

Theory of Rent

In ordinary language, '**rent**' refers to any periodic payment made for the use of a good. For example, when we live in someone's house, we pay rent. This rent is contract payment. The contract rent includes besides the payment made for the use of land, interest on the capital invested in the house, wages and profit. But classical economists like Ricardo referred by 'rent' to the payment made for the use of agricultural land. Rent arises because of the peculiar characteristics of land. The supply of land is inelastic and it differs in fertility. Rent arises because of differences in fertility. Those lands which are more fertile than others get rent.

The Ricardian theory of Rent

Ricardian theory of rent is one of the earliest theories of rent. It is named after Ricardo, a great classical economist of the 19th century.

David Ricardo, an English classical economist, first developed a theory in 1817 to explain the origin and nature of economic rent.

Ricardo defined rent as, **“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.”** In his theory, rent is nothing but the producer's surplus or differential gain, and it is found in land only.

Ricardo explained his theory by taking the example of colonization. If some people go and settle down in a place, first they will cultivate the best lands. If more people go and settle down, the demand for land will increase and they will cultivate the second-grade lands. The cost of production will go up. So the price of grain in the market must cover the cost of cultivation. In this case, the first grade land will get rent. After some time, if there is increase in population, even third grade lands will be cultivated. Now, even second grade lands will get rent and first grade lands will get more rent but the third grade land will not get rent. It is known as no - rent land. According to Ricardo, rent is price determined, that is, it is determined by price of the grains produced in the land. He also believed that rent is high because price is high and not the other way round. Ricardo came to the conclusion that rent did not enter price because there are some no - rent or marginal lands. As the produce of no-rent land gets a price, Ricardo argued that rent did not enter price.

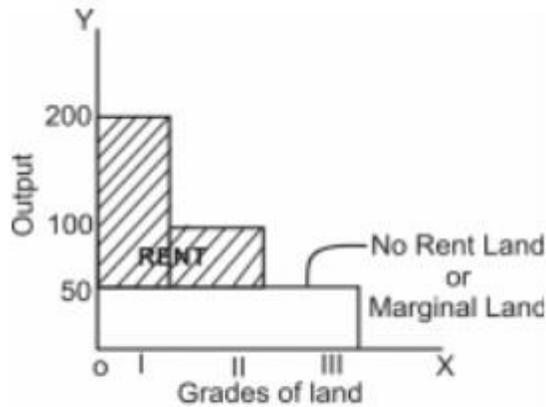


Fig.

In figure , grades of land are shown along the X axis and the output up the y - axis. The shaded area in the diagram indicates rent. In this case, grade I and grade II lands get rent. The grade III land will not get rent.

Assumptions of the Theory:

The Ricardian theory of rent is based on the following assumptions:

1. Rent of land arises due to the differences in the fertility or situation of the different plots of land. It arises owing to the original and indestructible powers of the soil.
2. Ricardo assumes the operation of the law of diminishing marginal returns in the case of cultivation of land. As the different plots of land differ in fertility, the produce from the inferior plots of land diminishes though the total cost of production in each plot of land is the same.
3. Ricardo looks at the supply of land from the standpoint of the society as a whole.
4. In the Ricardian theory it is assumed that land, being a gift of nature, has no supply price and no cost of production. So rent is not a part of cost, and being so it does not and cannot enter into cost and price. This means that from society's point of view the entire return from land is a surplus earning.

Criticism of the Ricardian Theory of Rent

Ricardo tells that only the best lands are cultivated first. There is no historical proof for this.

1. According to Ricardo, land has 'original and indestructible powers'. But the fertility of land may decline after some time because of continuous cultivation.
1. Ricardo believed that rent is peculiar to land alone. But many modern economists argue that the rent aspect can be seen in other factors like labour and capital. Rent arises whenever the supply of a factor is inelastic in relation to the demand for it.
2. Ricardo is of the view that rent does not enter the price of the commodity produced in it. But rent enters the price from the point of view of a single firm.
3. Ricardian theory does not take note of scarcity rent.
4. It is based on perfect competition. Only under perfect competition, there will be one price for a good. But in the real world, we have imperfect competition.

Though there are some criticisms against the Ricardian theory, we may note it tells that because of increasing pressure on land, we have to cultivate inferior lands.