

ECONOMIC FREEDOM IN AMERICA'S 50 STATES

A 1999 ANALYSIS

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THE CROSS-SECTIONAL VARIATION IN CERTAIN ASPECTS OF ECONOMIC FREEDOM ACROSS THE 50 STATES OF THE UNITED STATES

The Wealth of the States

There are an uncountably many ways to measure the elusive concept of economic freedom. One man's freedom is another man's burden. We all know the story, "Your freedom to swing your fist stops at my chin." We have no interest or even the capacity to resolve this philosophical puzzle. It doesn't have a solution. Our task is more humble and well specified. How do certain measurable elements of the human condition, namely the "right to truck and barter" vary within the United States? And, do these measurable qualities bear any relation to economic growth, capital formation, and movement of the citizens across the states?

We start this effort by collecting data on a wide range of economic variables. A note is in order. To most professional economists, economics is about all of human behavior. So the right to contract for the services of a prostitute is an economic event. Similarly, the right to consume marijuana is an economic choice, regularly delimited by the monopoly police power of the state. But as the biologist Garrett Hardin (1971) has observed, "freedom on the commons brings ruin to all." Hardin may be right or wrong, and surely it depends on how you define freedom and rights, and that was his point. So while most would readily assert that laws limiting an individual's prerogative to drink and drive on public roads are reasonable and welfare improving, we simply avoid this debate here. It is not our goal or purpose.

Our Methods

We have attempted to quantify some, but by no means all, of the restrictions on economic activity. In all we have collected data on about 200 various forms of activity. Armed with these we intend to create relative measures of economic freedom across the states of the United States. We will call these indexes of economic freedom.¹

Categories of Limits on Economic Freedom

¹ Some might contend that we have collected *too much* data. That overlaps between variables make it unnecessary to look under every rock. While we have no argument with this position, we believe our thorough approach allows us to find subtleties that might otherwise go unnoticed.

Taxation

The first step in index construction is to identify the types of indicators needed for the index. Taxes are obvious. Taxes are used to redistribute wealth, to fund public goods projects, to discourage entry into competitive markets, and to discourage the purchase of some particular good, to name a few uses. In general taxes distort the market, interfere with trade, discourage enterprise, and affect some prices. Whatever the purpose of the tax, it represents a government confiscation of private resources and is therefore a violation of economic freedom as the term is used here.

Regulation

Regulatory legislation affects the ability to freely truck and barter. Regulatory legislation may attempt to conserve natural resources or set standards for employment and worker safety. The economic theory of regulation promulgated by Stigler (1971) and Peltzman (1976) holds that economic regulation bestows favors on choice groups through direct subsidies of the group's business or activities, by raising barriers to entry and competition, imposing differential costs, by trying to affect the substitutes and complements of the group's product, or by fixing minimum prices. Whatever the purpose of regulatory legislation, it represents a restriction on the use and allocation of private resources and is therefore a violation of economic freedom.

Litigation

The ability of individuals in a polity to seek legal redress for wrongs and torts committed against them is a fundamental right. But the system for redress need neither be efficient, fair, or effective. If the structure of a state's judiciary system is such that it encourages frivolous law suits and presents abnormally large awards that overcompensate harmed parties, then the assets of private individuals or entities are unnecessarily exposed to higher risks of confiscation and redistribution. This is a violation of economic freedom. However, the ability to have grievances addressed creates economic freedom. A high incidence of civil litigation may not be entirely a reflection of frivolous and freedom hindering lawsuits. It may also be an indication that the judicial system is working to protect the individual, maybe even from abuses encouraged by legislation. It is difficult to decide if tort reform is an appropriate measure of protection of economic freedom simply because it may inhibit the pursuit of a just suit. A balancing act is at play here.

Communalism

The portion of a state's consumption and production that is publicly—democratically—allocated can be a useful measure of the freedom of

individuals in the polity. As a simple example, a state run telephone company divorces the citizens in the realm from direct control over some of their choices. In order to set prices, affect capital spending, and the like, telephone users have to become informed, coalesce, lobby, and vote. With private telephone systems, citizens are one step closer to choices, picking between alternative vendors directly without the necessity of registering and voting. Thus we assert that the fraction of total state income that runs through the political process is another, bold indicator of individual economic freedom.²

Conscription

Mandatory activities are indicators of economic freedom because they restrict the use of private resources and time.³ Mandatory schooling is a good example of this category because it affects so many citizens. States and localities where school choice is permitted, where a voucher system is in place, where restrictions on home-schooling are few, and where there is a good supply of private schools to compete with public schools, offer relatively more economic freedom for the citizens of that state.

Cash Transfers

Expenditures on social welfare programs are indicators of the violation of economic freedom. These expenditures help quantify the extent that a government is directly engaged in the direct redistribution of income. It is not a concern for the question of economic freedom whether or not these programs serve other purposes. They are violations of economic freedom because they are funded by the confiscation of private assets. Private charity, by contrast, is a manifestation of economic freedom.

Table 2.1
Creating the Decile Categories

State	State and Local Tax Revenue per capita, 1992	Rank	Decile	State and Local Tax Revenue per capita, 1994	Rank	Decile
<i>Alaska</i>	\$3,841	1	10	\$3,253	3	10
<i>New York</i>	\$3,532	2	10	\$3,858	1	10
<i>Connecticut</i>	\$3,059	3	10	\$3,447	2	10
<i>New Jersey</i>	\$2,938	4	10	\$3,213	4	10

² This category makes obvious the extreme difficulty in measuring economic freedom. There is a close link between taxes and state government spending. Our taxonomy is not meant to be clean, neat, and without controversy. There is a great deal of correlation between our base measures of freedom. Later, we will attempt to disentangle some of this confusion.

³ Again, caution is in order. Collectives such as private clubs, building associations, land covenants, and other freely entered contracts can and do restrict certain activities. We do not see these as a loss of freedom. Yet others might.

<i>Hawaii</i>	\$2,924	5	10	\$3,203	5	10
<i>Massachusetts</i>	\$2,552	6	9	\$2,841	6	9
<i>Minnesota</i>	\$2,473	7	9	\$2,733	7	9
<i>Delaware</i>	\$2,348	8	9	\$2,492	14	8
<i>Maryland</i>	\$2,336	9	9	\$2,666	9	9
<i>California</i>	\$2,335	10	9	\$2,409	17	7
<i>Wyoming</i>	\$2,330	11	8	\$2,518	12	8
<i>Washington</i>	\$2,326	12	8	\$2,598	10	9
<i>Wisconsin</i>	\$2,319	13	8	\$2,702	8	9
<i>Vermont</i>	\$2,287	14	8	\$2,486	15	8
<i>Rhode Island</i>	\$2,234	15	8	\$2,506	13	8
<i>Illinois</i>	\$2,202	16	7	\$2,478	16	7
<i>Pennsylvania</i>	\$2,187	17	7	\$2,344	20	7
<i>Michigan</i>	\$2,173	18	7	\$2,530	11	8
<i>Maine</i>	\$2,154	19	7	\$2,359	18	7
<i>New Hampshire</i>	\$2,105	20	7	\$2,196	27	5
<i>Oregon</i>	\$2,092	21	6	\$2,264	24	6
<i>Nevada</i>	\$2,044	22	6	\$2,351	19	7
<i>Iowa</i>	\$2,025	23	6	\$2,296	22	6
<i>Arizona</i>	\$2,022	24	6	\$2,139	30	5
<i>Colorado</i>	\$2,021	25	6	\$2,244	25	6
<i>Nebraska</i>	\$2,014	26	5	\$2,291	23	6
<i>Virginia</i>	\$1,989	27	5	\$2,166	29	5
<i>Kansas</i>	\$1,958	28	5	\$2,310	21	6
<i>Ohio</i>	\$1,937	29	5	\$2,206	26	5
<i>Florida</i>	\$1,922	30	5	\$2,185	28	5
<i>Texas</i>	\$1,860	31	4	\$2,026	35	4
<i>Georgia</i>	\$1,832	32	4	\$2,117	32	4
<i>North Carolina</i>	\$1,812	33	4	\$2,113	33	4
<i>New Mexico</i>	\$1,789	34	4	\$2,100	34	4
<i>Indiana</i>	\$1,785	35	4	\$2,123	31	4
<i>Idaho</i>	\$1,778	36	3	\$1,955	37	3
<i>Montana</i>	\$1,766	37	3	\$1,954	38	3
<i>North Dakota</i>	\$1,758	38	3	\$2,025	36	3
<i>Kentucky</i>	\$1,755	39	3	\$1,931	39	3
<i>Utah</i>	\$1,699	40	3	\$1,899	40	3
<i>Missouri</i>	\$1,665	41	2	\$1,864	41	2
<i>West Virginia</i>	\$1,657	42	2	\$1,843	43	2
<i>Louisiana</i>	\$1,651	43	2	\$1,723	47	1
<i>Oklahoma</i>	\$1,632	44	2	\$1,852	42	2
<i>South Carolina</i>	\$1,584	45	2	\$1,806	44	2
<i>South Dakota</i>	\$1,559	46	1	\$1,797	45	2
<i>Arkansas</i>	\$1,514	47	1	\$1,680	48	1
<i>Tennessee</i>	\$1,472	48	1	\$1,765	46	1
<i>Alabama</i>	\$1,436	49	1	\$1,596	50	1
<i>Mississippi</i>	\$1,323	50	1	\$1,657	49	1

Assembling and Organizing the Data

Data for each of these different categories were collected from a variety of sources. Details on these are found in section 4. Once collected, each particular variable was sorted and ranked into deciles by state. The five states with the most restrictive magnitudes for each indicator receive a score of ten, the next five states receive a

score of nine, and so on until the five least restrictive states are assigned a score of one.

An Example

Consider the example of the per capita state and local tax revenue indicator. The five states with the highest per capita tax revenues received a score of ten, the five states with the next highest per capita tax revenues received a score of nine, and so on until the five states with the lowest per capita tax revenues received a score of one. Table 2.1 lists the outcome of this rank ordering for 1992 and 1994.

To illustrate, at the top, the states of Alaska down through Hawaii, are the top five for state and local tax revenue per capita. Each of these states receives 10 points on the freedom index for this category. And similarly each of the states receives its score on all of the categories we measured.⁴

The decile scoring system has advantages and disadvantages in this application. It may lump together dissimilar entities, but it removes some subjective evaluation on our part. Its most useful feature is that it does not attempt to be more precise than the data actually are.

Organizing Categories

Armed with these decile delineations, there are a number of options for formulating an index. The first is simply to average the decile scores of all the indicators for every state, so that each state has one score between one and ten. Another way is to separate the indicators into sectors, average the decile scores for the indicators in each category to obtain a single score between one and ten for each sector, then average the sector scores together to obtain a score between one and ten for each state. This implicitly introduces weighting into the index. An indicator in a sector with only nine total indicators carries more weight than an indicator in a sector with sixty-seven total indicators.

There is no obviously correct way to divide the indicators into sectors, but we choose to group the indicators into five sectors. The first, the *fiscal* sector, is composed mainly of taxes. The second, the *regulatory* sector, is composed of regulatory legislation and data on mandatory participation programs (schools). The third, the *judicial* sector, is composed of indicators of the litigiousness of the judicial system, and the level of tort reform undertaken by a state. The fourth, the *government size* sector, is composed of indicators of the size of government. The last, the *welfare spending* sector, is composed of data on government spending on welfare programs.

⁴ Washington D.C. was excluded from the analysis due to a lack of compatible information.

While there is a sense of subjectivity here, this approach has the salutary effect of being able to identify those areas where a state's policies are relatively restrictive of economic freedom and those which are not. For instance, California has a high score in the regulatory legislation category, indicating a good deal of infringement upon economic freedom through regulations. Yet California fares differently in the judicial category, warranting one of the lowest scores for this category in the index and indicating a possible relatively high level of protection of private assets from frivolous lawsuits.

Weighting the Indicators and Categories

Another subjective issue in the construction of an index is the question of how to weight the indicators or sectors of indicators. One method is to weight each indicator equally. This raises some interesting questions. Is the fact that a state has or has not instituted tort reform as important to individuals as whether or not the state has high personal income tax rates? Is the licensing requirement for chiropractors as important as the law requiring state agencies to purchase recycled ink? The egalitarian method of weighting the indicators equally would say yes. There is the potential that this method will result in a situation where many minor indicators obscure the major indicators. However, it can also be considered the most fair way to weigh the indicators since it essentially admits that no one really knows how important the various indicators really are.

An alternative to the egalitarian method is to introduce weights based on our considered opinion. This is implicitly done, as noted above, when the indicators are grouped into sectors, and the sector scores produce the final index score. If one wants to reproduce the egalitarian results but still retain the sectors, then the sector scores can be calculated without using them to determine the final outcome of the index. Subcategories, within the sectors can also be created. In this manner, instead of a sector score being the average of the decile scores of sixty indicators, the sector score will be the average of the scores of ten subcategories of indicators. One could also choose to explicitly weight the subcategories within the sectors, and/or explicitly weight the sectors themselves. The possibilities are endless.

There are two objective methods of weighting the indicators. One is to use a statistical method known as principle components analysis to weight the indicators by the variances in the indicators. Another is to weight the indicators by regression coefficients produced by regression on an instrumental or hedonic variable. This technique has the feature that the regression coefficient of the freedom indicator on the instrumental variable (perhaps growth of per capita disposable income) measures the implicit value assigned to each attribute. We use principle components analysis.

Results of Index Construction

The foregoing discussion implies many choices for a single index. Indeed, in other work we have created as many as forty-eight indexes. However, for our purposes here we have chosen to use a single powerful index, the one based on principle components analysis. Principle components analysis removes subjectivity from the analysis and offers us a bias free approach to weighting the index. In the end, 27 percent of the weight in the index goes to the fiscal sector, 25 percent to the regulatory sector, 4 percent to the judicial sector, 14 percent to the government size sector, and 30 percent to the welfare spending sector.

In building the raw sector scores, we grouped the individual indicators into several subcategories within each sector, then averaged the subcategory scores to produce the sector scores. This prevents the domination of any one sector by a large group of individual indicators that are a similar. For example some subcategories, such as occupational licensing and education requirements have a lot of available indicators. Some such as school choice indicators have only a few. If the indicator scores were simply averaged to get the sector scores, the occupational licensing and education indicators would destroy the importance of the school choice indicators. This may distort the picture of economic freedom for each state. Our approach here mitigates this effect in all of the categories.

Table 2.2 reports the unweighted sector scores and ranks for each of the fifty states.

Table 2.2
Sector Indexes

	Fiscal		Regulatory		Judicial		Government Size		Welfare Spending	
	Index	Rank	Index	Rank	Index	Rank	Index	Rank	Index	Rank
<i>Alabama</i>	4.20	6	5.51	7	5.27	24	6.17	35	5.22	22
<i>Alaska</i>	5.45	26	5.72	14	4.45	15	7.17	46	7.72	48
<i>Arizona</i>	5.64	30	5.17	4	4.91	21	4.83	13	5.11	21
<i>Arkansas</i>	4.67	13	5.83	20	7.36	45	4.67	12	5.33	24
<i>California</i>	5.94	36	7.01	48	5.73	27	5.83	29	6.11	37
<i>Colorado</i>	4.48	9	5.13	2	3.09	1	5.00	19	4.67	12
<i>Connecticut</i>	8.04	50	6.12	29	5.82	29	3.83	4	7.00	45
<i>Delaware</i>	5.95	37	5.60	9	7.18	43	3.83	6	5.00	18
<i>Florida</i>	4.85	17	6.43	39	3.45	5	5.00	18	6.22	38
<i>Georgia</i>	3.65	1	5.92	26	4.14	14	4.67	11	4.78	14
<i>Hawaii</i>	6.39	45	5.17	3	4.73	19	5.33	22	6.89	42
<i>Idaho</i>	5.23	20	5.19	5	3.91	9	5.17	21	2.44	1
<i>Illinois</i>	5.54	27	6.30	32	4.91	20	4.17	8	6.89	43

<i>Indiana</i>	3.87	2	5.91	25	5.64	26	5.00	17	4.89	16
<i>Iowa</i>	5.80	34	6.68	43	4.00	11	6.00	31	4.06	6
<i>Kansas</i>	5.19	19	5.72	17	3.27	2	6.00	33	4.11	7
<i>Kentucky</i>	4.74	15	6.17	31	4.64	17	5.33	23	5.78	33
<i>Louisiana</i>	4.58	11	6.40	37	6.45	35	6.00	30	6.56	41
<i>Maine</i>	6.22	41	7.36	49	7.09	41	5.83	28	6.39	40
<i>Maryland</i>	5.71	31	6.65	42	6.64	38	3.83	5	6.00	35
<i>Massachusetts</i>	6.32	42	6.87	47	7.64	47	3.83	3	6.89	44
<i>Michigan</i>	5.43	24	5.89	24	5.36	25	5.83	26	5.67	32
<i>Minnesota</i>	6.81	48	6.35	34	4.45	16	6.50	39	5.61	30
<i>Mississippi</i>	4.44	8	5.47	6	4.64	18	6.00	32	5.11	20
<i>Missouri</i>	4.02	4	5.88	23	3.27	3	4.17	9	5.61	31
<i>Montana</i>	6.37	44	5.70	12	4.09	13	7.33	48	4.89	15
<i>Nebraska</i>	5.36	23	5.85	22	6.05	32	7.17	47	3.22	3
<i>Nevada</i>	5.73	33	6.35	33	6.73	39	2.33	2	5.44	26
<i>New Hampshire</i>	5.60	29	5.67	11	4.00	10	2.17	1	4.89	17
<i>New Jersey</i>	6.62	47	6.48	40	4.09	12	5.50	24	7.67	47
<i>New Mexico</i>	5.36	22	6.40	36	6.64	37	6.67	43	5.56	29
<i>New York</i>	6.33	43	6.85	46	5.09	22	8.17	50	9.33	50
<i>North Carolina</i>	5.43	25	5.72	15	7.64	49	4.50	10	4.78	13
<i>North Dakota</i>	5.35	21	5.59	8	3.36	4	7.50	49	5.33	25
<i>Ohio</i>	5.73	32	6.41	38	3.64	7	6.17	37	6.00	36
<i>Oklahoma</i>	4.89	18	6.02	27	6.45	33	6.67	42	4.44	8
<i>Oregon</i>	6.15	40	7.38	50	3.45	6	6.83	44	5.44	27
<i>Pennsylvania</i>	6.09	39	6.11	28	7.91	50	5.67	25	7.44	46
<i>Rhode Island</i>	7.31	49	6.57	41	7.55	46	5.83	27	8.56	49
<i>South Carolina</i>	4.22	7	5.66	10	6.00	31	6.67	41	4.67	11
<i>South Dakota</i>	4.68	14	5.05	1	5.09	23	4.83	15	4.56	9
<i>Tennessee</i>	4.56	10	5.72	16	6.91	40	5.00	16	5.56	28
<i>Texas</i>	4.77	16	6.69	44	5.73	28	5.17	20	4.56	10
<i>Utah</i>	4.64	12	5.84	21	3.73	8	6.33	38	2.67	2
<i>Vermont</i>	5.85	35	6.12	30	6.00	30	6.00	34	5.28	23
<i>Virginia</i>	4.01	3	5.76	18	6.45	36	4.00	7	3.33	4
<i>Washington</i>	6.00	38	6.73	45	6.45	34	7.00	45	6.00	34
<i>West Virginia</i>	5.54	28	6.35	35	7.18	44	6.50	40	6.33	39
<i>Wisconsin</i>	6.49	46	5.70	13	7.64	48	6.17	36	5.11	19
<i>Wyoming</i>	4.03	5	5.77	19	7.09	42	4.83	14	3.89	5

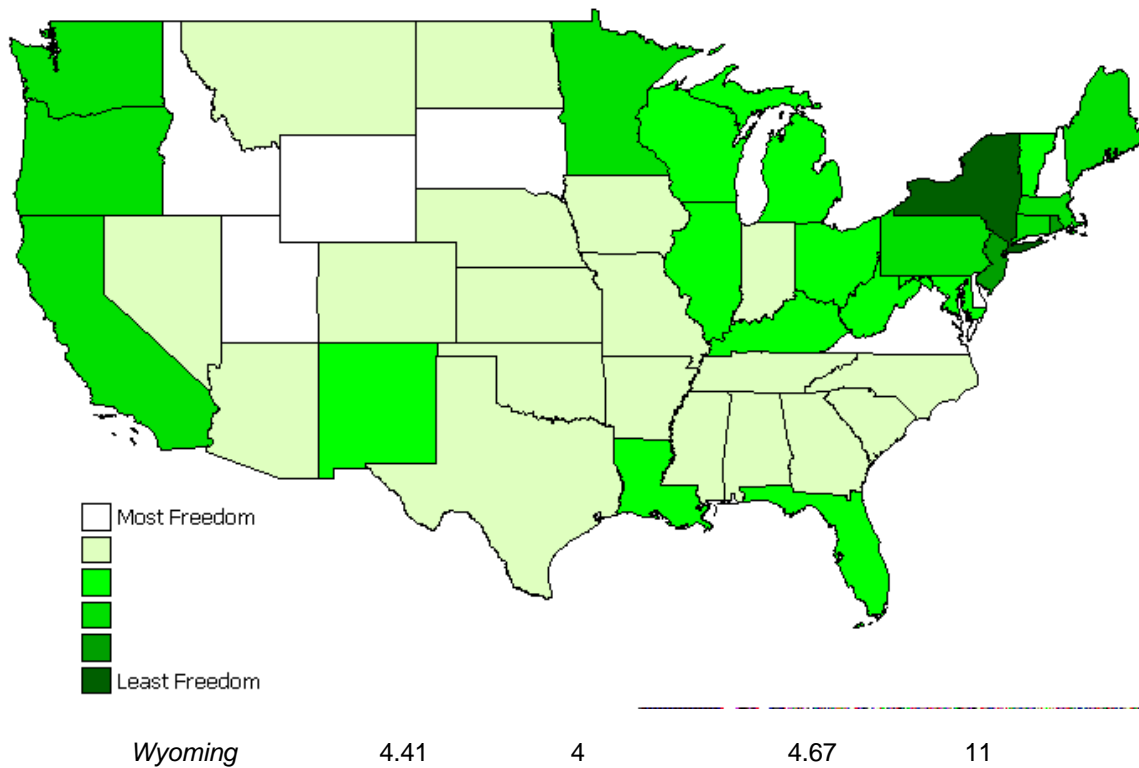
The Index

Table 2.3 reports the value of the freedom index using principle components for each state. Sorted by rank, Idaho has the greatest amount of freedom and New York, the least.

Table 2.3
The Freedom Index

State	Principle Components		Composite Index		Rank correlation
	Index	Rank	Index	Rank	
Alabama	4.73	11	4.4	4	0.955
Alaska	6.01	38	5.52	34	
Arizona	5.19	25	4.82	18	
Arkansas	4.83	15	4.75	14	
California	6.39	44	6.33	43	
Colorado	4.77	14	4.58	8	
Connecticut	6.66	46	6.52	48	
Delaware	4.56	7	4.64	9	
Florida	5.45	30	4.91	19	
Georgia	4.76	12	4.36	2	
Hawaii	6.08	39	5.63	35	
Idaho	3.92	1	4.22	1	
Illinois	5.95	36	5.51	33	
Indiana	5.02	22	5.11	24	
Iowa	5.11	24	5.35	31	
Kansas	4.71	10	4.8	17	
Kentucky	5.38	29	5.11	23	
Louisiana	5.48	31	5.21	26	
Maine	6.22	42	6.38	45	
Maryland	5.77	35	5.75	37	
Massachusetts	6.71	47	6.46	47	
Michigan	5.32	27	5.27	28	
Minnesota	6.38	43	6.33	42	
Mississippi	4.70	9	4.51	7	
Missouri	4.76	13	4.69	12	
Montana	5.20	26	5.27	29	
Nebraska	5.03	23	5.32	30	
Nevada	4.99	20	4.95	21	
New Hampshire	4.55	6	4.47	6	
New Jersey	6.84	48	6.43	46	
New Mexico	5.33	28	5.26	27	
New York	7.90	50	7.22	50	
North Carolina	4.91	17	5.02	22	
North Dakota	5.00	21	4.94	20	
Ohio	5.54	33	5.4	32	
Oklahoma	4.93	18	5.14	25	
Oregon	6.20	41	6.34	44	
Pennsylvania	6.53	45	6.23	41	
Rhode Island	7.00	49	6.74	49	
South Carolina	4.85	16	4.76	15	
South Dakota	4.47	5	4.37	3	
Tennessee	4.95	19	4.79	16	
Texas	4.62	8	4.7	13	
Utah	4.32	3	4.67	10	
Vermont	5.59	34	5.86	38	
Virginia	4.08	2	4.43	5	
Washington	6.19	40	6.13	39	
West Virginia	5.50	32	5.65	36	
Wisconsin	5.98	37	6.18	40	

Figure 2.1
The Freedom Index



Southern and Western states dominate at the top of the ranking while Northeast and Pacific Coast states rank at the bottom. For purposes of completeness and comparison, we have included the average of the 48 indexes we constructed. While we feel that the Principle Components Index in column two is the best one overall, as it comes from the principle components analysis, the average index also conveys information.

Figure 2.1 displays the freedom index in map form for the continental United States. This visual perspective reveals distinct regional patterns in economic freedom across the country.

Now we provide an economic snapshot of each of the states with some details on the economic freedom index for each of them. We then turn our attention to an analysis of the overall value and scientific usefulness of this approach. The analysis reported in section 4 attempts to link the index with various measures of state

economic health, for instance, population in-migration and growth of income. This exercise helps assess the usefulness and validity of the index construction.

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