

Forthcoming: Equality and Public Policy, Cambridge University Press.

Equality, Liberty, Prosperity

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Equality and Liberty

Equality of opportunity is difficult to behold, nearly impossible to measure, and likely impossible to achieve in the strictest sense of the term. Economic freedom is the nearest practical approximation of equality of opportunity, if only for the reason that it is impossible to ensure that each person is born into the exact same set of circumstances and subject to the exact same events. In short, economic freedom is the closest humans can come to equality of opportunity without suspending the laws of random chance. Like equality of opportunity, economic freedom can't be measured directly, but its manifestations are more easily enumerated and measured: less government spending, less regulation, fewer labor restrictions, less public corruption, more protections for private property.

Economic freedom, though, just as would be the case with the more abstract notion of equality of opportunity, necessarily yields inequality of outcome. Simply put, some are more skilled, gifted, and industrious than others. Against a backdrop of economic freedom, these

people will succeed to a higher degree than their less skilled, less gifted, and less industrious counterparts. Luck, too, plays a significant role.

Because they advocate for equality of outcome, progressives tend to argue against economic freedom. But the fact that more economic freedom causes more unequal outcomes does not imply that less economic freedom causes less unequal, or even preferable outcomes. The tools and methods we use to restrict economic freedom may themselves promote unequal outcomes. Those interested in achieving equality of outcome cannot know, a priori, that less economic freedom will achieve their goal, or at what cost. They must address two empirical questions:

- Does suppressing economic freedom cause more or less inequality of outcome than does securing economic freedom?
- Does suppressing economic freedom cause a greater or lesser level of outcome than does securing economic freedom?

If suppressing economic freedom causes both less inequality of outcome and a better level of outcome than does securing economic freedom, then we have a solid argument in favor of the progressive view of the proper role of government in society. Alternatively, if securing economic freedom causes both less inequality of outcome and a better level of outcome, then we have a solid argument in favor of a libertarian view of the proper role of government. But if securing economic freedom causes more inequality of outcome but a better level of outcome, then we have an argument for limited economic freedom wherein we must choose to trade some worsening in the inequality of outcome for an improvement in the level of outcome.

These are causal empirical questions that can only be answered through experimentation. Absent experimental data, the best we can do is to look for correlations between economic freedom and desirable socioeconomic outcomes. While correlation does not imply causation, the absence of correlation does imply the absence of causation. So let us ask the question in the negative: *Is economic freedom correlated with greater outcome inequality and lesser outcome levels?* If we do not find a correlation, then we know that there is also no causation. While that alone would not recommend economic freedom, it would demonstrate that securing economic freedom does not result in more harm than would the suppression of economic freedom. We could then fall back on the fact that equality of opportunity requires economic freedom, and say that our quest for equality must end at achieving equality of opportunity, knowing that we haven't made inequality of outcome any worse than it would have been had we suppressed economic freedom.

Economic Freedom

The preservation of property very clearly presupposes the accumulation of property, and the accumulation of property, in turn, requires some degree of economic freedom. And while there is no purely objective way to measure economic freedom, there are metrics which make it possible to ascertain whether economic freedom yields beneficial results. In short, it is possible by measuring observable data to determine whether the liberty that Americans consider their birthright is also a positive instrumentality in their lives individually, and more importantly, collectively.

The Fraser Institute's Economic Freedom of North America Index (EFNA) makes a consideration of this type possible. For each of the 50 states in every year from 1981 through

2009, Fraser considers a fixed set of economic variables that are correlated with economic freedom. Fraser combines these economic variables into a single index number that represents Fraser's estimate of economic freedom in each state for each year. The index number ranges from 1 (minimal economic freedom) to 10 (maximum economic freedom). Fraser designs the index number to be absolute so that, for example, 10 represents not the maximum *observed* freedom by maximum *attainable* freedom. Designing the index to be absolute makes it possible not only to compare economic freedoms among states in a given year, but to observe changing economic freedoms over time.

The twenty-eight economic variables Fraser uses in constructing its index fall into three groups: measures of government spending, measures of taxation, and measures of labor market freedom.¹ By way of example, some specific economic variables include: government spending within a state relative to the size of the state's economy, government subsidies given to people and companies within a state relative to the size of that state's economy, total tax revenue relative to the size of that state's economy, top marginal income tax rates and the thresholds at which they apply, government employment relative to total employment within that state, and minimum wage legislation.²

There is no purely objective way to measure economic freedom, but the EFNA is a quasi-objective measure in that, while the researchers choose which economic variables to include in the index and how to weight them, the values of the economic variables themselves are

¹ Whenever we refer to "government" we mean (as do the EFNA measures we use) all levels of government: federal, state, and local. For example, government spending in Texas includes all money spent by the federal government within the state of Texas, all money spent by the Texas state government, and all money spent by local levels of government within Texas.

² For the complete list of the economic variables Fraser uses to construct the index, see Stansel, Dean and Fred McMahon, 2013. *Economic Freedom of North America*, Fraser Institute.

objectively measured. For each year and each state, Fraser includes the same economic variables and applies the same weights. This means that Fraser's definition of economic freedom remains constant across states and across years. Because the measure is quasi-objective, other economic freedom indices (for example, Mercatus Center's Freedom in the 50 States, and Heritage Foundation's Index of Economic Freedom) will differ from the EFNA (and from each other), though they are all correlated. The EFNA, though, provides the longest history of freedom measures for the individual states.³

If economic freedom is beneficial to society, this story should emerge in the data. If there are elements of economic freedom that are detrimental to society, this too should be evident. The question now is what outcomes are beneficial to society? We look at five categories of outcomes that are important to human flourishing: incomes (as measured by median household income and per-capita personal income), poverty and inequality (as measured by the unemployment rate, the poverty rate, income inequality, and the percentage of uninsured people), population growth (as measured by population growth and by in-migration relative to out-migration), fiscal health of government (as measured by tax revenue and the magnitude of government debt relative to the size of the economy), and economic growth (as measured by the growth in the number of firms and growth in state GDPs). If economic freedom is beneficial, we should observe, quite simply, improved socioeconomic outcomes where we see increased economic freedom. If economic freedom is detrimental, we should observe diminished socioeconomic outcomes.⁴

³ While we do not report the results in this paper, we have applied our same analysis to the Mercatus Center's Freedom in the 50 States index. The results are in general agreement to the results obtained using the EFNA index.

⁴ The Fraser Institute has calculated freedom indices for each of the fifty states annually from 1981 to 2009, for a total of 1,450 observations. Most of the socioeconomic outcomes are readily available from 1985 to the present, which results in most of our analyses being based on 1,250 observations from 1985-2009.

The most straightforward way to examine socioeconomic outcomes relative to economic freedom is to divide the states into two groups: the 25 with economic freedom indices that are above the median economic freedom (the “more free states”) and the 25 with indices that fall below the median (the “less free states”). If economic freedom is beneficial, then the socioeconomic outcomes for the 25 more free states should be significantly and obviously better than those of the socioeconomic outcomes for the 25 less free states. The sets of “more free” and “less free” states are not constant over time. From 1985 to 2009, 13 states were in the “less free” category every year, 14 states were in the “more free” category every year, and 23 states switched from one category to the other at least once. Of the states that switched, the average state switched categories three times from 1985 through 2009. States that switched categories the most include California and Kansas (8 times each), Kentucky (5 times), and Florida, Idaho, Ohio, Vermont, and Wisconsin (4 times each). Only two states, South Dakota and Utah, switched only once. The states are shown, by category, in Figure 1.⁵ The individual EFNA indices range from a low of 4.95 for West Virginia in 1986 to a high of 8.48 for Delaware in 2004. The differences in the average EFNA indices between the categories are statistically significant over all the years, both in the aggregate and in each individual year.⁶

⁵ Data source: Ashby, Bueno, and McMahon, Economic Freedom of North America 2011, Fraser Institute.

⁶ The differences in the means are all statistically significant at the 1% level. For the 25 more free states over all years, mean = 7.20, s = 0.36, n = 625. For the 25 less free states over all years, mean = 6.42, s = 0.41, n = 625.

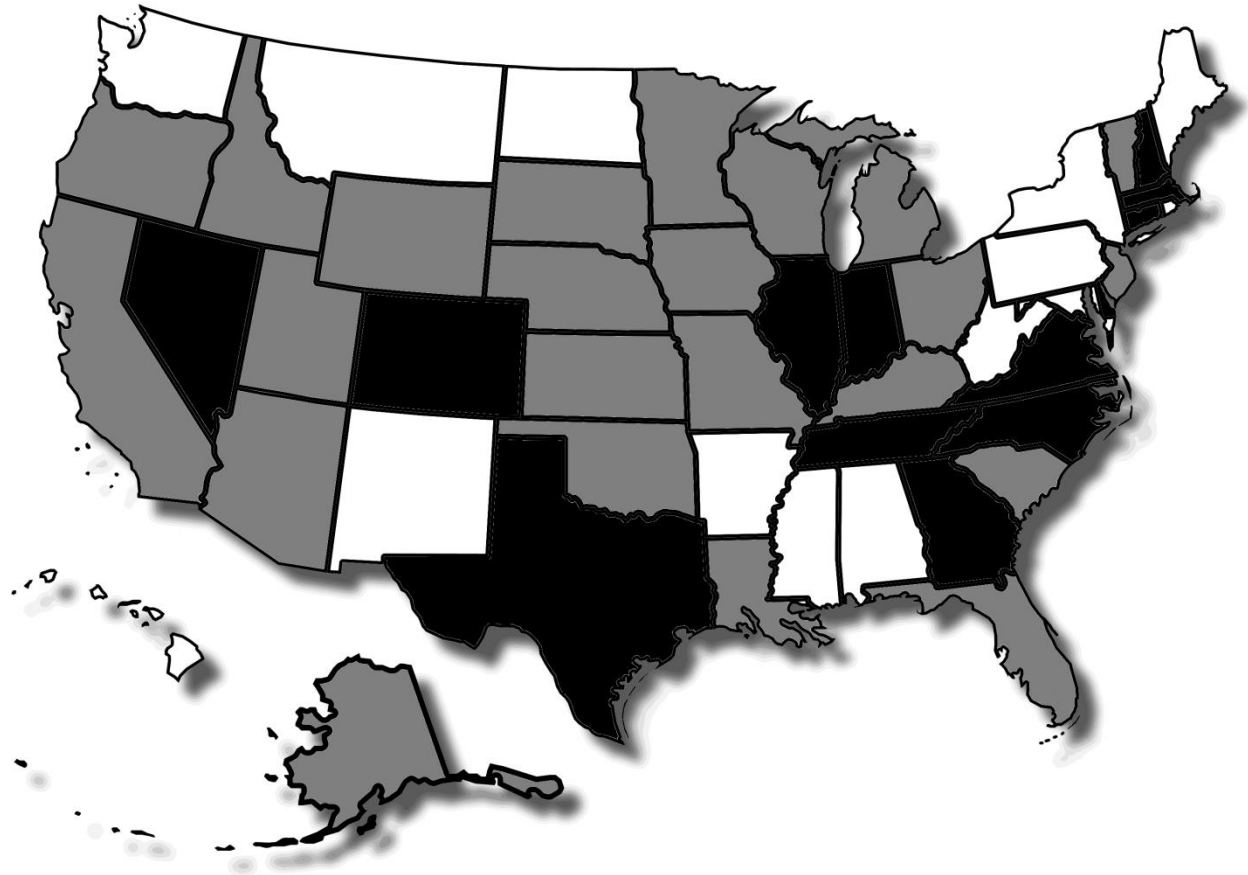


Figure 1. Over the period 1985 through 2009, 14 states always appeared among the least economically free (white), 13 states always appeared among the most economically free (black), and 23 states switched at least once between the least and most economically free (gray).

I. Incomes

A: *Median Household Income*⁷

There are a variety of income measures, each of which touches on a different nuance. The measure that comports most closely with what a non-economist would consider “income” is median household income. Average measures such as per-capita income, and average personal income can be influenced by outliers. For example, one very rich person can drive up an average income measure. Median measures are immune to outliers, as they reflect the “middle” income of the larger group. The measure is simply an identification of the absolute middle of the pack.

Figure 2 shows median household income for the fifty states over time.

⁷ In a separate analysis, we controlled for climate, education, natural resources (as proxied by energy production), size of state populations relative to the national population, and state specific fixed effects. A cross-section fixed effects panel data OLS regression of median household income on EFNA, mean temperature, percentage of the population with a bachelors degree, energy production as a fraction of total U.S. energy production, state population as a fraction of total U.S. population, and change in the relative population yields the following results: Observations = 1000, $R^2 = 0.85$, D.W. = 2.10, EFNA coefficient = 2441.7, EFNA p-value = 0.000. Additional data sources: U.S. Department of Energy (www.eia.gov/beta/state/), 2012 Statistical Abstract of the United States, Table 233, NOAA National Climate Data Center (www.currentresults.com/Weather/US/average-annual-state-temperatures.php).

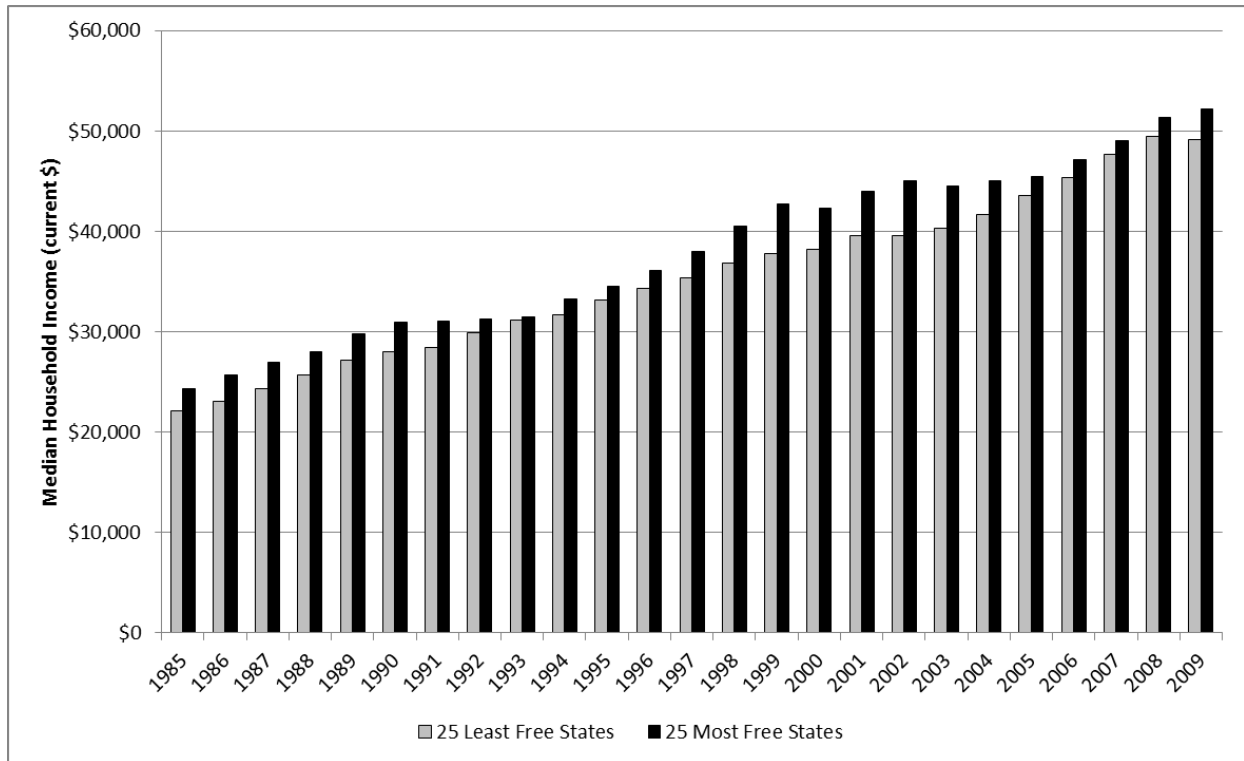


Figure 2. Average median household income for the least and more free states as measured by the EFNA index.⁸

From 1985 through 2009, the average of the median household incomes for the more free states was 7.8% greater than the average of the median household incomes for the less free states. In each individual year, median household income was higher among the more free states and the difference ranged from a high of 13% or more in 1999 and 2002 to a low of 1.2% more in 1993.⁹

⁸ Data source: U.S. Census Bureau, Historical Income Tables: Households, Table H-8 (www.census.gov/hhes/www/income/data/historical/household); Ashby, Bueno, and McMahon, Economic Freedom of North America 2011, Fraser Institute.

⁹ The difference in the means is statistically significant at the 1% level. For the more free states, mean = \$38,026, s = \$9,768, n = 625. For the less free states, mean = \$35,348, s = \$10,025, n = 625.

B: *Per-capita Personal Income*¹⁰

Comparing household incomes can distort the view of earnings if there is a systemic difference in the number of income earners residing in the same household across the two samples and even across years. This could happen as a result of workers earning the same salaries in the less and more free states, but with more couples living together in the more free states. This would cause household incomes to be higher in the more free states, even though the workers were earning the same incomes across the two sets of states. Per-capita personal income gets around this problem by scaling total income by the population rather than by the number of households.

¹⁰ In a separate analysis, we controlled for climate, education, natural resources (as proxied by energy production), size of state populations relative to the national population, and state specific fixed effects. A cross-section fixed effects panel data OLS regression of per-capita personal income on EFNA, mean temperature, percentage of the population with a bachelors degree, energy production as a fraction of total U.S. energy production, state population as a fraction of total U.S. population, and change in the relative population yields the following results: Observations = 1000, $R^2 = 0.89$, D.W. = 2.00, EFNA coefficient = 1338.5, EFNA p-value = 0.000. Additional data sources: U.S. Department of Energy (www.eia.gov/beta/state/), 2012 Statistical Abstract of the United States, Table 233, NOAA National Climate Data Center (www.currentresults.com/Weather/US/average-annual-state-temperatures.php).

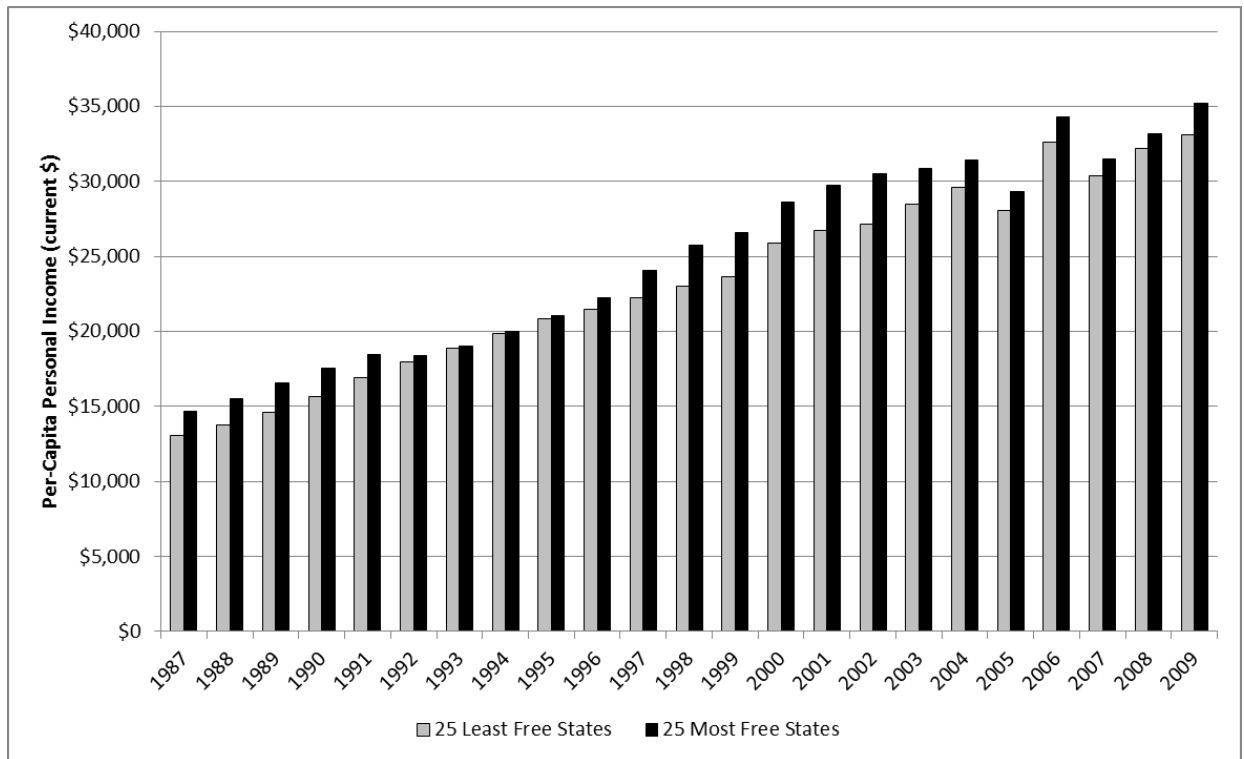


Figure 3. Average per-capita personal income for the least and more free states as measured by the EFNA index.¹¹

Over the sample, the average of the per-capita personal incomes for the more free states was 7.5% greater than the average of the per-capita personal incomes for the less free states. As with household income, in each individual year, per-capita personal income was higher among the more free states. The difference ranged from a high of above 13% in 1989 to a low of 0.8% in 1994 and 0.9% in 1995.¹²

¹¹ Data source: Census Bureau, Statistical Abstract of the United States, 1995 Table 713, 1996 Table 699, 1997 Table 706, 1998 Table 727, 1999 Table 733, 2000 Table 727, 2001 Table 652, 2002 Table 643, 2003 Table 671, 2004-2005 Table 653, 2006 Table 663, 2007 Table 660, 2008 Table 660, 2009 Table 660, 2010 Table 666, 2011 Table 680, 2012 Table 681; Ashby, Bueno, and McMahon, Economic Freedom of North America 2011, Fraser Institute.

¹² The difference in the means is statistically significant at the 1% level. For the more free states, mean = \$24,985, s = \$7,349, n = 575. For the less free states, mean = \$23,307, s = \$7,044, n = 575.

¹² The difference in the means is statistically significant at the 1% level. For the more free states, mean = 0.0517, s = 0.0169, n = 625. For the less free states, mean = 0.0580, s = 0.0173, n = 625.

II. Poverty and Inequality

A: *Unemployment Rate*¹³

Unemployment measures are especially telling. From 1985 through 2009, the average unemployment rate among the more free states was lower than that of the less free states in every year (Figure 4). Throughout the period, the average unemployment rate among the more free states was 5.2% versus 5.8% among the less free states.¹⁴

¹³ In a separate analysis, we controlled for climate, education, natural resources (as proxied by energy production), size of state populations relative to the national population, and state specific fixed effects. A cross-section fixed effects panel data OLS regression of unemployment on EFNA, mean temperature, percentage of the population with a bachelors degree, energy production as a fraction of total U.S. energy production, state population as a fraction of total U.S. population, and change in the relative population yields the following results: Observations = 1000, $R^2 = 0.55$, D.W. = 2.20, EFNA coefficient = -0.007, EFNA p-value = 0.000. Additional data sources: U.S. Department of Energy (www.eia.gov/beta/state/), 2012 Statistical Abstract of the United States, Table 233, NOAA National Climate Data Center (www.currentresults.com/Weather/US/average-annual-state-temperatures.php).

¹⁴ The difference in the means is statistically significant at the 1% level. For the more free states, mean = 0.0517, s = 0.0169, n = 625. For the less free states, mean = 0.0580, s = 0.0173, n = 625.

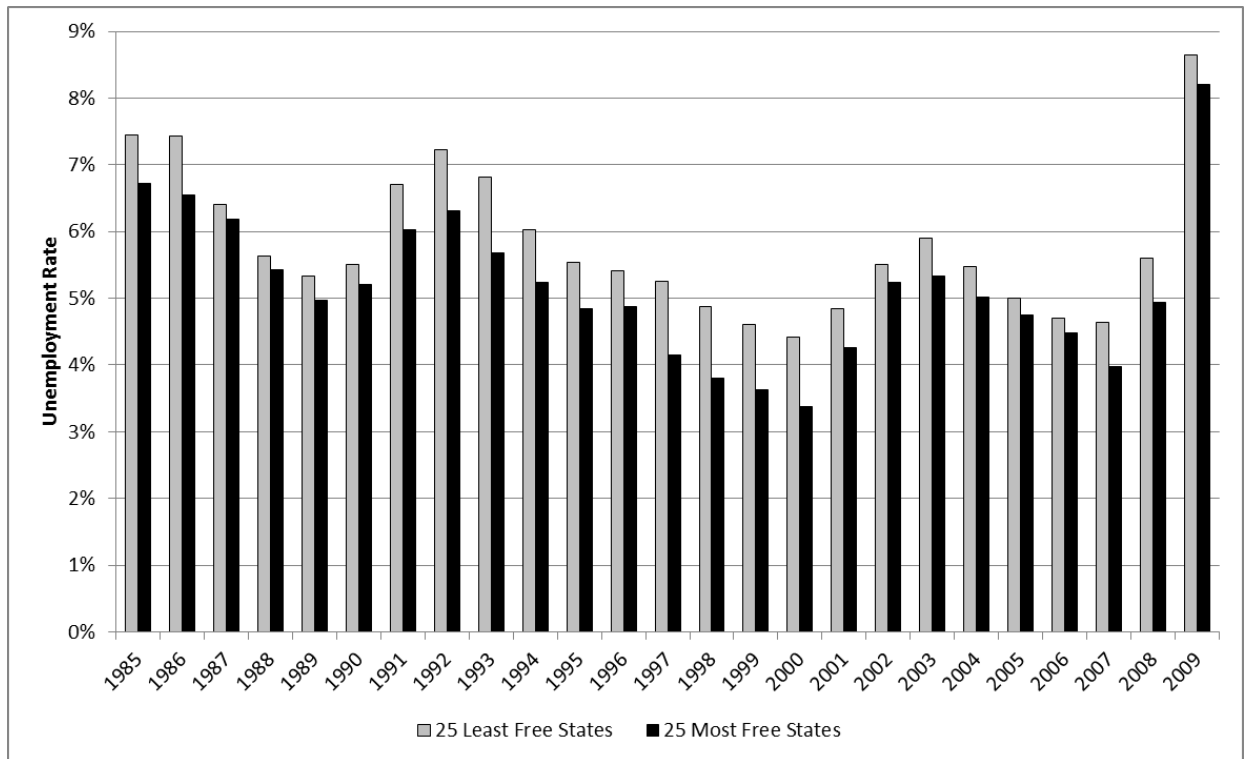


Figure 4. Average unemployment rates for the least and more free states as measured by the EFNA index.¹⁵

The difference in the average unemployment rates varied from a low of 0.2% in 1987 and 1988 to a high of 1% or more in 1993 and again from 1997 through 2000. Over the sample period, the U.S. labor force averaged over 136 million workers annually. Assuming the labor force is evenly distributed among the most and less free states, the lower unemployment rate among the more free states was equivalent, on average, to 430,000 additional jobs nationwide each year.¹⁶

¹⁵ Data source: Census Bureau, Statistical Abstract of the United States, 1995 Table 664, 1996 Table 650, 1997 Table 658, 1998 Table 683, 1999 Table 686, 2000 Table 680, 2001 Table 606, 2002 Table 600, 2003 Table 628, 2004-2005 Table 610, 2010 Table 628, 2011 Table 628; Ashby, Bueno, and McMahon, Economic Freedom of North America 2011, Fraser Institute.

¹⁶ U.S. Bureau of Labor Statistics (BLS): Current Population Survey (CPS) [Household Survey - LNS11000000].

¹⁶ www.census.gov/hhes/www/poverty/about/overview/measure.html. For poverty thresholds, see www.census.gov/hhes/www/poverty/data/threshld/index.html.

B: Poverty Rate¹⁷

Poverty thresholds are calculated and updated each year by the Census Bureau. Poverty thresholds vary by family size and composition and are adjusted to account for inflation. If a family's total income is less than the poverty threshold then every person in the family is classified as living in poverty.¹⁸

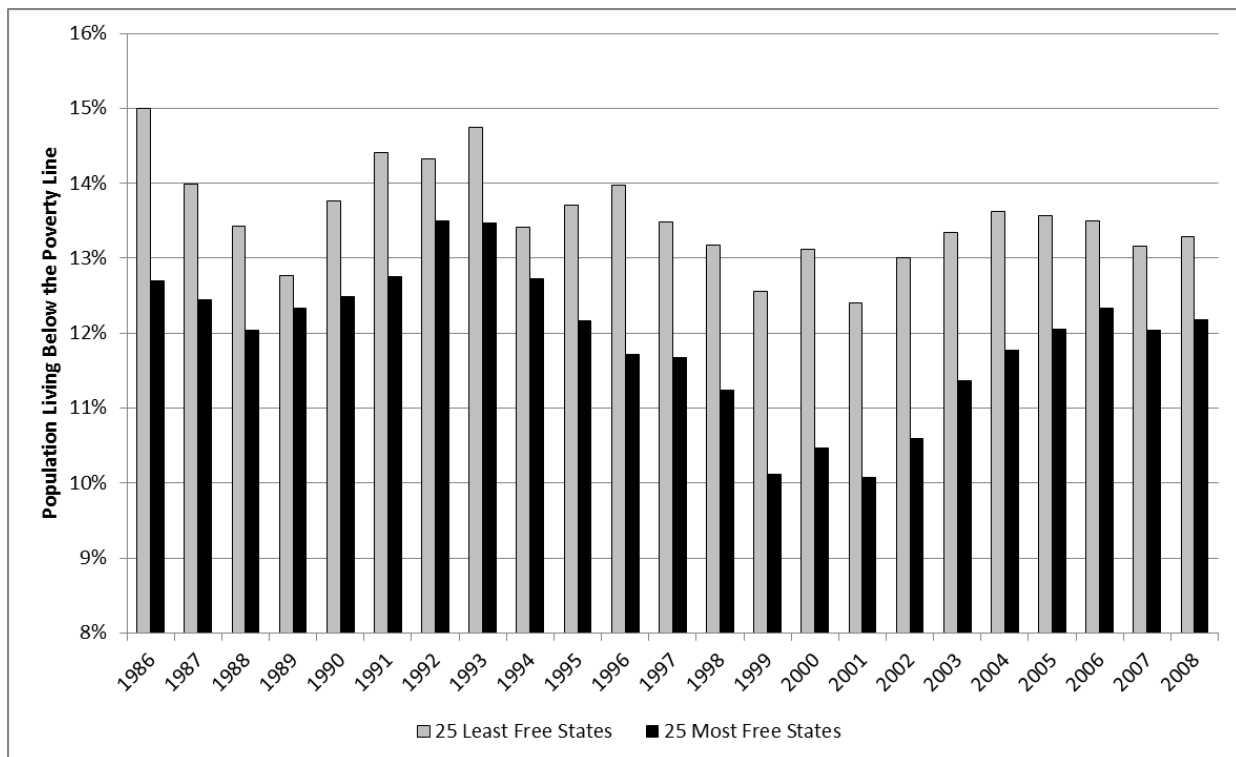


Figure 5. Average poverty rates for the least and more free states as measured by the EFNA index.¹⁹

¹⁷ In a separate analysis, we controlled for climate, education, natural resources (as proxied by energy production), size of state populations relative to the national population, and state specific fixed effects. A cross-section fixed effects panel data OLS regression of the poverty rate on EFNA, mean temperature, percentage of the population with a bachelors degree, energy production as a fraction of total U.S. energy production, state population as a fraction of total U.S. population, and change in the relative population yields the following results: Observations = 950, $R^2 = 0.59$, D.W. = 1.94, EFNA coefficient = -0.021, EFNA p-value = 0.000). Additional data sources: U.S. Department of Energy (www.eia.gov/beta/state/), 2012 Statistical Abstract of the United States, Table 233, NOAA National Climate Data Center (www.currentresults.com/Weather/US/average-annual-state-temperatures.php).

¹⁸ www.census.gov/hhes/www/poverty/about/overview/measure.html. For poverty thresholds, see www.census.gov/hhes/www/poverty/data/threshld/index.html.

¹⁹ Data source: Census Bureau, Statistical Abstract of the United States, 1992 Table 723, 1995 Table 749, 1996 Table 735, 1997 Table 741, 1998 Table 761, 1999 Table 765, 2000 Table 759, 2001 Table 684, 2002 Table 673, 2003 Table 705, 2004-2005 Table 688, 2006 Table 692, 2007 Table 690, 2008 Table 690, 2009 Table 687, 2010

The average poverty rate among the more free states is lower than the average poverty rate among the less free states in every year in the sample, averaging 1.6 percentage points lower in the more free states. The greatest differences exceeded 2 percentage points in 1986, 1996, and 1999 through 2003. The smallest difference was less than half a percent in 1989.²⁰

C: *Income Inequality*²¹

As Madison said in *Federalist 10*, the equality that Jefferson claimed was every human's birthright in the Declaration of Independence will, in the end, inevitably lead to inequality of outcome in a free society. It is the only possible outcome. As obvious as this was to Madison and Jefferson, though, "income inequality" has become a point of contention among academics and politicians alike. And when it is pointed out that more free states have higher income levels, the immediate rejoinder is inevitably that those higher incomes result, for many, in tremendous income disparity. But income inequality measures suffer from well-known defects. The manner in which the Gini coefficient (which measures statistical dispersion in order to represent income distribution), for example, is popularly quoted assumes that people do not move between income categories. For example, if the bottom 20% of wage earners earned 5% of all income this year and 4% next year, the popular interpretation would be that the poor got poorer. In fact, it is

Table 693, 2011 Table 708, 2012 Table 708; Ashby, Bueno, and McMahon, *Economic Freedom of North America 2011*, Fraser Institute.

²⁰ The difference in the means is statistically significant at the 1% level. For the more free states, mean = 0.119, s = 0.034, n = 575. For the less free states, mean = 0.136, s = 0.038, n = 575.

²¹ In a separate analysis, we controlled for climate, education, natural resources (as proxied by energy production), size of state populations relative to the national population, and state specific fixed effects. A cross-section fixed effects panel data OLS regression of the Gini coefficient on EFNA, mean temperature, percentage of the population with a bachelors degree, energy production as a fraction of total U.S. energy production, state population as a fraction of total U.S. population, and change in the relative population yields the following results: Observations = 200, R² = 0.56, D.W. = 1.93, EFNA coefficient = -0.004, EFNA p-value = 0.062. Additional data sources: U.S. Department of Energy (www.eia.gov/beta/state/), 2012 Statistical Abstract of the United States, Table 233, NOAA National Climate Data Center (www.currentresults.com/Weather/US/average-annual-state-temperatures.php).

possible (and even likely) that the bottom 20% of wage earners this year are not the same people as the bottom 20% of wage earners last year. Thus, the income inequality measure could rise because the poor got poorer, or because the rich got richer while the poor stayed the same, or because the poor got richer but the rich got richer faster, or because there was no pattern to who got richer and who got poorer, but people's movements between income groups caused the inequality coefficient to rise by random chance.

A good demonstration of the shortcomings of the popular interpretation of the Gini coefficient is found by applying it to people's ages. In 2000, the youngest 20% of Americans were, on average, 7.1 years old. By 2010, the youngest 20% of Americans were, on average, 6.9 years old. Applying a simpleminded interpretation of the Gini coefficient would have us conclude that the young got younger. Sadly, no one ever gets younger. Rather, the composition of the youngest 20% changed – some grew up and were no longer part of the youngest 20% and new people were born and entered the youngest 20%.

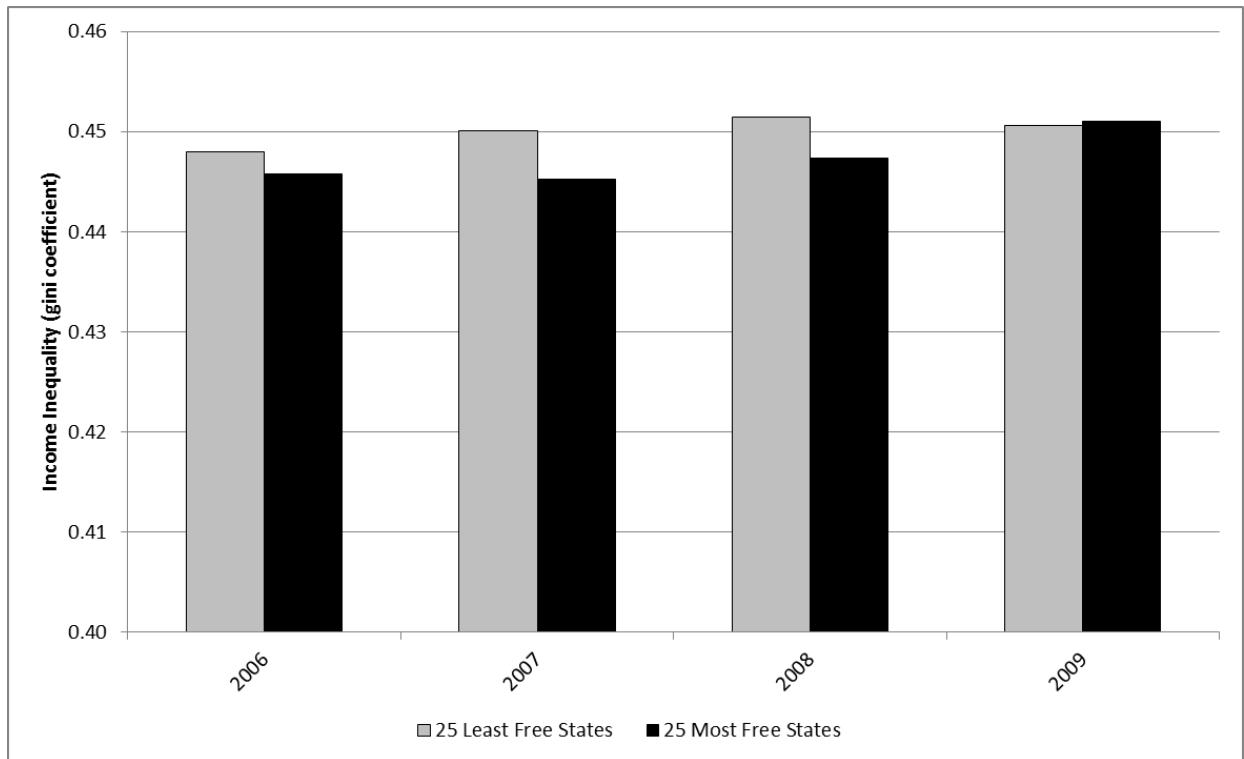


Figure 6. Average income inequality measures for the least and more free states as measured by the EFNA index.²²

Finally, it might well be the case that this is a moot discussion in any event. After all, the poor don't suffer from inequality; they suffer from poverty. To accept this argument is to render a discussion of Gini coefficients meaningless. Still, there are those who insist on considering inequality of outcome (the Madisonian inevitability) instead of equality of opportunity (the Jeffersonian necessity). So for those who do consider income equality to be a desirable social outcome, a comparison of the Gini coefficients for the more free and less free states is telling. The more free states exhibited less income inequality than the less free states in three out of the four years for which data is available.²³ The reduced income inequality among the more free states is not statistically significant, however. Be that as it may, the conventional claim is that

²² Data source: Census Bureau, American Community Survey, B19083 (factfinder2.census.gov/faces/nav/jsf/pages/searchresults.xhtml?refresh=t#none); Ashby, Bueno, and McMahon, *Economic Freedom of North America 2011*, Fraser Institute.

²³ The American Community Survey began recording Gini coefficients at the state level in 2006.

increasing income inequality is an inevitable byproduct of free markets. But as we see less income inequality on average in the more free states, even though the difference is statistically zero, this is sufficient evidence to rebut the claim.²⁴

D: *Percentage of Uninsured People*²⁵

One indicator of poverty is the percentage of the population that does not have health insurance. From 1995 through 2009, there were fewer uninsured people (per capita) in the more free states than in the less free states in eight out of the fifteen years. When the more free states experienced lower rates of uninsurance than the less free states, they did so by almost a full percentage point. Conversely, when the less free states experienced lower uninsurance rates than the more free states, they did so by only a third of a percentage point. This suggests that when citizens of the more free states have higher levels of insurance coverage, the levels of insurance coverage are much higher, but when citizens of the less free states have higher levels of insurance coverage, the coverage is only marginally higher.

²⁴ The difference in the means is not statistically significant. For the more free states, mean = 0.447, s = 0.020, n = 100. For the less free states, mean = 0.450, s = 0.019, n = 100.

²⁵ In a separate analysis, we controlled for climate, education, natural resources (as proxied by energy production), size of state populations relative to the national population, and state specific fixed effects. A cross-section fixed effects panel data OLS regression of the uninsured rate on EFNA, mean temperature, percentage of the population with a bachelors degree, energy production as a fraction of total U.S. energy production, state population as a fraction of total U.S. population, and change in the relative population yields the following results: Observations = 750, R² = 0.45, D.W. = 1.83, EFNA coefficient = -0.009, EFNA p-value = 0.000. Additional data sources: U.S. Department of Energy (www.eia.gov/beta/state/), 2012 Statistical Abstract of the United States, Table 233, NOAA National Climate Data Center (www.currentresults.com/Weather/US/average-annual-state-temperatures.php).

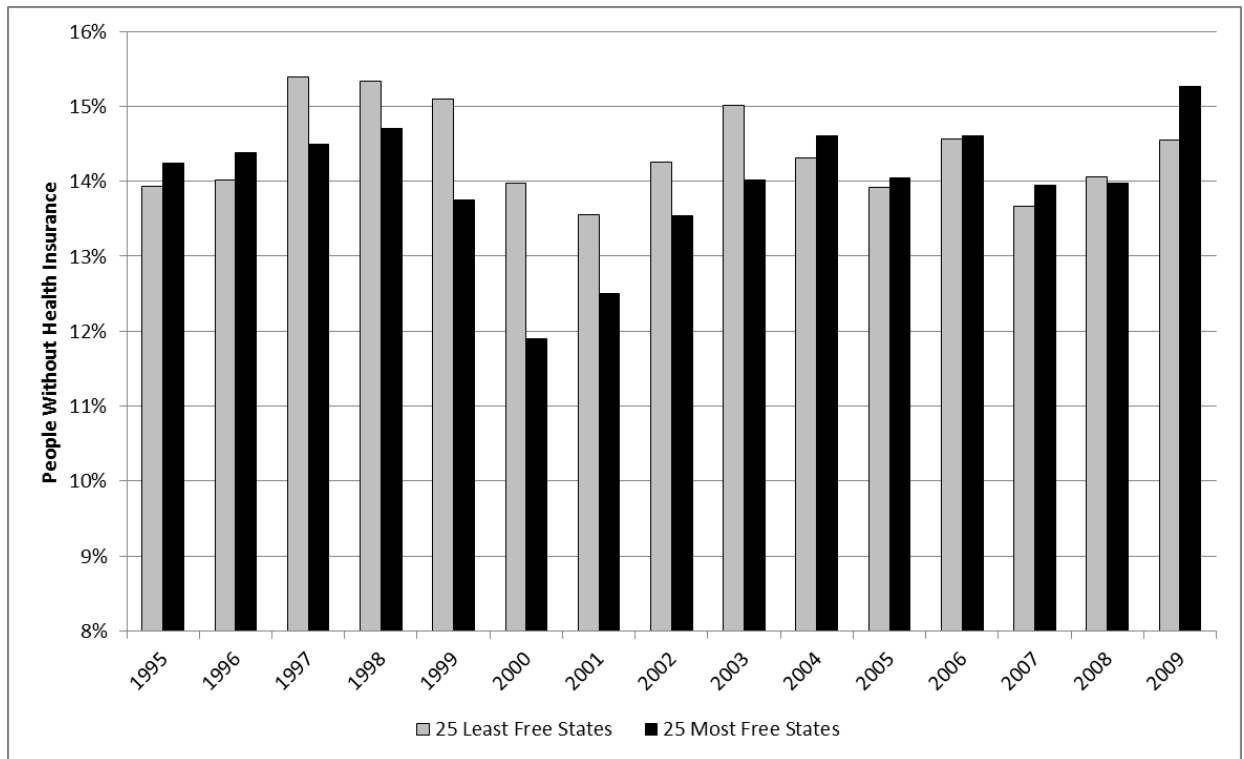


Figure 7. Percentage of uninsured people in the least and more free states as measured by the EFNA index.²⁶

Overall, the average rate of uninsurance among the more free states was less than the rate among the less free states, though the difference was not statistically significant.²⁷

²⁶ Data source: Census Bureau, Statistical Abstract of the United States, 1997 Table 172, 1998 Table 186, 1999 Table 190, 2000 Table 178, 2001 Table 145, 2002 Table 138, 2003 Table 153, 2004-2005 Table 140, 2006 Table 143, 2007 Table 145, 2008 Table 147, 2009 Table 147, 2010 Table 150, 2011 Table 152, 2012 Table 156; Ashby, Bueno, and McMahon, Economic Freedom of North America 2011, Fraser Institute.

²⁷ The difference in the means is not significant. For the more free states, mean = 0.140, s = 0.040, n = 375. For the less free states, mean = 0.144, s = 0.039, n = 375.

²⁷ The difference in the means is statistically significant at the 1% level. For the more free states, mean = 0.013, s = 0.012, n = 575. For the less free states, mean = 0.008, s = 0.009, n = 575.

III. Population Growth

*A: Population Growth*²⁸

Over the sample period, the more free states experienced population growths that were almost 60% higher than those of the less free states. From 1987 through 2009, the more free states saw their populations grow (on average) by 1.3% annually versus 0.8% for the less free states. Compounding those growth rates over the 23 years in the sample means that the average state among the more free saw its population grow by one-third versus one-fifth for the average state among the less free.²⁹

²⁸ In a separate analysis, we controlled for climate, education, natural resources (as proxied by energy production), size of state populations relative to the national population, and state specific fixed effects. A cross-section fixed effects panel data OLS regression of population growth on EFNA, mean temperature, percentage of the population with a bachelors degree, energy production as a fraction of total U.S. energy production, state population as a fraction of total U.S. population, and change in the relative population yields the following results: Observations = 1000, $R^2 = 0.21$, D.W. = 2.09, EFNA coefficient = 0.006, EFNA p-value = 0.000. Additional data sources: U.S. Department of Energy (www.eia.gov/beta/state/), 2012 Statistical Abstract of the United States, Table 233, NOAA National Climate Data Center (www.currentresults.com/Weather/US/average-annual-state-temperatures.php).

²⁹ The difference in the means is statistically significant at the 1% level. For the more free states, mean = 0.013, s = 0.012, n = 575. For the less free states, mean = 0.008, s = 0.009, n = 575.

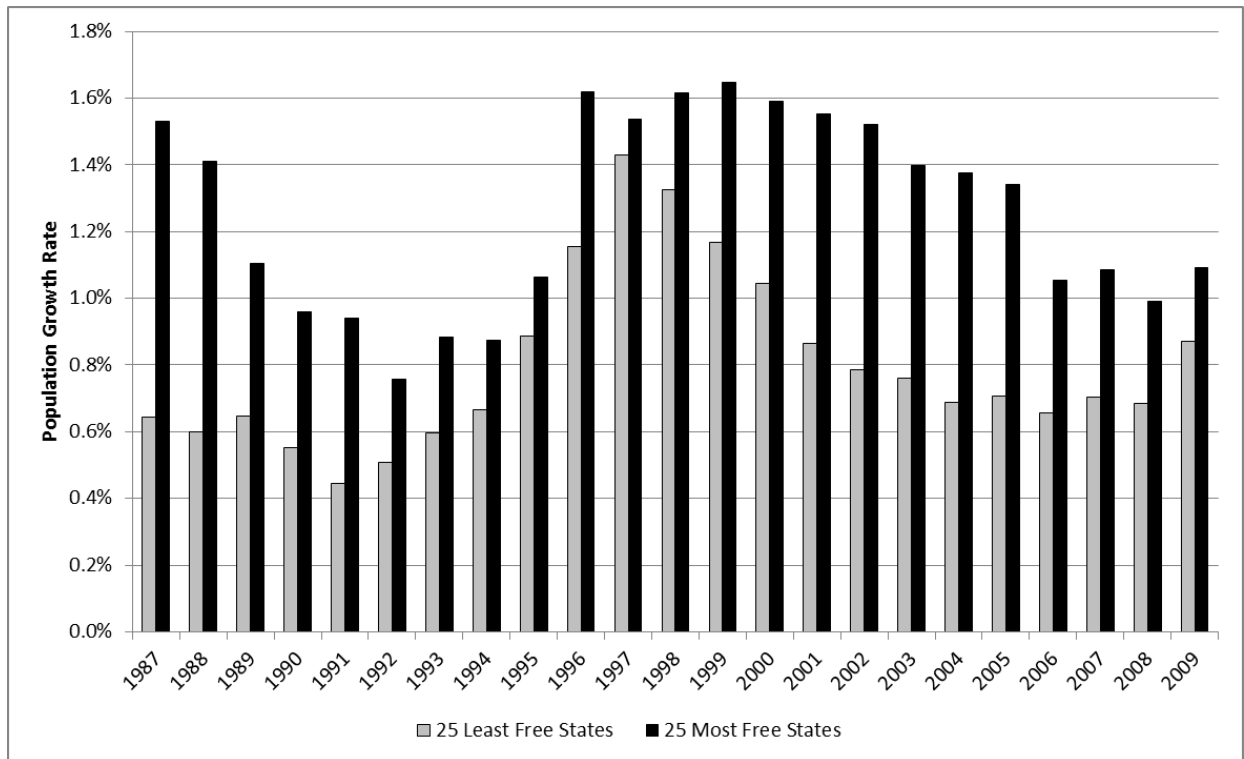


Figure 8. Average annual population growth for the least and more free states as measured by the EFNA index.³⁰

B: In-Migration Relative to Out-Migration

Population growth numbers are functions of births, deaths, international immigration, international emigration, and migration between the states. The most revealing available data show migration between the states only. The IRS has data going back to 2006 on migration between states as measured by states of residence, and states of prior-year residence, as reported on personal income tax returns. The relevant measure is the ratio of in-migrants to a given state from to out-migrants from a given state, which yields what we term the “in-migration ratio” for any given state. For example, to say that “state A has an in-migration ratio of 1.1 relative to state

³⁰ Data source: Census Bureau, PE-5, compiled by Moody Analytics (www.economy.com); Ashby, Bueno, and McMahon, *Economic Freedom of North America 2011*, Fraser Institute.

B” means that 1.1 people moved from B to A for every 1 person who moved from A to B.

Accounting for all pairwise combinations yields 1,225 in-migration ratios per year.

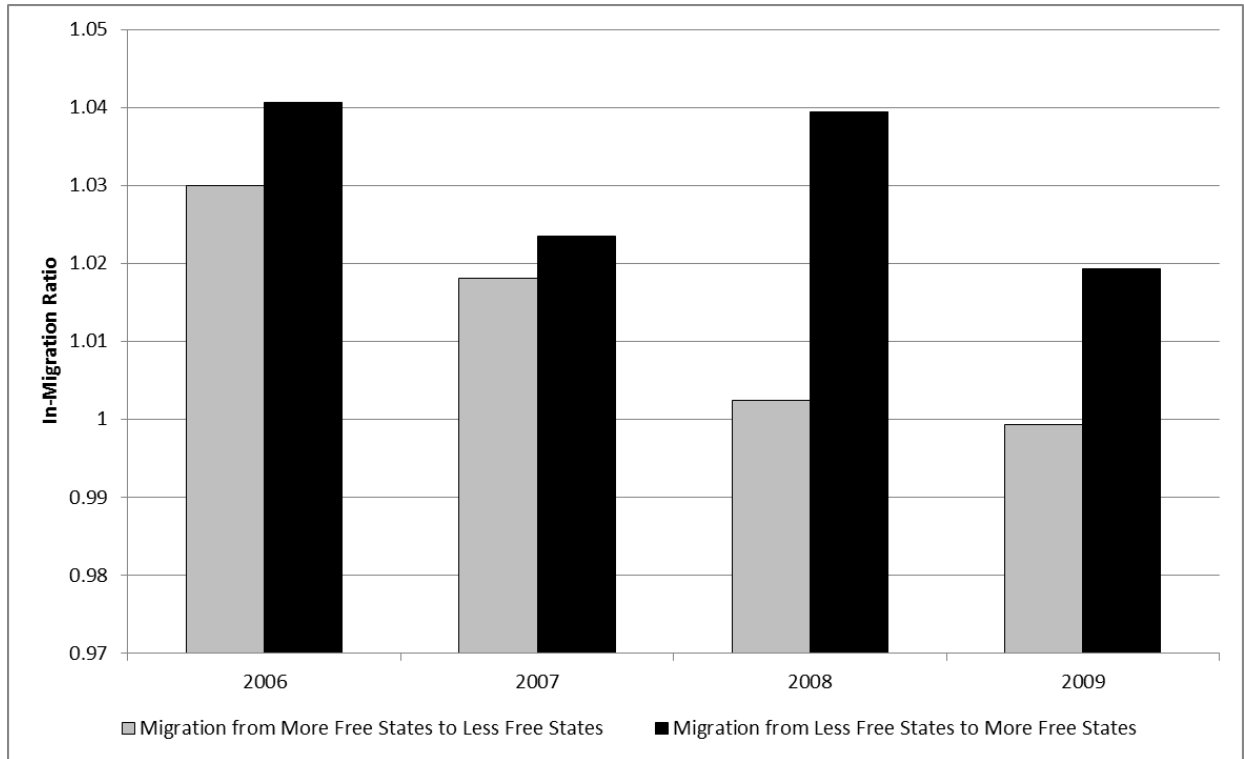


Figure 9. Average ratio of in-migrants to out-migrants for migrations between states of different freedoms as measured by the EFNA index.³¹

Since we are examining relative in-migrations, we cannot categorize states as “more free” or “less free” relative to the median freedom index. What is relevant in this instance is the freedom of the state into which the migrants are moving relative to the state out of which the migrants are moving, which we term the “freedom ratio.” For example, to say that “state A has a freedom ratio of 1.1 relative to state B” means that state A’s freedom index is 1.1 times state B’s freedom index.

Over the sample period, the in-migration ratio for people moving from less free states to more free states averaged 1.03 while the in-migration ratio for people moving from more free

³¹ Data source: IRS, SOI Tax Stats (www.irs.gov/taxstats/article/0,,id=212702,00.html); Ashby, Bueno, and McMahon, Economic Freedom of North America 2011, Fraser Institute.

states to less free states averaged 1.01.³² These results suggest not only that populations in the more free states are growing faster than in the less free states, but that part of the reason for the growth differential is a net migration of people from less free to more free states.

IV: Fiscal Health of the Government

A: Tax Revenue

State and local government revenue is derived from taxes, licensing, intergovernmental sources, and non-tax and non-licensing activities such as utility revenue, liquor store revenue, and social insurance trust revenue.³³ State and local tax revenue is a component in the construction of the EFNA index, so it is not surprising (see Figure 10) to find that more free states collected a significantly smaller share of GDP (18.1%) in tax revenue than did the less free states (21.9%).³⁴ Interestingly, if we classify states only according to labor market freedom – a criterion that is not based on government revenue – we get similar results. State and local government revenue averages 18.2% of GDP among the states with the most labor market freedoms, but 21.8% among the states with the fewest labor market freedoms.³⁵

³² The difference in the means is statistically significant at the 5% level. For freedom ratios above the median, mean = 1.031, s = 0.374, n = 2,448. For freedom ratios below the median, mean = 1.012, s = 0.268, n = 2,452.

³³ Government Finance and Employment Classification Manual, Census Bureau, 2006 (www2.census.gov/govs/pubs/classification/2006_classification_manual.pdf)

³⁴ The difference in the means is statistically significant at the 1% level. For the more free states, mean = 0.153, s = 0.022, n = 425. For the less free states, mean = 0.187, s = 0.032, n = 425.

³⁵ The difference in the means is statistically significant at the 1% level. For the more free states, mean = 0.182, s = 0.025, n = 425. For the less free states, mean = 0.218, s = 0.043, n = 425.

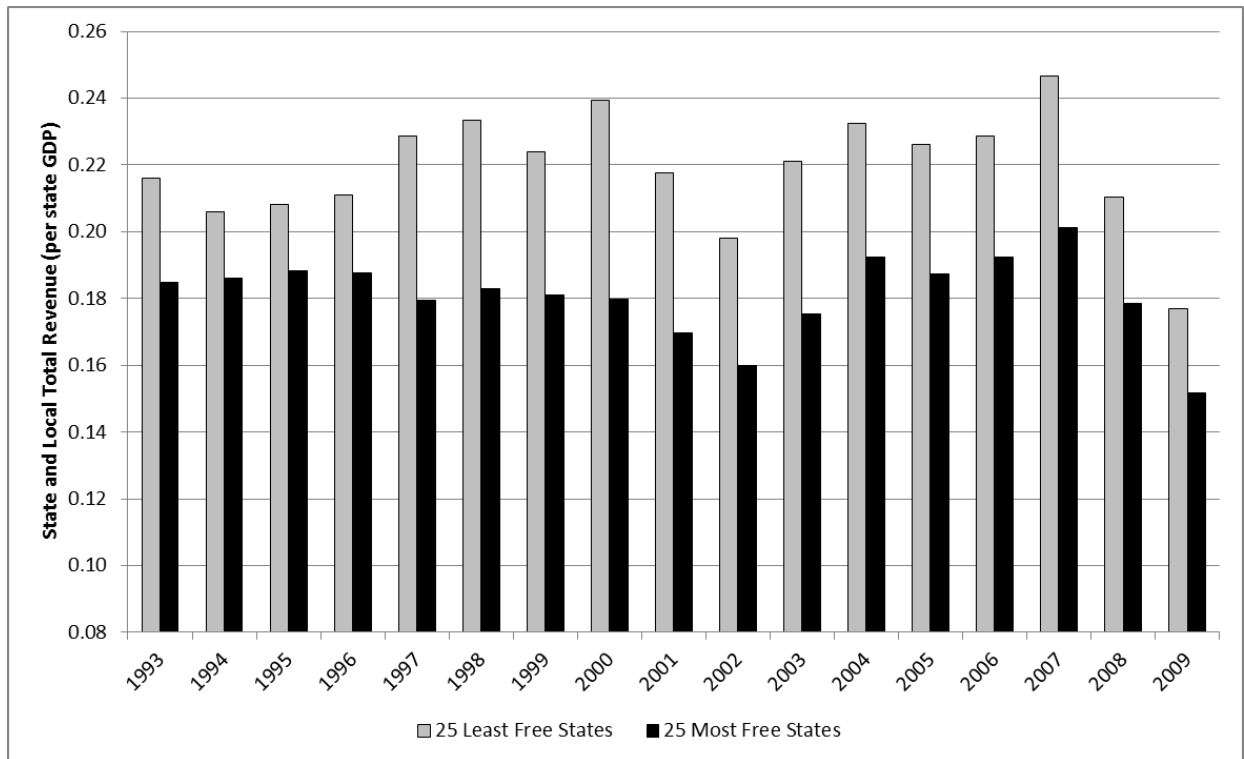


Figure 10. State and local government total revenue as a fraction of state GDP for the least and more free states as measured by the EFNA index.³⁶

B: Government Debt Relative to the Size of the Economy³⁷

One would expect that, since the more free states collect a smaller share of the economy in tax revenue, those states would also exhibit greater debt levels. This is not the case. One might also expect that states that collect a smaller share of the economy in tax revenue would exhibit

³⁶ Data source: Census Bureau, Census of Governments, 1997, 2002, 2007 (www.census.gov/govs/cog/); Bureau of Economic Analysis, GDP and Personal Income Regional Data (www.bea.gov/iTable/iTable.cfm?ReqID=70&step=1); Ashby, Bueno, and McMahon, Economic Freedom of North America 2011, Fraser Institute. Revenue data from missing years is interpolated.

³⁷ In a separate analysis, we controlled for climate, education, natural resources (as proxied by energy production), size of state populations relative to the national population, and state specific fixed effects. A cross-section fixed effects panel data OLS regression of state and local debt as a fraction of state GDP on EFNA, mean temperature, percentage of the population with a bachelors degree, energy production as a fraction of total U.S. energy production, state population as a fraction of total U.S. population, and change in the relative population yields the following results: Observations = 850, $R^2 = 0.24$, D.W. = 1.86, EFNA coefficient = -0.023, EFNA p-value = 0.000. Additional data sources: U.S. Department of Energy (www.eia.gov/beta/state/), 2012 Statistical Abstract of the United States, Table 233, NOAA National Climate Data Center (www.currentresults.com/Weather/US/average-annual-state-temperatures.php).

greater debt levels as a result of deficit spending. This is also not the case. The more free states, on average, have state and local debt equal to 14.7% of their GDPs. The less free states have debt loads equal to 16.5% of their GDPs.³⁸ The average state GDP is \$300 billion. The 1.8 percentage point difference in debt loads is the equivalent of \$5.3 billion in additional debt for the average less free state.

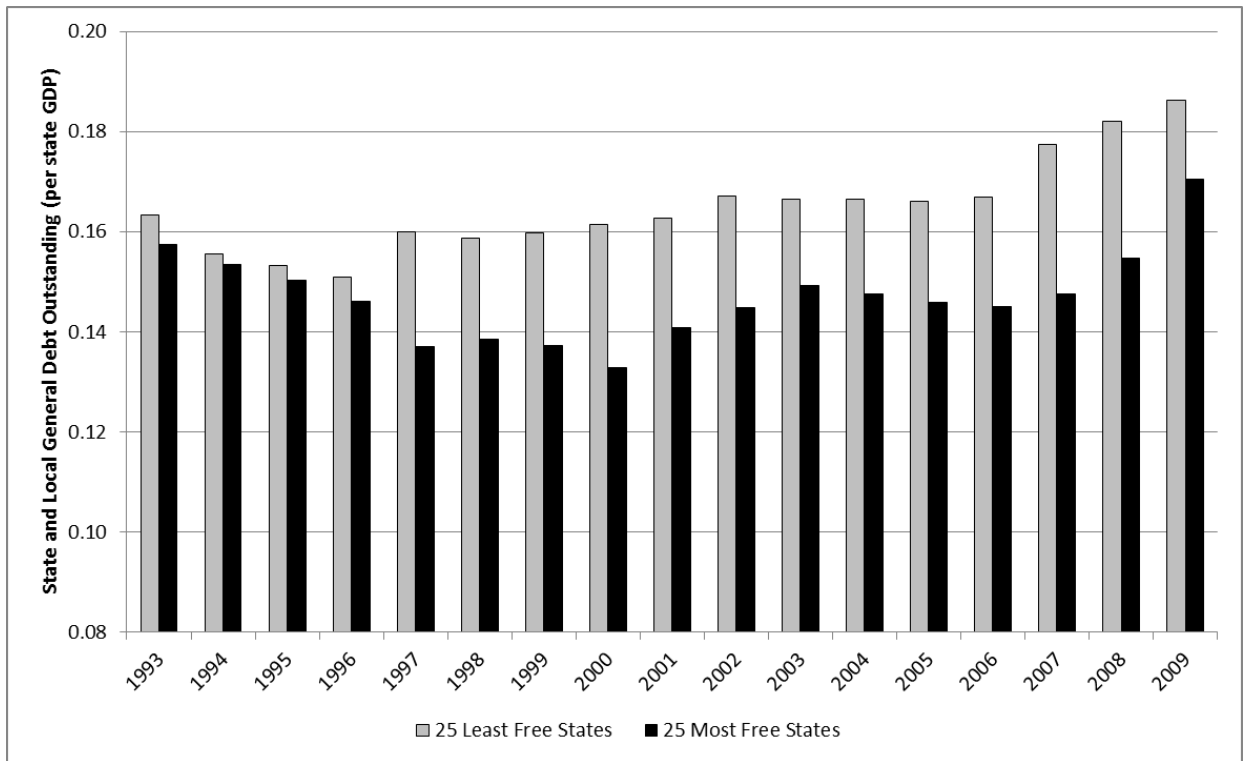


Figure 11. State and local general debt outstanding for the least and more free states as measured by the EFNA index.³⁹

³⁸ The difference in the means is statistically significant at the 1% level. For the more free states, mean = 0.147, s = 0.037, n = 425. For the less free states, mean = 0.165, s = 0.044, n = 425.

³⁹ Data source: Bureau of Economic Analysis, GDP and Personal Income Regional Data (www.bea.gov/iTable/iTable.cfm?ReqID=70&step=1); Ashby, Bueno, and McMahon, Economic Freedom of North America 2011, Fraser Institute. Revenue data from missing years is interpolated.

V: Economic Growth

A: *Growth in the Number of Firms*⁴⁰

Prior to 1993, the Census Bureau recorded the number of business incorporations and closures in each state. There is then a break in the Census data, and the series resumes recast as “business births and deaths” in 2003. One would expect that larger economies would have more firm births and deaths, therefore what is important is the ratio of the births to the deaths within the states. From 1986 to 1992, the ratio of business incorporations to closures averaged 16.5 for the less free states and 37.0 for the more free states. Corporations were being created in the more free states at more than twice the rate in the less free states.⁴¹

⁴⁰ In a separate analysis, we controlled for climate, education, natural resources (as proxied by energy production), size of state populations relative to the national population, and state specific fixed effects. A cross-section fixed effects panel data OLS regression of the growth in the number of firms on EFNA, mean temperature, percentage of the population with a bachelors degree, energy production as a fraction of total U.S. energy production, state population as a fraction of total U.S. population, and change in the relative population yields the following results: Observations = 650, $R^2 = 0.15$, D.W. = 2.09, EFNA coefficient = 5.892, EFNA p-value = 0.000. Additional data sources: U.S. Department of Energy (www.eia.gov/beta/state/), 2012 Statistical Abstract of the United States, Table 233, NOAA National Climate Data Center (www.currentresults.com/Weather/US/average-annual-state-temperatures.php).

⁴¹ The difference in the means is statistically significant at the 1% level. For the more free states, mean = 37.038, s = 124.918, n = 175. For the less free states, mean = 16.541, s = 26.548, n = 175.

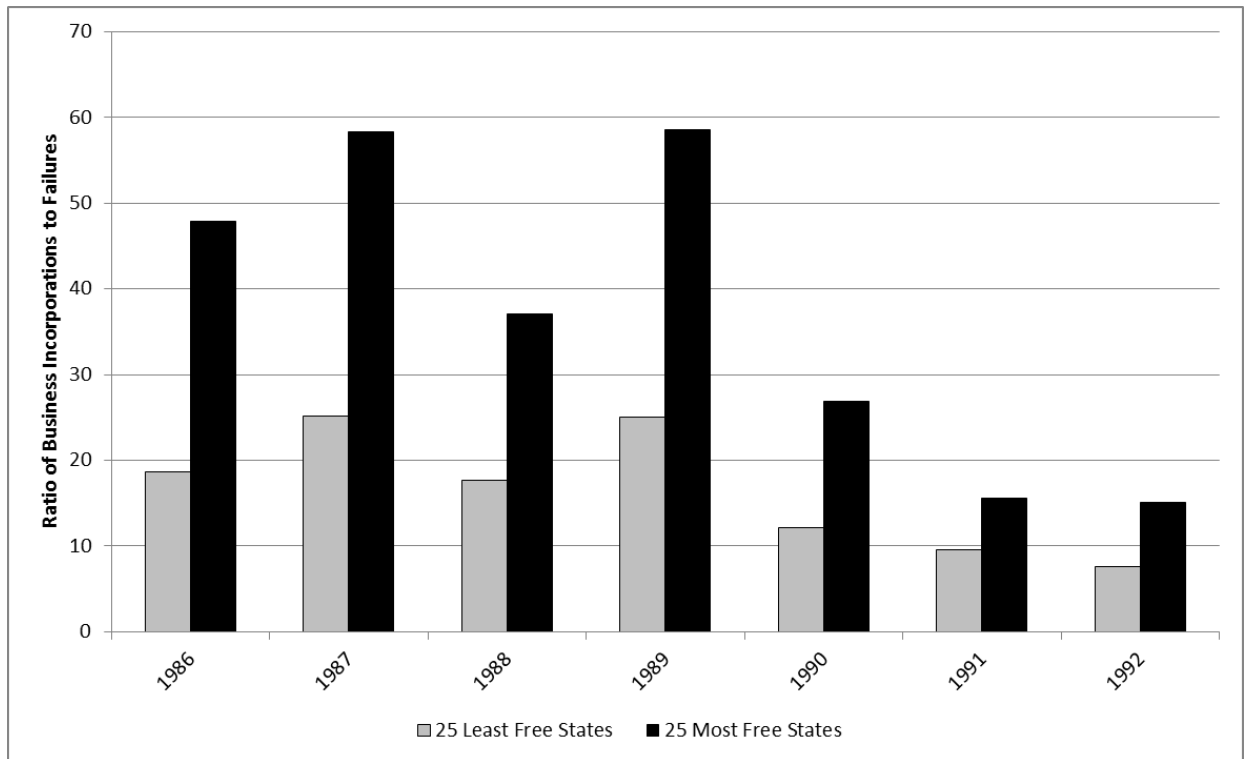


Figure 12. Ratio of business incorporations to business closures for the least and more free states as measured by the EFNA index.⁴²

From 2003 to 2008, the ratio of business births to deaths was 1.7 for the more free states and 1.4 for the less free states.⁴³

⁴² Data source: Census Bureau, Statistical Abstract of the United States, 1989 Table 864, 1990 Table 864, 1991 Table 864, 1992 Table 846, 1993 Table 862, 1994 Table 847, 1998 Table 878, 1999 Table 885, 2000 Table 876, 2006 Table 745, 2007 Table 744, 2008 Table 741, 2009 Table 742, 2010 Table 748, 2011 Table 766; Ashby, Bueno, and McMahon, Economic Freedom of North America 2011, Fraser Institute.

⁴³ The difference in the means is statistically significant at the 10% level. For the more free states, mean = 1.714, s = 1.971, n = 250. For the less free states, mean = 1.439, s = 1.149, n = 250.

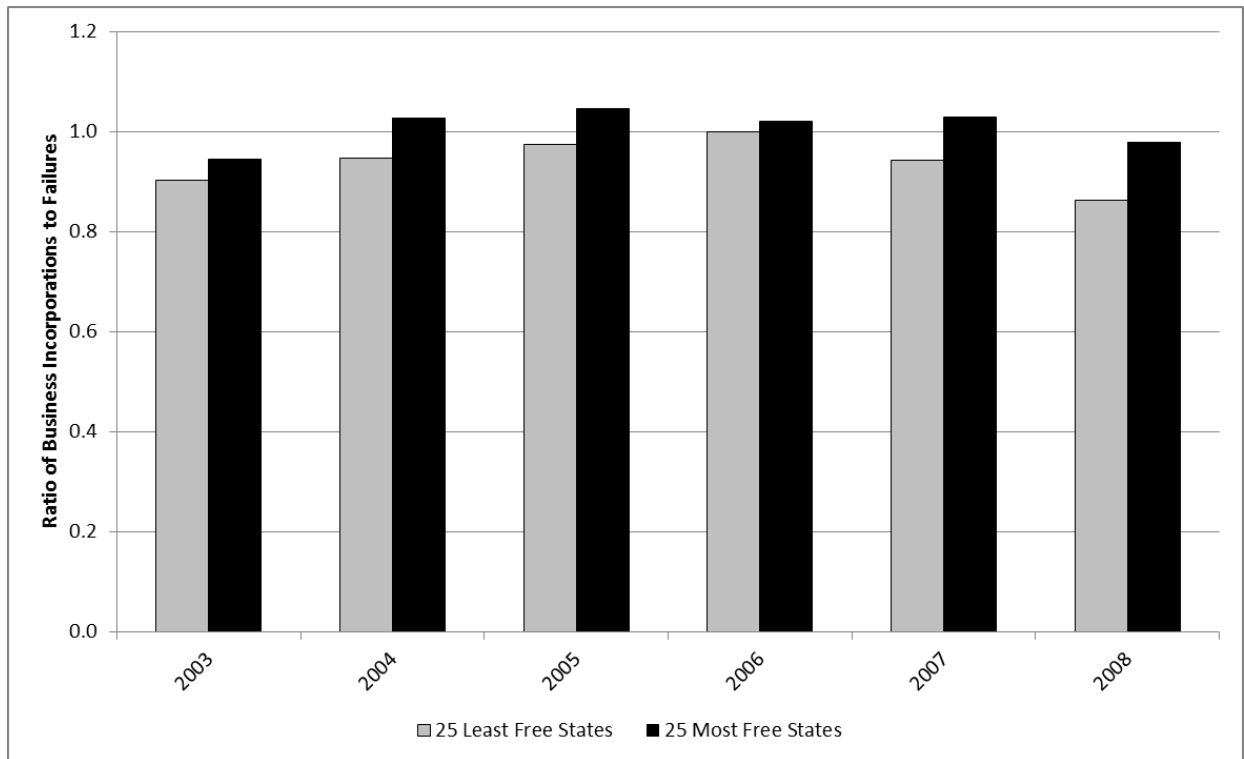


Figure 13. Ratio of business births to business deaths for the least and more free states as measured by the EFNA index.⁴⁴

B: Growth in State GDP⁴⁵

If state and local governments in the more free states collect a smaller share of the economy in tax revenue, then spending in those states would also be more constrained. And if the general Keynesian observation that state and local governments enhance aggregate demand,

⁴⁴ Data source: Census Bureau, Statistical Abstract of the United States, 1989 Table 864, 1990 Table 864, 1991 Table 864, 1992 Table 846, 1993 Table 862, 1994 Table 847, 1998 Table 878, 1999 Table 885, 2000 Table 876, 2006 Table 745, 2007 Table 744, 2008 Table 741, 2009 Table 742, 2010 Table 748, 2011 Table 766; Ashby, Bueno, and McMahon, *Economic Freedom of North America 2011*, Fraser Institute.

⁴⁵ In a separate analysis, we controlled for climate, education, natural resources (as proxied by energy production), size of state populations relative to the national population, and state specific fixed effects. A cross-section fixed effects panel data OLS regression of state GDP growth on EFNA, mean temperature, percentage of the population with a bachelors degree, energy production as a fraction of total U.S. energy production, state population as a fraction of total U.S. population, and change in the relative population yields the following results: Observations = 1000, $R^2 = 0.43$, D.W. = 2.14, EFNA coefficient = 0.009, EFNA p-value = 0.000. Additional data sources: U.S. Department of Energy (www.eia.gov/beta/state/), 2012 Statistical Abstract of the United States, Table 233, NOAA National Climate Data Center (www.currentresults.com/Weather/US/average-annual-state-temperatures.php).

which in turn should drive economic growth, then GDP growth in those more free states should be lower. But this is not the case. Average annual GDP growth among the more free states is a full percentage point higher than for the less free states. Over the period 1986 through 2009, the economies of the more free states grew at an average nominal rate of 5.8% versus 4.8% for the less free states.⁴⁶ A state economy that grows one percentage point faster per year will, over the course of a decade, end up 10% larger than it would otherwise. For the average state, this is the equivalent of an additional \$30 billion in economic activity.

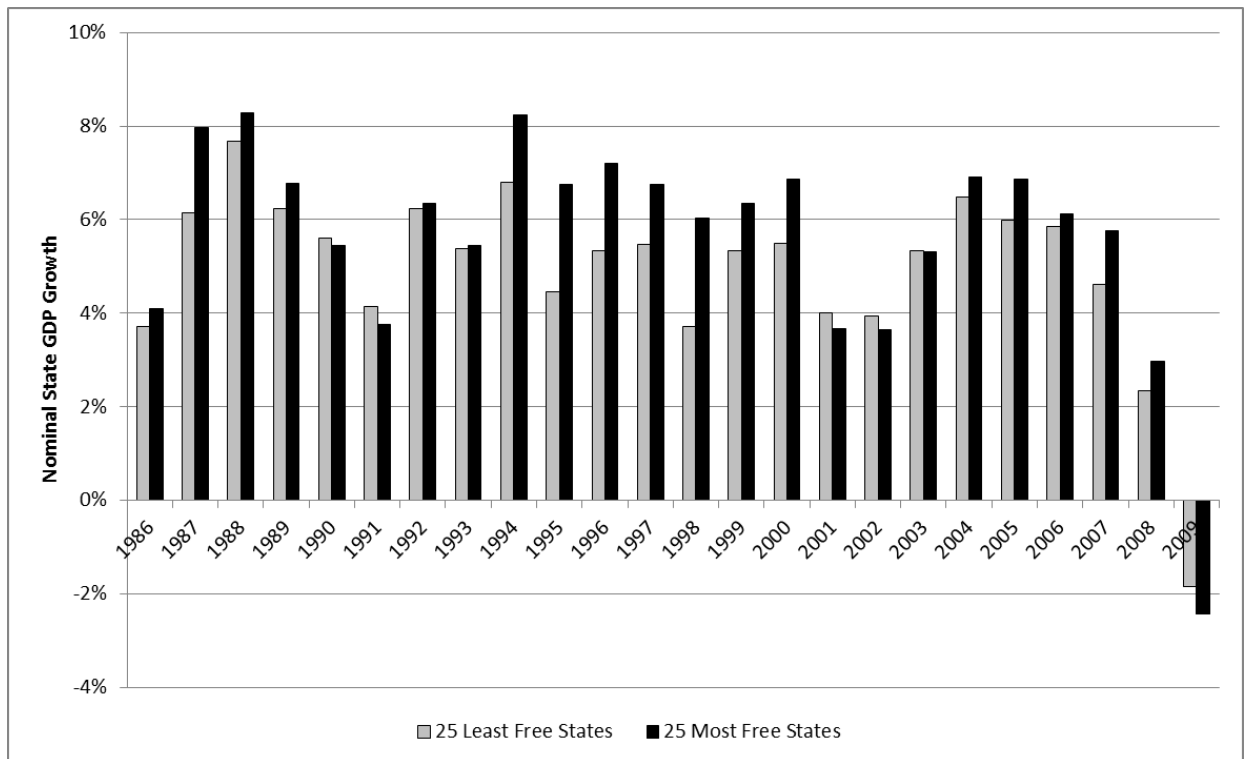


Figure 14. State GDP growth for the least and more free states as measured by the EFNA index.⁴⁷

⁴⁶ The difference in the means is statistically significant at the 1% level. For the more free states, mean = 0.058, s = 0.034, n = 600. For the less free states, mean = 0.048, s = 0.036, n = 600.

⁴⁷ Data source: Bureau of Economic Analysis, GDP and Personal Income Regional Data (www.bea.gov/iTable/iTable.cfm?ReqID=70&step=1); Ashby, Bueno, and McMahon, Economic Freedom of North America 2011, Fraser Institute. Revenue data from missing years is interpolated.

Prosperity

Given the randomness of time, place, circumstances of birth, and specific events, economic freedom is the best approximation of equality of opportunity humans can hope to achieve. Across time and across states, data show that more economic freedom is correlated with improved socioeconomic outcomes. That is, economic freedom and prosperity tend to go hand-in-hand. And this prosperity is not limited to the rich but permeates all strata of society. In the presence of economic freedom, median incomes are higher, unemployment is lower, poverty is lower, the likelihood of being uninsured is lower, the public fisc is more sound, and entrepreneurship is more robust. Even if this were all that economic freedom had to offer, we would be hard pressed to justify trading off this bounty for greater equality of outcome. Yet the data also show that economic freedom goes hand-in-hand with greater income equality. This is not to say that economic freedom somehow promotes equality of outcome. So long as people are born with different talents and under different circumstances, economic freedom will guarantee inequality of outcome. What the data do suggest, however, is that economic freedom promotes less inequality of outcome than do systems that repress economic freedom. Where practical economic choices are concerned, what matters is not the comparison of economic freedom to the ideal, but to the alternative. According to the data, the alternative to economic freedom not only attains less equality of opportunity, it also attains less equality of outcome and a lower level of outcome.