



## **LECTURE EIGHT - PART FIVE**

## **Productivity Differences**

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- Why does an acre of land to build a house in rural Mississippi cost so much less than an acre of land in Carmel, California?
- Why does an acre of farmland in Iowa cost so much more than an acre of farmland in New Mexico?

## All Land Not Created Equally



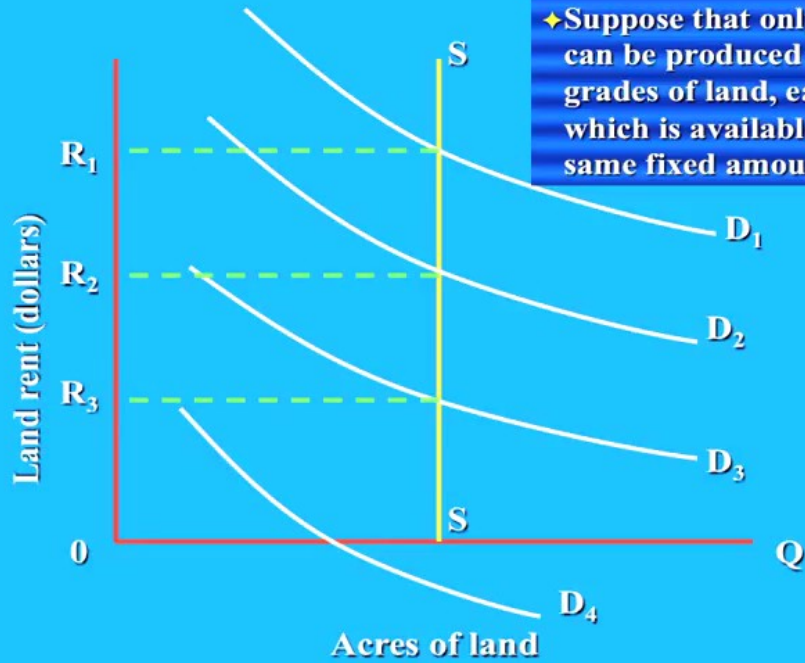
- Thus far, we have assumed that all units of land are of the same grade.
  - This is clearly not so.
- Different acres of land vary greatly in productivity.
- These productivity differences stem primarily from differences in soil fertility and such climatic factors as rainfall and temperature.

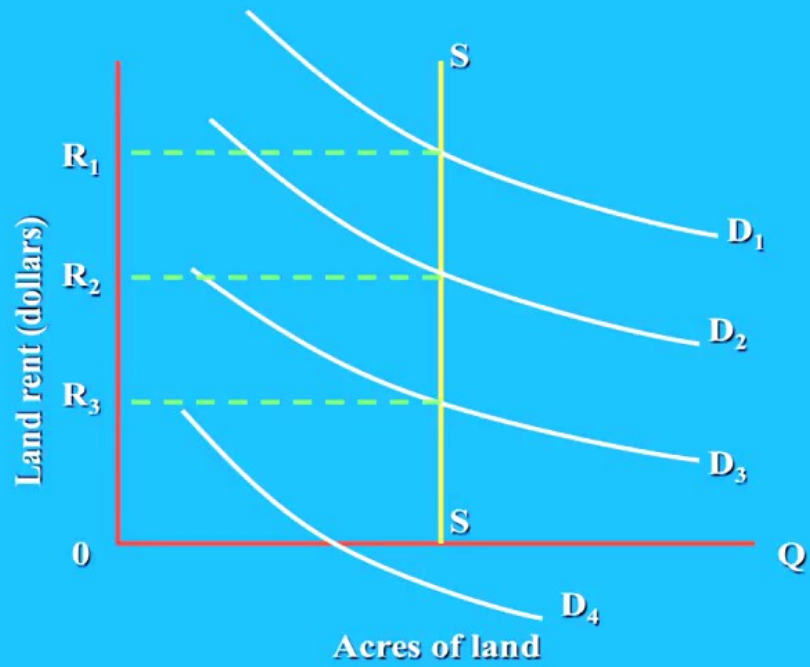
## These Factors Explain

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- Why Iowa soil is well-suited to corn production, while the desert wasteland of New Mexico is incapable of corn production.
- These productivity differences will be reflected in **resource demand**.

✦ Suppose that only corn can be produced on four grades of land, each of which is available in the same fixed amount.





## Location, Location, Location!

- Just as productivity is important in explaining differences in land rent, so, too, is **location**.
- Other things equal, business renters will pay more for a unit of land which is strategically located with respect to materials, labor, and customers than for a unit of land that is remote from the markets.



## Locational Rents

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- Witness the extremely higher land rents in large metropolitan areas.
- Witness the difference in the cost of a scenic house lot in Carmel, California versus a similar parcel in rural Mississippi.





## **#1: Rent Allocates Land Resources**

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- Although rising economic rents do not increase the quantity of land supplied, rents do have a certain economic function.
- In particular, rents serve to allocate a scarce factor among competing uses.
- More importantly, the most valuable use will determine the market rent.

## Example

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- Much of the land in New York City was once used for pasture crops.
- However, over time, the rising price of land drove the fixed costs of farming so high that farmers could no longer make a profit in Manhattan.
- These farmers were initially replaced by modest homes, rooming houses, and factories, and ultimately by sky-scraping office buildings.

## **The Market Determines Land Use**

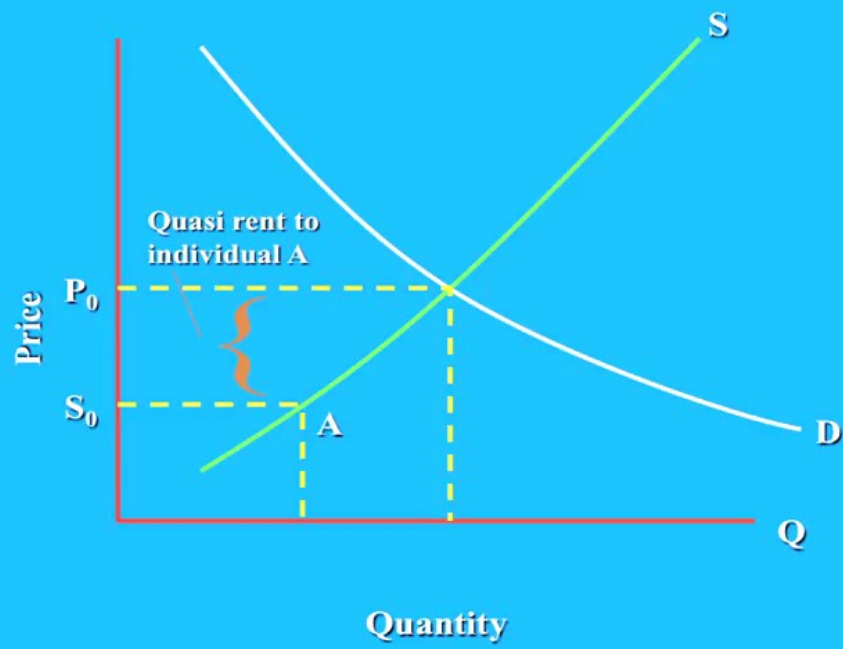
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- Each step in this evolutionary process was propelled in part by increasing rents.
- Firms and individuals with more valuable uses for the scarce land offered increasingly high prices for its use.
- In turn, the high rents forced others to move their firms or households to other locations.
- Accordingly, the most valuable use of land will be determined by the market rent.

## #2: Quasi-rents

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- The concept of rents has been extended by economists to include any payment to a factor resource above its opportunity cost -- that is, above the amount it would receive in its next-best use.



## **Superstars and Quasi-rents**

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- This quasi-rent situation looks a lot like the market for superstars.
- The demand for these performers is very high because they can generate substantial revenues for their musical, comedic, and athletic talents.
- However, the salaries these superstars command are significantly above the salaries they might earn in their next best job.



## A Great Historical Example

- Michael Jordan, one of the greatest basketball players in history, quit to play baseball.
- He not only couldn't hit a curve ball, he earned a small fraction of his basketball salary.





### #3: Rent Seeking

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- The broadened definition of rent has led economists to the insight that if individuals could somehow restrict the supply of a factor, the rent they could receive for the factor would be higher.
- **Rent seeking** is the name given to the restricting of supply in order to increase the price suppliers receive.
- Put another way, rent seeking is an attempt to create either ownership rights or institutional structures that favor you.

## **More Efficient Production**

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### Problem

You are the Chairman of GM facing stiff competition from Japan



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**TOYOTA**

### **Solution**

Become a more efficient producer!

## An Alternative Political Solution



- Use the company's political clout to lobby the Congress to impose a **tariff** or **quota** on Japanese auto imports.
- This would be an example of **rent seeking** by a **special-interest group** in our economy.

## In The Next Lesson

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- That concludes our discussion of the land market.
- We will look more closely at how labor unions influence wages and more broadly at how wages are determined in the labor market.



## THE POWER OF MICROECONOMICS

Professor Peter Navarro  
University of California-Irvine

# END OF LESSON EIGHT

**Coming Up Next!**

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Lesson Nine:  
The Labor Market and Wage Determination