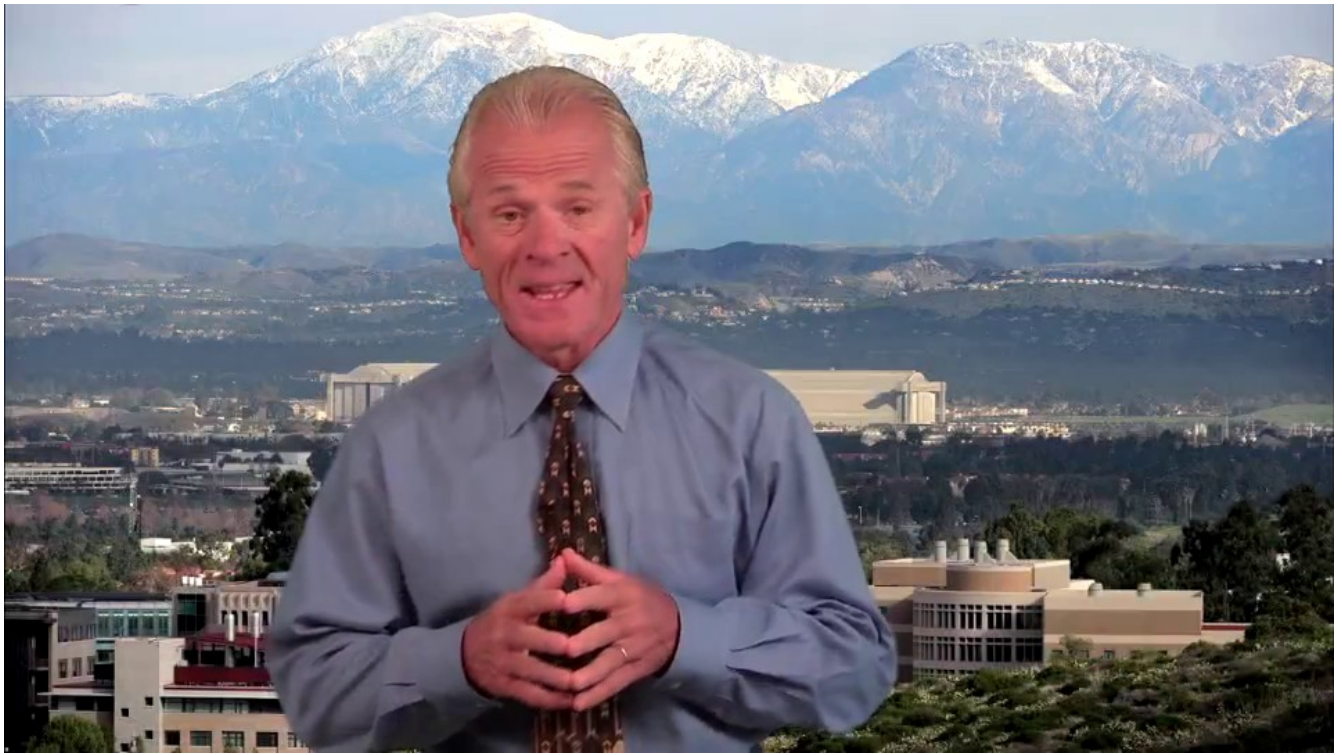


The Power of Microeconomics

Lecture Eight:
Land and Rent



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Introduction To Land and Rent

- A nation's **gross domestic product** or “GDP” is the most common measure of its productive output.
- One way of measuring the GDP is to add up all the income that people receive each year from producing the year's output using the three major **factors of production** -- **land, labor, and capital**.

Land, Labor, and Capital: The Main “Factors of Production”

- Each factor input has a price.
- **Price of Labor:** The wage rate.
- **Price of Capital:** Related to both the interest rate and the profits earned on capital.
- **Price of Land:** The rent the firm must pay for it.

Key Point

Economists have a much narrower definition of rent than we are used to!

An Important Formula

$$\text{GDP} = \text{Wages} + \text{Rents} + \text{Interest} + \text{Profits}$$

Workers

**Property
owners**

Lenders

Firms

Why Is This Important?

- The **distribution of income** in a country is determined in large part by the price for which each of the major factors of production can be sold or rented.
- In your own personal terms, that means **factor prices** will be a major determinant of your annual income.


Your Future Income Depends On...

- The **wages** you earn at your job.
- The **interest** and **profits** derived from any stocks and bonds or other capital that you hold.
- The **rents** from any land that you might own.

Resource Allocation

- The fact that your future income will depend on **factor pricing** is a great reason to study this topic, but it's not the only reason.
- From a broader economic view, factor pricing also guides **resource allocations**.

Resource Prices



- Just as product prices ration finished goods and services to consumers, so do resource prices allocate scarce resources among industries and firms.
- An understanding of how resource prices affect resource allocation is particularly significant since the efficient allocation of resources over time calls for continuing shifts in resources among alternative uses.

Factor Pricing Illustrates Cost Minimization

- To maximize profits, your firm must produce the **profit-maximizing** output with the least costly combination of factor resources.
- Given technology, resource prices will play the major role in determining the quantities of land, labor, capital, and entrepreneurial ability that you will use in your production process.

Ethical Questions, Policy Issues

- Should the government use tax policy to redistribute income from the upper and middle-classes to the poor?



The Impacts of Government and Unions

- Should the government tax the “**excess profits**” of corporations, put a cap or ceiling on the sometimes exorbitant interest rates charged by credit card companies, or provide workers with a wage floor in the form of a **minimum wage**?
- Do labor unions actually raise the wages of workers and if so, do unions do so at the expense of jobs?



Our Roadmap Ahead

- In this lecture, we will begin by examining how rents are set in the market for land.
- We will work our way through each of the other factors starting with labor and finishing with the capital market.