# Another Look at Economic Freedom

Typically, when I talk about "economic freedom" and how West Virginia compares to the rest of the country, I am referring to the Economic Freedom of North America Report, published annually by the Fraser Institute. Economic freedom is a difficult concept to quantify; we know that freer states exhibit stronger growth, but how exactly does one put a number to it? The Fraser Institute's rankings are on a scale of ten; does a higher marginal income tax rate balance out a business environment with low regulation? Do lower sales taxes fully compensate for the lack of Right to Work laws? If not, exactly how much do we modify the rankings? Clearly, it's not an easy process, but the idea is to see the forest from the trees and to get a general feel for which states are getting it right relative to those who are not.

As such, it is fruitful to have as many measures as possible to try and capture economic freedom. Recently, the American Legislative Exchange Council (ALEC) released a publication called "Rich States, Poor States" that compares the fifty states through what they call the ALEC-Laffer State Economic Competitive Index. By looking at sixteen separate variables, from assorted tax levels to state-level spending, minimum wages to educational freedom, the report then ranks states by their economic outlook, a forward-looking measure that gives a glimpse into each state's prospects for a stronger economy in the future as things currently sit. Out of fifty states, West Virginia ranks 40th; not our typical doormat position, but still far from ideal.

The report identifies a number of areas particularly harmful to West Virginia's economic outlook. West Virginia ranks 43rd in personal income tax progressivity. As West Virginians make more money, an increasingly higher percentage of their income is taken in taxes. This creates the incentive to earn less; naturally, this does not lead to good economic outcomes. Our much maligned state liability system ranks at the bottom of the country. ALEC also puts forth what they call an "Education Freedom Index," or the degree to which market-based reforms are prevalent within the state's education system and the ease by which parents can pursue alternatives to public schooling. West Virginia is 47th in this regard.

(West Virginia does, however, rank somewhat favorably—18th—in average worker's compensation costs, which brings up my article from two weeks ago. I received an email from an employee at Brickstreet immediately following the publication of my article on July 25 concerning the privatization of West Virginia's worker's compensation system; all figures put forth in the article are accurate, though there was one minor error. Brickstreet is a mutual company, which means that the policyholders are actually the owners of the company. I referred to Brickstreet's "shareholders" and, as written, the term is technically incorrect. My apologies for the oversight.)

As useful as the rankings are, the concisely written introduction about the role of the government in state economic growth is equally as valuable; I encourage you to head to the ALEC website, www.alec.org, and read the report for yourself.

The study also puts forth a story that should be mandatory reading for our state's legislators. As the 1990s progressed, New Mexico found its income per capita falling in comparison to the rest of the country; in 1994, their income per capita ranked 26th in America, yet by 2000, New

Mexico was 43rd, and remained at that level for the next half of the decade. (This position should be familiar to West Virginians.) Seeking economic growth, as every state does, New Mexico took a decidedly pro-market approach towards their future—they reduced their highest income tax rate by over three percentage points, and cut the state's capital gains tax in half. The results were unmistakable; despite the reduction in tax rates, tax *revenues* grew faster than any other state in the nation. Revenues generated through taxation are the product of tax rates and the tax base; in this case, the tax base is amount of income earned by New Mexicans and capital gains realized. The revenue increase New Mexico experienced points directly to a sizeable gain in tax base—a gain large enough to overcome the drop in tax rates. The lower taxes encouraged business to set up shop in New Mexico. "After all," noted governor Bill Richardson, "businesses move to states where taxes are falling, not rising."

Many legislators and pro-tax supporters feel that lowering tax rates reduces the "state's money." Firstly, tax money is nobody's but the citizens of West Virginia from whom it was taken; there is no "state's money." Nonetheless, the argument of lower taxes necessarily leading to less tax revenue is simply wrong. (Arthur Laffer, co-author of the study mentioned in this piece, is best known for investigating the relationship between tax rates and tax revenues.) Legislators' fears of fewer funds to allocate should taxes be lowered, though misguided, are grounded in a very real political reality; remember, it is being able to secure funding for their constituencies that, at least partially, helps keep them in office. But pro-tax commentators that lament the loss of "state's money" due to a lowering of tax rates have no such excuse for defending their erroneous position; after all, they stand to lose out on future economic growth along with the rest of us due to keeping our tax rates high.

As economist Murray Rothbard once noted, economic ignorance is no character flaw, but being outspoken about economic issues while unknowledgeable about them is. I could wish nothing more upon the supporters of a larger government within West Virginia, or maintenance of the status quo, than the discipline of economics.

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