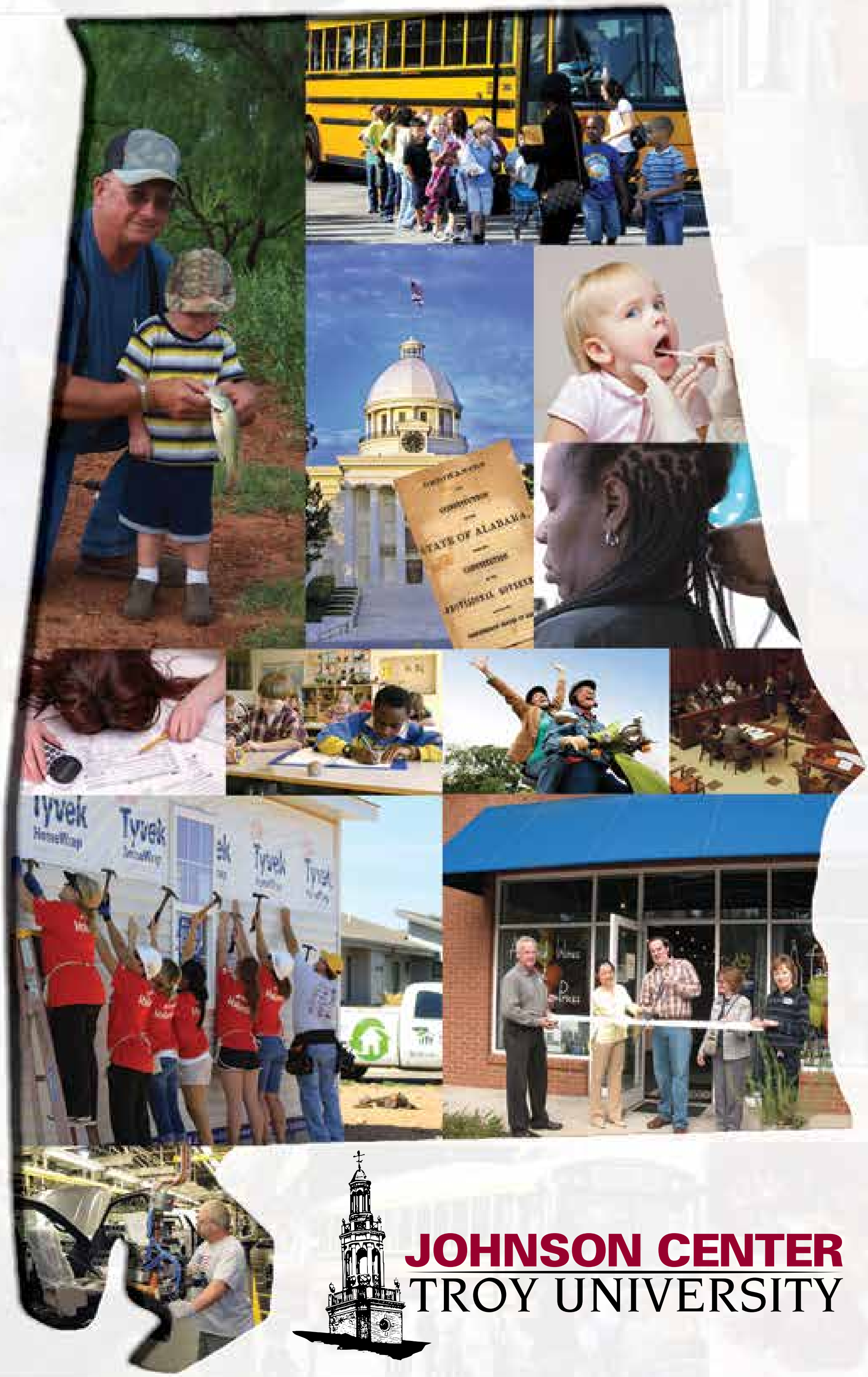
IMPROVING LIVES IN ALABAMA

A Vision for Economic Freedom and Prosperity



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For media inquiries, please contact:

Manuel H. Johnson Center for Political Economy
137 Bibb Graves Hall
Troy University
Troy, AL 36082

(334) 670-6583
business.troy.edu/JohnsonCenter/

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G. P. Manish and Malavika Nair

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Summary Points

- Economic freedom allows citizens to use their time, talents and property to their benefit through voluntary exchange, with knowledge that their property is protected from theft or government confiscation.
- Under economic freedom, prices and profit and loss in the market emerge, providing signals to allow entrepreneurs to direct resources to uses valued by consumers, resulting in prosperity and economic growth
- The Economic Freedom of the World and Economic Freedom of North American indexes measure the extent to which nations and the U.S. states respectively approach the ideal of free markets. The indexes help convincingly establish the link between economic freedom and prosperity, as well as health, income equality, and overall well-being.
- Alabama's low state and local tax burden and labor market policies contribute favorably to the state's economic freedom scores. But a high level of Federal spending and poor scores on other areas of business regulation lower Alabama's economic freedom.

1. Introduction

One of the most enduring questions facing economists is why some countries are rich and others are poor. What applies across countries also applies within countries. While the United States consistently ranks as one of the wealthiest countries in the world, there exists a wide variation in income and standards of living across the states. In the year 2010, for instance, Connecticut was the richest state in America with a personal per capita income of $55,427, a figure significantly higher than that of the poorest state, Mississippi, which had a corresponding figure of $30,841.[1]

What explains these wide variations in income per capita across states and countries? More importantly, if we can explain what causes economic growth, are there particular policies that can be pursued to promote economic growth? In this chapter, we make the case that policies that promote economic freedom are the ones that bring about more growth. This is because economic freedom fosters an environment conducive to competition, productive entrepreneurship and capital accumulation, which in turn cause economic growth. We then evaluate Alabama's freedom and growth performance over the last two decades.

Economic prosperity and growth translate not just into higher standards of material well-being, but also better life expectancy, health, literacy and leisure. We value material well-being not just because we value money, but because having a bigger income allows us to enjoy more of the things that money can buy. This means more people or previously poor people are able to afford things like better healthcare, education for their children, vacations or more time to spend with family and so on as a result of economic growth.

Section 2 of this chapter lays out the process of economic growth and the role that entrepreneurship, private property and capital accumulation play in it. It also shows how certain policies like lower taxes, less burdensome regulation and a well-functioning legal environment are crucial elements of economic freedom for their ability to foster entrepreneurship. Section 3 provides evidence from cross-country data in the Economic Freedom of the World Index to show that the positive relationship between freedom and growth is robust and holds across countries. Section 4 then presents Alabama's case.

2. The causes of economic growth

Economists must understand the process of economic growth in order to recommend policies to promote economic growth. It is no coincidence that the policies of economic freedom are highly correlated with various measures of human well-being across the world. More economic freedom means better institutions or rules of the economic game. This encourages productive entrepreneuership that in turn grows the economic pie.

Economic growth implies a bigger and improved consumption basket of goods and services for everyone, which translates into higher livings standards that can be measured by rising levels of GDP per capita. For growth to occur, entrepreneurs need to accumulate more capital, invest in better technology and produce the goods and services that consumers desire in a more productive manner. Thus, policies that promote entrepreneurship like secure private property rights, lower taxes and less burdensome regulation also promote economic growth. This section briefly lays this process as well as the crucial role played by businesses, entrepreneurs and economic freedom.

i. Capital Accumulation and Technology

Economists often use the imaginary example of a man stranded on an island to portray some fundamental economic truths. Consider Robinson Crusoe, the English sea voyager in Daniel Defoe's famous 18th Century novel, who finds himself ship wrecked on a deserted island with no food or any other consumer goods. Shorn of any other resources, Robinson must rely solely upon his own labor to sustain himself.

Given his pressing need for food, Robinson decides that wading into the nearby ocean and trying to catch fish with his bare hands offers the quickest way to obtain something to eat. After having persevered at this for ten hours, he obtains a catch of ten fish at the rate of one fish per hour worked. Dissatisfied with his low productivity, Robinson thinks of a more efficient way of utilizing his labor in the production of fish. He realizes that he could potentially obtain a much bigger catch of fish per hour worked by fishing with the aid of a raft and a net. Having a raft would allow him to strike out into deeper waters, where fish are far more abundant and possessing a net would allow him to catch them with ease.

Constructing these capital goods, i.e., the raft and net, however, will take him time, say thirty hours, or three ten hour working days. To survive while producing the raft and net he needs to save, i.e., not consume some of the fish that he currently has. In other words, Robinson needs to save and invest his only resource, his labor, to produce the capital goods that will make him a more productive fisherman. He would, indeed, need to do the same, not only to enjoy more fish, but also to produce other consumer goods like meat or a house. For the former, he would need to construct a bow and some arrows to enable him to kill his prey, whereas for the latter he would need to construct an axe to be able to chop wood.

Thus, the production and accumulation of capital goods allow Robinson's economy to grow, i.e., for him to enjoy an ever-growing basket of the goods and services that he desires. Also essential is constantly improving technology, or the knowledge of how to produce various goods and services. To ensure that he continues to be more productive and therefore also more prosperous, Robinson needs to know how to produce a variety of goods and services and the most efficient way of producing any good or service.[2]

Thus, a Robinson who knows how to build a raft and a net, a set of bow and arrows and an axe and who saves enough to produce these capital goods will be wealthier and able to enjoy more fish, consume meat and will no longer have to sleep out in the open, at the mercy of the forces of nature. On the other hand, a Robinson who does not possess such advanced technology, i.e., who does not know how to produce these capital goods or one who does not save and invest in their production will be significantly poorer. He will be a much less productive fisherman and will not have the luxury of eating meat or enjoying the shelter of a home.

What applies to an economy of one individual also applies with equal force for an economy of millions. The developed countries of today enjoy high levels of productivity and a vast array of goods and services as a result of the past accumulation of capital goods and technology. Individuals in these economies enjoy a vast stock of capital goods produced over past generations along with the knowledge of a rich menu of various production processes. Poorer, less developed economies are, on the other hand, characterized by a relatively small consumption basket and rudimentary capital goods and technology.

Entrepreneurship and Private Property

A crucial difference between Crusoe's one-man economy and our modern world is that we are constantly engaged in trading with one another. While Crusoe was forced to produce all the goods he desired by himself, participants in a modern economy are engaged in a highly specialized division of labor. In such an economy, people are not self-sufficient in the production of the consumer goods; they do not produce these goods for themselves and their own families. Instead, they rely on others to produce the consumer goods that they need. More specifically, they rely on *entrepreneurs* to produce these goods and services.

In a complex market-based economy, the all-important decisions of what to produce, how to produce and how much to produce are made by private entrepreneurs. How do entrepreneurs make these decisions? They do so guided by what the father of economics, Adam Smith, famously termed the "invisible hand" of the price system.[3] Those entrepreneurs who undertake projects and reap profits as a result are the ones who remain in business and continue to make these important production decisions. On the other hand, those entrepreneurs who incur sustained losses are forced to abandon their ventures and exit the market and no longer serve consumers' wants.

The profit and loss system not only decides who becomes and remains an entrepreneur, but also ensures allocation of scarce resources based on the preferences of consumers. When entrepreneur A earns a profit, it implies that consumers are willing to pay more for the product than the entrepreneur paid for the resources utilized to produce it. The entrepreneur's cost of production reflects the opportunity cost of using the resource, i.e., the amount that other entrepreneurs competing for the resource were willing to pay to utilize it in the production of other products. Thus, the fact that consumers were willing to pay more for A's product than his total cost of production implies that A has succeeded in bidding away these resources from alternate lines of utilization into the production of a commodity more highly valued by consumers.

On the other hand, entrepreneurs who fail to produce goods and services in line with the preferences of consumers earn losses. The amount that consumers are willing to pay for these products is less than their cost of production, indicating that the resources used up in producing the products would be better utilized in the production of other commodities. Hence the price system guides entrepreneurs in a way that consumer wants are being fulfilled as well as society's scarce resources are being utilized most efficiently.[4]

Market prices and the associated profits and losses also guide entrepreneurial activity in the realms of capital accumulation and technological improvement. Economic growth requires accumulation of capital and investment in research and development (activities far removed from consumption) in ways that ultimately conform to the preferences of consumers. Since all capital goods and technology are ultimately geared towards the production of consumer goods, entrepreneurs must be keen forecasters and use strong judgment while making decision regarding capital. Here again, the profit and loss system allows entrepreneurs to produce precisely those capital goods and invest in exactly those technologies that will result in consumer goods that are most highly valued by the consumers.[5]

A well-functioning price system is therefore the key to directing entrepreneurial activities and ensuring sustained economic growth. For a well-functioning price system, however, secure private property rights are vital. Without secure private property there can be no exchange of goods and services and therefore no price formation. In a world without private property rights in the ownership of resources and consumer goods, these goods can no longer be traded. Without markets for these goods there would be no prices of either resources or consumer goods established, thereby making the calculation of profits and losses impossible. As Austrian economists F.A. Hayek (Hayek 1935a; 1935b)) and Ludwig von Mises (Mises 1920) pointed out, without profits and losses the allocation of resources in line with consumer preferences becomes impossible.

In fact, highly centrally planned economies like the erstwhile Soviet Union and India were characterized by poverty and underdevelopment in the face of a substantial accumulation of capital and the employment of state of the art technology in certain areas of the economy. A dearth of the consumer goods amongst the broad masses and the production of consumer goods of poor quality existed side by side with imposing steel mills and hydroelectric projects.[6]

The lack of a coherent and meaningful price system explains this anomaly of poor economic growth in the face of sizeable capital accumulation. Both these economies were characterized by highly insecure private property rights in the ownership of goods, with widespread and numerous controls and regulations placed on private economic activity. As a result, prices in these economies neither reflected the valuations that consumers placed on products nor the actual state of resource scarcities. Resource allocation undertaken on the basis of these prices did not ensure an allocation in line with consumer preferences, but instead reflected the whims and fancies of the planners.

In other words, where there is no private property or property rights are insecure, entrepreneurs cannot exercise control over resources. Hence they are unable to undertake production of consumer or capital goods in a way that not only maximizes profit but also fulfills consumer wants and allocates scarce resources efficiently.

Policies that promote entrepreneurship

Policies that promote private property rights also promote entrepreneurship and economic growth. Secure private property rights allow several pathways of control over resources. The most obvious pathway is personal choice or freedom. Individuals who lack the freedom to make choices about how to spend or invest their income are worse off than they would be with that freedom. An inability to make personal choices regarding one's own property hampers economic growth. However, economic freedom extends well past personal freedom and civil liberties. Entrepreneurs need the freedom to trade with other entrepreneurs and employ resources (capital and labor) as they wish. This implies that the aforementioned system of prices, profit, and loss must be allowed to guide entrepreneurs. Any policy hampering the smooth functioning of this system (such as price controls, taxes or bailouts) and its coordinative function in the market will also hamper entrepreneurship and economic growth.

Another crucial element of economic freedom is the ability for new businesses to freely enter an industry and compete with existing businesses. Entrepreneurs must be able to start new businesses without having to deal with unnecessarily burdensome regulations. Heavy start-up costs imply that on the margin some entrepreneurs are shut out of the market and hence consumers are made worse off. Government granted legal privileges also impair the freedom to enter certain markets. Privileges reduce the amount of competition in the market place and create an incentive for incumbent firms to lobby politicians for additional favors.[7] Business lobbying impoverishes society by channeling scarce resources away from satisfying consumer wants and into unproductive uses, like lobbying itself. In this case, the economic pie does not grow, rather it is merely being re-distributed and a few gain at the expense of many.

Finally, a well-functioning legal system that enforces property rights is very important. Entrepreneurs, businesses and investors need to know that they and their property are secure against theft, violence or fraud. An unbiased, and low cost mechanism for dispute resolution and restitution allows entrepreneurs to undertake projects and risks without worrying about unfairly losing the fruits of their labor. In countries with corrupt and poorly enforced legal systems, uncertainty regarding the ability to keep one's own property leads to poor incentives to start new businesses. Entrepreneurs can only rely on family networks to resolve disputes allowing business activity only within family or clan boundaries and leaving possible gains from trade unrealized.

3. Economic Freedom of the World

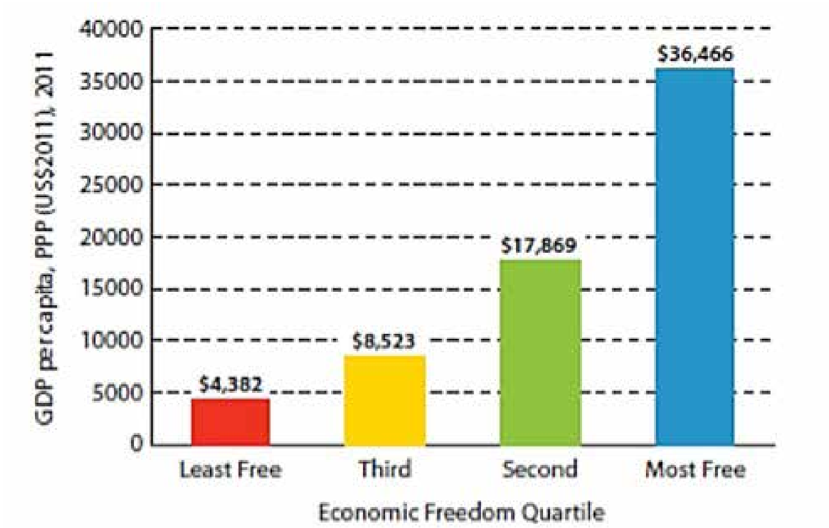
Does economic freedom really provide a formula for growth in Alabama? The evidence overwhelmingly says yes, and it is instructive to start with the cross-country data. We therefore start by showing correlations between Economic Freedom of the World index (EFW, Gwartney, Lawson and Hall 2013) and different measures of prosperity and well-being like GDP per capita and life expectancy. The results are unequivocal, economic freedom across the world does indeed correlate highly with measures of well-being.

The EFW index measures economic freedom for 153 countries through 5 sub-categories of freedom important for entrepreneurs and markets. The categories are: 1) The Size of Government; 2) Legal System and Property Rights; 3) Sound Money; 4) Freedom to Trade Internationally; 5) Regulation. The size of government variable takes into account the levels of taxes and government expenditure, plus the extent of government owned enterprises. Higher taxes, more government spending and large government sectors imply lower economic freedom (Gwartney, Lawson and Hall 2013, p. 3-7).

The legal system and property rights category measures the fairness and reliability of the police and court system. A better functioning legal system supports the contracts needed by entrepreneurs and businesses to produce goods and services and capture gains from trade. The sound money component measures money growth and inflation in a country. Low inflation and stable monetary growth provide a foundation for a smoothly functioning economy. Hence, sound money provides a foundation for translates into more economic freedom in a country.

The freedom to trade internationally component measures the extent of tariffs, capital controls and other barriers hampering free trade across countries. Lower tariffs and capital controls increase economic freedom since entrepreneurs are able to source products and sell goods to whichever market values them most highly. Finally, the regulation component captures the extent of regulations which increase start-up costs and compliance costs for businesses as well as the extent of labor market and credit market regulations. Less regulation reduces the costs of starting or growing a business and hence translate into more economic freedom.

Figure 1.1



Source: Gwartney, Lawson and Hall 2013, p. 21.

Figure 1.1 shows the relationship between economic freedom in 2011 and GDP per capita adjusted for purchasing power parity in 2011 across nations. Countries are ranked for economic freedom and then divided into quartiles to aid visual depiction. The relationship between the two is strong and obvious. Countries like Hong Kong, Singapore, United States and Switzerland that rank in the highest quartile for economic freedom also rank in the highest category for GDP per capita. Countries like Zimbabwe, Chad and Nepal rank in the lowest quartile for economic freedom as well as the lowest category for GDP per capita. Some countries in the middle catergories include Belgium, Portugal, Brazil, Morocco and India.

Nations with more economic freedom are clearly more prosperious, but critics might argue that economic freedom only benefits the wealthy of a country at the expense of the poor. The strong, positive correlation of GDP per capita with economic freedom does not automatically imply that economic freedom also benefits the poor in the same way. The status of the poorest people in a nation may not be captured accurately by country averages. **Figure 1.2** shows the relationship between economic freedom and the income level of the poorest 10% of people in each country in 2011. The benefits of economic freedom run deep: the more economic freedom in a country, the richer its poorest members will be. Economic freedom and competition make consumer goods abundant and cheap and benefit all members of a society.

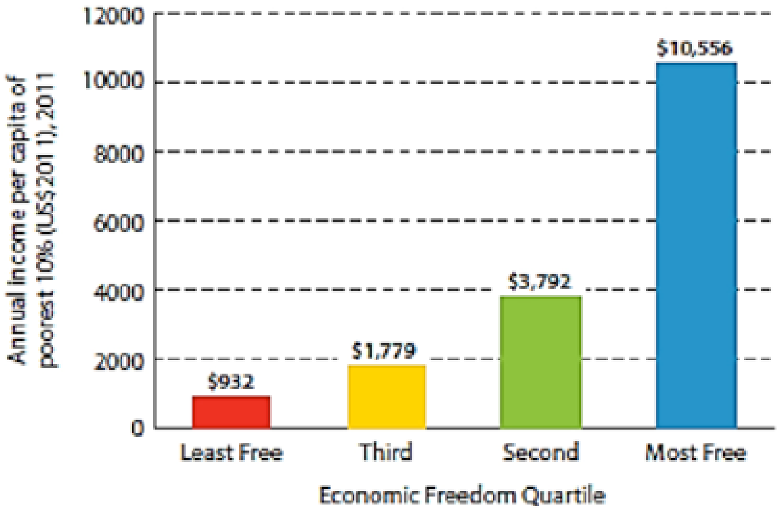
Figure 1.3 shows the relationship between economic freedom and life expectancy at birth for all countries in 2011. Once again, there is a positive relationship. More economic freedom translates into higher life expectancy for all countries, although the relationship is not as dramatic as the one between freedom and income. This is explained by the fact that poor countries around the world have benefited from the huge advances in medicine during the twentieth century through exports and humanitarian efforts aimed at making vaccinations and antibiotics available to the masses.

Now that we have shown there is indeed a strong relationship across countries between economic freedom and economic growth, we now turn to this question specific to Alabama. While certain federal level policy variables will no longer be relevant, namely sound money and the freedom to trade internationally; others like regulation, size of government and legal environment will still play into the level of economic freedom within the state.

4. Economic Freedom and Growth in Alabama

In the globalized and economically integrated world of today, Alabama must compete not only with other states in America, but also with nations all over the world to attract the entrepreneurship and the investment that drives economic growth. Instituting policies that secure private property rights and promote economic freedom are vital to ensure success in this competitive endeavor, for they provide both the incentive

Figure 1.2



Source: Gwartney, Lawson and Hall 2013, p. 22

for entrepreneurial investment as well as the system of profits and losses to ensure that these investments ultimately satisfy the preferences of consumers.

Over the past two decades, Alabama's economic performance has been rather poor. Indeed, Alabama consistently ranks in the bottom ten states in per capita personal income (PCPI). When analyzing these rankings for the twenty year period between 1991 and 2010, one finds that Alabama was ranked 39th in 1991 with a per capita income of $16,337 and at 42nd in 2010 with a per capita income of $33,710. The state's highest annual ranking during these years was 39th, achieved in 1991, 1995 and 1997, and its lowest rank was 46th in 2001. In fact, for some years between 2001 and 2010 Alabama was ranked worse than 42, often finding itself in the 43rd and 44th positions.[8]

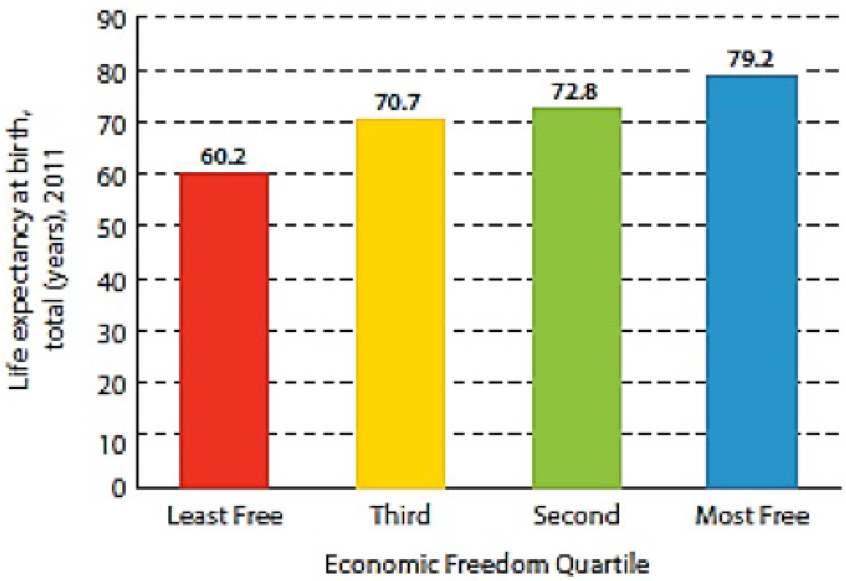
In keeping with this low ranking, Alabama witnessed relatively low growth of real PCPI during the two decades between 1990 and 2010. During the 1990s, for instance, real PCPI in Alabama grew at a modest 1.6 per cent, whereas this rate fell significantly to 1.1 per cent during the following decade. As a result of this poor growth performance Alabama's PCPI as a percentage of US PCPI grew only by a little more than 3 per cent over these twenty years, from 81 per cent to 84.40 percent. In sharp contrast, during this same period Louisiana's PCPI as a percentage of US PCPI grew from 78 per cent to 93 per cent. Thus, unlike its neighbor, Alabama did not significantly outperform the other states and catch up with the rest of the country during this period.[9]

How does economic freedom help explain Alabama's underwhelming income and growth performance? It turns out that despite being a "red state," Alabama has a relatively low level of economic freedom relative to other states. Thus, consider the most recent *Economic Freedom of North America (EFNA)* report (Bueno, Ashby and Mcmahon 2012), an annual publication of the Fraser Institute. The report features two indices that rate the economic freedom of the various states on a ten point scale. The first of these is an all-government index that captures the impact of restrictions on economic freedom by all levels of government (federal, state and local/municipal), whereas the second is a subnational index that only captures the impact of restrictions at the state and local levels. These indices are both composed of ten sub-components that focus on various government imposed restrictions to economic freedom in three broad areas, namely, the size of government (area 1), takings and discriminatory taxation (area 2) and labor market freedom (area 3) (Bueno, Ashby and Mcmahon 2012, p. 6-11).

As in the case of the rankings of per capita income, Alabama consistently finds itself in the bottom ten states in the area of economic freedom when the all-government index (federal, state and local) is considered. Indeed, when the scores of all the states are compared, Alabama's average rank during the 1990s is 39th, with this figure falling slightly to 40th during the following decade. The state's rank remains persistently low and also relatively stable throughout the period, with the highest ranking during these two decades being the 36th achieved in 1995 and 1996, whereas the lowest rank was a 42nd recorded in 2000.[10] The state does, however, perform significantly better in relation to other states when the subnational index is considered. For in this case Alabama's rank in 1990 was 3rd; a rank that fell to 19th in 2000 before rising to 9th by the end of that decade in 2010.

Table 1.1 below depicts Alabama's rank relative to other states in the three key areas of the EFNA index. As seen below, the rankings for all these three areas are provided both for the all-government as well as the subnational indices. Several important points are worth noting: first, Alabama performs poorly in area 1, or the size of government. Moreover, it does so in both indices, i.e., regardless of whether one counts the size of the federal government's footprint in Alabama's economy or not. The state does, however, perform much better in area 2, i.e., in the area of state taxation, an area that takes both direct as well as indirect taxes into account. And finally, Alabama performs remarkably and consistently well in the area of labor market freedom at the

Figure 1.3



Source: Gwartney, Lawson and Hall 2013, p. 23

subnational level, thereby indicating that labor market policies at the state and local levels are relatively free and unrestrictive.

Let us now turn to another economic freedom index to analyze Alabama's performance on this front relative to other states. *The Freedom in the 50 States* index published by the Mercatus Center (Ruger and Sorens 2013)[12] scores and ranks states in over 200 policy variables that fall into three broad categories of freedom, namely, fiscal, regulatory and personal freedom. Unlike the EFNA index, the Mercatus Index does not have an all government index that includes the impact of the policies of the Federal government on economic freedom along with those of the state and local governments. Instead, it only considers the actions of the state and local governments in its calculations of a state's economic freedom score.

Alabama, as in the case of the subnational EFNA index, performs relatively well in the overall Mercatus Index, coming in at a rank of 18th in the latest rankings released in 2013. Its performance does, however, vary greatly across the three broad sub-categories included in the index. Thus, whereas it performs very well in the area of fiscal freedom, with a rank of 5th, it performs relatively poorly in the areas of regulatory and personal freedoms, with ranks of 38th and 43rd respectively.

In order to better understand Alabama's performance in the various areas of economic freedom, let us begin by focusing on an area in which it does poorly throughout the period between 1990 and 2010, namely, the size of government. Its average ranking in this area in the all-government freedom index of the EFNA stood at 43rd during the 1990s and 45th during the 2000s, and throughout the latter decade Alabama consistently remained in the bottom five states in this category. In fact, in 2010 Alabama's total government (federal, state and local) expenditure as a percentage of its gross domestic product (GDP) stood well above the national average, with 33 percent of the state's GDP being expended by the various levels of government as compared to the national average of 25.9 percent. Indeed, Alabama does very poorly when compared to other states on this front, with an average rank of 46 for the years between 2000 and 2010.[13]

The relatively large role played by government expenditure in the Alabama economy is also reflected in the figures for the proportion of the state's workforce employed by government at all levels (federal, state and local). During the period between 2001 and 2010, Alabama's average rank in this area was 39, and the proportion of Alabamans employed by the various levels of government stood at 19.8 percent in 2010, above the national average of 17.2 percent. In fact, if the proportion of Alabama's workforce employed in the government sector corresponded to the national average, the state would have seen approximately 56,000 workers released and available to work in the private sector in the year 2010 alone.[14] Moreover, the numbers are similar if only the state and local levels of government are considered. Here too, Alabama employs a greater proportion of its workforce in government employment than the national average. For instance, in 2010 Alabama employed 16.8 percent of its workforce in state and local governments, whereas the national average for this year stood at 14.8 percent.[15]

The significant role played by both government expenditure and government employment in Alabama's economy act as a drag on the economic growth of the state. The relatively large share of the workforce employed in government employment implies that fewer resources are available for employment in the private sector for capital accumulation and technological growth. Entrepreneurs now have less to work with, whereas governments at all levels have more. Governments, however, are notoriously inefficient producers of goods and services. Bureaucrats, due to a lack of incentives, are not known either for their level of customer service or for their desire to be more efficient. Moreover, government expenditure is not guided by any system of profit and loss, implying that there is really no way to verify whether it does serve consumer preferences or it does not.[16]

Another area of concern for Alabama in relation to economic freedom is that of business regulation, as indicated by the lowly rank of 38th recorded in this are in the Freedom in the 50 States index published by the Mercatus Center (Ruger and Sorens 2013, p. 43).[17] To a large extent, this low ranking is due to the state's especially poor legal liability system. Citing a survey of business owners and managers conducted by the U.S. Chamber of Commerce, Ruger and Sorens note that Alabama has a particularly unfavorable lawsuit climate facing businesses, where they are especially vulnerable to be the victims of tort abuse. In fact, Alabama ranks 47th among American states in the area of freedom from tort abuse in 2011, a rank that has remained virtually unchanged over the last decade (Ruger and Sorens 2013, p. 29).

Needless to say, the heightened threat of being potential victims of lawsuits greatly increases the potential cost of doing business in Alabama. It also makes businesses that operate in Alabama relatively less competitive, since the increased risks and costs associated with it are often passed on to the consumers in the form of higher prices. Thus, a reform of the tort law system in Alabama is essential in order to attract more entrepreneurs and therefore for greater economic growth.

Over and above this poor performance in the area of business regulation, Alabama performs even more poorly in the area of personal freedom, with a ranking of 43rd in the nation. The state performs exceedingly poorly in the areas of the incarceration rate for victimless crimes, the regulation of alcohol distribution and the taxation of alcohol sales and in its policies with respect to medical and recreational marijuana use, with its rank in the three areas standing at 39th, 46th and 50th respectively (Sorens and Ruger 2013, p.50-61). Such repressive policies in the realm of personal freedoms could have a significant negative impact on the state's ability to attract young, motivated and skilled workers.

As indicated by table one above, Alabama does perform well on some components of economic freedom. For example, at 7.6 percent of personal income, Alabama has one of the lowest tax burdens in the nation, ranking 5th among the fifty states in this area in 2011 (Ruger and Sorens 2013, p. 15). The state also scores very highly in the areas of labor market freedom and health insurance regulation, ranking 2nd and 4th in these areas respectively as of 2011 (Ruger and Sorens 2013, p. 35, 33); the latter a result of fewer state-level mandates than the national average and the absence of any price controls. Moreover, Alabama ranks 9th in the important area of property rights protection in 2011 thanks to flexible, decentralized zoning rules and comprehensive eminent domain reform (Ruger and Sorens 2013, p. 31).

Table 1.1: Ranks for Alabama in the Three Component Areas (EFNA Index) [11]

AREA	1990	2000	2010
Area 1 (All Government)	48	44	45
Area 1 (Subnational)	21	47	39
Area 2 (All Government)	11	14	17
Area 2 (Subnational)	6	14	12
Area 3 (All Government)	38	38	44
Area 3 (Subnational)	7	5	5

The greater economic freedom brought forth as a result of these lighter regulations bodes well for economic growth in Alabama in the long run as proven by the fact that the state has received an A+ grade for overall business friendliness in a nationwide survey of small business owners conducted by the website Thumbtack.com in association with the Kauffman Foundation in 2013. Alabama rates highly in various areas of business and entrepreneurial freedom, scoring a grade of A+ in the category of ease of hiring, A for the ease of starting a business, A+ in regulations and A+ in zoning.[18]

Conclusion

In this chapter we have argued that Alabama has not benefited from economic growth over the last two decades because it has failed to implement policies that promote economic freedom. The size of government spending, low personal freedom, heavy regulatory burden and a weak legal system have prevented the state from reaping the benefits of more entrepreneurship and competition. This helps explain why Alabama consistently ranks poorly when compared to other states in the nation in terms of personal income per capita.

We also argued that it is no coincidence that more economic freedom leads to more economic growth. There are strong a priori reasons for this, more economic freedom fosters an environment that encourages the right kind of entrepreneurship through competitive market forces as well as capital accumulation that increases productivity. The more entrepreneurs are engaged in trying to earn profits by having to compete with other entrepreneurs in a fair level playing field, the more consumers are served as the supply and variety of goods becomes more abundant and cheaper. On the other hand, when government plays a large part in this process of resource allocation, scarce resources are channeled away from serving consumers and squandered trying to win favors by lobbying politicians and restricting competition. In order to reap more benefits of this virtuous market process that benefits both entrepreneurs and consumers simultaneously while efficiently making use of society's resources, the state of Alabama needs to make a move towards policies that promote economic freedom.

Notes

1. Indeed, the personal per capita income of the District of Columbia was even higher than that of Connecticut and stood at a figure of $71,220.
2. For more on the relationship between capital accumulation and economic growth see Rothbard (2009 [1962] p. 47 – 70, 517 – 527), Mises (1998 [1949] p. 479 – 520) and Hayek (2008).
3. For Adam Smith's three references to the "invisible hand" see Smith (1976 [1776]).
4. See Mises (1952) and Kirzner (1973) for more on how profits and losses guide entrepreneurial decision making and the allocation of resources on the market.
5. See Kirzner (1971) for a brief and lucid exposition on the relationship between entrepreneurship and economic growth and development.
6. For more on economic development under central planning in the erstwhile Soviet Union see Nutter (1962) and Boettke (1990). India's economic performance during its socialist era is dealt with in Bhagwati and Desai (1970) and Manish (2011; 2013).
7. As noted by Baumol (1990) and Boettke and Coyne (2009), in an environment with widespread government intervention, a significant portion of a nation's entrepreneurial energy is diverted into unproductive channels like rent-seeking.
8. Per Capita personal income figures are nominal and are from the U.S. Chamber of Commerce, Bureau of Economic Analysis (March 2013 release). The rankings of American states have been calculated using these figures by the Bureau of Business and Economic Research, University of New Mexico. Spreadsheet containing both the per capita income figures as well the rankings based on them available online at http://bber.unm.edu/econ/us-pci.htm.
9. Growth rates of real PCPI were calculated by the authors using the nominal PCPI figures from the Bureau of Economic Analysis and Consumer Price Index (CPI) numbers from the Bureau of Labor Statistics. The PCPI figures for Alabama and Louisiana as a percentage of US PCPI are from the Bureau of Economic Analysis.
10. Rankings calculated by the authors from data provided in the dataset for researchers accompanying Bueno, Ashby and Mcmahon (2012) and available online at freetheworld.com.
11. The rankings in all the three areas were calculated by the authors using the data provided in in the dataset for researchers accompanying Bueno, Ashby and Mcmahon (2012) and available online at freetheworld.com.
12. Available online at http://freedominthe50states.org/.
13. Figures available in dataset for researchers accompanying Bueno, Ashby and McMahon (2012). Available online at freetheworld.com. Rankings calculated by the authors using this data.
14. The figure of 56,000 was calculated by the authors using the figure of 1.872 million for Alabama's workforce in 2010 (this figure, obtained from the Bureau of Labor Statistics is the figure for only December 2010 but has been used as an approximation for the figure for 2010 as a whole.
15. Figures available in dataset for researchers accompanying Bueno, Ashby and McMahon (2012). Available online at freetheworld.com.
16. For more on the perverse incentives facing bureaucrats see Niskanen (1971). The classic work on the implications of the lack of a profit and loss system on bureaucratic efficiency is Mises (1944).
17. Available online at http://freedominthe50states.org/.
18. Available online at http://www.thumbtack.com/survey#2012/states.

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About the Contributors

G.P. MANISH is an Assistant Professor of Economics in the Sorrell College of Business and a member of the Manuel H. Johnson Center of Political Economy at Troy University. He received his Ph.D. in economics from Suffolk University in May 2012. His areas of interest include development economics, entrepreneurship and price theory, monetary and business cycle theory and the history of economic thought. His research has been published in journals such as The Independent Review, Review of Austrian Economics and Atlantic Economic Journal.

MALAVIKA NAIR is an Assistant Professor of Economics and a member of the Manuel H. Johnson Center for Political Economy at Troy University. She received a Ph.D. in economics from Suffolk University in 2012. Her research focuses on monetary and financial theory, history and innovation. Her scholarly research has been published in the *Review of Austrian Economics*, the *Quarterly Review of Economics and Finance*, the *Independent Review*, and the *Quarterly Journal of Austrian Economics.*