



# Public Choice and Regulation

BECO-3310 Fall 2025

# Re-cap

- Markets lead to efficient outcomes when transaction costs are zero.
- When transactions costs are *not* zero, externalities and information asymmetries can exist given a specific assignment of property rights...
- and they can lead to inefficiencies.

# What to do?

- If decentralized coordination of producers and consumers is unlikely to lead to the efficient level of production, some other method of *collective action* may be preferred.
- One possibility is to rely on government (i.e., the use of coercion to orchestrate collective action).

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- One possibility is to rely on government (i.e., the use of coercion to orchestrate collective action).
- Presumes...
  - 1. that government can achieve the efficient level of production (or at least come closer than markets can);
  - 2. that government aims to achieve that efficient level.

# What to do?

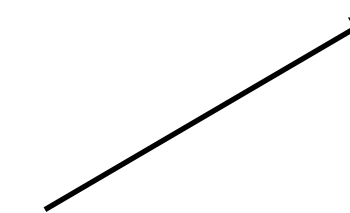
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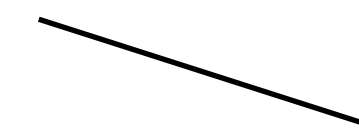
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Information problems



Incentive Problems



# Avoid the “nirvana fallacy”.

- A failure in logical reasoning.
  - E.g., the ad hominem fallacy: when you reason based on the person making an argument rather than the argument that the person is making.
- *Nirvana Fallacy*: occurs when someone criticizes a market, policy, or institution for not working perfectly and then advocates for government intervention or regulation on the assumption that the government will correct the failure flawlessly—ignoring the fact that governments, like markets, face informational, incentive, and organizational constraints.

# Avoid the “nirvana fallacy”.

- “Markets don’t provide affordable housing for everyone. The government should just regulate rent and build housing because it will ensure everyone has a place to live.”
- “People are misled by fake news and disinformation online. The government should regulate online content to ensure truth.”
- “If the market decides which drugs get released, unsafe drugs could harm people. The government should guarantee that only safe and effective drugs reach the market.”

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- Markets and governments are *both* recognized to be imperfect.
- While sources of market failure (e.g., externalities; information asymmetries) are emphasized in policy discussions ...
- Public choice economists insist on also acknowledging (and taking into account) sources of *government failure*.



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# Public Choice

- **Public choice** analysis rejects the presumption that public policy can correct market failures.
- Public choice analysis applies the assumptions of economic analysis to political agents and their constituents.
  - Government is not a benign “social planner.”
  - It is composed of individuals who make choices and take actions.
  - Political agents are rational and self-interested.
  - They **respond to incentives** and **need certain information** to act consistently with those incentives.

# Public choice analysis suggests that ...

- 1. Voters will be ignorant and participation rates will be low.
- 2. Politicians will favor special interests over the public interest.
- 3. Bureaucracies will be inefficiently large.
- 4. Political agents who favor general interests and efficient bureaucracies will be selected against.

# 1. Voters will be ignorant; their participation rates will be low.

- Why do people vote?
- There are two primary theories.
  - Instrumental Voting Theory
  - Expressive Voting Theory
- **Instrumental voting** is aimed at influencing election outcomes; having preferred policies enacted.
- **Expressive voting** is aimed at sending a signal to others.

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- When asked, most people claim to be instrumental voters.
  - “If you didn’t vote then you have no right to complain!”
- The costs of voting are non-negligible while the probability of being the decisive voter are essentially zero.
  - The average voter has a  $1/60,000,000$  probability of being decisive in a presidential election.
  - In a “battleground” state the probability rises to  $1/10,000,000$ .
- Instrumental voting is irrational.

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  - Consistent with observed behavior.



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- Expressive voting is aimed at sending a signal to others.
  - E.g., demonstrate that you are a “good” (“responsible”) person.
  - Consistent with observed behavior.
- Individuals will not necessarily vote their true policy preferences.
  - Someone may prefer peace to war on instrumental grounds...
  - But also recognize that their vote will not be decisive and place positive value on expressing patriotism.

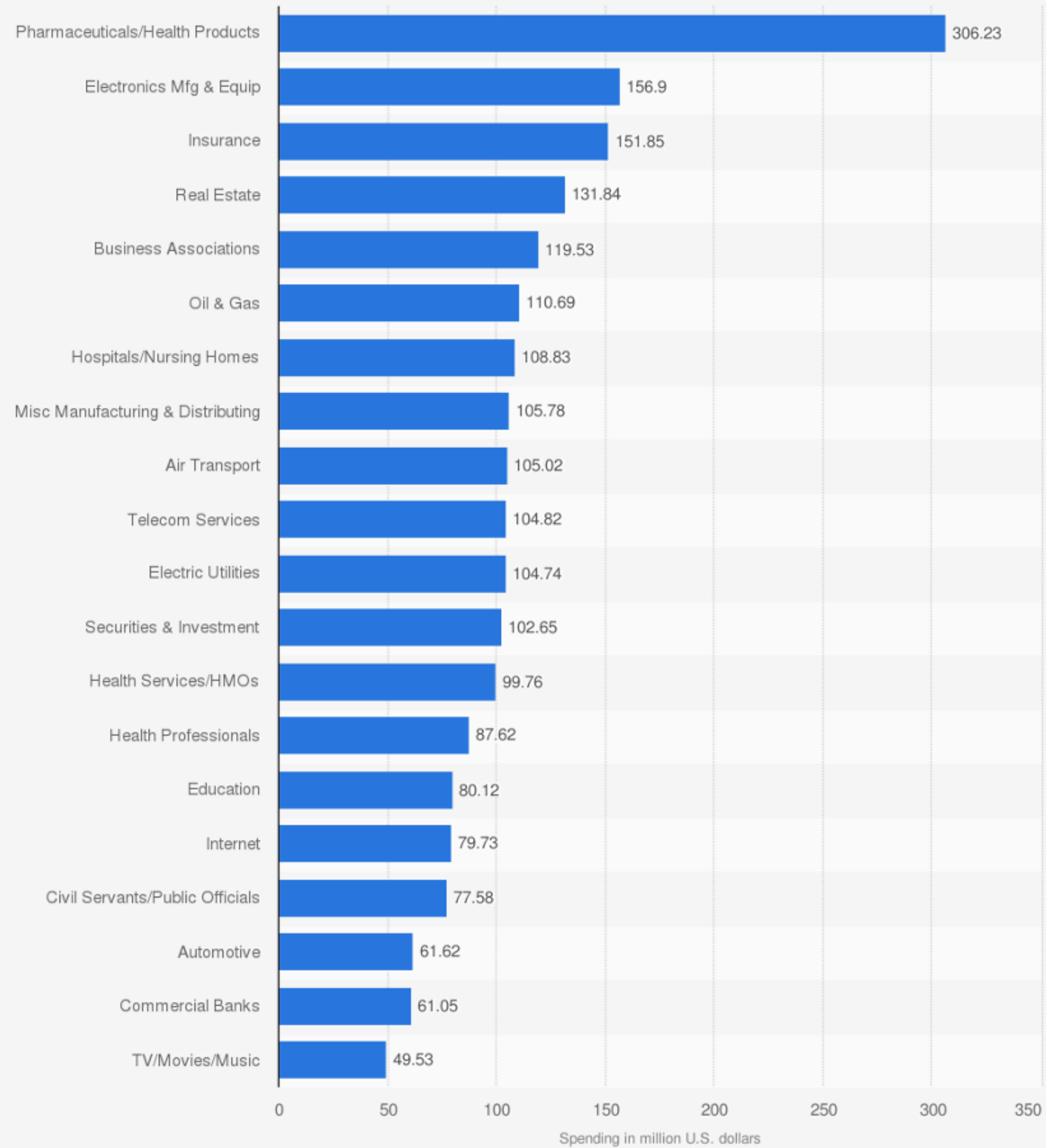
# 1. Voters will be ignorant; their participation rates will be low.

- Whether instrumental or expressive, voters are likely to be rationally ignorant of the policy issues.
- There are a large number of complex policy issues.
  - Being informed is costly.
  - If the probability of a vote being decisive is essentially zero, the marginal benefit to becoming better informed is also zero.
  - And being ignorant does not decrease the expressive value of one's vote.

## **2. Politicians will favor special interests over the public interest.**

- Politicians pay a lot of attention to special interests, as indicated by special interest lobbying.

**Leading lobbying industries in the United States in 2020, by total lobbying spending  
(in million U.S. dollars)**



**Sources**  
opensecrets.org; CRP  
© Statista 2021

**Additional Information:**  
United States; 2020

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- Politicians pay a lot of attention to special interests •(as indicated by special interest lobbying).
- Politicians aim to win/retain office: they are *vote maximizers*.
- Special interest groups will pay for policies that *concentrate benefits* on them and *spread costs* widely.
  - By funding a politician's campaign, a special interest group increases his/her ability to gain votes.
  - Voters (again) are rationally ignorant.
    - And special interests advocate policies that *taken individually* impose very small costs on any individual voter.

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- Firms maximize profits; politicians maximize votes;...
- Bureaucrats maximize the size and budget of their agency/department.
- Why? With command over more resources (people and money) comes raises and promotions.
  - Firms are “successful” when they are profitable.
  - Politicians when they are (re)elected.
  - Bureaucrats when they are move visible and powerful.

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- However, a candidate that does not pander to special interests is less likely to be elected ...
- And a bureaucrat that does not maximize budget and agency/department size is less likely to be promoted.
- There is essentially an adverse selection problem.
  - Principled political agents are either selected against ...
  - or they must compromise their principles (at least in part).

# Public choice

- Public choice helps to understand the *regulatory environment* that you will face in business.
- **Regulation:** government intervention into markets, including taxes, subsidies, and legislative and administrative controls over economic activity.
- How do we understand and navigate (and shape?) the regulatory environment?

# Public Interest Theory

- Markets are fragile and likely to work inefficiently if left to operate unfettered.
- Government intervention can offset social welfare losses associated with the inefficiencies.
- In addition to inefficiencies, regulation can be aimed at ...
  - ensuring an adequate allocation of resources;
  - increasing productivity;
  - addressing equity concerns;
  - enforcing morality (however conceived).

# Public Interest Theory

- Markets are fragile and likely to work inefficiently if left to operate unfettered.
- Government intervention can offset social welfare losses associated with the inefficiencies.
- Interventions
  - protection of labor unions
  - price controls on utilities and other natural monopolies
  - agricultural subsidies
  - minimum wage laws
  - occupational licensing

# However...

- Many regulations appear *prima facie* to not be in the public interest.
- While the benefits are unclear, they regulations impose direct and indirect costs.
- Example: occupational licensing.

# Texas

## 37

of 102 lower-income occupations licensed

## 21<sup>st</sup>

most burdensome licensing laws

## 42<sup>nd</sup>

most broadly and onerously licensed state

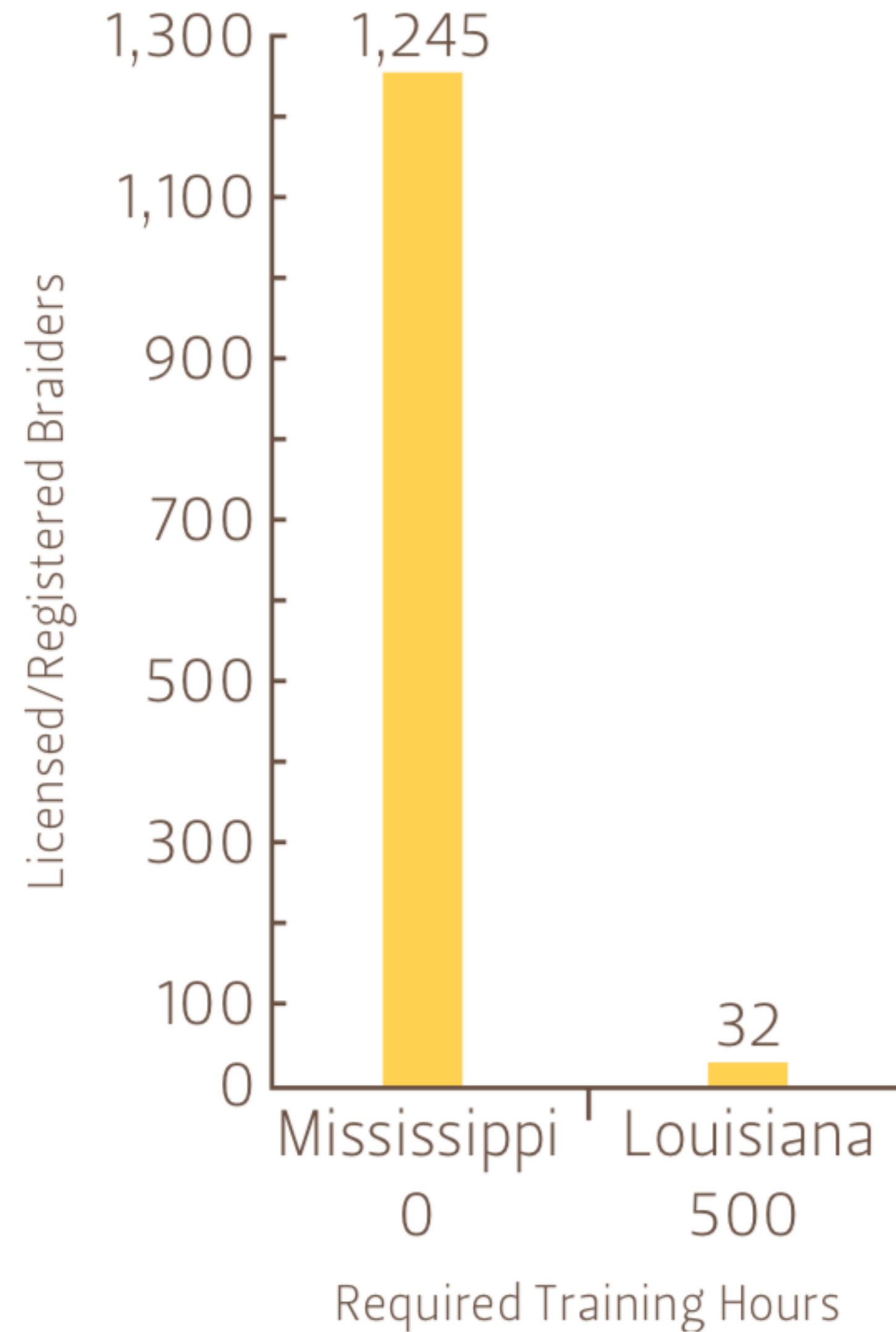
Burden Rank	Occupation	States Licensed	Fees	Estimated Calendar Days Lost	Education	Experience	Exams	Min. Grade	Min. Age
1	Preschool Teacher, Public School	50	\$375	1,460	4 years	None	2	0	18
2	HVAC Contractor (Commercial)	37	\$209	1,460	None	4 years	1	0	18
2	Sheet Metal Contractor, HVAC (Commercial)	37	\$209	1,460	None	4 years	1	0	18
4	Athletic Trainer	49	\$544	1,460	4 years	None	2	0	0
5	HVAC Contractor (Residential)	35	\$195	1,460	None	4 years	1	0	18
5	Sheet Metal Contractor, HVAC (Residential)	36	\$195	1,460	None	4 years	1	0	18
7	Security Alarm Installer	37	\$462	730	None	2 years	1	0	18
8	Earth Driller, Water Well	51	\$267	730	None	2 years	1	0	0
9	Midwife, Direct Entry	28	\$1,235	365	1 year	None	2	12	0
10	Cosmetologist	51	\$176	350	1,500 clock hours	None	2	12	17
11	Pest Control Applicator	51	\$678	379	28 clock hours	1 year and 40 clock hours	2	0	0
11	Vegetation Pesticide Applicator	51	\$678	379	28 clock hours	1 year and 40 clock hours	2	0	0
13	Barber	51	\$55	350	1,500 clock hours	None	2	0	16
14	Skin Care Specialist	50	\$176	175	750 clock hours	None	2	12	17
15	Manicurist	50	\$176	140	600 clock hours	None	2	12	17
16	Massage Therapist	44	\$346	117	500 clock hours	None	2	0	18
17	Emergency Medical Technician	51	\$144	35	150 clock hours	None	2	12	18
18	Shampooer	37	\$156	70	300 clock hours	None	2	7	16
19	Auctioneer	30	\$155	19	80 clock hours	None	1	12	18
20	School Bus Driver	51	\$84	3	20 clock hours	None	6	0	18
21	Child Care Home, Family	44	\$76	7	1 clock hour	30 clock hours	0	12	21
22	Truck Driver, Tractor-Trailer	51	\$85	0	None	None	5	0	18
23	Bus Driver, City/Transit	51	\$84	0	None	None	5	0	18
24	Truck Driver, Other	51	\$85	0	None	None	4	0	18
25	Pharmacy Technician	44	\$209	0	None	None	1	12	0
26	Fire Alarm Installer	39	\$700	0	None	None	2	0	0
27	Mobile Home Installer	39	\$591	2	12 clock hours	None	1	0	0
28	Security Guard, Unarmed	34	\$62	1	6 clock hours	None	1	0	18
29	Locksmith	14	\$63	0	None	None	0	0	18
30	Weigher	25	\$500	0	None	None	0	0	0

Burden Rank	Occupation	States Licensed	Fees	Estimated Calendar Days Lost	Education	Experience	Exams	Min. Grade	Min. Age
31	Animal Control Officer	7	\$75	2	12 clock hours	None	2	0	0
32	Milk Sampler	42	\$0	1	1 day	None	1	0	0
33	Travel Guide	37	\$132	0	None	None	0	0	0
34	Landscape Contractor (Commercial)	47	\$75	0	None	None	0	0	0
34	Landscape Contractor (Residential)	48	\$75	0	None	None	0	0	0
36	Fisher, Commercial	43	\$53	0	None	None	0	0	0
37	Coach, Head (High School Sports)	48	\$0	1	5 clock hours	None	0	0	0
<b>Averages</b>		<b>41.6</b>	<b>\$253</b>	<b>341.0</b>			<b>1.6</b>	<b>2.8</b>	<b>10.1</b>



*Figure 1: Stricter Licensing Often Means Fewer Jobs and Service Providers*

*Required Training Hours vs. Number of Licensed/Registered Hair Braiders, Mississippi and Louisiana, 2012*



# Capture Theory

- Both regulators and the regulated firms/individuals are rational and self-interested.
- *Regulatory capture* occurs when groups of individuals/firms have an interest in the outcome of policy decisions.
  - They allocate resources to achieve desirable policy outcomes.
  - Regulators can gain (votes; campaign finance; control over resources; etc.) by providing those policy outcomes.
- Groups form *special interests* that can rent-seek.

# Capture Theory

- Firms can obtain monopoly rents through traditional means (e.g., alertness to profit opportunities; collusion) or through influencing legislators/regulatory agencies.
- When the latter approach has higher net benefits, firms will organize special interests and rent-seek.
- This creates a demand for regulation which can be satisfied by the supply offered by the legislators/regulatory agencies.



***George Stigler (1911-1991)***  
***Nobel Laureate 1982***

# Public Choice

- "Politics without romance" is how James Buchanan, one of the founders of public choice theory, described the approach.
- **The "Romantic" View of Politics:**
- Traditional political theory often assumes that:
  - **Politicians are benevolent**
  - **Bureaucrats are public-spirited experts**
  - **Government acts in the public interest**
  - This is the **idealized, almost "storybook" version of government**—where everyone works selflessly to improve society.

- The Public Choice Approach:
- Public choice **removes the romance** and applies the same **economic reasoning** we use to study markets to the behavior of:
  - **Politicians**
  - **Voters**
  - **Bureaucrats**
  - **Interest groups**
- People in government respond to incentives, face constraints, and act in their own self-interest, just like people in the private sector.

# Examples of "Politics Without Romance":

- Politicians may support policies that win votes, even if they're economically inefficient.
- Bureaucrats may grow their agencies and budgets because it benefits them, not because it's best for society.
- Special interest groups lobby for favors, and politicians grant them in exchange for donations or votes.

**End of class.  
Thanks for your attention.**