# Section 3: The Theory of Rent-encroaching

The analysis of general factor market in Section 1 is classified as microeconomic in the textbooks of MSE. The analysis of labor market in Section 2 belongs to new institutional economics. In this section, we will continue to analyze the labor market, but what will be analyzed is unemployment that is classified as macroeconomics in the textbooks of MSE. However, as mentioned in Lecture 6, it is not necessary to divide economics into micro and macro.

Let us discuss a problem between new institutional economics and the so-called micro and macro-economics first: if a government policy that intervenes in the market causes the price of a production factor to be higher than the equilibrium determined by the market, it will violate the marginal productivity theory (the theory of income distribution), because the income obtained from that production factor is higher than the contribution of it, which can only be achieved by encroaching on the income of the other production factors. Therefore, the essence of the government policy that intervenes in the market is to infringe on PPRs (the right to income) of other factors, which is precisely “rent-encroaching”. Rent is the income obtained from an asset (production factor). Some factors obtain higher income than their contributions, which must be at the expense of encroaching on the rent of the other factors. For example, when government has implemented the minimum wage law, the workers with the equilibrium wage lower than the minimum wage will encroach on the rent of the other factors.

However, rent-encroaching is best observed from the perspective of the whole society rather than a specific firm. A firm can choose to dismiss the workers who are not worth getting the high salary to avoid losses, so rent-encroaching is best observed from the decline in output and wealth caused by unemployment in the whole society. If government further implements unemployment benefits, the government expenditures are in fact ultimately burdened by the taxpayers. Therefore, although firms dismiss the workers and avoid rent-encroaching by not paying them wages, the taxpayers of the whole society have to pay them unemployment benefits, and their rents are encroached on by the unemployed. Unemployment benefit is usually lower than the minimum wage level, so it seems that the rent-encroaching on the taxpayers is lower than that on the firms. However, if the firms continue to employ the workers, they have made some contributions even if they are lower than the minimum wages. By contrast, the unemployed get welfare benefits without working, and they make no contribution to the society. Therefore, it is uncertain which loss in rent is higher.

How about a society without unemployment benefits? Regardless of the grievances of the unemployed that may lead to social instability and increase the governance cost (also a kind of transaction cost in broad sense), there are two options for the unemployed: to simply rest at home, or to peddle on the streets.

If the unemployed choose to rest at home, it is essentially different from the voluntary unemployment. For the voluntary unemployed, the value of leisure is higher than what they can earn from work. The rent of the whole society will not decline due to voluntary unemployment because the non-monetary income (the value of leisure) is higher than the income (rent) of work. However, for the unemployed, the value of leisure is not so high as the minimum wage, because they are willing to work, but just no firms are willing to employ them. The non-monetary income earned by the unemployed in enjoying leisure must be lower than the income of work, so the rent of the whole society has indeed dropped due to the unemployment.

If the unemployed choose to peddle on the street, they are actually self-employed. There is no unemployment in this case, but if there were no minimum wage law, they would prefer to work in a firm. Although the equilibrium wage is lower than the minimum wage, it must be still higher than the income of peddling, otherwise they would have chosen to peddle instead of be employed by the firm. Just because there is no firm willing to employ them due to the minimum wage law, they have to be self-employed, and the income of peddling must be not only lower than the minimum wage, but also lower than the equilibrium wage determined by the market, which implies that the rent of the labors has decreased. In this case, the factor of labor has not encroached on the rent of other factors, but rent of it decreases, so the rent of the whole society still decreases due to the minimum wage law.

In a word, no matter whether the rent of the whole society decreases due to the rent-encroaching on other factors or on the taxpayers, or whether the rent of the labor decreases, the policies that raise the price of labor (wage) over the equilibrium (such as the minimum wage law) will cause the transaction cost to rise because of infringement of PPRs. And the decrease in the rent of the society is precisely rent dissipation, so rent-encroaching must lead to rent dissipation.