.Sem-II

Modern Theories Of Rent

From elasticity point of view, there are three possibilities, i.e.:

1. Supply of factors of production is perfectly elastic.

2. Supply of factors of production is perfectly inelastic.

3. Supply of factors 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 scare. 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

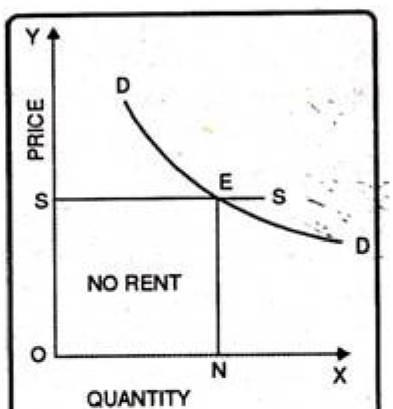

Fig. 6.

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 equates 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 earnings will be zero and the difference between actual earning and transfer earning will be equal to actual earning. Therefore, all the actual earnings will be called rent.

Rent = Actual Earning (Since Transfer Earning is zero)

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.

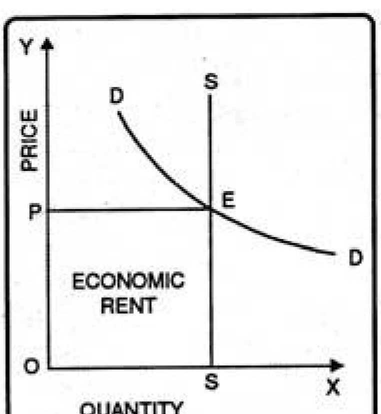

Fig. 7.