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U.S. METROPOLITAN AREA ECONOMIC FREEDOM INDEX

by Dean Stansel
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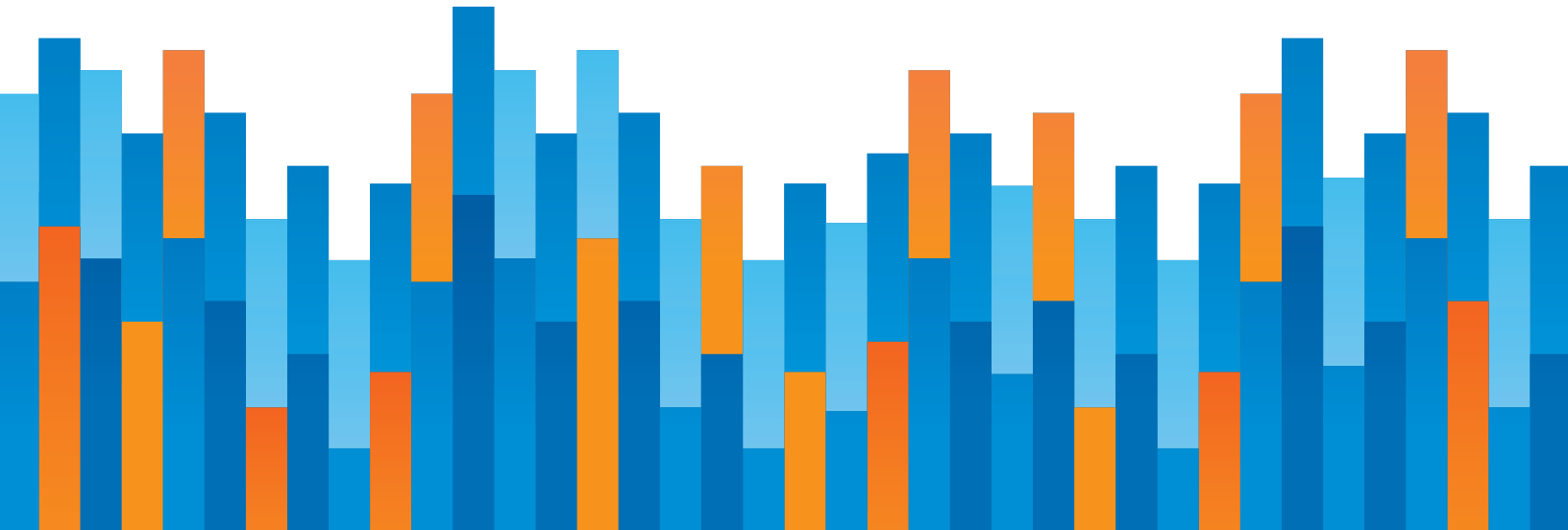

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TABLE OF CONTENTS

PART 1: INTRODUCTION 1

PART 2: ECONOMIC FREEDOM CORRELATIONS WITH PROSPERITY 3

PART 3: ECONOMIC FREEDOM IN U.S. METROPOLITAN AREAS 7

PART 4: CONCLUSION 12

ABOUT THE AUTHOR 13

METHODOLOGY AND DATA 14

PART 1

INTRODUCTION

For centuries, experts have been trying to discover why some places are so rich and others so poor. Some economists suggest that a largely unregulated system leaves individuals maximally free to pursue their own plans, spurring entrepreneurial activity and innovation.

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About 30 years ago, Nobel Laureate economists Milton Friedman, Gary Becker, and Douglas North, as well as a host of other economists and public policy experts, began an effort to quantify how free the economies of individual nations were. About 10 years later, that resulted in the production of the first *Economic Freedom of the World* report, and later a state-level version: *Economic Freedom of North America* (EFNA), which is now produced annually.[1]

[1] *Economic Freedom of the World*. Fraser Institute. Stansel, Torra and McMahon. *Economic Freedom of North America*. 14th edition. 2018. It should be noted that there have been other state economic freedom indexes published in the past, but they have not been updated annually.

That state-level index shows us how the level of economic freedom can vary across sub-national jurisdictions within the same country (e.g., Texas and Florida have less-burdensome economic policies and therefore much greater economic freedom than New York and California). However, levels of economic freedom can also vary *within* those subnational jurisdictions. For example, the San Jose metro area has substantially higher economic freedom than Los Angeles. The same is true for Nashville compared to Memphis. In some places, metropolitan areas straddle state borders, skewing state-level economic data. This report[2] quantifies those intra-state disparities by providing a local-level version of the *EFNA,* ranking 382 metropolitan areas by their economic freedom levels.[3]

Most recently, Ruger and Sorens (2018) provided an index of both personal and economic freedom in the U.S. states. Their *Freedom in the 50 States* report has now been produced five times (in 2018, 2016, 2013, 2011, and 2009).

2 This brief is a revised, updated, and expanded version of the first economic freedom index for local economies in the U.S.: Stansel, Dean. "An Economic Freedom Index for U.S. Metropolitan Areas." *Journal of Regional Analysis and Policy* 43 (1) 2013. 3–20.

3 It builds upon the first such index (Stansel, 2013), which provided only one year of data, by improving the methodology, updating the data, and expanding it backwards in time as well. It provides an economic freedom index for the 382 U.S. metropolitan statistical areas (MSA) as defined in 2015, with data for nine years over five decades (years ending in "2" and "7" from 1972 to 2012).

PART 2

ECONOMIC FREEDOM CORRELATIONS WITH PROSPERITY

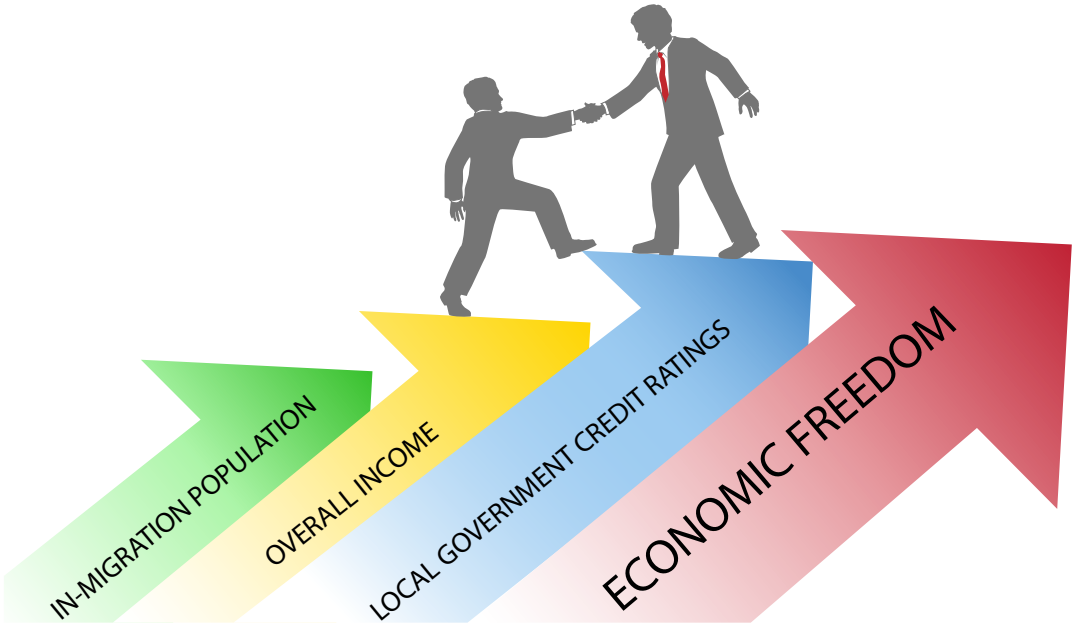
A large and growing literature of both the country and state levels finds economic freedom to be associated with a plethora of positive economic (and other) outcomes.[4] The local level literature, still in its infancy, has produced similar findings. For example, one study found an association between economic freedom and entrepreneurial activity, measured by new businesses created and non-farm employment.[5] Other research finds level and growth of per capita income, domestic migration, and female labor market participation are positively associated with economic freedom.[6] Very recent research finds higher economic freedom

4 See Hall and Lawson (Hall, Joshua C., and Robert Lawson. 2014. "Economic Freedom of the World: An Accounting of the Literature." *Contemporary Economic Policy,* 32(1): 1-19.) for a review of the country-level literature and Stansel and Tuszynski (Stansel, Dean and Meg Patrick Tuszynski. 2018. "Sub-national Economic Freedom: A Review and Analysis of the Literature." *Journal of Regional Analysis and Policy*, 48(1):61–71 for a review of the state-level literature.

5 Bologna, Jamie. 2014. "A Spatial Analysis of Entrepreneurship and Institutional Quality: Evidence from U.S. Metropolitan Areas." *Journal of Regional Analysis and Policy* 44(2): 109–131.

6 Bologna, Jamie, Andrew T. Young, and Donald J. Lacombe. (2016). "A Spatial Analysis of Incomes and Institutional Quality: Evidence from U.S. Metropolitan Areas," *Journal of Institutional Economics,* 12(1): 191-216. Also, Koch, James V. (2015). "Why Do People Move from One Metropolitan Area to Another?" in *Economic Behavior, Economic Freedom, and Entrepreneurship,*

correlated with higher local government credit ratings, more net in-migration of population, increased overall income, and increased per capita income.[7]



> *Very recent research finds higher economic freedom correlated with higher local government credit ratings, more net in-migration of population, increased overall income, and increased per capita income.*

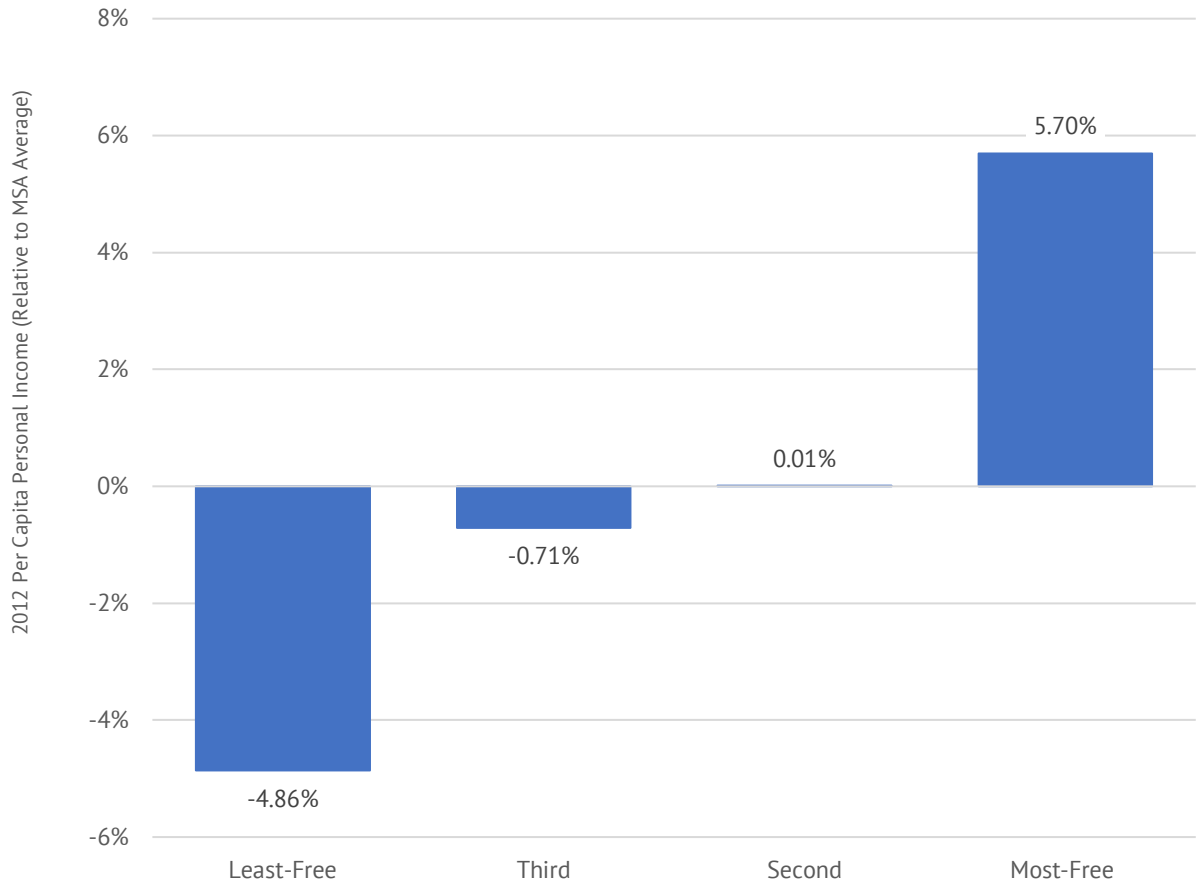
To determine whether this positive correlation extends to very local levels, this analysis examines the 2012 economic freedom rankings of 382 U.S. greater metropolitan areas

ed. Richard Cebula, Joshua C. Hall, Franklin G. Mixon, Jr., and James E. Payne, Northampton, MA: Edward Elgar Publishing, 145-160. And Wong, Crystal and Dean Stansel. (2016). "An Exploratory Empirical Note on the Relationship between Local Labor Market Freedom and the Female Labor Force Participation Rate in U.S. Metropolitan Areas." *Empirical Economics Letters*, 15(11): 1095-1100.

[7] Dove, John. (2017). "The relationship between local government economic freedom and bond ratings," *Journal of Financial Economic Policy*, 9(4):435-49. Also, Shumway, J. Matthew. (2017). "Economic Freedom, Migration and Income Change among U.S. Metropolitan Areas," *Current Urban Studies* 5(4): 1-35.

(known as "metropolitan statistical areas" or MSAs), broken down into quartiles, for metrics associated with prosperity.[8] As Figure 1 shows, 2012 per capita personal income in the most-free quartile of MSAs was 5.70% above the MSA average while it was 4.86% *below* the MSA average in the least-free quartile. In addition, 2012–2016 population growth was 4.83% in the most-free quartile but only 1.22% in the least-free quartile (Figure 2). Figure 3 illustrates a fairly strong correlation between economic freedom in 2012 and subsequent population growth from 2012 to 2016.[9]

FIGURE 1: PER CAPITA INCOME IN U.S. METROPOLITAN STATISTICAL AREAS



[8] Since 382 does not divide evenly by four, the most-free quartile consists of the top 96 MSAs, the second quartile consists of MSAs 96-191, the third quartile consists of MSAs 192-287, and the least-free quartile is MSAs 287-382. In other words, the middle MSA in both the top and bottom half is included in both the quartile above it and the one below it.

[9] The correlation coefficient is 0.408.

FIGURE 2: POPULATION GROWTH IN U.S. METROPOLITAN STATISTICAL AREAS (2012 ECONOMIC FREEDOM SCORE)

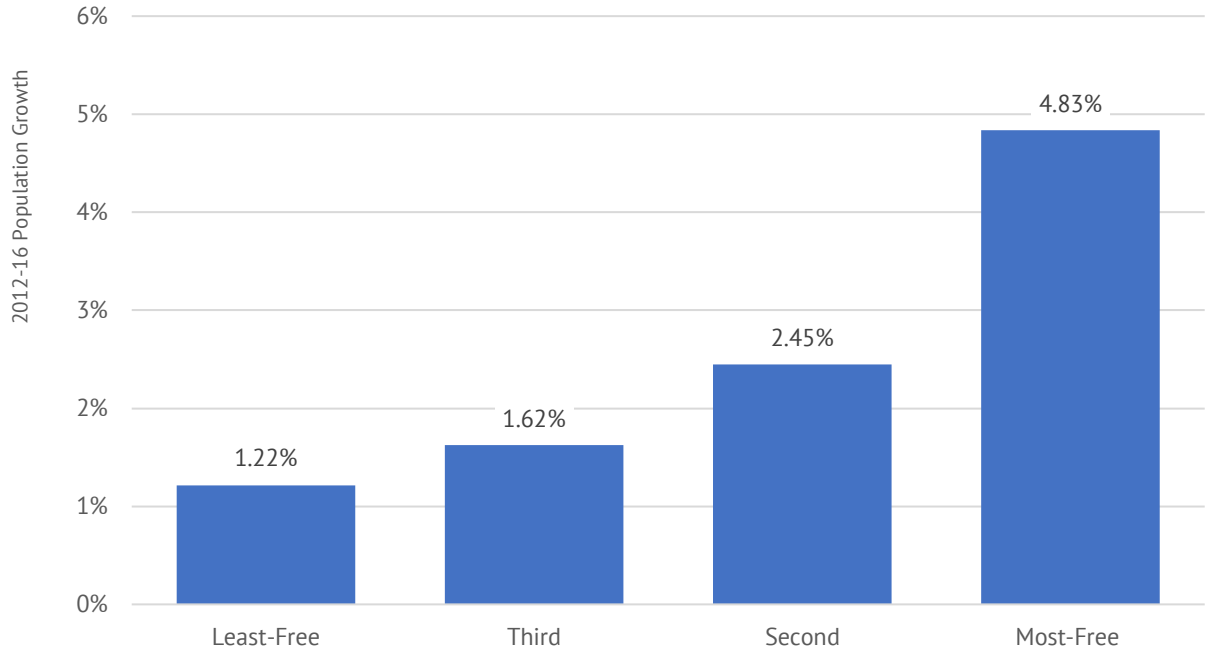
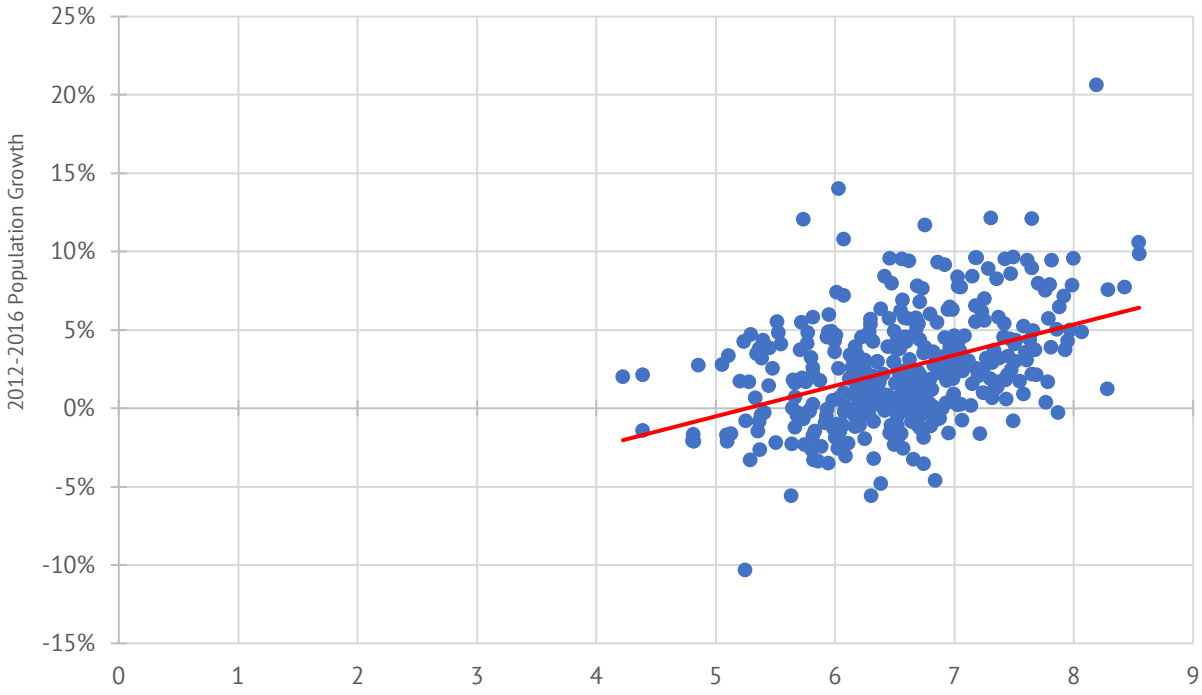


FIGURE 3: ECONOMIC FREEDOM AND POPULATION GROWTH IN U.S. METROPOLITAN STATISTICAL AREAS (2012 ECONOMIC FREEDOM SCORE)



PART 3

ECONOMIC FREEDOM IN U.S. METROPOLITAN AREAS

Because there are important, population-driven differences between the largest metro areas and the smaller ones, for purposes of ranking them, they are divided into two groups: the 52 with 2012 population of one million or higher and the 330 with population below one million.[10] The top three large areas are Houston, Jacksonville, and Tampa; the bottom three are Riverside, Rochester, and Buffalo. As Table 1 shows, among the largest 52 MSAs, the top 10 consists of four areas in both Texas and Florida, and one each in Virginia and Tennessee. The bottom 10 has three in both California and New York, two in Ohio, and one each in Oregon and Rhode Island.

[10] There are 11 large metro areas that contain multiple "metropolitan divisions" (as termed in the official definitions). The 31 metropolitan divisions within those 11 larger areas are not included in the rankings. They are however given a score, which provides some insight into how economic freedom varies within those 11 areas. (Those scores are provided at the end of Table A1 in the Appendix.)

TABLE 1: TEN MOST-FREE AND LEAST-FREE U.S. MSAS (AMONG 52 LARGEST MSAS*)

Metropolitan Area	2012 Economic Freedom Score	Rank	2012 Population
Houston-The Woodlands-Sugar Land, TX MSA	8.00	1	6,180,817
Jacksonville, FL MSA	7.92	2	1,379,131
Tampa-St. Petersburg-Clearwater, FL MSA	7.88	3	2,847,624
Richmond, VA MSA	7.81	4	1,233,682
Dallas-Fort Worth-Arlington, TX MSA	7.80	5	6,704,080
Nashville-Davidson—Murfreesboro—Franklin, TN MSA	7.70	6	1,727,218
Miami-Fort Lauderdale-West Palm Beach, FL MSA	7.66	7	5,779,518
Austin-Round Rock, TX MSA	7.65	8	1,834,319
Orlando-Kissimmee-Sanford, FL MSA	7.50	9	2,226,473
San Antonio-New Braunfels, TX MSA	7.47	10	2,237,381
Riverside-San Bernardino-Ontario, CA MSA	5.23	52	4,342,166
Rochester, NY MSA	5.38	51	1,083,350
Buffalo-Cheektowaga-Niagara Falls, NY MSA	5.41	50	1,135,633
New York-Newark-Jersey City, NY-NJ-PA MSA	5.44	49	19,864,434
Cleveland-Elyria, OH MSA	5.68	48	2,064,240
Columbus, OH MSA	5.94	47	1,946,428
Portland-Vancouver-Hillsboro, OR-WA MSA	5.95	46	2,288,142
Sacramento-Roseville-Arden-Arcadee, CA MSA	6.01	45	2,193,741
Providence-Warwick-Pawtucket, RI MSA	6.03	44	1,604,242
Los Angeles-Long Beach-Anaheim, CA MSA	6.14	43	13,038,490

*Those with 2012 population of one million or greater.

The top three smaller metro areas are Naples, FL, Midland, TX, and Sebastian-Vero Beach, FL. The bottom three are El Centro, CA, Kingston, NY, and Visalia-Porterville, CA.

TABLE 2: TEN MOST-FREE AND LEAST-FREE MSAS (AMONG 330 SMALLER MSAS*)

Metropolitan Area	Economic Freedom Score, 2012	Rank	2012 Population
Naples-Immokalee-Marco Island, FL MSA	8.55	1	332,332
Midland, TX MSA	8.54	2	152,143
Sebastian-Vero Beach, FL MSA	8.43	3	140,650
Sioux Falls, SD MSA	8.28	4	237,753
Manchester-Nashua, NH MSA	8.28	5	402,651
The Villages, FL MSA	8.19	6	102,790
Tyler, TX MSA	8.06	7	214,774
Crestview-Fort Walton Beach-Destin, FL MSA	7.99	8	247,584
Pensacola-Ferry Pass-Brent, FL MSA	7.97	9	462,584
San Angelo, TX MSA	7.95	10	114,993
El Centro, CA MSA	4.22	330	177,287
Kingston, NY MSA	4.39	329	181,811
Visalia-Porterville, CA MSA	4.39	328	450,701
Binghamton, NY MSA	4.81	327	249,219
Glens Falls, NY MSA	4.81	326	128,484
Ocean City, NJ MSA	4.81	325	96,460
Merced, CA MSA	4.86	324	261,430
Yuba City, CA MSA	5.05	323	167,263
Atlantic City-Hammonton, NJ MSA	5.09	322	275,604
Vineland-Bridgeton, NJ MSA	5.10	321	157,071

*Those with 2012 population below one million.

As Table 2 shows, the top and bottom smaller areas show a similar pattern state-wise:[11] Local economies with greater freedom occur mostly in states with higher economic freedom.

[11] The data files, which can be found here: reason.org/mefi-data/, contains the full list for both groups of MSAs with the 2012 scores and ranks for the overall index, as well as all three areas of the index. Tables A2-A5 contain the full list of scores for all nine years for the overall index

One reason that a local-level index is important is that economic freedom can vary quite widely within the same country and even the same state. Table 3 provides an example of this, showing the most-free and least-free MSAs for the 10 most populous states.

TABLE 3: MOST-FREE AND LEAST-FREE MSA IN TEN MOST POPULOUS STATES

Metro/County	Economic Freedom Score, 2012	2012 Population
San Jose-Sunnyvale-Santa Clara, CA MSA	6.71	1,895,787
El Centro, CA MSA	4.22	177,287
Naples-Immokalee-Marco Island, FL MSA	8.55	332,332
Panama City, FL MSA	7.20	187,698
Atlanta-Sandy Springs-Roswell, GA MSA	7.23	5,452,145
Rome, GA MSA	5.98	96,065
Peoria, IL MSA	6.47	380,386
Kankakee, IL MSA	5.81	112,976
Midland, MI MSA	6.62	83,678
Bay City, MI MSA	5.50	107,091
Albany-Schenectady-Troy, NY MSA	5.66	875,637
Kingston, NY MSA	4.39	181,811
Jacksonville, NC MSA	7.43	183,807
Rocky Mount, NC MSA	5.88	150,986
Canton-Massillon, OH MSA	6.17	403,394
Mansfield, OH MSA	5.66	122,590
State College, PA MSA	6.74	155,936
East Stroudsburg, PA MSA	5.35	168,567
Midland, TX MSA	8.54	152,143
McAllen-Edinburg-Mission, TX MSA	6.30	806,388

The average difference between the most- and least-free areas in these ten states is 1.38, with a high of 2.49 in California. El Centro, California is the overall least free area in the

and all three areas of the index. Tables A6-A9 do the same for the ranks. Table A10 lists the areas by state, sorted within states by overall economic freedom score.

country with a score of 4.22. San Jose-Sunnyvale-Santa Clara is the most-free area in California at 6.71. However, the San Jose area still has substantially less freedom than the least-free area in Florida (Panama City at 7.20), the state with the overall most-free area in the country.[12] In fact, in 35 states, the most-free area has less freedom than Panama City, Florida.

[12] That area is Naples-Immokalee-Marco Island at 8.55, highest among the entire set of 382 metro areas (combining the 52 largest with the 330 smaller ones). Naples was also highest in the previous version of this index.

PART 4

CONCLUSION

There are several national and state economic freedom rankings, which provide more comprehensive measures of the economic restrictions governments impose than simple measures of taxes or government spending, but some differences exist across metropolitan areas that those national and state indexes do not reflect. Furthermore, research using those indexes suffers from the fact that there are numerous differences across areas that cannot easily be quantified, and thus cannot be incorporated into statistical tests. That problem is most pronounced with nations, but it is also troublesome with states within the same nation. By examining economic freedom at the local level, those unquantifiable differences across areas are kept to a minimum. Simple statistical analysis indicates that metropolitan areas with higher economic freedom tend to have higher per capita incomes and faster population growth, which mirrors such prosperity metrics found in research on nations and states.

ABOUT THE AUTHOR

Dean Stansel is a research associate professor at the O'Neil Center for Global Markets and Freedom in the Cox School of Business at Southern Methodist University. He earned his B.A. in economics (with honors) and politics from Wake Forest University and his M.A. and Ph.D. in economics from George Mason University. Before entering academia, Prof. Stansel worked for seven years at the Cato Institute, a public-policy research organization in Washington, D.C., where he produced over 60 publications on fiscal policy issues, including the first four editions of their "Fiscal Policy Report Card on America's Governors." Since 2013, he has been the primary author of the Fraser Institute's annual *Economic Freedom of North America,* which ranks the states. He has also authored numerous academic journal articles on a variety of issues in public finance and urban economics. Prof. Stansel's research has been discussed in many publications including *The Wall Street Journal, The New York Times, San Francisco Chronicle,* and *Atlanta Journal-Constitution*; and his op-eds have appeared in the *The Wall Street Journal, Washington Post, Investor's Business Daily, Chicago Tribune*, and *Dallas Morning News,* among others.

APPENDIX

METHODOLOGY AND DATA

The time-tested methodology used in the *Economic Freedom of North America* is used to measure economic freedom in U.S. metropolitan statistical areas. The MSA is a county-based concept intended to capture the boundaries of the local economy. Utilizing data on commuting patterns, the definition of an individual MSA includes all of the counties that are part of that local economy. For a variety of reasons, the MSA is preferable to the city or the county. First, the MSA approximates the entire local economy. Second, unlike cities, the MSA's boundaries can be held constant over time.[13] (As cities expand, it is not feasible to get historical data on things like taxes and government spending for the areas that were previously not part of the city.) While it is very uncommon, there have been examples of counties expanding or contracting as well. Third, there are numerous special district governments that have boundaries overlapping more than one city and/or county. It is not possible to separate the taxes and spending across those cities and counties.

There are three areas of economic freedom measured in the *EFNA*, and in this local index. Area 1 measures government spending, Area 2 measures taxes, and Area 3 measures labor

[13] The 2015 definitions are used herein. Those same definitions are used for all years of the dataset. The definitions are provided by the U.S. Office of Management and Budget. They are available here: https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/bulletins/2015/15-01.pdf

market freedom. There are three variables used in each of those three areas.[14] For each of those nine variables, the raw data is converted to a standardized 0 to 10 score, in which the value representing highest economic freedom gets a 10, the one representing lowest economic freedom gets a 0, and all others are given a score proportionately in between 0 and 10.[15] Those three standardized scores within each area are averaged to get an overall score for each of the three areas. Those three area scores are then averaged to get an overall economic freedom score. This approach maintains objectivity by giving each variable (and each area) an equal weight, rather than subjectively determining a different weight for each variable and area.

Table A1 lists the nine variables. The first two areas utilize fiscal measures based on data from the U.S. Census Bureau. Their *Census of Governments* is conducted every five years, in the years ending in "2" and "7". They survey all of the more than 90,000 individual local governments and collect data on various detailed components of taxes, spending, debt, and government employment. That includes not only cities and counties, but also school districts, transportation districts, and all other such single-purpose special districts. The data are summed at the county level. In the case of special district governments that overlap multiple city and county boundaries, the data are included within the county in which the government is headquartered.[16]

Because states differ in how much they centralize state and local government functions at the state level, looking just at local data would provide an incomplete picture. For example, in Vermont, state government accounts for 85% of total state and local government expenditures, whereas in Nebraska the state accounts for only 48%. The burden of *state* government on economic freedom must be incorporated in order to provide a complete picture of the level of restrictions faced by residents in each metropolitan area. For the six fiscal variables in Areas 1 and 2, a state-level figure for each variable is calculated (e.g., state government general consumption expenditures as a percentage of personal income).

[14] In the *EFNA*, there are four variables in Area 2 because a variable for the top marginal income tax rate is included. While that variable provides important information, there is no central source of historical local income tax rates, and there are hundreds of jurisdictions that levy them, so including that variable herein was not feasible.

[15] In three cases, there are outliers that would skew the relative scores. In those cases, the cut-off for a zero is changed so that there are multiple areas with the lowest possible score.

[16] This is the primary reason why a county-level index is not feasible. The scores would be biased against that headquarters county, which tends to be the county in which the largest central city is located.

That figure is added to the local government figure discussed above to produce the total state and local value used to calculate each area's score. In the 46 metro areas that overlap state borders, a population-weighted average for the state government figure was used[17] (rather than using the figure for the state with the largest share of population, as was done in the previous version).

TABLE A1: AREAS AND COMPONENTS OF THE U.S. METRO AREA ECONOMIC FREEDOM INDEX

1. Government Spending
1A. General Consumption Expenditures as a Percentage of Personal Income
1B. Transfers and Subsidies as a Percentage of Personal Income
1C. Insurance and Retirement Payments as a Percentage of Personal Income
2. Taxation
2A. Income and Payroll Tax Revenue as a Percentage of Personal Income
2B. Sales Tax Revenue as a Percentage of Personal Income
2C. Revenue from Property Tax and Other Taxes as a Percentage of Personal Income
3. Labor Market Freedom
3A. Minimum Wage (full-time income as a percentage of per capita personal income)
3B. Government Employment as a Percentage of Total State Employment
3C. Private Union Density (private union members as a percentage of total employment)

Combined together, variables 1A, 1B, and 1C account for all of state and local government spending with two exceptions: capital outlays (spending on things like physical infrastructure) and interest on debt. The former can fluctuate highly from year to year, so including it can be problematic. This can also be a problem for the latter, though the fluctuations are less dramatic and less frequent. Variables 2A, 2B, and 2C account for all tax revenue with the exception of severance taxes, which are levied only at the state level.

[17] For example, in the Allentown-Bethlehem-Easton, PA-NJ MSA, 87% of the 2012 population was in Pennsylvania and 13% was in New Jersey, so for 2012 the state figure that was added to the local figure was the Pennsylvania number times 0.87 plus the New Jersey number times 0.13.

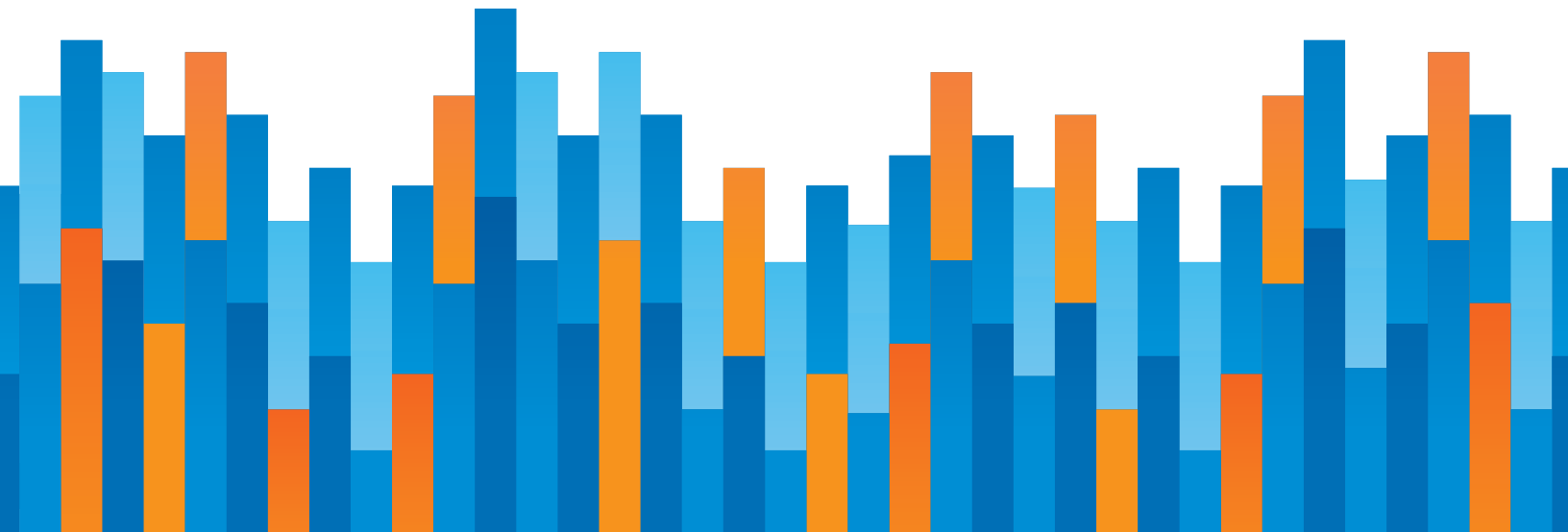
Examples of these are taxes on natural resources such as oil and timber. These are excluded because they tend to be factored into resource prices and thus paid by consumers of those goods all over the country, not just in that state.

Area 3 is more complicated. Variable 3A captures the extent to which the minimum wage that prevails in each area is a binding constraint on the ability of employers and employees to enter into voluntary labor agreements. Until recently, the vast majority of minimum wages that were higher than the federal minimum wage were based on state-level laws. While there have been numerous increases at the local level in the past few years, as of 2012, the most recent year of this index, there were still only four local-level minimum wage laws: San Francisco, CA; Washington, DC; Albuquerque, NM; and Santa Fe, NM. For variable 3A, with the exception of Washington for all years and San Francisco, Albuquerque, and Santa Fe for 2007 and 2012, the data are based on the state minimum wage.[18] As of 2012, there were 18 states with a minimum wage higher than the federal level of $7.25. For the remaining states the federal level was used. The full-time annual income is calculated by multiplying the minimum wage in each area by 40 hours a week and 52 weeks a year. That number is divided by the metro area's per capita personal income to adjust for varying levels of income in each MSA. In a poor area, a minimum wage of $7.25 will be much more of a binding constraint than in a rich area where it likely will not be as far above the prevailing equilibrium wage for low-skilled labor. That percentage is what is used to calculate the standardized scores for variable 3A. In the case of the 46 multi-state metro areas, the same population-weighted average procedure is used as was described previously for the variables in Areas 1 and 2.

Variable 3B is the total number of local government employees divided by the total number employed in the metro area plus the total number of state government employees divided by the total number employed in the state. The population-weighted average is used to calculate the state portion for the 46 multi-state metros. This is included to capture the extent to which the government competes with the private sector for workers.

[18] In each of those four cases, since those were city-level laws, a population-weighted figure was calculated in which the higher local minimum wage was only attributed to that percentage of the population that lived in the city itself, as opposed to the entire metro area. The state-level minimum wage was attributed to the non-city portion of MSA population.

Variable 3C measures the percent of employees who are members of a private employee union.[19] (We use only private employees because government employee share is already captured in Variable 3B.) This provides a more refined measure of the impact of state employment laws regarding unions than would a simple binary variable for whether or not a state has a "right to work" law. Due to small sample sizes, the local union density data can fluctuate greatly from year to year.[20] For that reason, we use state-level data in variable 3C. Population-weighted averages are used for the multi-state metros.

[19] Those data come from Barry Hirsch and David Macpherson at www.unionstats.com.

[20] For example, Athens, GA, had a union density of 0% in 2005 and 11% in 2007. McAllen, TX had 0.5% in 2005 and 12.3% in 2007.