TEARING DOWN THE BARRIERS TO PROSPERITY

How More Economic Freedom Can Reduce Poverty and Boost Prosperity in Pennsylvania

MEG TUSZYNSKI

MANAGING DIRECTOR
AT THE BRIDWELL INSTITUTE
FOR ECONOMIC FREEDOM

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Author

Meg Tuszynski BRIDWELL INSTITUTE FOR ECONOMIC FREEDOM, COX SCHOOL OF BUSINESS, SOUTHERN METHODIST UNIVERSITY

Meg Tuszynski is the Managing Director of the Bridwell Institute for Economic Freedom at Southern Methodist University (SMU) and a Research Assistant Professor at SMU's business school. Her research focuses primarily on why economic freedom varies across states and why this matters for broader social and economic outcomes. A second, but related, strand of research focuses on the entangled relationships between private sector and public sector actors, and how a better understanding of these relationships changes our perception of both economic and political problems. Before joining the Bridwell Institute, Meg was the Program Manager for the Spending and Budget Initiative at the Mercatus Center. She earned her PhD and MA in economics and a dual BA in philosophy and economics from George Mason University. Her research interests include Austrian Economics, Public Choice, New Institutional Economics, and Political Economy.

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Key Findings

- Economic freedom, specifically lower government spending, strongly and consistently offers both increases in prosperity and reductions in poverty.
- States that gained economic freedom from 2010 to 2019 tend to have lower levels of poverty and higher levels of prosperity.
- In Pennsylvania specifically, a **one-point improvement in the Economic Freedom of North America (EFNA) Index score over five years** is associated with a **2.08 percentage point increase in employment and a $2,338 increase in per capita income.**
- In Pennsylvania, a **one-point improvement in the EFNA Index score over five years** is associated with a decrease in poverty rates, resulting in up to **176,970 fewer Pennsylvanians in poverty**.

Introduction

It is no secret: states that are more economically free do better. Citizens in economically free states see greater income growth, greater in-migration, higher levels of employment growth, and higher levels of foreign direct investment.[1,2,3,4,5] Notably, economic scholars James D. Gwartney and Joseph S. Connors associate improvements in cross-national economic freedom with lower rates of both extreme and moderate poverty.[6]

This report explores the relationship between economic freedom, poverty, and prosperity at the state level to guide policymakers' efforts in boosting prosperity. It expands on the Texas Public Policy Foundation's 2017 state-level study of economic freedom and poverty, which offers evidence for a small but positive relationship between economic freedom and the United States Census Bureau's Supplemental Poverty Measure (SPM).[7] The research, presented here, augments the 2017 findings with additional years in the analysis, the use of panel methods, and the inclusion of both poverty and prosperity metrics.

The research finds more economically free states tend to have lower levels of poverty and enjoy higher levels of prosperity.

1 Nathan J. Ashby and Russell S. Sobel, "Income Inequality and Economic Freedom in the U.S. States," *Public Choice* 134, No. 3 (March 2008), 329–46, https://doi.org/10.1007/s11127-007-9230-5.
2 Nathan J. Ashby, "Economic Freedom and Migration Flows Between U.S. State," *Southern Economic Journal* 73, No.3 (January 2007), 677–97, https://doi.org/10.1002/j.2325-8012.2007.tb00796.x.
3 Sean E. Mulholland and Rey Hernández-Julián, "Does Economic Freedom Lead to Selective Migration by Education?" *Journal of Regional Analysis & Policy* 43, No. 1 (2013), 65–87, https://jrap.scholasticahq.com/article/7924-does-economic-freedom-lead-to-selective-migration-by-education.
4 Thomas A. Garrett and Russell M. Rhine, "Economic Freedom and Employment Growth in U.S. States," Federal Reserve Bank of St. Louis Working Paper No. 2010-006A, March 3, 2010, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1564262.
5 Dennis Pearson, Dong Nyonna, and Kil-Joong Kim, "The Relationship Between Economic Freedom, State Growth and Foreign Direct Investment in U.S. States," *International Journal of Economics and Finance* 4, No.10 (2012), 140–46, https://www.ccsenet.org/journal/index.php/ijef/article/view/20378.
6 James D. Gwartney and Joseph S. Connors, "Economic Freedom and Global Poverty," in *Accepting the Invisible Hand*, ed. Mark D. White, (New York: Palgrave Macmillan, 2010), 43-68, https://myweb.fsu.edu/jdgwartney/Documents/Gwartney%20Connors-Economic%20Freedom%20and%20Global%20Poverty.pdf.
7 Courtney A. Collins, "Poverty Rates, Demographics, and Economic Freedom Across America," Texas Public Policy Foundation, August 2017, https://www.texaspolicy.com/wp-content/uploads/2018/08/2017-08-RR-PovertyRatesAmerica-CEF-CourtneyCollins.pdf.

Economic freedom, in short, is the freedom of citizens to make their own economic choices, free of government interference, so long as those choices do not infringe upon the rights of others. In the 1980s Nobel laureates Milton Friedman and Friedrich Hayek alongside "like-minded economists and policy experts" sought a "measure of economic freedom consistent with Adam Smith's idea of 'the obvious and simple system of natural liberty.'"[8] Their work resulted in the first publication of the annual *Economic Freedom of the World (EFW)* report in 1996, spearheaded by the Fraser Institute, a Canadian think tank. The EFW's numeric economic freedom ranking, or EFW Index, now ranks 165 countries worldwide.[9] Annual reports on the *Economic Freedom of North America (EFNA)* began in 2002 with a numeric ranking, or EFNA Index, for the United States, Canada, and Mexico.[10,11] This report analyses the 2021 EFNA Index (utilizing 2019 data) against United States Census Bureau poverty measures for 2019.

The pre-pandemic data is a deliberate choice given the challenge of understanding how COVID-19 and the government's response impacted individual incomes. In fact, the Census Bureau did not release supplemental poverty rates for the American Community Survey in 2020 or 2021. Appendix 2 explains the methodology further.

The EFNA Index, which includes yearly U.S. state-level panel data back to 1981, considers economic freedom comprised of three broad areas: government spending, taxation, and labor market regulations. In brief, states that maintain low and reasonable levels of government spending, relatively low tax burdens, and low levels of labor market regulation perform better on this index.

For policymakers concerned with helping those living in poverty, there are at least two distinct mental models. **One set of policy prescriptions involves thinking about how to alleviate the problems of poverty. Another set looks to extend the benefits of prosperity more broadly.** To be sure, these are not mutually exclusive. **Policies that deliver on both these fronts should outweigh any policy which strictly deals with poverty. As this report shows empirically, economic freedom does both things.**

By breaking down economic freedom into component parts, less government spending emerges as the key driver behind both reductions in poverty and increases in prosperity. Naturally, this report also discusses a concrete proposal for "right-sizing" spending in Pennsylvania.[12]

Poverty is a difficult problem. This paper demonstrates policies that create the right economic environment can be more successful than policies that actively try to target the problem. With just a little faith in people and an institutional environment that encourages people to make their own decisions, reductions in poverty are feasible without significant government spending increases. In fact, spending more on this problem could prove counterproductive, given the relationship between government spending and prosperity.

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8 Dean Stansel and Meg Patrick Tuszynski, "Sub-National Economic Freedom: A Review and Analysis of the Literature," *Journal of Regional Analysis & Policy* 48, No. 1 (2018), 61–71, https://jrap.scholasticahq.com/article/3713-sub-national-economic-freedom-a-review-and-analysis-of-the-literature; Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (London: Methuen & Company Ltd, 1776[1904]), 687.

9 James Gwartney, et al "Economic Freedom of the World: 2021 Annual Report," Fraser Institute, September 14,2021, https://www.fraserinstitute.org/studies/economic-freedom-of-the-world-2021-annual-report.

10 Dean Stansel, José Torra, and Fred McMahon, "Economic Freedom of North America: 2021 Annual Report," Fraser Institute, 2021, https://www.fraserinstitute.org/sites/default/files/economic-freedom-north-america-2021.pdf.

11 To the reader, while the EFNA also rates and ranks the Canadian provinces and the Mexican states in terms of economic freedom, in the empirical literature, the cross-state data is the most widely used data from this set.

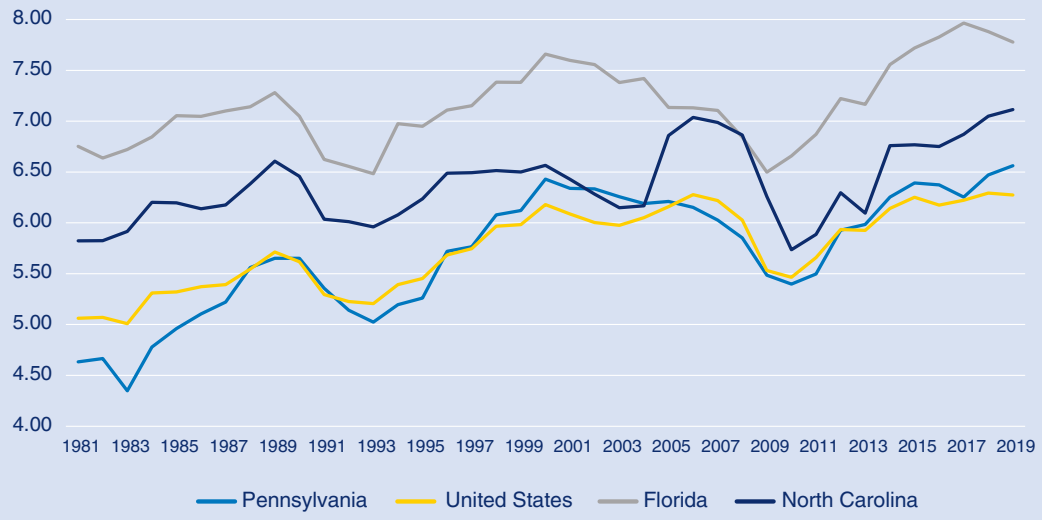
12 To the reader, "right-sizing" is a phrase borrowed from the Commonwealth Foundation January 2022 report, "How Government Overspending Hurts Pennsylvania Families," https://www.commonwealthfoundation.org/research/government-overspending-hurts-pennsylvania-families/.

Data

Data from the EFNA Index is this report's key measure of economic freedom. Therefore, it is essential to detail what the economic freedom metric entails. The EFNA Index includes ten variables, divided into three broad areas: (1) government spending freedom, (2) taxes, and (3) labor market regulation. Appendix 3 offers greater detail on the sub-components of these three areas.[13]

Figure 1 shows the evolution of economic freedom over the past 40 years, both across the nation and in Pennsylvania. In 2019, Pennsylvania ranked 19th out of the 50 states in terms of overall economic freedom. The commonwealth ranked 32nd for government spending, 29th for tax freedom, and ninth for labor market freedom. For context, Florida and North Carolina are included, these are the top destination states for Pennsylvanians leaving the commonwealth.[14]

FIGURE 1: OVERALL ECONOMIC FREEDOM, 1981–2019



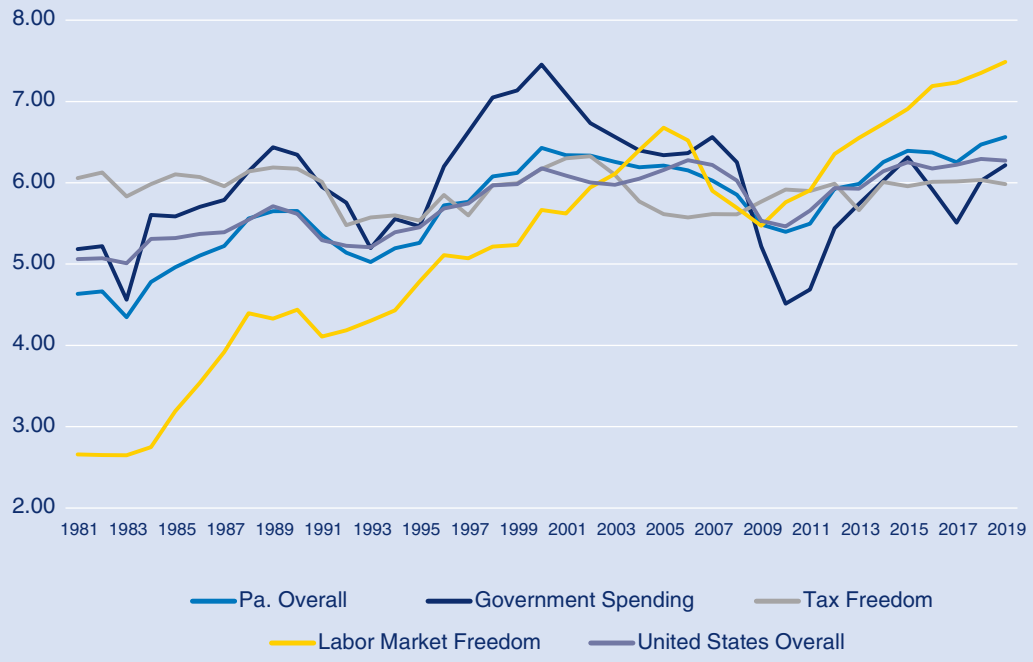
Source: Fraser Institute, Economic Freedom of North American Index 2021.

Figure 2 breaks down the economic freedom trajectory in Pennsylvania by the three component parts and shows improvements to state labor market regulations have contributed the most toward bettering the commonwealth's economic freedom environment. A deeper dive into the data shows that this improvement in the labor market is due to two factors: (1) a state minimum wage at the federal level and growing per capita income, and (2) an erosion in government employment as a percentage of total state employment.

13 To the reader, the EFNA Index uses the term government spending freedom to describe the burden of government spending, but this term can be misunderstood to mean governments should have the freedom to spend versus citizens keeping more of their earnings. Therefore, this report uses the term government spending for clarity.

14 Stansel, Torra, and McMahon, "Economic Freedom of North America: 2021 Annual Report." To the reader, in the 2022 EFNA Index, Pennsylvania's ranking changed slightly to 17th overall, 27th for government spending, 26th for tax freedom, and 11th for labor market freedom.

FIGURE 2: PA.'S ECONOMIC FREEDOM COMPONENTS, 1981–2019



Source: Fraser Institute, Economic Freedom of North American Index 2021.

Since the 1960s, the Census Bureau has released the Official Poverty Measure (OPM), its nationwide cash-based poverty line. The dollar amount of the threshold varies depending on the ages of family members, as well as the number of children in the family. The Census Bureau updates this dollar amount annually to account for inflation. The OPM is the most used metric for determining program eligibility. However, it only considers pre-tax/pre-benefit cash income to determine poverty status and does not adjust for variations in the cost of living across states. At best, it provides an imperfect proxy for the living standards of the poor. Hence, in 2011 the Census Bureau began publishing the Supplemental Poverty Measure (SPM) in addition to the OPM.[15]

The SPM considers the myriad of cash and non-cash benefits received by low-income families and considers geographic differences in the cost of living to provide a more accurate picture of actual resources. While the OPM still determines program eligibility, the SPM is arguably a better metric to assess relative poverty rates since it adjusts, at least roughly, for government transfers, taxes, and the cost of living.

This research employs both the OPM and the SPM measures. Table 1 contains state information on the percentage of people falling below the poverty line, according to the 2019 OPM and the SPM. In addition, it ranks the states on each metric. Because the SPM considers differences in the cost of living across states, some states experience dramatic ranking differences. Hawaii,

15 United States Census Bureau, "About the Supplement Poverty Measure," November 22, 2021 [revision], accessed January 10, 2023, https://www.census.gov/topics/income-poverty/supplemental-poverty-measure/about.html. To the reader, the SPM also subtracts for estimated child-care costs, taxes, medical expenses, and more.

for example, falls from fifth place when using the OPM to the 42nd-ranked state due, in large part, to its high cost of living. Pennsylvania ranks 28th according to both metrics.

TABLE 1. 2019 STATE RANKINGS BY OPM AND SPM

State	OPM	OPM Rank	SPM	SPM Rank	Rank Difference
Alabama	15.3	43	15.1	42	-1
Alaska	10.6	19	12.1	17	-2
Arizona	13.2	37	14.3	36	-1
Arkansas	16.4	47	14.7	39	-8
California	11.5	27	18.2	48	21
Colorado	9.2	6	12.3	18	12
Connecticut	10.0	14	12.5	22	8
Delaware	10.7	21	12.4	20	-1
Florida	12.5	31	17.3	47	16
Georgia	13.3	38	14.7	39	1
Hawaii	9.1	5	15.1	42	37
Idaho	10.9	22	10.6	10	-12
Illinois	11.2	23	12.4	20	-3
Indiana	12.0	29	12.3	18	-11
Iowa	11.2	23	10.1	7	-16
Kansas	11.3	26	11.0	12	-14
Kentucky	15.9	46	14.8	41	-5
Louisiana	18.5	49	18.5	50	1
Maine	10.3	16	9.6	4	-12
Maryland	8.9	3	12.9	26	23
Massachusetts	9.2	6	12.5	22	16
Michigan	12.9	35	12.9	26	-9
Minnesota	8.7	2	8.6	1	-1
Mississippi	19.4	50	18.2	48	-2
Missouri	12.4	30	12.5	22	-8
Montana	12.7	33	12.8	25	-8
Nebraska	10.1	15	10.2	8	-7
Nevada	12.9	35	14.5	38	3
New Hampshire	7.3	1	9.5	3	2
New Jersey	8.9	3	13.3	29	26
New Mexico	17.5	48	15.7	45	-3
New York	12.5	31	15.9	46	15

TABLE 1. 2019 STATE RANKINGS BY OPM AND SPM (CONTINUED)

State	OPM	OPM Rank	SPM	SPM Rank	Rank Difference
North Carolina	13.3	38	13.9	35	-3
North Dakota	10.6	19	10.3	9	-10
Ohio	12.8	34	11.5	16	-18
Oklahoma	15.3	43	13.7	33	-10
Oregon	11.2	23	13.6	32	9
Pennsylvania	11.9	28	13.0	28	0
Rhode Island	10.4	17	11.2	14	-3
South Carolina	13.6	41	13.8	34	-7
South Dakota	10.4	17	8.8	2	-15
Tennessee	13.7	42	13.5	31	-11
Texas	13.5	40	15.2	44	4
Utah	9.2	6	10.7	11	5
Vermont	9.9	13	11.4	15	2
Virginia	9.7	11	13.4	30	19
Washington	9.4	9	11.0	12	3
West Virginia	15.6	45	14.3	36	-9
Wisconsin	9.5	10	9.8	6	-4
Wyoming	9.8	12	9.7	5	-7

Source: Fraser Institute, Economic Freedom of North American Index 2021 and the U.S. Census Bureau, American Community Survey, 5-year 2019 estimates.

To measure state-level prosperity, two indicators capture two separate facets of prosperity. Both come from the American Community Survey five-year estimates. One is the percent of the population employed. The other examines the relationship between economic freedom and per capita income since this metric provides an easy comparison of living standards across the states.

Three control variables come from the formula for staying out of poverty, developed in 2009 by Ron Haskins and Isabel Sawhill from the Brookings Institution.[16] These are: (1) whether an individual has finished high school, (2) if they have waited until they're 21 and married before having children (or at least have planned their children, even if not married), and (3) if they have a full-time job that they're able to stick with.

The research data covers the years 2010–19, to maintain data comparability across all variables. Table 2 contains the summary statistics for Pennsylvania.

16 Ron Haskins and Isabel V. Sawhill, *Creating an Opportunity Society*, (Washington, DC: Brookings Institution Press, 2009), 15.

TABLE 2. PA. 2019 SUMMARY STATISTICS

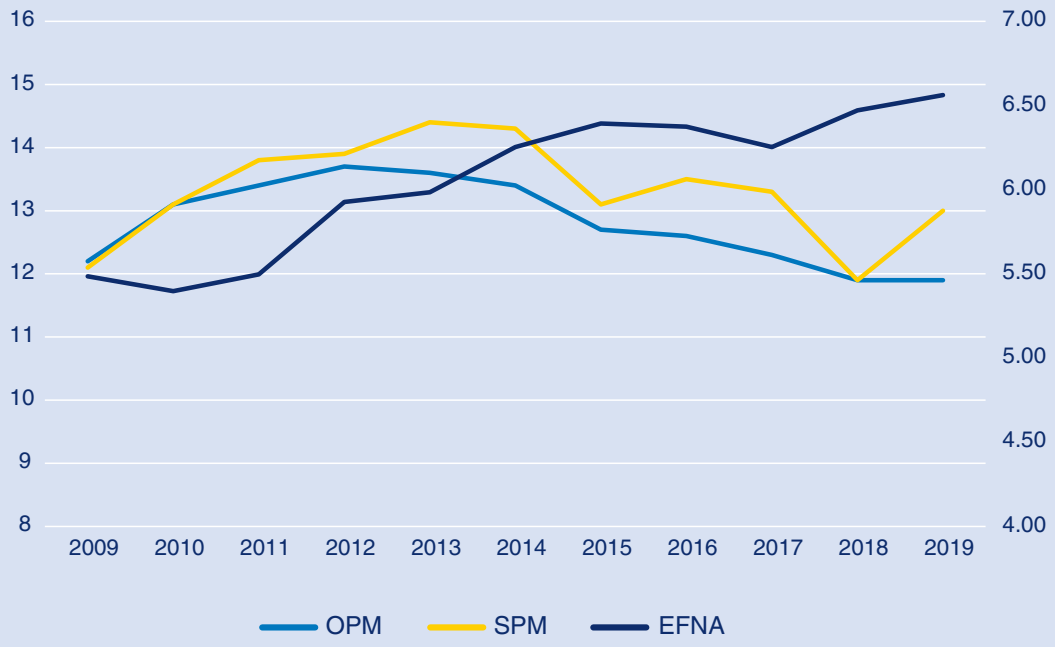
Variable	Mean	Std. Dev.	Min	Max	N
Official Poverty Measure (OPM)	13.8	3.3	6.7	24.2	499
Supplemental Poverty Measure (SPM)	14.0	3.0	7.1	25.1	499
Economic Freedom Summary Score	6.0	0.9	3.7	8.0	500
Government Spending Score	6.1	1.5	1.3	9.0	500
Tax Score	6.0	1.0	2.9	8.3	500
Labor Market Score	6.0	1.0	3.6	8.2	500
Percent of Population 25+ with High School Diploma	88.1	3.2	79.6	93.6	500
Percent of Population Married	49.8	2.8	43.4	58.1	500
Percent of Population Employed	59.5	4.0	49.5	67.6	500
Income Per Capita	29107.5	4629.7	19977.0	44496.0	500
Economic Freedom Score, Rolling Avg.	6.1	0.9	3.9	7.8	250
Government Spending Score, Rolling Avg.	6.2	1.5	1.5	8.9	250
Tax Score, Rolling Avg.	6.0	1.0	3.0	8.0	250
Labor Market Score, Rolling Avg.	6.0	0.8	4.0	7.9	250
Percent with High School Diploma, Rolling Avg.	87.9	3.2	80.8	92.9	250
Percent Married, Rolling Avg.	49.8	2.7	43.8	57.1	250

Sources: Fraser Institute, Economic Freedom of North American Index 2021 and U.S. Census Bureau, American Community Survey, 5 year 2019 estimates.

Economic Freedom and Poverty

In any given year, large movements in a state's economic freedom score are rare. Between 2018 and 2019, for example, Pennsylvania's overall score on the EFNA Index improved only 0.09 points, from a score of 6.47 to a score of 6.56. However, both improvements in economic freedom and deteriorations in economic freedom tend to compound over a matter of years. **Between 2011 and 2019, for example, Pennsylvania did improve more than a full point on the EFNA Index, from 5.50 to 6.56. There was a noticeable downward trend for both OPM and SPM rates over this period,** as Figure 3 shows.

FIGURE 3: PA. ECONOMIC FREEDOM AND POVERTY, 2009–2019



Source: Fraser Institute, Economic Freedom of North American Index 2021.

Because the time over which one would expect economic freedom to affect poverty is unclear, the research tests both one-time contemporary changes and the five-year lagged effects of economic freedom on both the OPM and SPM measures.[17] Whether using the OPM or the SPM, higher levels of overall economic freedom are associated with lower levels of poverty.

The relationship between economic freedom and poverty is both statistically significant and economically strong. However, the relationship between the overall economic freedom and the SPM is slightly stronger than the relationship between economic freedom and the OPM. This suggests that improvements in economic freedom could be particularly helpful for low-income individuals in areas where the cost of living is high. Here, a one-unit increase in the overall economic freedom score is associated with a nearly one-percentage-point decrease in the SPM.

Table 3 shows that a one-unit increase in a state's government spending score is associated with a 0.39 percentage point decrease in the OPM, and a 0.63 percentage point decrease in the SPM.[18] The tax freedom component is negatively related to the OPM, but not statistically significant to the SPM. This indicates that the relationship between this economic freedom component and the poverty level is sensitive to the poverty metric used. There appears to be no significant relationship between the labor market freedom component and the two poverty metrics.

17 To the reader, a one-time model measures the contemporary, relationship between the model's variables and components. And a lagged model evaluates the time series data of its variables and components.

18 To the reader, increases in government spending freedom reflect the fiscal ability to limit or lower spending while sustainably meeting government policy goals.

TABLE 3. PA. POVERTY RATE REDUCTIONS AFTER A ONE-UNIT INCREASE IN ECONOMIC FREEDOM: ONE-TIME

Types of Economic Freedom	OPM Reduction	SPM Reduction
Economic Freedom Summary Score	**-0.85*** **	**-0.94*** **
Government Spending Score	**-0.39*** **	**-0.63*** **
Tax Score	**-0.71*** **	-0.37
Labor Market Score	-0.17	0.00

Notes: Asterisks *, **, *** indicate significant at the 90, 95, and 99 percent levels, respectively. Robust standard errors (heteroskedasticity-consistent estimators) in parenthesis.

This contemporaneous model does not show the directional nature of the relationship between economic freedom and poverty. Yes, measured poverty rates are lower in areas with higher levels of economic freedom. But does this mean that improvements in economic freedom will lead to lower levels of poverty? Or that poverty must decrease in an area before improvements in economic freedom can happen?

A lagged model helps better understand the direction of the relationship. Table 4 summarizes the relationship's time series changes in economic freedom components from 2014 to 2018 and how they affect poverty in 2019. The intuition behind this model is that measured poverty in 2019 cannot meaningfully impact prior-year changes in economic freedom, but changes in economic freedom that have accumulated over previous years may meaningfully impact measured poverty rates in a subsequent year.

The results from this lagged model are striking. Not only is the overall economic freedom score still strongly statistically significant, but the point estimates are much larger than the one-time change or contemporaneous models. **Here, a one-unit change in the economic freedom score over the previous five-year period is associated with a 1.41 percentage point decrease in the OPM and a 1.83 percentage point decrease in the SPM.**

> **In other words, a one-point improvement in the EFNA Index score over five years (2017–21) is associated with 176,970 fewer Pennsylvanians in poverty.**

Likewise, the relationship between lower government spending and subsequent decreases in the OPM and SPM retained strong statistical significance and had stronger point estimates in the lagged model than in the one-time change model. **A one-point increase in the government spending score over the previous five years is associated with a 0.58 percentage point decrease in the OPM, and a 1.31 percentage point decrease in the SPM in the subsequent year.**

The labor market freedom score is also significantly related to the OPM, indicating loosening restrictions on labor markets over a five-year period is associated with a decrease in the OPM the subsequent year. This relationship, however, loses significance when we measure poverty using the SPM. There is no discernable relationship between tax freedom and poverty in the lagged model.

TABLE 4. PA. POVERTY RATE REDUCTIONS AFTER A ONE-UNIT INCREASE IN ECONOMIC FREEDOM: OVER FIVE YEARS, LAGGED ROLLING AVERAGE

Types of Economic Freedom	OPM Reduction	SPM Reduction
Economic Freedom Summary Score	**-1.41*** **	**-1.83*** **
Government Spending Score	**-0.58*** **	**-1.31*** **
Tax Score	-0.88	-0.24
Labor Market Score	-0.82**	-0.16

Notes: Asterisks *, **. *** indicate significant at the 90, 95, and 99 percent levels, respectively. Robust standard errors (heteroskedasticity-consistent estimators) in parenthesis.

The perennial question for policymakers when determining how best to help those in poverty is whether poor people can make their own choices, or whether they require active government assistance to alleviate their problems. **The negative relationship between the government spending variable and both poverty metrics lends credence to the former view. When the government makes fewer decisions for people, they are better off.**

It is worth noting the relationship between the poverty measures and control variables. The education variable is negative and significant across all specifications. An increase in the percentage of the population with at least a high school diploma is associated with a strong and statistically significant decrease in both poverty measures. The marital status variable is negative and significant in the one-time change models, but not the lagged specifications. States that have a larger percentage of the population that is married tend to have fewer people in poverty, but this effect seems swamped by both education and the economic freedom environment over the longer term. Full results are available in Appendix 1.

Economic Freedom and Prosperity

If it turns out that economic freedom can both decrease measured poverty and increase measured prosperity, states should pursue an agenda of economic freedom over a sole focus on alleviating poverty. This section examines the relationship between economic freedom and a couple of broad measures of prosperity. In particular, it looks at employment and per capita income.[19] As in the previous section, it employs both one-time change and lagged models.

Table 5 contains the one-time change results. There is no discernable relationship between any measure of economic freedom and the report's employment measure. There is a positive relationship between the government spending component of economic freedom and per capita income, suggesting that areas with lower levels of government spending tend to experience higher per capita incomes.

However, there is a short-term negative relationship between the labor market freedom component and per capita income, suggesting that areas with higher levels of labor market freedom initially see slightly lower per capita incomes. Table 6 shows how this effect disappears over the long term.

19 United States Census Bureau, American Community Survey, 5-year Estimates, 2014–2019, https://api.census.gov/data/2019/acs/acs5/profile.

TABLE 5. PA. PER CAPITA INCOME AFTER A ONE-UNIT INCREASE IN ECONOMIC FREEDOM: ONE-TIME CHANGE

Types of Economic Freedom	Increase Per Capita Income
Government Spending Score	**$601.83*** **
Labor Market Score	-$607.57*
Notes: Asterisks *, **. *** indicate significant at the 90, 95, and 99 percent levels, respectively. Robust standard errors (heteroskedasticity-consistent estimators) in parenthesis.	

Moving to the lagged model, the results of prosperity regressions look very much like the results of the poverty regressions. For both employment and per capita income, improvements in economic freedom over a prior five-year period are associated with improvements in these metrics. **A one-unit improvement in economic freedom over the previous five-year period is associated with a 2.08 percentage point improvement in employment and a $2,338 increase in per capita income.**

For context, a 2.08 percentage point increase in employment from 2018 to 2022 indicates Pennsylvania could have added an additional 125,573 jobs.[20] Once again, lower government spending seems to be the key driver. A one-unit increase in the government spending score over the previous five-year period is associated with a 1.14 percentage point increase in state employment and an increase in per capita income of $1,829.

Whether or not the labor market freedom score is significant depends on the prosperity metric under examination, but it is positively and significantly related to employment. A one-unit increase in the labor market freedom score over one five-year period is associated with a 0.83 percentage point increase in employment in a subsequent year.

TABLE 6. PA. EMPLOYMENT AND PER CAPITA INCOME AFTER A ONE-UNIT INCREASE IN ECONOMIC FREEDOM: FIVE YEARS-LAGGED ROLLING AVERAGE

Variables	Employment Increase	Increase Per Capita Income
Economic Freedom Summary Score	**2.08*** **	**$2338.72*** **
Government Spending Score	**1.14*** **	**$1828.991*** **
Tax Score	0.65	$973.38
Labor Market Score	**0.83*** **	-$393.70
Notes: Asterisks *, **. *** indicate significant at the 90, 95, and 99 percent levels, respectively. Robust standard errors (heteroskedasticity-consistent estimators) in parenthesis.		

Not only are reductions in government spending associated with decreases in poverty, but as this section shows, these reductions are also related to increases in prosperity. **While tax cuts often take top billing in political debates, getting spending under control could be a better way to help improve people's lives.**

20 U.S. Bureau of Labor Statistics, "State and Metro Area Employment and Earnings December 2022," accessed January 2023, https://www.bls.gov/news.release/metro.toc.htm.

In addition to discussing concrete ways to address the problems of poverty, the next section will also discuss at least one way Pennsylvania can slow the pace of state spending growth.

State Role in Encouraging Human Flourishing

The most robust finding of this research is that lower levels of government spending are associated with lower levels of poverty *and* higher levels of prosperity.

Two key themes characterize the recommendations: (1) The preference for programs that encourage work. In Pennsylvania, programs like SNAP intentionally waive work and education requirements, or programs like child care subsidies and Medical Assistance unintentionally discourage promotions and added work hours by creating a benefits cliff. (2) Contrary to much of current poverty policy, a precept to trust people to make good decisions for themselves and their families.

Unfortunately, Pennsylvania's track record on spending restraint is weak. General Fund expenditures, for example, have increased about 51 percent since fiscal year (FY) 2015–16. In FY 2022–23 alone, expenditures increased by 10.7 percent.[21] According to the 2021 EFNA Index, the state ranks 32nd out of the 50 states in terms of government spending, down from a rank in the mid-20s in the early 2000s. This lack of fiscal restraint has real consequences. Census Bureau data shows that between July 2021 and July 2022, for example, almost 40,000 residents left Pennsylvania.[22] The economic literature has made clear that people move from areas with low levels of economic freedom to areas with high levels of economic freedom.[23,24]

One way to slow the growth of state spending is the proposed Taxpayer Protection Act (TPA). Currently, 33 states have some sort of tax and expenditure limit (TEL) in place, though the design of these programs varies across states. The effectiveness of TELs depends critically on program design and application. The current proposal in Pennsylvania contains two design elements that tend to make these types of programs more effective: the limitation is constitutional instead of statutory, and it focuses on spending instead of revenue.[25]

Still, changing state spending habits, while difficult, can have long-lasting effects on poverty. The question remains as to how we can best help Pennsylvanians experiencing poverty in the short term. For some of the more notable U.S. anti-poverty programs, states receive block grants from the federal government and have broad latitude in how they administer these programs. The Temporary Assistance for Needy Families (TANF) program is the largest of these programs. The dramatic welfare reform law passed by Clinton in 1996 was the genesis for this block grant

21 Nathan Benefield, "What to Know About the 2022 Pennsylvania State Budget Deal," Commonwealth Foundation, July 7, 2022, https://www.commonwealthfoundation.org/research/pennsylvania-state-budget-deal-2022/.

22 Commonwealth Foundation, "Pennsylvania's Troubling and Continuing Population Declines," December 22, 2022, https://www.commonwealthfoundation.org/2022/12/22/pennsylvania-population-decline/.

23 Daniel Meierrieks and Laura Renner, "Stymied Ambition: Does a Lack of Economic Freedom Lead to Migration?" *Journal of Population Economics* 30, No. 3 (January 2017), 977-1005, https://doi.org/10.1007/s00148-017-0633-4.

24 Richard J Cebula, Maggie Foley, and Joshua C. Hall, "Freedom and Gross In-Migration: An Empirical Study of the Post-Great Recession Experience," *Journal of Economics and Finance* 40, No. 2 (April 2016), 402–20, https://doi.org/10.1007/s12197-014-9315-1.

25 Tirzah Duren, "TEL-Tale Heart: Crafting Effective Policies to Reduce Spending," Commonwealth Foundation, July 12, 2021, https://www.commonwealthfoundation.org/research/tel-tale-heart-crafting-effective-policies-to-reduce-spending/.

approach to funding state poverty assistance programs, with the idea being that states could become effective laboratories of innovation. And though TANF is just one of many means-tested welfare programs, its unique history allows us to draw some broader conclusions with respect to effective reform.

The first lesson from the TANF experience is that policies that encourage work are more effective at achieving long-term poverty-reduction goals than policies that implicitly discourage work.

For example, within a few years of the 1996 reforms, 47 states had liberalized earnings disregards, meaning that working families could continue to keep more assistance funding even as their incomes grew. Over this same period, most states strengthened the work requirement for receiving aid. Forty-three states required individuals to be engaged in "work-related activities" within 24 months to receive aid, and 38 of those states required potential recipients to be engaged in such activities immediately.[26] The earning disregards are important to help poor individuals avoid hitting up against so-called "benefits cliffs." These benefits cliffs occur when assistance phases out rapidly as individuals earn more income.

The Pennsylvania Department of Human Services demonstrates how these "benefits cliffs" hold back families.[27] Take a family consisting of one adult and one child, for example. Once annual income hits $5,000, that family is no longer eligible to receive TANF benefits. That amounts to a loss of about $7,207—an implicit tax rate of over 100 percent. Once earnings hit $24,000, Medicaid benefits disappear, and with an additional $1,000 of earned income, the Supplemental Nutrition for Needy Families (SNAP) benefits also go away. Other benefits, including childcare benefits, continue to disappear as that family earns more income. Indeed, this family would have to achieve a discontinuous jump in wages from $35,000 to $45,000 to overcome a dip in real living standards caused by the benefits cliff. Even high-income workers do not often realize a $10,000 jump in pay.

As the variations in TANF reform after the 1996 Clinton-era welfare reforms reveal, more gradual reductions in benefits as incomes rise can encourage low-income individuals to work more. As people work more, their skills grow. Over time they generally become less reliant on public aid.

Further, the number of states offering earned income tax credits (EITCs) has grown since the mid-2000s, and 28 states currently offer their own EITCs as a supplement to the federal EITC.[28] The construction of EITCs matters a great deal. Research by the Cato Institute suggests that poorly designed EITCs hurt individuals more than they help since fraud, overhead, and earnings disincentives might plague the program.[29] Still, well-designed EITC programs can encourage work. In 22 states, EITCs are refundable—just like the federal EITC—meaning individuals who

26 Thomas Gais and R. Kent Weaver, "State Policy Choices Under Welfare Reform," Policy Brief 21, (Washington, DC: Brookings Institution, April 2002), https://www.brookings.edu/wp-content/uploads/2016/06/pb21.pdf.

27 Pennsylvania Department of Human Services, "What is the Benefits Cliff?" accessed January 10, 2022, https://www.dhs.pa.gov/about/Pages/Benefits-Cliff.aspx.

28 Urban Institute, State Earned Income Tax Credits, accessed January 10, 2022, https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/state-and-local-backgrounders/state-earned-income-tax-credits#:~:text=The%20federal%20earned%20income%20tax,Columbia%20offer%20a%20state%20EITC.

29 Chris Edwards and Veronique de Rugy, "Earned Income Tax Credit: Small Benefits, Large Costs," October 2015, Cato Institute Tax & Budget Bulletin No. 73, https://www.cato.org/sites/cato.org/files/pubs/pdf/tbb-no-73.pdf.

pay very little in taxes can receive the rest of their credit in the form of a refund from the state. A state EITC can help overcome some of the cash-cliff problems discussed here since families' credits generally increase as they earn more, up to a certain amount, after which credits slowly phase out.

Often, the tendency is to view big problems, like poverty, in terms of market failure, with the implication that governments can and should step in to alleviate these failures. Yet, this dichotomous framing of the problem misses the amazing variety of institutions that are neither market nor government, but nonetheless solve major problems. A variety of nonprofit and philanthropic organizations are actively working to alleviate the problems of poverty and help encourage mobility. No one program can reach all people who need its services, but neither can government programs. The optimal mix of aid likely consists of some combination of government and non-government solutions.

One innovative program that has had substantial success is UpTogether, previously the Family Independence Initiative. This organization began explicitly premised on the idea that people at or near the poverty line know better than any third party what exactly they need to improve their lives. Founder Mauricio Miller recognized that people in poverty are smart, hardworking, and creative—they just lack resources. He combined the ideas of philanthropy and investment. If people in his program produce an idea worthy of investment, Miller and his team work to get it funded. Crucially, UpTogether also harnesses the power of social networks amongst individuals at the lower end of the income distribution, so they can learn from one another how to find jobs, buy houses, or start businesses.[30]

Traditional aid programs reward individuals based on how needy they appear to be. UpTogether instead rewards individuals on how hardworking and innovative they are.

Over the past 20 years, the program has expanded to all 50 states, investing over $135 million in more than 200,000 individuals or groups. On average, participating families have seen a 23 percent increase in monthly income, a $665 increase in savings account balances, a 77 percent increase in monthly business income, a decrease in SNAP and TANF usage, and improved grades among their children, among other things.[31]

A program like this is not designed to reach all people. Indeed, many successful nonprofit and philanthropic programs are not scalable. Yet a multitude of small-scale programs could, in fact, be preferable to having a small set of larger programs. State governments should provide assistance in a way that incentivizes work and encourages mobility.

30 Mauricio L. Miller, *The Alternative: Most of What You Believe About Poverty Is Wrong*, (Lulu Publishing Services, 2017).
31 UpTogether, "Investing in People Has Huge Returns," accessed January 10, 2023, https://www.uptogether.org/impact/.

Conclusion

Tackling poverty and promoting broad-based prosperity is a complicated issue that requires a mix of removing barriers, and direct aid by state governments. **Yet too often the alleviation of poverty, not the promotion of prosperity, has been the primary policy objective. While there are similarities in these goals, they are not the same**. Policies that provide resources are important, but they should not be the end of the discussion. Further, such policies are often riddled with damaging unintended consequences—including the ever-present benefits cliff problem.

The main finding of this paper is that **economic freedom is strongly and consistently associated with both reductions in poverty and increases in prosperity.** This creates a tension for policymakers. Spending more on programs to combat poverty might have the opposite effect. To be sure, the government spending component of the EFNA Index includes more than transfer spending; yet getting spending under control will require broad-based reductions in spending. **But the oft-repeated argument that the poor will be worse off if the government cuts spending simply does not hold water.** In fact, based on the findings of this paper, coupled with findings from the economic freedom literature more broadly, **reductions in spending can create enormous benefits for all people.**

Pennyslvanians experiencing poverty lack resources and sometimes education, but that does not mean they are incapable of making good decisions.

Appendix 1:

TABLE 3. ECONOMIC FREEDOM AND POVERTY, CONTEMPORANEOUS

	OPM				SPM			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Economic Freedom Summary Score	-0.85***				-0.94***			
	(0.30)				(0.35)			
Government Spending Score		-0.39***				-0.63***		
			(0.14)				(0.15)	
Tax Score			-0.71***				-0.37	
			(0.25)				(0.37)	
Labor Market Score				-0.17				0.00
				(0.26)				(0.28)
% of Population 25+ with HS Diploma	-1.06***	-1.08***	-1.08***	-1.08***	-0.86***	-0.89***	-0.89***	-0.89***
	(0.10)	(0.10)	(0.11)	(0.11)	(0.19)	(0.17)	(0.20)	(0.20)
% of Population Married	-.049***	-042***	-0.30***	-0.31*	-0.70***	-0.71***	-0.46**	-0.43*
	(0.16)	(0.13)	(0.11)	(0.16)	(0.25)	(0.23)	(0.20)	(0.24)
Constant	136.89***	132.78***	128.34***	124.94***	13049***	131.15***	117.58***	114.33***
	(14.99)	(14.41)	(14.31)	(15.81)	(26.82)	(25.79)	(25.57)	(27.44)
R^2	0.56	0.58	0.54	0.61	0.63	0.62	0.66	0.66
N	499	499	499	499	499	499	499	499

Notes: Asterisks *, **. *** indicate significant at the 90, 95, and 99 percent levels, respectively. Robust standard errors (heteroskedasticity-consistent estimators) in parenthesis.

TABLE 4. ECONOMIC FREEDOM AND POVERTY, LAGGED ROLLING 5 YEAR AVERAGES

	OPM				SPM			
	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
Economic Freedom Summary Score	-1.41***				-1.83***			
	(0.38)				(0.60)			
Government Spending Score		-0.58***				-1.31***		
		(0.18)				(0.29)		
Tax Score			-0.88				-0.24	
			(0.66)				(1.03)	
Labor Market Score				-0.82**				-0.16
				(0.37)				(0.49)
% of Population 25+ with HS Diploma	-0.92***	-0.95***	-0.92***	-0.83***	-0.53*	-0.63**	-0.51*	-0.49*
	(0.25)	(0.25)	(0.23)	(0.23)	(0.30)	(0.29)	(0.30)	(0.32)
% of Population Married	0.12	0.29	0.47	0.31	-0.15	-0.22	0.43	0.41
	(0.40)	(0.37)	(0.31)	(0.42)	(0.41)	(0.38)	(0.35)	(0.42)
Constant	95.98**	85.90**	75.39**	75.24*	78.53	88.07*	38.06	37.04
	(42.32)	(40.37)	(34.37)	(41.24)	(46.19)	(44.81)	(40.81)	(45.56)
R^2	0.62	0.67	0.47	0.70	0.52	0.52	0.23	0.23
N	249	249	249	249	249	249	249	249

Notes: Asterisks *, **. *** indicate significant at the 90, 95, and 99 percent levels, respectively. Robust standard errors (heteroskedasticity-consistent estimators) in parenthesis.

TABLE 5. ECONOMIC FREEDOM AND PROSPERITY, CONTEMPORANEOUS

	EMPLOYMENT				PER CAPITA INCOME			
	(17)	(18)	(19)	(20)	(21)	(22)	(23)	(24)
Economic Freedom Summary Score	0.25				375.16			
	(0.22)				(455.09)			
Government Spending Score		0.10				601.83***		
		(0.10)				(218.69)		
Tax Score			0.22				13.09	
			(0.26)				(342.50)	
Labor Market Score				0.06				-607.57*
				(0.15)				(327.68)
% of Population 25+ with HS Diploma	0.71***	0.71***	0.71***	0.71***	2089.92***	2094.37***	2102.22***	2146.14***
	(0.09)	(0.09)	(0.09)	(0.09)	(216.86)	(196.42)	(218.80)	(225.914)
% of Population Married	1.07***	1.05***	1.02***	1.03***	546.78**	706.77***	441.98***	240.26
	(0.11)	(0.10)	(0.09)	(0.10)	(217.66)	(208.85)	(174.15)	(179.38)
Constant	-57.74***	-56.25***	-55.42***	-54.55***	-184424	-194210	-178103	-168201***
	(12.46)	(11.98)	(12.46)	(12.37)	(26352)	(25434)	(26304)	(26075)
R^2	0.49	0.49	0.48	0.49	0.16	0.15	0.17	0.19
N	500	500	500	500	500	500	500	500

Notes: Asterisks *, **. *** indicate significant at the 90, 95, and 99 percent levels, respectively. Robust standard errors (heteroskedasticity-consistent estimators) in parenthesis.

TABLE 6. ECONOMIC FREEDOM AND PROSPERITY, ROLLING 5 YEAR AVERAGES

	EMPLOYMENT				PER CAPITA INCOME			
	(25)	(26)	(27)	(28)	(29)	(30)	(31)	(32)
Economic Freedom Summary Score	2.08***				2338.72***			
	(0.29)				(832.96)			
Government Spending Score		1.14***				1828.991***		
		(0.13)				(366.41)		
Tax Score			0.65				973.38	
			(0.74)				(839.63)	
Labor Market Score				0.83***				-393.70
				(0.29)				(613.69)
% of Population 25+ with HS Diploma	0.56***	0.64***	0.54***	0.47**	1890.63***	2032.41***	1882.05***	1887.84***
	(0.17)	(0.17)	(0.20)	(0.19)	(342.52)	(315.66)	(374.06)	(393.65)
% of Population Married	0.34	0.24	-0.26	-0.07	-947.16**	-778.04**	-1586.39***	-1853.57***
	(0.26)	(0.25)	(0.22)	(0.28)	(465.12)	(388.58)	(365.57)	(368.07)
Constant	-18.83	-15.49	20.63	17.27	-102481	-120493	-61569	-40612
	(27.87)	(27.57)	(25.52)	(29.31)	(51586)	(46607)	(49150)	(47842)
R^2	0.49	0.52	0.35	0.68	0.37	0.32	0.41	0.42
N	250	250	250	250	250	250	250	250

Notes: Asterisks *, **. *** indicate significant at the 90, 95, and 99 percent levels, respectively. Robust standard errors (heteroskedasticity-consistent estimators) in parenthesis.

Appendix 2

NOTES ON METHODOLOGY

The Economic Freedom in North America (EFNA) index scores components on a 0 to 10 scale, with 10 denoting the highest possible level of economic freedom. The average of these three component areas creates an overall economic freedom score. To avoid imposing subjective value judgements about the relative weighting of the three areas, each area receives equal weight in the overall score.

Because all data used in the construction of the index comes from reputable third-party sources (i.e., Bureau of Labor Statistics, Bureau of Economic Analysis, Census Bureau, etc.), and much of this data is only available on a two-year lag. The most recent version of the index represents 2020 data. This study looks at the pre-pandemic period of 2010 to 2019 to avoid distortions in the 2020 data and the absence of American Community Survey state-level SPM and OPM poverty rates for 2020.

The empirical models include both percentage of the population aged 25+ with at least a high school education and percentage of the population that is married. Both come from the American Community Survey five-year estimates. Percent employed was dropped from the final regressions, since it added no explanatory power after controlling for the other factors, and because including it as a control variable meant losing its use as a dependent variable. Research accounts for both state- and year-fixed effects to control for state-level trends that are constant across years, and shocks to all states experienced within a given year.

Appendix 3

THE AREAS AND COMPONENTS OF THE ECONOMIC FREEDOM OF NORTH AMERICA (EFNA) INDEX SUBNATIONAL INDEX

1. Government Spending
   - A. General Consumption Expenditures by Government as a Percentage of Income
   - B. Transfers and Subsidies as a Percentage of Income
   - C. Insurance and Retirement Payments as a Percentage of Income
2. Taxation
   - A. Income and Payroll Tax Revenue as a Percentage of Income
   - B. Top Marginal Income Tax Rate and the Income Threshold at Which It Applies
   - C. Property Tax and Other Taxes as a Percentage of Income
   - D. Sales Taxes as a Percentage of Income
3. Labor Market Freedom
   - A. Full-time Minimum Wage Income as a Percentage of Per Capita Income
   - B. Government Employment as a Percentage of Total State/Provincial Employment
   - C. Union Density

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