The SIZZLE of ECONOMIC FREEDOM

How Economic Freedom Helps You and Why You Should Demand More

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January 2009

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Acknowledgements

We thank our colleagues at the Pacific Research Institute (PRI) Lance T. Izumi, John R. Graham, and Vicki E. Murray for their suggestions regarding studies in education and health care that we should examine.

We also thank Dr. Benjamin Powell, assistant professor of economics and senior economist at the Beacon Hill Institute, Suffolk University, Boston, Massachusetts, and Dr. Russell S. Sobel, professor of economics and James Clark Coffman Distinguished Chair in Entrepreneurial Studies, West Virginia University, Morgantown, West Virginia, for their formal peer review of this study. We are responsible solely for any remaining errors or omissions.

Our views and conclusions do not necessarily represent those of the board, supporters, or staff of PRI.

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Executive Summary

Freedom lovers have long tried to win converts—and especially voters—by appealing to first principles of classical liberalism embraced by the Founding Fathers: above all, the inalienable right of an individual to chart the course of his own life. This approach has had limited success, because most Americans do not feel unfree. Instead of selling the freedom steak, perhaps a better approach would be to sell the freedom sizzle: all the secondary benefits that flow from greater economic freedom.

Economic freedom is the right of individuals to pursue their interests through voluntary exchanges of private property under the rule of law. This freedom forms the foundation of market economies. The premise of this report is simple: Most Americans do not realize what the restrictions on their economic freedom are costing them. Americans would likely demand more economic freedom, and be willing to pay a higher price to achieve it, if they knew about the benefits that would flow to them in return.

Because of advances in research, there is now a large body of scholarship that has quantified the benefits of economic freedom to individuals and to civil society generally. This report describes in easy-to-understand language the benefits of more economic freedom and the costs of imposing more restrictions on free enterprise and consumer choice.

The benefits of greater economic liberty include:

- Higher personal income
- Less unemployment
- Faster economic growth
- More macroeconomic stability
- Greater capital investment and productivity
- More business startups
- More entrepreneurship and innovation
- A better-educated workforce
- Less poverty and inequality
- Better health
- Greater population inflows
- A cleaner environment
- Better quality of life
- More democracy and peace

The benefits of greater economic freedom are sweeping and substantial for individuals and societies. In the future, Americans might still vote for restrictions on economic freedom, but this study will allow them to cast educated votes. They will know what they are losing through having less economic freedom and what they would gain from having more economic freedom. The price of infringements on economic freedom is substantial, though often not easily or immediately seen by citizens, voters, and taxpayers—or by their lawmakers. This does not mean the costs are any less real. Understanding the trade-offs is especially important in a slowing economy, when jobs are scarcer and incomes are falling.

I. Selling the Sizzle of Economic Freedom

There is an old adage in marketing that "you don't sell the steak, you sell the sizzle," meaning it is the ancillary benefits of a product that lead people to buy it, not the obvious core features. A toothpaste manufacturer is not selling you clean teeth; it is selling you more friends and a better social life. A cell phone company is not selling you better reception; it is selling you a better quality of life.

Freedom lovers have long tried to win converts—and especially voters—by appealing to first principles of classical liberalism embraced by the Founding Fathers: above all, the inalienable right of an individual to chart the course of his own life. This approach has had limited success, because most Americans do not feel unfree.[1] Instead of selling the freedom steak, perhaps a better approach would be to sell the freedom sizzle: all the secondary benefits that flow from greater economic freedom.

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Because of advances in research, there is now a large body of scholarship that has quantified the benefits of economic freedom. This report describes in easy-to-understand language the benefits of more economic freedom to individuals and to civil society generally and the costs of imposing more restrictions on free enterprise and consumer choice. The failed economic policies in recent years of the Bush administration, the U.S. Congress, and many state legislatures, notably California's, demonstrate why this study is vitally needed. In the future, Americans might still vote for restrictions on economic freedom, but this study will allow them to cast educated votes. They will know what they are losing through having less economic freedom and what they would gain from having more economic freedom. Understanding the trade-offs is especially important in a slowing economy, when jobs are scarcer and incomes are falling.

II. What Is Economic Freedom?

Americans are very familiar with the concepts of political freedom and religious freedom because they study these concepts thoroughly in school, beginning in first grade. Few Americans, on the other hand, understand the concept of economic freedom, let alone its importance to American society and its contribution to America's high standard of living.

Economic freedom is the right of individuals to pursue their interests through voluntary exchanges of private property under the rule of law. This freedom forms the foundation of market economies. Apart from a minimal level of government intervention needed to provide safety and a stable legal foundation for exchanges of private property, legislative or judicial actions that inhibit this right reduce economic freedom. Government actions that advance this right increase economic freedom.

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In a nutshell, economic freedom is the right of an individual to own what he earns and choose how to use his income; to produce what he wants in accordance with his own values; and to compete in product and labor markets of his choosing, subject to the restriction that he cannot use force or fraud to further his interests. Clearly, this definition of economic liberty is in the tradition of the Founding Fathers' conception of a free and just society and in line with the writings of classical liberals going back to Adam Smith, who argued that humans' natural propensity to "truck, barter, and exchange" will maximize social welfare.[2]

The level of economic freedom varies from one country to another and from one U.S. state to another based on government policies. Greater economic freedom allows businesses and individuals to make decisions that best promote their well-being. The best places to start a new business, find a new job, or climb up the economic ladder are in countries or U.S. states with the fewest regulatory body blocks and fiscal obstacles, everything else considered.

III. Who Measures Economic Freedom and How Is It Done?

Four indexes regularly measure economic freedom—specifically, how friendly or unfriendly government policies are toward free enterprise and consumer choice—and some of the world's top social scientists have used these indexes in statistical studies to explain economic and social phenomena.[3] Since 1995, the Heritage Foundation in Washington, D.C., and the *Wall Street Journal* have partnered to co-publish the *Index of Economic Freedom*.[4] In its 2008 report, the index measures how well 162 countries score on a list of variables divided into 10 categories of freedom: business freedom (few regulatory hurdles), trade freedom (low tariffs), fiscal freedom (low tax burden), government size, monetary freedom (price stability), investment freedom (few capital controls), financial freedom (private banks), property rights, freedom from corruption, and labor freedom (worker choice).

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The Fraser Institute in Vancouver, British Columbia, and the Cato Institute in Washington, D.C., have co-published an annual report since 1996 titled *Economic Freedom of the World*.[5] It is an effort to measure objectively economic freedom around the world. The latest version of the report (2007) looks at 141 nations and examines 42 variables designed to identify the compatibility of institutional arrangements and policies with economic freedom in five areas: size of government; legal structure and protection of property rights; access to sound money; international exchange; and regulation of credit, labor, and business.

The main factor that both indexes take into account is the institutional environment of a country in terms of market openness and government intervention in economic activities. Of course, the variation across nations is much greater than the variation across U.S. states. The U.S. Constitution provides the fundamental framework for social and economic activities in America, which results in some conformity, though it also leaves room for states to decide many issues. Two indexes directly measure economic freedom in the 50 U.S. states.

The first study ever to accomplish this task is the *U.S. Economic Freedom Index*, published by PRI in association with *Forbes* magazine.[6] This index, first published in 1999 by State Policy Network under the title *Eco-*

nomic Freedom in America's 50 States, was updated in 2004 and 2008 by PRI. It examines 143 indicators of economic freedom across all 50 states and ranks the states accordingly. Each indicator is put into one of five sectors: fiscal, regulatory, judicial, government size, and welfare spending.

Last, the Fraser Institute has published an annual report since 2002 titled *Economic Freedom of North America*.[7] It measures economic freedom in the 10 Canadian provinces, 50 U.S. states, and 31 Mexican states. The Fraser index is based on 10 variables in three areas: size of government, takings and discriminatory taxation, and labor-market freedom. Each area is weighted equally, and each variable within each area is weighted equally. We believe that the PRI index is better because it is based on more variables and weights the data in a more reasonable manner.

Each of these four indexes is a tool to measure economic freedom, specifically government regulatory and fiscal obstacles in people's daily lives. Measurement is the first step to understanding, and understanding is required for reasoned discussion and sound reform. In addition to these four core indexes, other studies measure micro aspects of economic freedom such as the extent of school choice. Some of these studies are referenced below.

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It is hoped that with the help of research that measures economic freedom and studies its effects, people will learn the important imprint economic freedom makes on the economic and political fabric and will work for new laws to preserve and strengthen economic freedom for all people across the United States and around the world.

The present study examines the link between economic freedom and people's daily lives so that we will begin to have a greater understanding of the important effect economic freedom, or the lack thereof, has on all of us, whether we realize it or not. Unless people understand the benefits of economic freedom, they are unlikely to demand more of it or be willing to pay a higher price to achieve it.

IV. The Benefits of Greater Economic Freedom

Greater economic freedom brings many benefits to individuals and to civil society generally. Some benefits are visible and easy to quantify, while other benefits are hidden and difficult to measure. This section briefly discusses the best scholarly studies that have measured the benefits of economic freedom in 14 different dimensions.

When deciding which studies to highlight, we chose the most recent and academically rigorous peer-reviewed studies in the top academic journals whenever possible. Preference was also given to studies that were most consistent with the prevailing consensus view of top researchers who have examined these factors.[8] For a list of other relevant studies that were not highlighted in this paper, visit PRI's website at www.pacificresearch.org and view the Suggested Further Reading list.

Let's begin by looking at the benefits of more economic freedom in terms of people's incomes.

Higher personal income

One of the best-documented relationships in the literature is the connection between economic freedom and personal income. With fewer restrictions on workers and businesses, labor and other resources are channeled into their most productive uses. Low tax rates also spur workers to put in more hours, and they encourage increased investment in tools and equipment that enhance productivity. Economists are very confident that, other things being equal, greater economic freedom leads to higher personal income.

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Steve H. Hanke and Stephen J. K. Walters provide an overview of various approaches to quantifying economic freedom.[9] The various rankings of countries are similar, but not identical, because each approach gives different weights to the various components of economic freedom. Hanke and Walters next took five of the most popular indexes of economic freedom, and took their scores for the year 1996 for 29 countries common to all five surveys. Standard regression analysis showed that a given country's economic freedom score has significant influence on its per-capita output. In particular, Hanke and Walters found that for a representative country such as New Zealand, a 10-percent increase in economic freedom leads to an increase in per-capita income of between 7.4 percent and 13.6 percent, depending on which freedom index is used.

In a more technical paper, Stephen T. Easton and Michael A. Walker took the standard economic growth model—which assumes that output is produced by labor, capital, and technology—and added in "economic freedom" as a separate input.[10] When calibrating the new model with data from 59 countries, Easton and Walker found that changes in economic freedom are just as important as changes in physical investment, schooling, and workforce growth, when trying to explain differences in long-run income levels among countries. In fact, they found that a one-standard-deviation change in freedom corresponds to an increase of more than $1,500 in average annual income.

Less unemployment

A freer economy has less distorted prices and greater profit incentives to minimize idle resources, especially idle workers. Horst Feldmann looked at whether and to what extent economic freedom affects labor unemployment.[11] After examining the experience of 87 countries during a 24-year period, he found that expanded economic freedom substantially reduces unemployment, especially among women and young people. A small government sector and a legal system characterized by an independent judiciary, impartial courts, and effective protection of property rights have the most beneficial effect in reducing unemployment. Free trade and few regulations lower unemployment in the long run.

Expanded economic freedom substantially reduces unemployment, especially among women and young people.

In a separate study looking only at industrial countries, Feldmann confirms the above finding that a large government sector increases unemployment.[12] It has a particularly detrimental effect on women and the low-skilled, and substantially increases long-term unemployment. Feldmann controlled for other factors such as the impact of the business cycle and the impact of all major labor market institutions and unobserved country effects.

Faster economic growth

One of the most robust findings in the literature is that economic freedom promotes not only higher incomes but also higher *growth rates* in output and income.[13] This is especially important for developing countries, which are starting at a very low initial level of economic output. It is also important for the poorest members of relatively advanced countries, because when economies expand, it is easier for the unemployed to find work, and for workers in unattractive occupations to land more attractive jobs.

Economic freedom promotes not only higher incomes but also higher *growth rates* in output and income.

An excellent representative study was conducted by Julio H. Cole, who looked at 106 countries during a 20-year period.[14] Cole found that the policy measures used by the Fraser and Cato Institutes' *Economic Freedom of the*

World had significant explanatory power across competing theories of economic growth. In other words, Cole looked at the factors that different groups of economists believe are important for economic growth and showed that adding the factor of "economic freedom" sheds more light on which countries grow faster than others.

The connection between economic freedom and growth has been documented both at the international level and at more regional levels. The most recent edition of *Economic Freedom of North America* shows that growth in per-capita GDP is linked to a U.S. state's freedom score, and that the pattern also holds for Canada's provinces and Mexico's states.[15] Specifically, the report finds:

> A 1.00% increase in the growth rate of economic freedom at the all-government level (e.g., from 4.00% per year to 4.04% per year) will induce an increase of 1.08% in the growth rate of per-capita GDP for U.S. states and an increase of 0.60% in the growth rate of per-capita GDP for Canadian provinces. A 1.00% increase in the growth rate of economic freedom at the subnational level will induce an increase of 0.77% in the growth rate of per-capita GDP for U.S. states and [a] 0.57% increase in the growth rate for Canadian provinces.

Brent M. Eastwood used PRI's *U.S. Economic Freedom Index* to examine the impact of greater state economic freedom on local economic growth, measured by total employment growth and total personal income growth in 272 U.S. cities from 2000 through 2004.[16] He found that greater state economic freedom resulted in stronger growth in jobs and incomes for the nation's cities.

Greater state economic freedom resulted in stronger growth in jobs and incomes for the nation's cities.

One explanation for these findings is that greater economic freedom encourages more efficient allocation of resources. For example, fewer resources are devoted to the unproductive activity of acquiring political favors from the state and are instead devoted to satisfying customers with new and better products at lower prices.

More macroeconomic stability

As the housing-related financial crisis has demonstrated, there is more to a strong economy than just long-run economic growth rates. It is also very desirable to have *balanced* growth, where incomes rise steadily over years, rather than a volatile boom-bust cycle. Reducing the volatility in growth rates, and ensuring stability in the price level, lets businesses engage in longer-term projects, and lets individuals better plan for their future expenses, whether those involve funding a child's education or saving for retirement.

The literature shows that freer economies produce more and better products for their citizens and also achieve this with more balance and stability over time. In other words, people living in freer societies tend to be richer *and* more secure in their wealth. Lino Briguglio et al. analyzed a group of small nations, which naturally must rely more on international trade and hence are more vulnerable to external shocks to their economies. Relying on policy measures used by the Fraser and Cato Institutes' economic freedom index, the authors found that the prosperity of a small nation was more dependent on its government's policies than on natural factors.[17] In other words, although small economies are vulnerable to external shocks such as changes in the world prices of their main exports, nonetheless the institution of secure property rights and low tariffs can more than offset these natural disadvantages. The prosperity of Hong Kong and Singapore attests to this finding.

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Ludovic Comeau reached similar conclusions when contrasting the poor economic performance of Latin American countries with the much stronger performance of East Asian countries during the 1970s and 1980s. He found that policies "adopted by governments, particularly to control inflation and foreign indebtedness and to enhance economic freedom and human capital accumulation, appear crucial for stability."[18]

Greater capital investment and productivity

Capital flows to regions and industries that offer the highest after-tax rate of return and least risk. Greater economic freedom enhances both factors through lower tax rates and greater stability of property rights and political environments. James D. Gwartney, Randall G. Holcombe, and Robert A. Lawson looked at the impact of economic freedom on both the level and the productivity of investment for 94 countries during a 21-year period.[19] Countries with more economic freedom have both higher levels of private investment and higher productivity of that investment. Specifically, the productivity of private investment, measured as the impact of investment on growth, was 74 percent greater in countries with high levels of economic freedom.

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Marshall L. Stocker shows that this higher productivity translates into higher returns to investors.[20] He studied the relationship between economic freedom and equity market returns and found that the rate of increase in economic freedom is directly related to equity returns and that an investment strategy based on economic freedom earned attractive investment returns.

Marta Bengoa-Calvo and Blanca Sánchez-Robles explored whether economic freedom influences foreign direct investment flows.[21] They examined the experience of 18 Latin American countries and found that greater economic freedom in the host country increases foreign direct investment inflows. Foreign direct investment is also positively correlated with economic growth in the host country; however, the host country must have adequate human capital, economic stability, and liberalized markets to benefit from long-term capital inflows.

Greater economic freedom in the host country increases foreign direct investment inflows.

More business startups

A sign of a healthy and dynamic economy is the formation of new businesses. Greater economic freedom makes it easier for entrepreneurs to start new businesses, add new jobs to the economy, and for the new businesses to survive and thrive.

Noel D. Campbell and Tammy M. Rogers examined whether the level of economic freedom among the states affects entrepreneurial activity as measured by net business formation.[22] Specifically, they contend that more state economic freedom will increase the net change in the number of businesses as a percentage of total businesses in the state.

They concluded from their statistical analysis that "consistent with our expectations, we find that there is a strong positive relationship between economic freedom in a state and net business formation, after controlling for state population, income, median age, federal intergovernmental revenue, minority percentage in the population, and commercial lending."[23]

Similarly, Russell S. Sobel looked at the impact of economic freedom on various measures of productive entrepreneurship. He found that greater state economic freedom increases venture capital investment per capita, patents per capita, the growth rate of sole proprietorships, and business establishment birth rates. He concluded: "As the evidence presented here makes clear, states with policies consistent with economic freedom encourage higher levels of productive entrepreneurial activity. . . . [E]ntrepreneurship serves as the conduit between economic freedom and economic prosperity. That is, economic freedom is correlated with income and growth *because* economic freedom promotes productive entrepreneurship, which is the underlying source of economic growth."[24]

More entrepreneurship and innovation

Economists have long recognized the connection between entrepreneurship and economic prosperity. Entrepreneurs are the engines of the market economy by providing new jobs, products, and services. Because of this, some state and local governments try to enact policies that will encourage entrepreneurship, including such typical measures as providing venture capital funding and other items required by new businesses.

Steven F. Kreft and Russell S. Sobel turn this conventional analysis on its head.[25] Using U.S. state-level data, they apply statistical tests to demonstrate that it is entrepreneurial activity—measured by new sole proprietorships and patents for new products—that leads to venture capital investment, rather than vice versa. In other words, Kreft and Sobel find that if a state has entrepreneurs, venture capital will come to them automatically, without extra prodding from policy makers and discriminatory government subsidies or loans.

Kreft and Sobel next turn to the obvious question of how a state can attract or inculcate entrepreneurship, and their answer is "economic freedom." Even after accounting for other factors such as a state's unemployment rate, percentage of college-educated workforce, and so on, Kreft and Sobel find that a state's level of economic freedom has a significant impact on its growth rate of sole proprietorships. Their conclusion is that states do not need to spend tax dollars on venture funds to stimulate new businesses. On the contrary, a state need only provide the basic framework of economic freedom, and entrepreneurs will thrive naturally, attracting investment in the process.

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A better-educated workforce with parental school choice and school competition

In the area of education, economic freedom means the ability of parents to choose which school their child attends regardless of the geographical area or the school district where the family resides. School-choice options vary greatly, from charter schools to private schools to voucher programs to geographical-area choice.

After conducting an exhaustive survey of the research, Herbert J. Walberg wrote: "it may be confidently concluded that school choice generally works better than public school monopolies."[26] Three studies give a flavor of the effects. Jay P. Greene developed an Education Freedom Index to measure the level of school choice in all 50 states.[27] He found that a one-point increase in the index scale (more education freedom) produced a 24-point increase on the Scholastic Aptitude Test and a 5.5-percent increase in the number of students performing proficiently on the National Assessment of Educational Progress. School choice increased both student aptitude and achievement.

Jay P. Greene, Paul E. Peterson, and Jiangtao Du studied Milwaukee's public voucher program and found that children who received vouchers through a lottery scored six percentile points higher on reading tests and 11 percentile points higher on math tests than did lottery losers.[28] Further, Stanford University economist Caroline M. Hoxby found that Milwaukee children who did not receive vouchers still benefited because voucher school competition forced neighboring schools to improve. She concluded: "In every subject, achievement grew most in the schools that faced the most voucher competition."[29] School choice and competition raise student achievement dramatically.[30]

School choice and competition raise student achievement dramatically.

Walter Y. Oi argues that human capital is a consequence of economic growth, not a cause, and that economic freedom allows the best chance for economic growth to occur.[31] Human capital is the stock of skills and knowledge embodied in people enabling them to perform labor so as to produce economic value.

Less poverty and inequality

Some critics of free markets concede that it is an engine of prosperity, cranking out more goods and better services than rival systems. But these critics allege that free markets shower the lion's share of benefits on the rich and powerful, leaving behind vulnerable groups such as the poor, minorities, and women. This claim is simply false.

Members of unpopular racial minorities have the greatest chance for success in a decentralized system, where they need find only one fair employer who will pay them based on their merit. After all, if a society really does harbor widespread racism against minorities, then clearly the worst thing to do is allow *majority rule* to determine economic outcomes.

Similarly, groups that traditionally are economically disadvantaged, including women, can best succeed in an environment where businesses are free to make whatever hiring decisions they wish, but where these businesses will also enjoy the profits—or suffer the losses—from their actions. Government programs to assist the poor and to eliminate discrimination carry unintended consequences that actually end up hurting the very groups they are supposedly helping. A casual inspection of housing projects or inner-city public schools confirms this observation.

U.S. states with greater economic freedom have less income inequality.

Empirical studies confirm these generalizations. Regarding poverty, the most recent edition of *Economic Freedom of North America* shows that those U.S. states with higher economic freedom scores tend to have higher per-capita incomes and lower poverty rates.[32] Nathan J. Ashby and Russell S. Sobel also found that U.S. states with greater economic freedom have less income inequality, after controlling for other factors.[33]

On the international level, Gerald Scully recently looked at 26 countries including newly industrializing Asian nations and found that freer countries have "more equal economies; economic freedom reduces inequality by increasing the share of market income going to the poor and lowering the share going to the rich."[34] At first, Scully's conclusion might sound impossible, until one remembers that the gap between the elite and the average person is highest in authoritarian countries. Furthermore, there is a growing body of literature showing that foreign aid per se does not help poor countries grow out of poverty, unless these countries embrace economic freedom.[35]

Empirical studies have also shown that women do relatively better with greater economic freedom. In a recent paper, Terry Miller looked at international data and found a strong correlation between a country's score on the Heritage Foundation/Wall Street Journal's *Index of Economic Freedom* and its score on the UN's measure of "gender equality."[36]

Better health

Free markets deliver superior goods and services to consumers at lower prices, and this truism applies to health care as much as it applies to apples or personal computers. In the debate over health care, advocates for consumer choice point to the long waiting lists for common procedures in countries with "free" health care, and they describe how government programs actually inflate costs. Rather than focusing on particular policies,[37] however, in the present survey we seek overarching patterns connecting economic freedom with desirable outcomes such as better health.

In a recent paper, Michael Stroup examined more than 100 countries to assess the connections among economic freedom, political liberties, and various measures of health such as life expectancy at birth, childhood mortality rate, and the percentage of two-year-olds who have received certain vaccinations.[38] Stroup found that greater economic freedom improved these measures of health, as well as other standard indicators of well-being, such as literacy rates.

For those countries suffering from the worst government oppression, the basic health of their citizens would be boosted more by gaining more secure property rights than by gaining democratic voting rights.

Stroup also found that for countries starting at low levels of both economic and political freedom, a given increase in their economic freedom was six times more effective in increasing the inoculation rate among infants, and twice as effective in reducing childhood mortality rates. His results suggest that for those countries suffering from the worst government oppression, the basic health of their citizens would be boosted more by gaining more secure property rights than by gaining democratic voting rights.

Greater population inflows

More economic freedom makes a country or state a more attractive place to live and work. This increases population inflows and reduces population outflows, bringing much-needed new consumers, workers, investors, and entrepreneurs to regions with greater economic freedom.

Nathan J. Ashby has shown that states with higher relative economic freedom experience greater migration inflow because of the direct impact of economic freedom on increasing income and job opportunities. Ashby found that individuals migrate to states with relatively lower tax burdens and to states with more freedom with respect to labor decisions in the form of lower minimum wages, less union concentration, and less dependence on public employment.[39]

Lawrence J. McQuillan, Michael T. Maloney, Eric Daniels, and Brent M. Eastwood report in PRI's *U.S. Economic Freedom Index* that for every 1,000 people in the 20 states with the most economic freedom, there has been a net gain of 27 new people since 2004.[40] In the same period, the 20 least free states gained only 1 person per 1,000. People are fleeing the most economically oppressed states to live in the states offering more friendly state-government policies toward free enterprise and consumer choice. This migration also has an impact on the political map through its effect on congressional apportionment. For example, current projections have California losing a seat in the U.S. House of Representatives after the 2010 census because of the mass exodus from the Golden State.

A cleaner environment

Although many activists believe there exists a trade-off between economic growth and environmental quality, in reality there is no conflict. As societies grow richer, they can afford the luxury of switching to production techniques that minimize pollution. As noted by Steven F. Hayward, author of PRI's *Index of Leading Environmental Indicators*, "the affluent society does not want to be the effluent society."[41] Moreover, private property rights give owners of natural resources the ability and incentive to engage in sustainable development practices. Many economists argue that endangered animals would best be protected through private ownership; after all, nobody worries about cows going extinct. Environmentalist organizations typically espouse a very anti-capitalist position, yet ironically some of the most egregious examples of pollution and overdevelopment have occurred under communist governments.

Although many activists believe there exists a trade-off between economic growth and environmental quality, in reality there is no conflict.

Michael Stroup assessed environmental quality in the wealthy OECD countries by looking at conventional measurements of air and water pollution, as well as carbon dioxide (greenhouse gas) emissions, and then compared the results to each country's index scores on economic and political freedom. Stroup also controlled for each country's per-capita income, population, urbanization, and industry composition. He found that both measures of freedom—economic and political—improved a country's environmental score. Increases in economic freedom, however, were more potent than increases in political rights, leading Stroup to conclude that poor countries (outside his sample of OECD countries) wishing to achieve economic growth with the lowest impact on their environment should focus on liberalizing their economies, rather than reforming democratic institutions.[42]

In an earlier study, Brett D. Schaefer found a strong correlation between countries' scores on the Heritage Foundation/Wall Street Journal's *Index of Economic Freedom* and the "Environmental Sustainability Index," a composite of 21 indicators of environmental stewardship developed by the Yale Center for Environmental Law and Policy and two other groups.[43]

Better quality of life

Greater economic freedom allows an individual to chart more fully the course of his own life, achieving greater satisfaction. The literature confirms this result. Tomi Ovaska and Ryo Takashima looked at whether more economic freedom affects people's

The freedom to make economic decisions that are consistent with personal preferences increases one's self-perceived level of well-being and happiness.

self-perceived level of well-being.[44] The researchers used two different measures of well-being—happiness and life satisfaction—both of which come from a survey database managed by the Erasmus University in the Netherlands. They found that economic freedom consistently turned out to be statistically significant in determining people's level of well-being. The freedom to make economic decisions that are consistent with personal preferences increases one's self-perceived level of well-being and happiness.

More evidence is provided by Alfredo G. Esposto and Peter A. Zaleski, who analyzed the effect of economic freedom on the quality of life as measured by life expectancy and literacy rates.[45] The researchers found that greater economic freedom both enhances the quality of life as measured across nations at a point in time and it increases improvements in the quality of life over time.

More democracy and peace

People in the United States are more focused on international issues than probably at any other time since World War II. Thus, it seems important to discuss studies showing how economic freedom promotes peace, security, and democracy.

Anthony B. Kim demonstrated a positive relationship between economic freedom, measured by the *Index of Economic Freedom*, and democratic governance (political freedom), measured by the Economist Intelligence Unit's democracy index.[46] W. Ken Farr, Richard A. Lord, and J. Larry Wolfenbarger believe greater economic freedom causes more political freedom indirectly through the positive effect of economic freedom on economic well-being.[47] (In other words, in the parlance of economists, democracy and good governance are "normal goods.")

There is also evidence that in developing countries more democracy (political freedom) results in more economic freedom. People initially use their newfound political freedom to expand economic opportunities.[48]

Also, it is now abundantly clear that greater economic freedom promotes peace and security. Eric Gartzke examined the relationship between economic freedom and international disputes and concluded: "economic freedom significantly decreases the probability that a country will experience a dispute."[49] He also found that democracies are not more peaceful than other forms of government if one first takes into consideration the peace-inducing effects of economic freedom.

Finally, John A. Tures looked at the level of conflicts within countries from the 1970s through the 1990s. He examined the impact of economic freedom on the reduction of conflict and concluded: "the major lesson from our study is that economic freedom promotes peace. Consequently, the more a government erodes economic liberties, the greater the likelihood that a severe crisis or war will erupt."[50] An unfree country is more than three times as likely to have an internal conflict as a free country. A prosperous country that respects property rights is much less inclined to steal wealth or wage war internally or with other countries.

V. Why You Should Demand More Economic Freedom: Summary and Conclusion

Most Americans do not realize what the costs are of restricting economic freedom or what the benefits would be of expanding economic freedom. Americans would likely demand more economic freedom, and be willing to pay a higher price to achieve it, if they knew about the benefits that would flow to them in return. Table 1 on page 22 summarizes the sweeping and substantial benefits to individuals and to societies from greater economic freedom. The table is essentially a menu of trade-offs facing voters and lawmakers when they consider making legislative changes that will affect the level of economic freedom.

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Expanding economic freedom will result in more of these good effects. Restricting economic freedom comes at the price of these good effects. The table shows that there is no free lunch in public policy; everything comes with a price tag. The price of limiting economic freedom is real and substantial, but not always apparent or easily understood by citizens, voters, and taxpayers, or by lawmakers. This table clearly reveals the high cost of suppression of economic freedom and the big gains over time from greater economic liberty.

Table 1: Summary of the Benefits of Greater Economic Freedom

Higher personal income	Higher incomes for workers and entrepreneurs, comparable to the benefits from increases in investment or education.
Less unemployment	Substantially reduces unemployment, especially among women, young people, and the low-skilled. Substantially decreases long-term unemployment.
Faster economic growth	When countries or states increase their economic freedom, they experience faster economic growth.
More macroeconomic stability	Shields a country from external shocks and helps it avoid international crises.
Greater capital investment and productivity	Countries with more economic freedom have both higher levels of private investment and higher productivity of that investment—74 percent higher. Greater economic freedom in the host country increases foreign direct investment inflows. A higher rate of increase in economic freedom increases equity market returns to investors.
More business startups	A more dynamic economy because of greater net business formation and increases in venture capital investment per capita, new product patents per capita, the growth rate of sole proprietorships, and business establishment birth rates.
More entrepreneurship and innovation	Promotes entrepreneurship and innovation, without the need for government subsidies or loans. Venture capitalists step in.
A better-educated workforce with parental school choice and school competition	School choice increases both student aptitude and achievement. Students using vouchers scored six percentile points higher on reading tests and 11 percentile points higher on math tests than did students without vouchers. Vouchers improve student achievement even for students without vouchers because they force schools to compete.
Less poverty and inequality	Reduces poverty and inequality between rich and poor as well as between men and women.
Better health	Longer life expectancy at birth, lower childhood mortality rates, and greater vaccination rates. Economic freedom improves health more than political freedom for the most oppressed countries.

Greater population inflows	Greater inflows of people to a country or state, resulting in much-needed new consumers, workers, investors, and entrepreneurs.
A cleaner environment	Economic freedom creates greater wealth, allowing people the luxury of "buying" a cleaner environment.
Better quality of life	Increases self-perceived levels of happiness and life satisfaction. Increases the quality of life, as measured by life expectancy and literacy rates, across countries at a point in time, and also increases improvements over time.
More democracy and peace	More economic freedom is associated with more democracy. In developing countries, people initially use political freedom to expand economic liberties. Countries with less economic freedom are more than three times as likely to have an internal conflict as freer countries, and are likelier to have disputes with other countries, including wars.

Greater economic freedom results in more business startups and new products, a better-educated workforce with less unemployment, greater capital investment with rising productivity, faster economic growth over time, and higher and more stable personal incomes. These effects also tend to lower prices, other things being equal. Greater economic freedom also results in less poverty and inequality, better health, a dynamic and growing population, a cleaner environment, better quality of life, and more democracy and peace around the world.

In the future, Americans might still vote for restrictions on economic freedom, but now they can cast educated votes.

In the future, Americans might still vote for restrictions on economic freedom, but now they can cast educated votes. This briefing exposes what they are losing because of less economic freedom and what they would gain from more economic freedom. The price of infringements on economic freedom is substantial, though often not easily or immediately seen. This does not mean the costs are any less real. Voters and lawmakers would be wise to mull this over before approving any further restrictions on economic freedom given the high price, detailed here, of losing economic freedom.

Notes

[1] See David Boaz, "Are We Freer?" *Cato Policy Report* (July/August 2007), p. 2.

[2] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776), online Liberty Fund edition, http://www.econlib.org/LIBRARY/Smith/smWN.html.

[3] We note that there are other, more regionally focused, indexes such as *Economic Freedom of the Arab World*, produced by the Fraser Institute since 2005, and indexes of economic freedom in China's provinces, states of India, Argentina's provinces, European Union countries, and Italy's regions (see http://www.freetheworld.com/regional-other.html). We did not highlight these indexes, either because they are not updated regularly or because there have been no, or few, quality applications of these indexes in the scholarly literature.

[4] http://www.heritage.org/Index/.

[5] http://www.freetheworld.com/release.html.

[6] http://special.pacificresearch.org/pub/sab/entrep/2008/Economic_Freedom/.

[7] http://www.freetheworld.com/efna.html.

[8] We relied on the following survey article for many of the citations: Niclas Berggren, "The Benefits of Economic Freedom: A Survey," *Independent Review* 8, no. 2 (2003), pp. 47–58. We also collected citations from a web page maintained by the Fraser Institute, http://www.freetheworld.com/papers.html; a web page maintained by the Heritage Foundation, http://www.heritage.org/research/tradeandforeignaid/; and the academic journal database JSTOR.

[9] Steve H. Hanke and Stephen J. K. Walters, "Economic Freedom, Prosperity, and Equality: A Survey," *Cato Journal* 17, no. 2 (fall 1997), pp. 117–46.

[10] Stephen T. Easton and Michael A. Walker, "Income, Growth, and Economic Freedom," *American Economic Review* 87, no. 2 (May 1997), pp. 328–32.

[11] Horst Feldmann, "Economic Freedom and Unemployment around the World," *Southern Economic Journal* 74, no. 1 (2007), pp. 158–76.

[12] Horst Feldmann, "Government Size and Unemployment: Evidence from Industrial Countries," *Public Choice* 127, nos. 3-4 (2006), pp. 451–67.

[13] Although there is a consensus that *increases* in economic freedom lead to faster economic growth, some researchers have found that higher *levels* of freedom do not *per se* contribute to faster growth. See, for example, Lee C. Adkins, Ronald L. Moomaw, and Andreas Savvides, "Institutions, Freedom, and Technical Efficiency," *Southern Economic Journal* 69 (July 2002), pp. 92–108; and Jan-Egbert Sturm and Jakob de Haan, "How Robust is the Relationship between Economic Freedom and Economic Growth?" *Applied Economics* 33, no. 7 (June 2001), pp. 839–44.

[14] Julio H. Cole, "The Contribution of Economic Freedom to World Economic Growth: 1980–99," *Cato Journal* 23, no. 2 (fall 2003), pp. 189–99.

[15] See *Economic Freedom of North America: 2008 Annual Report*, executive summary, at http://www.fraserinstitute.org/Commerce.Web/product_files/EconomicFreedomNorthAmerica2008USed.pdf.

[16] Brent M. Eastwood, chapter 4 of *U.S. Economic Freedom Index: 2008 Report*, Lawrence J. McQuillan, Michael T. Maloney, Eric Daniels, and Brent M. Eastwood (San Francisco: Pacific Research Institute, 2008), pp. 43–46.

[17] Lino Briguglio, Gordon Cordina, Nadia Farrugia, and Stephanie Vella, "Economic Vulnerability and Resilience: Concepts and Measurements," in *Building the Economic Resilience of Small States*, Lino Briguglio, Eliawony J. Kisanga, and Gordon Cordina, eds. (Malta: Islands and Small States Institute, and London: Commonwealth Secretariat, 2006), pp. 265–87, http://events.um.edu.mt/resilience2007/papers/briguglio_cordina.pdf.

[18] Ludovic Comeau, "The Political Economy of Growth in Latin America and East Asia: Some Empirical Evidence," *Contemporary Economic Policy* 21, no. 4 (October 2003), pp. 476–89.

[19] James D. Gwartney, Randall G. Holcombe, and Robert A. Lawson, "Institutions and the Impact of Investment on Growth," Kyklos 59, no. 2 (2006), pp. 255–73.

[20] Marshall L. Stocker, "Equity Returns and Economic Freedom," *Cato Journal* 25, no. 3 (fall 2005), pp. 583–94.

[21] Marta Bengoa-Calvo and Blanca Sánchez-Robles, "Foreign Direct Investment, Economic Freedom, and Growth: New Evidence from Latin America," *European Journal of Political Economy* 19, no. 3 (2003), pp. 529–45.

[22] Noel D. Campbell and Tammy M. Rogers, "Economic Freedom and Net Business Formation," *Cato Journal* 27, no. 1 (winter 2007), pp. 23–36.

[23] Ibid., p. 24.

[24] Russell S. Sobel, "Economic Freedom, Entrepreneurship, and Economic Growth at the Subnational Level," chapter 2 of *Economic Freedom of North America: 2008 Annual Report*, Amela Karabegovi and Fred McMahon (Vancouver, B.C.: Fraser Institute, 2008), p. 50.

[25] Steven F. Kreft and Russell S. Sobel, "Public Policy, Entrepreneurship, and Economic Freedom," *Cato Journal* 25, no. 3 (fall 2005), pp. 595–616.

[26] Herbert J. Walberg, *School Choice: The Findings* (Washington, D.C.: Cato Institute, 2007), p. 109.

[27] Jay P. Greene, "Education Freedom Index," Manhattan Institute Civic Report no. 14, September 2000.

[28] Jay P. Greene, Paul E. Peterson, and Jiangtao Du, "School Choice in Milwaukee: A Randomized Experiment," in *Learning from School Choice*, ed. Paul E. Peterson and Bryan C. Hassel (Washington, D.C.: Brookings Institution, 1998), pp. 335–56.

[29] Caroline M. Hoxby, "How School Choice Affects the Achievement of Public School Students," in *Choice with Equity*, ed. Paul T. Hill (Stanford, Calif.: Hoover Institution Press, 2002), p. 150.

[30] It has also been shown that counties with voucher programs have rates of youth entrepreneurship approximately one percentage point higher than counties without voucher programs. Voucher programs foster youth entrepreneurship and influence career paths because of the more business-like, competitive, and innovative environment that students are exposed to in these schools, and because the students see their teachers and school administrators deal with competitive challenges. See Russell S. Sobel and Kerry A. King, "Does School Choice Increase the Rate of Youth Entrepreneurship?" *Economics of Education Review* 27 (2008), pp. 429–38.

[31] Walter Y. Oi, "The Hearty and Cheery State," *Contemporary Economic Policy* 17, no. 1 (January 1999), pp. 138–46.

[32] See the Fraser Institute's *Economic Freedom of North America: 2008 Annual Report*, chapter 2, at http://www.fraserinstitute.org/Commerce.Web/product_files/EconomicFreedomNorthAmerica2008USed.pdf.

33 Nathan J. Ashby and Russell S. Sobel, "Income Inequality and Economic Freedom in the U.S. States," *Public Choice* 134, nos. 3-4 (March 2008), pp. 329–46.

34 Gerald Scully, "Economic Freedom and the Trade-Off between Inequality and Growth," NCPA Policy Report no. 309 (Dallas: National Center for Policy Analysis, March 2008).

35 See, for example, Tomi Ovaska, "The Failure of Development Aid," *Cato Journal* 23, no. 2 (fall 2003), pp. 175–88; and Ian Vásquez, "Official Assistance, Economic Freedom, and Policy Change: Is Foreign Aid like Champagne?" *Cato Journal* 18, no. 2 (fall 1998), pp. 275–86. An even stronger argument against foreign aid is that it actively promotes statism by politicizing economic life and thereby reducing economic freedom. See Benjamin Powell and Matt E. Ryan, "Does Development Aid Lead to Economic Freedom?" *Journal of Private Enterprise* 22, no. 1 (fall 2006), pp. 1–21.

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48 Jakob de Haan and Jan-Egbert Sturm, "Does More Democracy Lead to Greater Economic Freedom? New Evidence for Developing Countries," *European Journal of Political Economy* 19, no. 3 (September 2003), pp. 547–63.

49 Eric Gartzke, "Economic Freedom and Peace," chapter 2 of *Economic Freedom of the World: 2005 Annual Report* (Vancouver, B.C.: Fraser Institute, 2005), p. 34.

50 John A. Tures, "Economic Freedom and Conflict Reduction: Evidence from the 1970s, 1980s, and 1990s," *Cato Journal* 22, no. 3 (winter 2003), pp. 533–42.

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Since joining PRI in 2001, Dr. McQuillan has specialized in tax, budget, regulation, and legal-reform issues. He is coauthor of *Jackpot Justice: The True Cost of America's Tort System* and the 2006 and 2008 *U.S. Tort Liability Index*—these books have reached a combined audience of more than 77 million people. He is also coauthor of both the 2004 and 2008 *U.S. Economic Freedom Index*, published in association with *Forbes* magazine, which ranks the 50 states according to how friendly or unfriendly their state-government policies are toward free enterprise and consumer choice.

McQuillan speaks regularly to civic and policy groups across the country and with the national news media. His television appearances include FOX, NBC News, CNBC, and CNNfn. YouTube hosts some of his interviews. He is a frequent guest on nationally syndicated radio talk shows, including the *Ron Insana Show*, *Roger Hedgecock Show*, and *Jerry Doyle Show*. He counsels governors, legislators, and advocacy groups across the country; provides legislative testimony; and was a member of Governor Arnold Schwarzenegger's task force on a constitutional spending limit for California.

McQuillan has published more than 125 articles in such outlets as the *Wall Street Journal*, *USA Today*, *Forbes*, *Investor's Business Daily*, *National Review Online*, *Los Angeles Times*, *New York Times*, *San Francisco Chronicle*, *Washington Times*, and *The Weekly Standard*. He has written on such topics as tax and spending limits, lawsuit abuse, pensions, workers' compensation, the housing crisis, and economic freedom. His recent writings include "Ambulance Chasers Bad for Our Health," "Make a Bad Mortgage: Take the Hit," and "Live Free or Move."

McQuillan created the quarterly *California Golden Fleece Awards*, exposing fraud and abuse in California government. Cited in *The Nation* and the *Los Angeles Times*, these awards led to the overhaul of the California Victim Compensation Program and helped reform California's workers' compensation system in 2003 and 2004.

From 1998 until 2001, McQuillan was a research fellow at the Hoover Institution, Stanford University, where he specialized in international economics. He edited the book *The International Monetary Fund—Financial Medic to the World?* (translated into Japanese) and wrote the study *The Case against the International Monetary Fund*, which Nobel laureate Milton Friedman reviewed as "excellent."

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About the Pacific Research Institute

The Pacific Research Institute champions freedom, opportunity, and personal responsibility by advancing free-market policy solutions. It provides practical solutions for the policy issues that impact the daily lives of all Americans, and demonstrates why the free market is more effective than the government at providing the important results we all seek: good schools, quality health care, a clean environment, and a robust economy.

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