On Monopoly Rent: Reply

Author(s): Alan W. Evans

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Alan W. Evans

In his brief note Foldvary makes a number of points but his argument can be summarized as saying that since land is fixed in supply, those who own the land gain a reward which is greater than if it were not fixed in supply, even though the several land owners compete against each other, and this increased reward may be described as monopoly rent.

Suppose the position were as Foldvary describes. The supply of land like the supply of taxi medallions is fixed, and the rent payable is determined by the intersection of the (downward sloping) demand curve with the (vertical) supply curve as in Figure 1. What then is monopoly rent? It would appear to be *OPRQ*. But how does this differ from economic rent? The transfer earnings for land are zero for a supply between *O* and *Q*; it follows that economic rent is *OPRQ* also, and what Foldvary wishes to call monopoly rent is what is usually called economic rent. And the difference between transfer earnings and price is called economic rent in economics, in the case of all factors of production, not just land, precisely by analogy with the rent of land. Thus, the Foldvary classification of land rent is actually subsumed within one of the categories set out in the original paper.

Moreover, the Foldvary classification appears to include all rent. Although admitting that there may be "an upward diagonally-sloping supply curve for a particular usage of land," he then states that "the market for land itself, for all uses, contains a fixed supply of site area" (p. 108). If the supply were greater the price would be lower. "If the cost of production of virgin land were zero, land would have a price of zero. Hence, differential rents exist only because land of a given quality is finite within a given local market" so "differential rent itself depends on such monopoly" . . . . and "it is possible to interpret all land rent as a monopoly rent due to the fixity of land within some meaningful economic region" (p. 109).

But once we have reached the conclusion that all rent is monopoly rent such a conclusion ceases to be useful or meaningful and becomes a play with words, a question of semantics. Foldvary is of course entitled to call all rent "monopoly rent" if he so wishes, but doing so would add nothing but merely confuse the issue.

The above discussion accepts Foldvary's assumption of a fixed supply of land and treats his argument on its terms. But his basic assumption is in practice incorrect. Early on he states (p. 108) that "in any given local market, such as a metropolitan area or farm region, the acreage is fixed in size. New land, i.e., acreage, can neither be manufactured nor imported." Frankly one is sometimes appalled at the way in which Ricardo's assumption that the supply of land is fixed—an assumption made, like the assumption that only one product is produced, in order to simplify his analysis of the distribution of income amongst the classes of society, as Buchanan (1929) makes clear—the way in which this assumption is taken up and repeated unthinkingly by economists, and Foldvary is not to blame for joining in. Of course the acreage of a metropolitan area is not fixed in size. Metropolitan areas everywhere have grown by spreading, some would say sprawling, over surrounding areas. Some have actually manufactured new land, for example 33, 10, and 5 percent of the total land surfaces of the cities of Macau, Singapore, and Hong Kong, respectively, have been created by landfill, "reclaiming" land from the sea (Glaser, Haberzettl, and Walsh, 1991). Much farmland is new, in that it was woodland, marsh, or desert. The fens in England

Professor of environmental economics, University of Reading, England.

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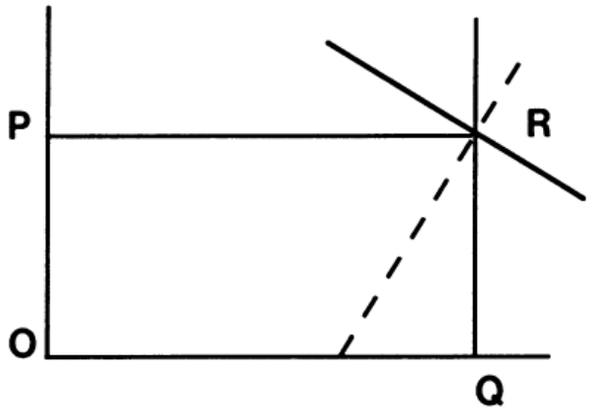

FIGURE 1

were drained in the 17th century, the deserts of the Southwest of the United States are being reclaimed now. If the price is high enough, it is worth investing capital to create "new" land.

It follows that the supply curve for land is not vertical but merely very inelastic. Does it make a difference to Foldvary's argument if the situation is as shown by the dotted line in Figure 1? For in practice the alternative uses for land ensure that the supply of land for a particular use is upward sloping in order to attract land for alternative uses, and that, in some cases, if the price is right, "new" land can be created, i.e. at some margins the price of land will be equal to its cost of production as with any other good.

To go back to his "taxi medallions" argument, in London taxi drivers do not buy a medallion; the supply is restricted by the fact that every would-be London taxi driver has to pass an examination regarding London routes. Called "The Knowledge," it is known to be difficult (see Beesley 1973) and so the supply of taxi drivers is relatively inelastic. Do they earn a monopoly income in Foldvary's terms? It would appear not.

Finally one should note that in my paper I attempted to define monopoly rent as an additional rent which arose when land owners behaved monopolistically. The question seemed to me both one of means and of intention. The landowner(s) had to be able to increase rents by restricting supply and to intend to do so. The analogy is with a cartel. We do not describe a group of producers as a cartel, even if the number is limited by, say, nature. So oil-producing countries in the sixties were not described as a cartel even though they were a small specific group, and even though the price of oil was presumably higher than if there had been more producers. On the other hand OPEC was a cartel after 1973 because the countries did reduce output in order to raise prices.

So to repeat an argument from Evans (1991, 10):

> if planning authorities restrict the availability of sites for particular kinds of land use, and this results in the prices and rents of these sites being higher than they otherwise would be, the author would not wish to argue that these higher rents are monopoly rents. On the other hand, if particular land owners operate through the political process to ensure that competitive land uses are not allowed permission for development by the planning authorities, then the resulting higher rents certainly would be monopoly rents.

This distinction is intended to ensure that the term monopoly rent is useful, meaningful, and well defined, something I hope I achieved in my earlier paper, and which is not achieved in Foldvary's comment.

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