# Section 3: The Core of the Theory of Price Control

Price control is one of the main causes of rent dissipation in reality, which has been analyzed in detail in Lecture 9.

The analysis of price control in MSE focuses on the so-called “shortage”, but the key lies in the fact that price control partially infringes on the right to income right of the seller, which leads to non-price criteria. Take rent control as an example. Suppose the rent in the market is RMB1000 per month, and is controlled to only RMB800, so there is RMB200 of income that becomes ownerless income. Government only forbids the owner to collect this part of rent, but does not clearly say who has right to it. If it is owned by the lessee, the use right is actually in the hand of the owner, and he can take it back by many means such as contract fee. Even if government strengthens regulation and successfully prohibits him from taking back the regulated rent, the owner can degrade the quality by not providing furniture and appliances, and even stops supplying. Anyway, the owner has a lot of means to prevent the lessee from getting this part of income.

Nevertheless, if government clearly stipulates that the value of the property is divided by equity, 80% belongs to the original owner and 20% belongs to the lessee, the latter actually becomes the owner of the 20% of shares. In this case, the property rights are clearly delineated, and the so-called lessee is similar to the manager with shares in a company. On the one hand, he actually runs the company (uses the house), on the other hand, he also has part of the shares. He distributes 80%of the income (RMB1000) to the original owner (RMB800), and keeps the other 20% (RMB200). Obviously, a manager has some shares of the company, which will not cause any rent dissipation, but will care more about the company because some of his interests are closely related to the operation of the company. Now, don’t many companies offer equity to the executives as motivations?

However, in reality, government that implements price control never does so. The regulated price becomes ownerless income, which causes self-interested people to compete by non-price criteria and so rent dissipation. Why does not government do so to avoid the loss of rent dissipation? Because if government does so, it will become very obvious that price control is equivalent to openly robbing the owner of the property rights and transferring to the lessee. Although the property rights are clearly delineated after the robbery that will not cause rent dissipation, the robbery itself is the infringement on property rights and will make the owner take defensive measures that will cause rent dissipation. Government frequently does such things as openly robbery, which is equivalent to poor public security that thieves can openly rob without being stopped by police, resulting in the transfer of property rights from the original owners to the thieves. In such a society, people will not be willing to have property or engage in production, and the economic performance will naturally be poor. Property rights are not delineated in fact because they cannot be protected. That is why in reality, price control never starts with the delineation of property rights, but the infringement on the right to income, and government tries to help to ambiguously delineate the rights by laws[^1].

As mentioned in Lecture 14, the purpose of all institutions is to save transaction cost, and the market is also an institution, so it is also used to save transaction cost. The question is: what kind of transaction cost is saved by the market? According to the analysis of rent dissipation, what the market saves is mainly the transaction cost of rent dissipation. Because using the market means using price criterion to determine the outcome of competition, and price criterion is the only competition criterion that will not cause rent dissipation.

Of course, price in the market can also transmit the information such as the changes in supply and demand or the quality of goods to various economic entities in the market with low cost, which means the information cost is relatively low. However, the behaviors of price-making analyzed in Lecture 17 shows that price in the market can also be used to mislead consumers, which lead to the increase in information cost. Thus, the market as an institution can save some transaction costs, but will also lead to the increase in other transaction costs. People will compare the costs and benefits of this institution to decide whether to use it or not.

The core of the theory of price control is not that there will be competition by non-price criteria for ownerless income, which will cause rent dissipation, but that there are so many non-price criteria, and which one or combination will be chosen? Due to the postulate of self-interest, rent dissipation is bad for anyone, so all will try to reduce rent dissipation as much as possible under certain constraints. In other words, the rent dissipation under price control should be minimized under the constraints. There are two kinds of effects for price control: one is the rising transaction cost, and the other is the falling asset value. Therefore, people will choose the non-price criterion that causes the least increase in transaction cost and the least decrease in asset value.

Take the example of price control of petroleum in the 1970s in the US mentioned in Lecture 9 again. Why did not gas stations take back the regulated price directly by contract fee, just like the owners of house who were imposed by rent control, but indirectly did so by increasing the price of lubricants that were not subject to price control? The reason is obvious: refueling is not a one-time sale within a long time (such as one year) like renting house, so the transaction cost caused by negotiation about contract fee is higher. If the gas stations, like the owners of house, negotiated with everyone who came to refuel (those who accepted contract fee were given the priority to refuel, and those who did not had to wait in line), there would still be a long queue because the negotiations inevitably took some time. In other words, due to the different constraints of refueling and renting house, the transaction cost of contract fee for taking back the income infringed by price control is different, and the rent dissipation is also different. Self-interested people will choose the means with least transaction cost and least rent dissipation.

However, when government thinks of “strengthening regulation”, it will first press such countermeasures with least increase in transaction cost and least decrease in rent dissipation, which naturally causes greater social loss.

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[^1]: If the delineation is too clear, it will be too obvious that government is openly robbing the original owners, so there will still be ownerless income, which attracts people to compete by non-price criteria, resulting in rent dissipation.