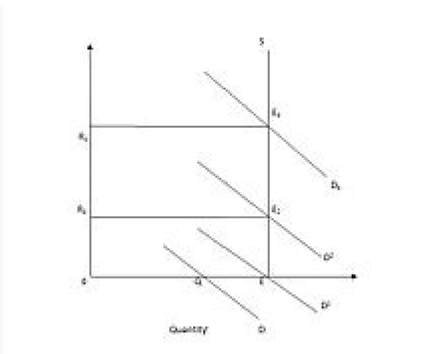
Wages,Interest &Rent

Dr.Alok Kumar

Class-M.A.Sem-II

Theory of rent



Equilibrium rent

This theory was first developed by the economist David Ricardo; it was called *The ricardian theory of rent*. Ricardo defined rent as "that portion of produced of the earth which is paid to the landlord for the use of the original and indestructible powers of the soil". However, later on the modern theory of rent was developed by the modern economists. The main difference between the Ricardian theory and this theory was that, Ricardian theory used the difference between surplus enjoyed from superior land to the inferior land. In the modern theory the rent was determined by the demand and supply forces in the market like the other factors of production. Demand for land means total land demanded by the economy as a whole. Demand for land like others depends upon the marginal revenue productivity. Rent paid by the economy will be equal to the marginal revenue productivity which is also subject to law of diminishing returns. This suggests that the demand curve like any other demand curve will be downward sloping. It shows that the demand for land and rent are negatively related. On the other hand, supply of land for an economy is fixed that is it is perfectly inelastic.

Theory of profit

Profit is another important factor in factor payments. This theory was first developed by Edgeworth, Chapman, Stigler, and Stonier. This theory is also depended upon the marginal revenue productivity. It is also called *marginal product* and *capital demand*.

Let one consider an example. The main objective of firm is to maximize profit. As we know that profit would be difference between the revenue and costs .Where the revenue would be equal to the price of the good multiplied by the output of the firm . On the other hand, the costs of the firm include labor costs , capital costs ,rent cost if any.Now if we substitute our production function . Then we would see that the profit of the firm is depended on **factor prices** and **factor inputs**. Hence firm would choose the optimal level of **factor inputs** that would maximize profit of the firm.