BUILDING ECONOMICS
THE PRICING OF LAND & RESOURCES

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PRIMARY SOURCES:

Harvey, J. Urban Land Economics, Macmillan, 3rd edn.

ECONOMIC RENT (DIAGRAM)

- Land as a whole — the earth's land surface — is fixed in supply.
- From the viewpoint of any one use, (unless it can be used in only one way) the supply of land can never be regarded as being fixed.
- Since land as a whole is a fixed supply, the earnings of 'pure' land are determined solely by demand.
- The total supply of land is the same, regardless of the size of the earnings, so the opportunity cost is zero.
- the earnings of land as a whole represent economic rent.
- Economic rent accrues to any factor that is fixed in supply and is determined by demand.
- Economic rent is also the difference between the return made by a factor of production and the return necessary to keep the factor in its current occupation.
- The price of land performs the function of rationing a scarce supply among competing uses.
- Shops in the central CBD earn a high economic rent because of the high commercial rents that they command.

THE DEMAND FOR LAND AS A FACTOR OF PRODUCTION

- The demand for land as a factor of production is a derived demand — it is wanted for the contribution it can make to a final product and the demand is thus dependent on its marginal productivity.
- The quantity of land that a firm demands depends upon the productivity of land, the price of land relative to other factors, and the price of the firm's product.

Change in price of land (diagram)

- When the price of land increases relative to the price of capital, more capital is combined with less land than before. Because less land can be bought with a given outlay, the level of output is reduced.

A change in productivity of land (diagram)

- An increase in the productivity of a factor will lead to an increase in demand for the factor.

A change in price of product (diagram)

- When the price of a product increases, more capital and more land would be demanded even at the same relative prices.

The equilibrium market price (diagram)

Land will be surrendered by less profitable uses when rent for that land in a particular use rises.

Short run and long run supply (diagram)

The short period supply (S_s) can be altered by engaging those factors that are variable over time.

In the long run, the long run supply (S_l) can be increased by adding to fixed capital to combine the factors of production (land and capital) in their best proportions.

THE DOMINANCE OF STOCKS OVER FLOWS (DIAGRAM)

- Changes in demand tend to be more significant than changes in supply in determining the market price because the supply of buildings is inelastic in the short run.
- The price of buildings is largely determined by demand. New supplies of buildings follow rather than determine this price.
- In the short term, the price of new buildings is determined by the price at which existing buildings sell.
- A high price offered for existing and, therefore, new buildings will encourage developers to erect new buildings and this will continue so long as the cost of new buildings is less than the price of old buildings.
- Over time, the flow of new buildings on to the market will be sufficient to influence the stock of buildings, and the price of old buildings will tend to fall.
- In the long run, the flows of new buildings affect the price of old buildings and the cost of constructing new buildings affects the price of old buildings.

The impact of construction costs

- Current construction costs are not relevant in determining prices and rents of real property.
- As the price of houses rises, land costs form a greater proportion of that price.
- Since the price of land is determined by the demand for housing, controlling the price of land artificially would not result in falling house prices.