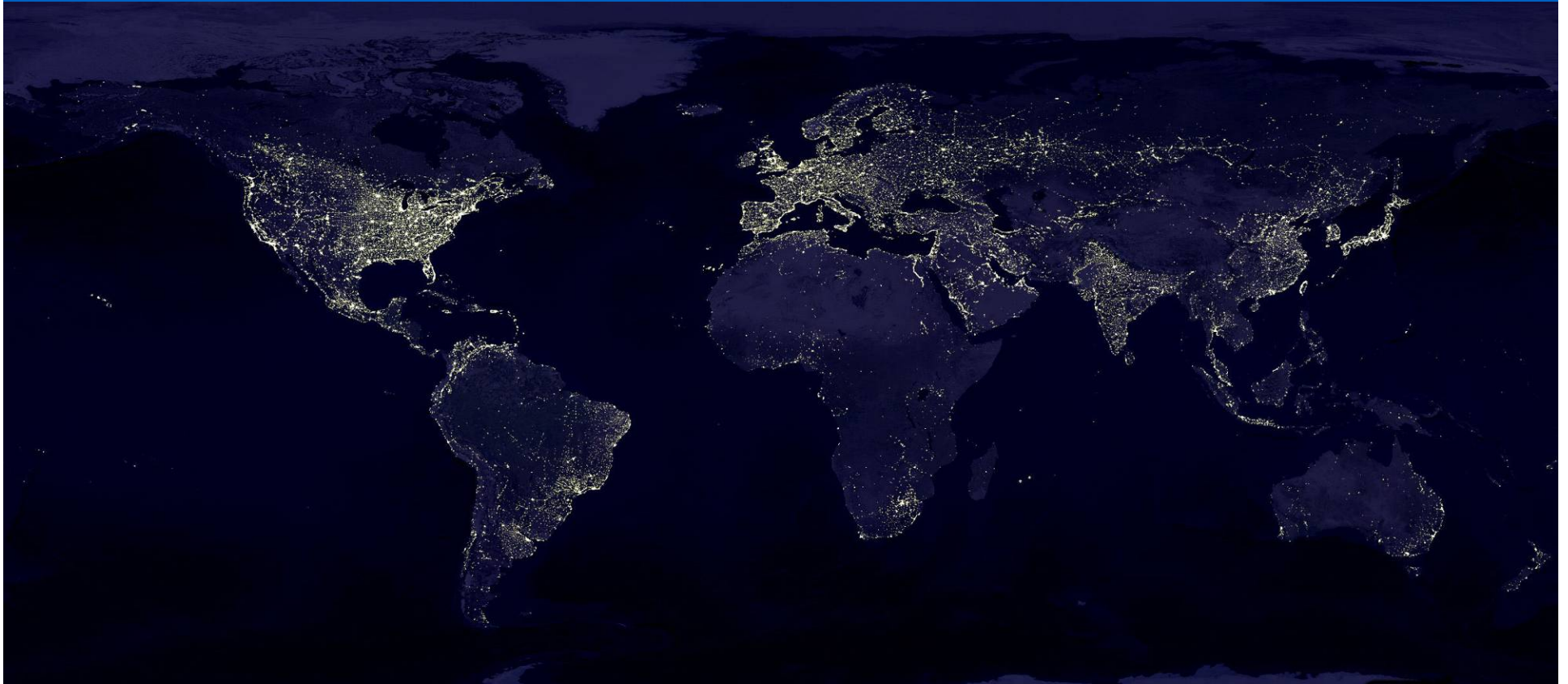


# Using Pro-Growth Public Policy to Create a Real Strategy for American Innovation

Russell S. Sobel, Ph.D.

Professor of Economics  
James Clark Coffman Distinguished Chair  
West Virginia University

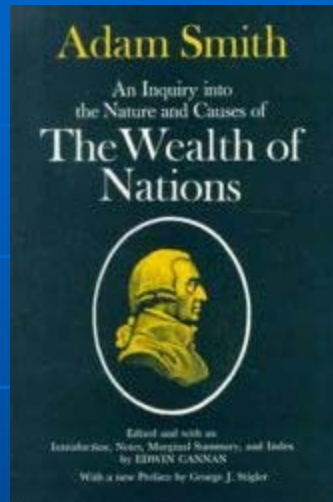
# What Explains Prosperity?



Earth at Night  
More information available at:  
<http://antwrp.gsfc.nasa.gov/apod/ap001127.html>

6.64 x 9.54 inch photo quality  
image available in the book:  
"The Universe: 365 Days"

# Adam Smith's Question: Why Are Some Countries Rich and Others Poor?



An Inquiry into the Nature and Causes of the Wealth of Nations (1776)

- Policies and the system of economic organization (e.g., capitalism) matter more than things such as resources, geography, education, democracy, etc., in determining prosperity

# Rankings of Reliance on Capitalism



The key ingredients of economic freedom are personal choice, voluntary exchange, freedom to compete, and the protection of persons and property. Economic freedom creates an environment in which personal ingenuity can flourish.

A special chapter by William Easterly of New York University compares the impact of economic freedom with that of foreign aid, the old nostrum for creating economic well-being in the developing world. He shows that foreign aid is ineffective, but he has extremely good news for poorer countries. They can lift themselves from poverty on their own, without depending on uncertain and often politically motivated outside "help."

Dr. Easterly shows that economic freedom is a powerful tonic for growth. Quite literally, poorer nations only need liberate their people from policies that limit economic freedom. The unleashed dynamism and ingenuity will build prosperity and reduce poverty in a way that foreign aid has repeatedly failed to achieve.

The *Economic Freedom of the World* provides the most comprehensive index of economic freedom available. It uses reproducible measures appropriate for peer-reviewed research. Approximately 200 scholarly articles have employed the index.



The full data-set, including all of the data published in this report, can be freely downloaded at: [www.freetheworld.com](http://www.freetheworld.com)

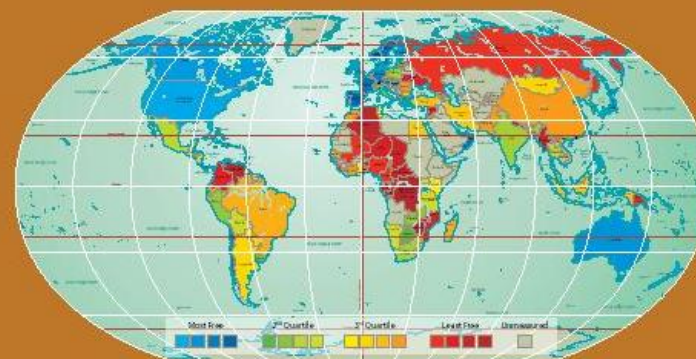
Economic Freedom of the World:  
2006 Annual Report  
Printed and bound in Canada



Economic Freedom of the World 2006 Annual Report James Gwartney & Robert Lawson with William Easterly

## Economic Freedom of the World 2006 Annual Report

James Gwartney and Robert Lawson with William Easterly  
with a Dedication to Sir John Cowperthwaite



Algeria: Algerian Centre for Economic Research (ACEP) • Argentina: Fundación Libertad • Australia: Institute of Public Affairs • Austria: IFOP • Azerbaijan: Center for Economic and Political Research • Bahrain: The Bahrain Institute for Economic and Social Studies (IBES) • Belgium: Scientific Research Policy Center • Belgium Center for the New Europe • Bolivia: Fundación Libertad y Democracia (FLADE) • Brazil: Instituto Liberal do Rio de Janeiro • Bulgaria: Institute for Market Economics • Cambodia: Center for Institute of Development Study • Canada: The Fraser Institute • Chile: Instituto Libertad y Desarrollo • Colombia: Instituto Libertad y Progreso (ILP) • Costa Rica: Instituto para la Libertad y el Desarrollo • Croatia: Institute of Economics • Czech Republic: Libertas Institute • Denmark: Center for Political Studies • Dominican Republic: Instituto de Estudios Económicos y Democáticos • Ecuador: Instituto Ecuatoriano de Economía Política • Estonia: International University of Co-operation in Business • France: Association pour la Liberté Economique et le Progrès Social (ALPES) • Georgia: Society for Democratic Economic Knowledge • New Economic School • Georgia • Germany: Überlebenshilfe • Ghana: The Institute of Economic Affairs • Guatemala: Centro de Investigaciones Económicas y Sociales • Haiti: Institut de Recherche pour le Développement et le Progrès (IRDP) • Hong Kong: Hong Kong Centre for Economic Research • Hungary: Szabadegyesület • Iceland: Centre for Social and Economic Research (CSER) • India: Centre for Civil Society • Indonesia: The Institute for Development of Economics and Finance • Ireland: Open Public Institute • Israel: Institute for Advanced Strategic and Political Studies • Italy: Centro Studi • Ivory Coast: Bureau d'Analyse d'Économies et de Logique (BEALOG) • Kenya: Africa Research Centre for Public Policy and Market Process • South Korea: Center for Free Enterprise • Kyrgyz Republic: Economic Policy Institute • Kyrgyzstan: Core Econ • Lithuania: Lietuvos Laisvės Taryba • Luxembourg: O.L. Liberté et Progrès • Mexico: Centro de Investigación y Promoción del Comercio Exterior • Mongolia: Open Society Policy • Mozambique: The Center for Entrepreneurship and Economic Development • New Zealand: The New Zealand Business Roundtable • Norway: Institute of Public Policy Analysis • Norway: Center for Business and Society • Independent Center • Oman: International Research Foundation (IRF) • Pakistan: Al-Mawana Solutions Institute • Panama: Fundación Libertad • Peru: Centro de Investigación y Estudios Sociales (CIES) • Philippines: The Center for Research and Communication • Poland: Centrum im. Adama Smitha • Portugal: Casa Liberal • Romania: Romania Think Tank • Russia: Institute of Economic Analysis • Serbia: Free Market Center (FMC) • Slovakia: Public The SA, Slovak Foundation • South Africa: The Free Market Foundation of Southern Africa • Sri Lanka: The Pathfinders Foundation • Sweden: Timbro • Switzerland: Überlebenshilfe • Trinidad and Tobago: Institute of Business • Turkey: Association for Liberal Thinking • Ukraine: The Ukrainian Center for Independent Political Research • United Kingdom: The Institute of Economic Affairs • USA: Cato Institute • Venezuela: The Center for the Dissemination of Economic Knowledge (CEDEK) • Vietnam: Research Center for Entrepreneurship and Development Policies • Zambia: Zambia Institute for Public Policy Analysis (ZIPPAA)





# A Quick Tour of The World

# Example 1

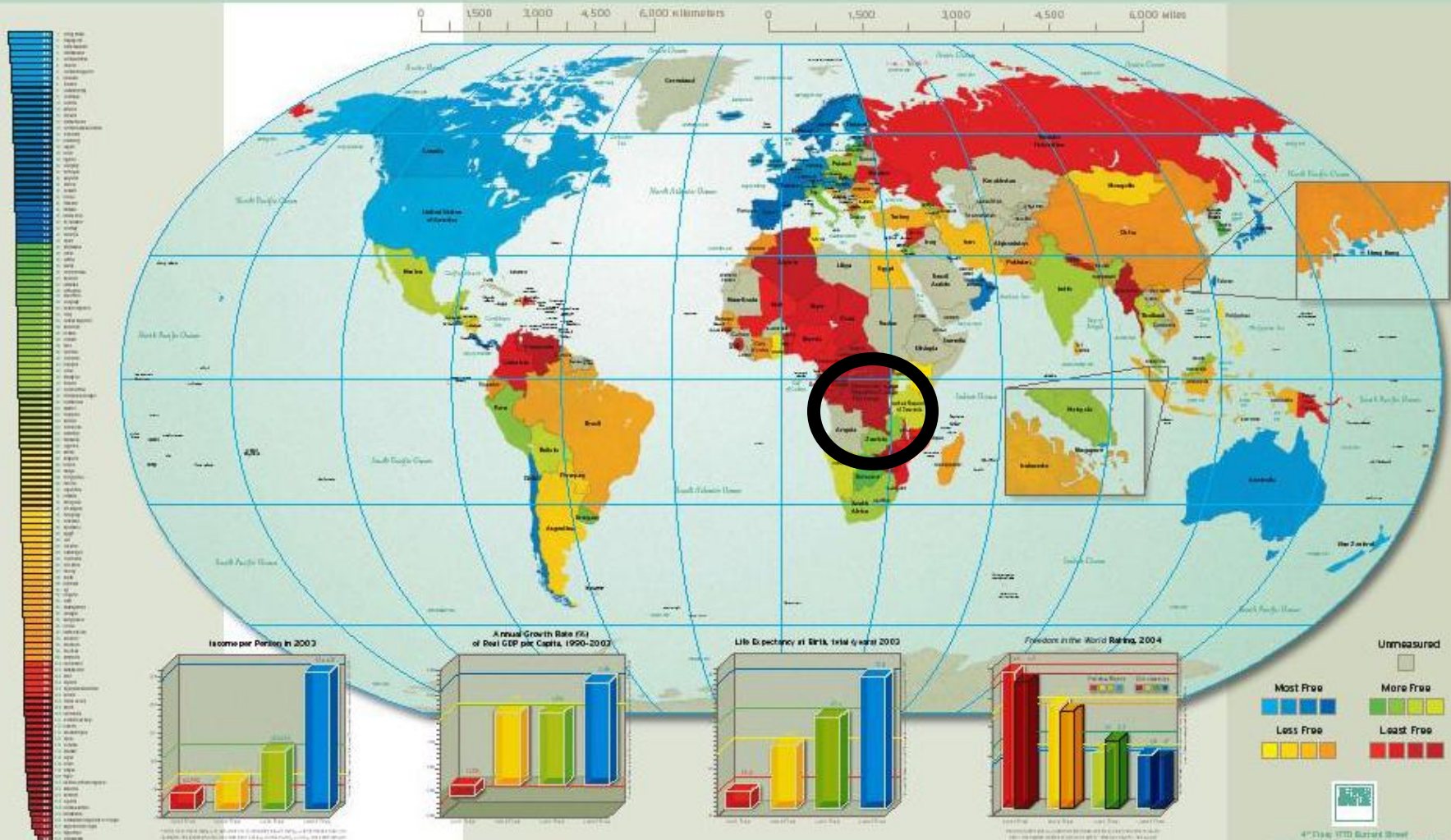
- A Country with VERY LOW Economic Freedom

# Zimbabwe



## Economic Freedom of the World

Economic freedom means that people are free to trade with others, compete in markets, buy what they want, earn a living in a job they choose, keep what they earn, and own things privately. This index indicates the degree to which economic freedom can be found in various countries.



Source: James Gwartney and Robert Lawson, *Economic Freedom of the World: 2006 Annual Report* © 2006, The Fraser Institute

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# Families in Zimbabwe





# Families in Zimbabwe



# Example 2

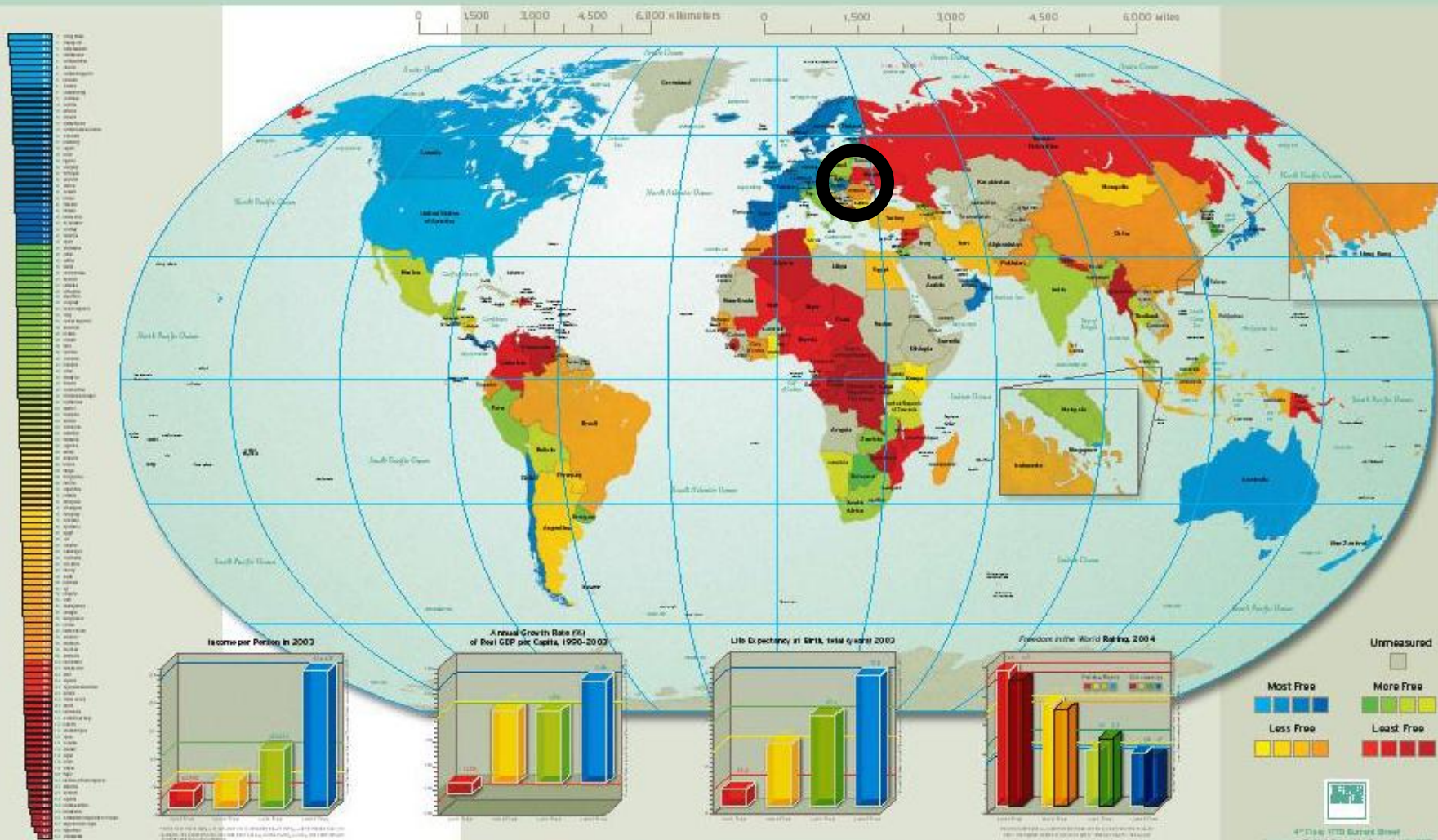
- A Country with LOW Economic Freedom

# Romania



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# Families in Romania





# Families in Romania



# Families in Romania



# Families in Romania



# Families in Romania





# Families in Romania



Certainly one cannot argue that Romania is poor because they don't have enough entrepreneurial people....

# Families in Romania



# Families in Romania



# Example 3

- A Country with MEDIUM Economic Freedom

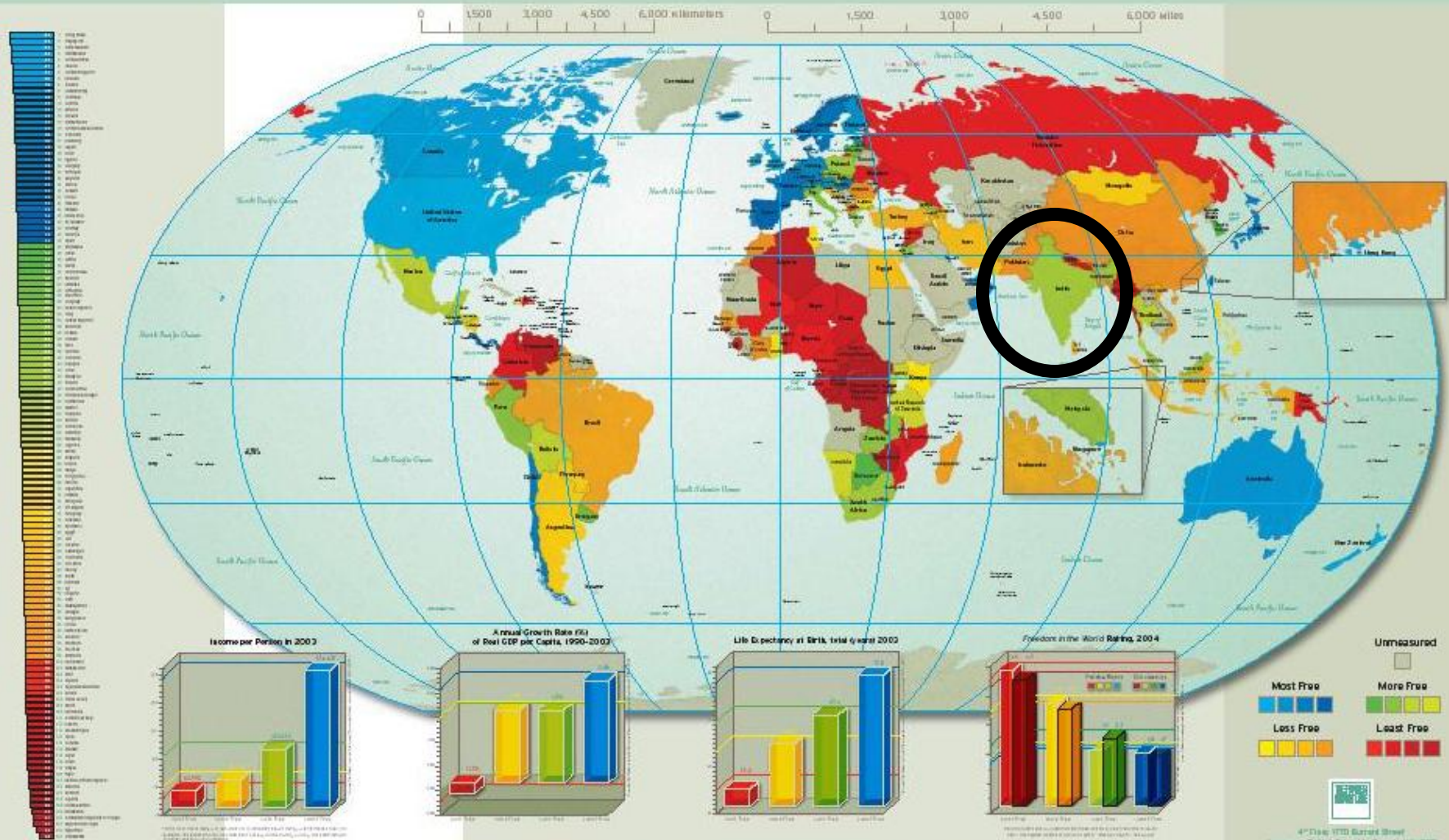


# India



## Economic Freedom of the World

Economic freedom means that people are free to trade with others, compete in markets, buy what they want, earn a living in a job they choose, keep what they earn, and own things privately. This index indicates the degree to which economic freedom can be found in various countries.



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# Families in India



# Families in India





# Example 4

- A Country with HIGH Economic Freedom

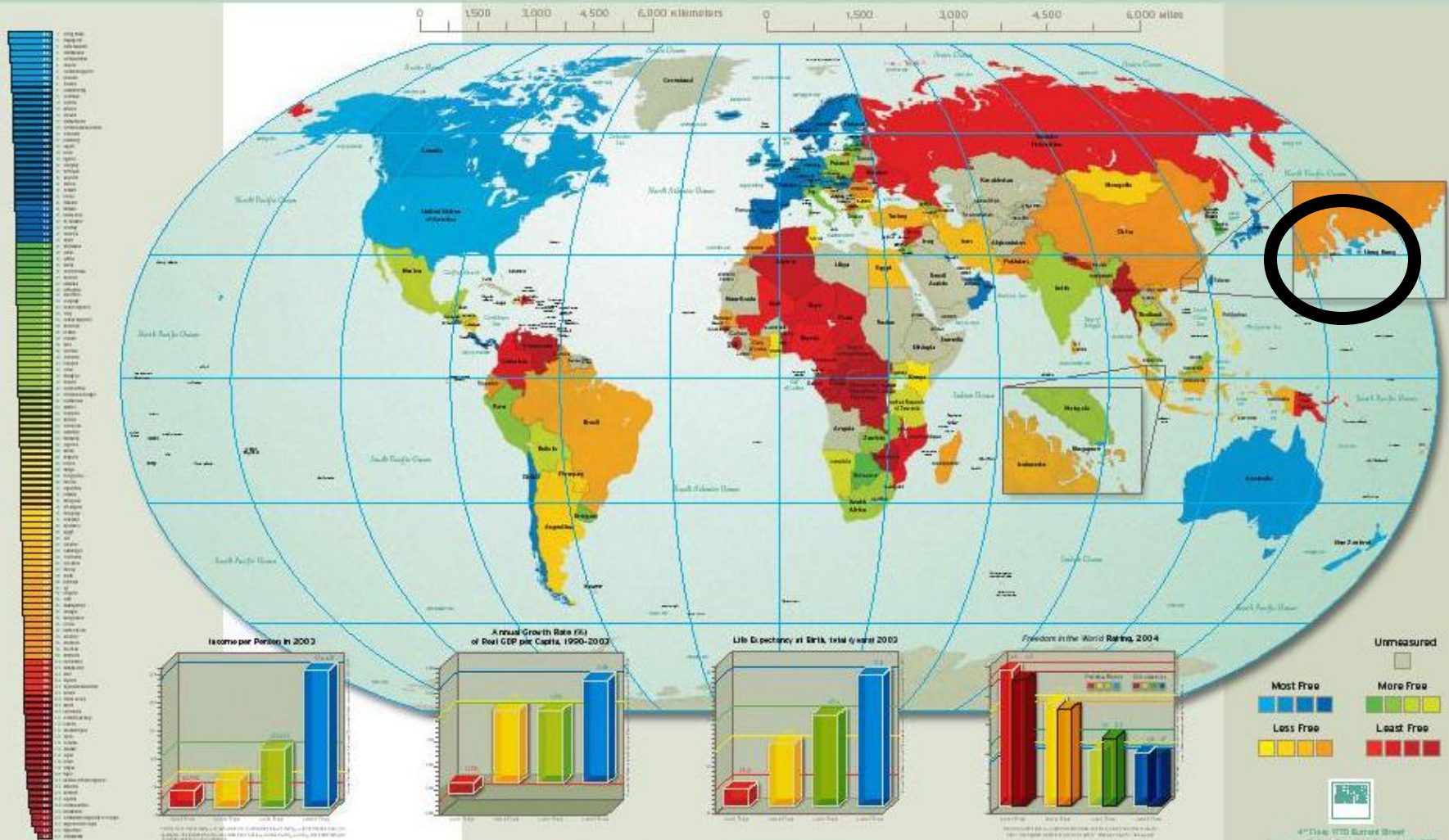


# Hong Kong



## Economic Freedom of the World

Economic freedom means that people are free to trade with others, compete in markets, buy what they want, earn a living in a job they choose, keep what they earn, and own things privately. This index indicates the degree to which economic freedom can be found in various countries.



Source: James Gwartney and Robert Lawson, *Economic Freedom of the World: 2006 Annual Report* © 2006, The Fraser Institute

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# Families in Hong Kong





# Families in Hong Kong



# The Role of the Entrepreneur

- Decentralized entrepreneurship is one main reason why capitalism works to generate progress and prosperity
- Entrepreneurs keep inventing new things that improve our way of life



# Our Homes



- Percent of homes with Heating & Air Conditioning  
1956 = 6%                      1996 = 81%
- Percent of homes with only one bathroom  
1956 = 71%                      1996 = 9%

# And They are Better: Our Showers



# Our Cars



- We now have DVD players, Air Conditioning, Anti-lock Brakes, Power windows

# Our Phones





# Our Entertainment



# Our Science



# Our Computers



## Tandy 5000 MC Professional System

NEW FOR **89** **8499<sup>00</sup>**

Monitor and mouse not included

- 20 MHz Intel® 80386™ Microprocessor ■ VGA Graphics
- 2 MB RAM (16 MB Capacity) ■ Cache Memory

Our most powerful computer ever! The Tandy 5000 MC Micro Computer is strictly business, from the look of its 256,000-color VGA graphics to the tactile feel of its newly-designed keyboard. Its Intel 80386 processor operates at a lightning-fast 20 MHz, and a memory cache controller provides RAM-fast access to your data. IBM® Micro Channel™ compatible architecture provides a 32-bit wide data path for virtually simultaneous data transfer between peripherals. Will operate MS-DOS® 3.3, MS® OS/2, SCO® XENIX® 386 and network operating software. The 5000 MC's technology, performance and price all add up to an incredible value. VGA graphics, serial and parallel ports and mouse support included.

25-6000 ..... 8499.00

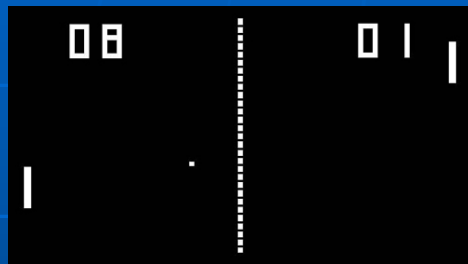




# Our Video Games



# From Pong to Rock Band





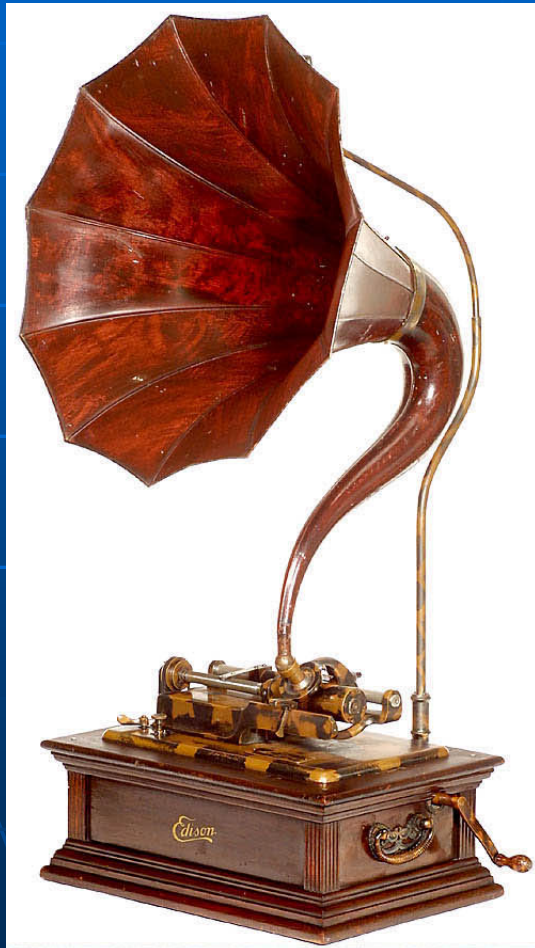
# Our Medicine



U.S. Life Expectancy has risen from 48 in 1900 to 76 today



# Our Music



# Creative Destruction

An economy undergoes continuous change  
– some industries fail, others are born

Capitalism critically relies on  
entrepreneurship and the profit and loss  
system to direct this process

This process cannot be centrally planned or  
directed effectively - it must be *discovered*  
within the marketplace

# Nobody Knows Enough to Centrally Plan an Economy: The Future Must be Discovered

Ken Olson, chairman/founder of Digital Equipment Corp., 1977.  
"There is no reason anyone would want a computer in their home."

Fred Smith's (FedEx) Yale University Senior Project Grade Remark:  
"The concept is interesting and well-formed, but in order to earn  
better than a 'C,' the idea must be feasible."

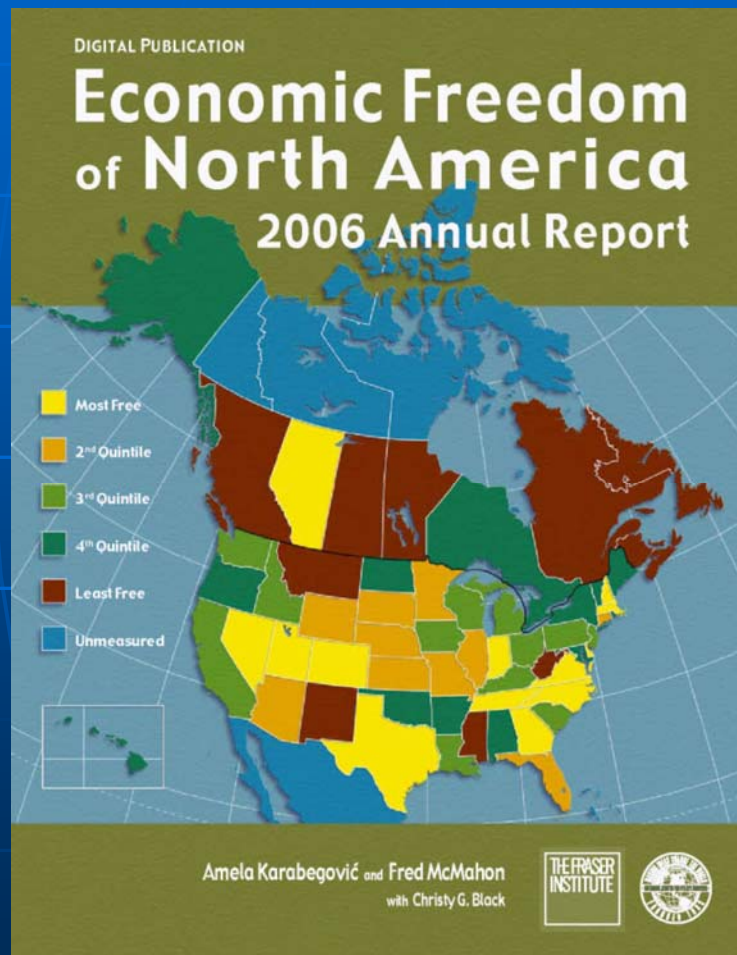


# Would you have invested?



Microsoft Corporation 1978

# Cross State Differences in Economic Freedom Matter Too



## West Virginia Ranks:

50<sup>th</sup> in Economic Freedom/Capitalism

48<sup>th</sup> in Per Capita Income

47<sup>th</sup> in Private Entrepreneurship

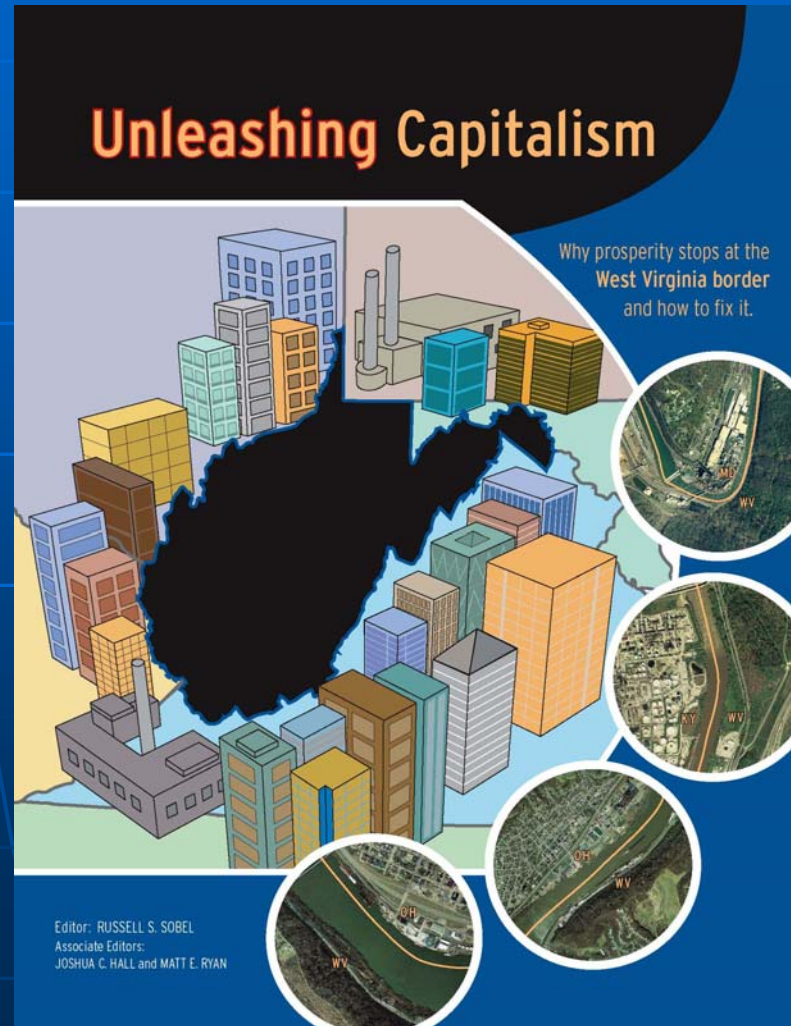
We can learn a lot about what NOT to do from WV's policies

## Table 2: Economic Freedom and Entrepreneurial Activity

State	Economic Freedom Index			Measures of Entrepreneurial Activity (annual averages)					
	Score	Overall Rank	Rank (among U.S. states only)	Venture Capital Investment Per Capita	Patents Per Capita (per 100,000)	Sole Proprietorship Growth Rate	Establishment Birth Rate	Establishment Birth Rate (Large Firms Only)	
<b>Top 5 States</b>									
Delaware	8.5	1	1	\$60.97	52.6	5.5%	13.1%	14.2%	
Texas	7.8	2	2	\$113.29	25.9	3.3%	12.8%	12.0%	
Colorado	7.6	4 (tie)	3 (tie)	\$333.22	37.1	4.6%	14.2%	13.0%	
Georgia	7.6	4 (tie)	3 (tie)	\$103.63	14.6	4.0%	13.5%	11.7%	
North Carolina	7.6	4 (tie)	3 (tie)	\$82.57	19.5	3.5%	11.7%	10.3%	
<b>Bottom 5 States</b>									
Montana	6.0	47 (tie)	46 (tie)	\$14.30	12.6	1.9%	12.0%	10.7%	
New Mexico	6.0	47 (tie)	46 (tie)	\$10.08	16.3	2.7%	12.1%	10.8%	
Maine	5.8	49 (tie)	48 (tie)	\$34.96	9.3	3.0%	11.2%	9.5%	
Mississippi	5.8	49 (tie)	48 (tie)	\$18.53	5.6	3.4%	11.1%	9.7%	
West Virginia	5.3	55	50	\$0.00	0.0	2.8%	9.5%	8.6%	
Average - Top 5				\$138.74	29.9	4.2%	13.1%	12.2%	
Average - Bottom 5				\$15.57	8.8	2.8%	11.2%	9.9%	
Difference				\$123.16	21.2	1.4%	1.9%	2.4%	



# Policy Reforms to Promote Entrepreneurship

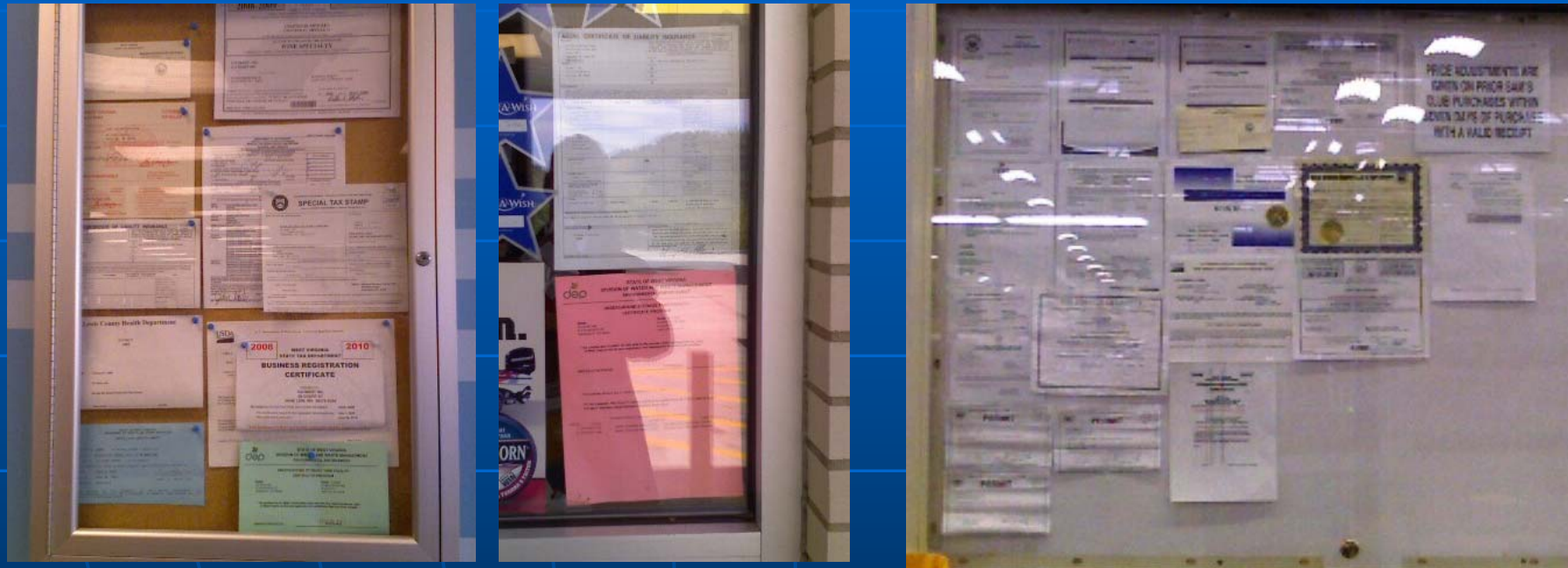


# Policy Reforms to Promote Entrepreneurship

Three general categories:

- Make it easier to start a business by reducing artificial barriers to entry and competition
- Make it easier for existing businesses to be profitable and grow by lowering the cost of doing business
- Reduce the role of government in “playing favorites” or picking winners and losers

# Reduce Barriers to Entrepreneurship & Create a Regulatory Review Process



There is no natural profit & loss type process to get rid of "bad" or outdated regulations.



# Increasing Profitability & Growth

Lower Taxes on  
Capital Investment



Legal reform: Excessive lawsuits make it both more costly and risky to do business

Specialization is limited by extent of the market – lowering costs makes businesses more competitive in national and global markets

# Quit Playing Favorites

- “Crony Capitalism” is when business winners and losers are determined by political connections rather than private market forces
  - - The Case of Serious Materials
- Baumol’s Theory of Productive and Unproductive Entrepreneurship
  - “Too Many Lobbyists & Lawyers and Too Few Scientists and Engineers”
  - WV Ranks 47<sup>th</sup> in Productive Entrepreneurship but 5<sup>th</sup> in Unproductive Entrepreneurship
- Eliminate Targeted Tax Credits & Subsidies in favor of Broad Based Taxes

# Reduce Government Control & Centralization

Reduce the Size of Government to Shift Resources Back into the Private Sector

- WV Govt. Spending > 50% of Economy

Decentralize Government

- WV is 2nd most centralized state



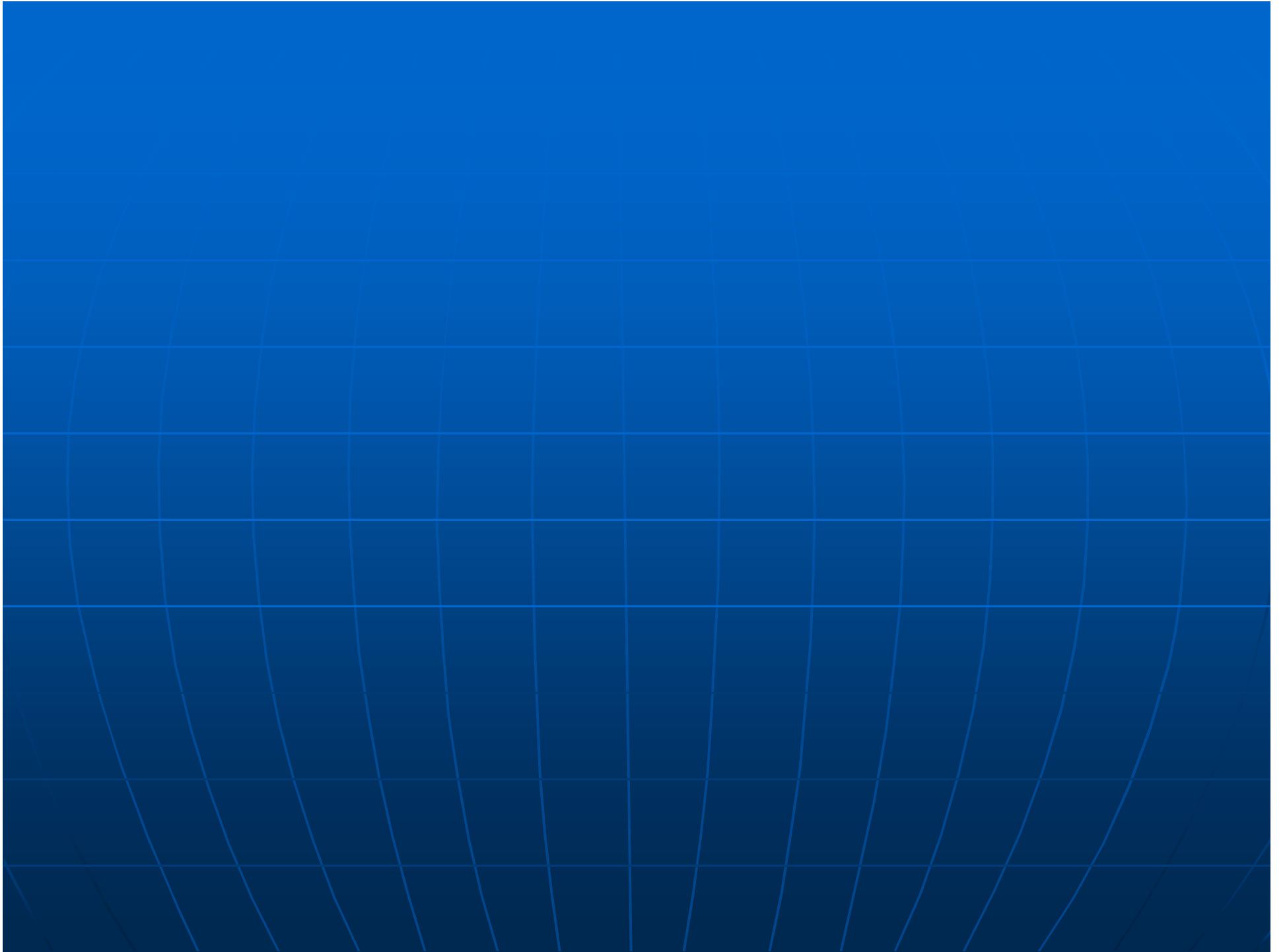
# *Thank You / Q&A*

## Contact Information:

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Coffman Distinguished Chair  
Dept. of Economics, WVU

[Russell.Sobel@mail.wvu.edu](mailto:Russell.Sobel@mail.wvu.edu)

(304) 293-7864



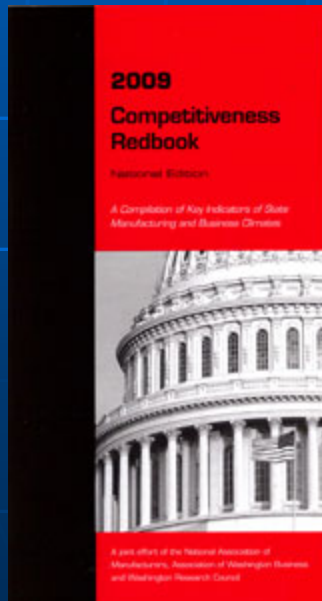
Slides for possible  
Q&A answers follow





# 1. Lower Taxes on Productive Activities

Example:  
Taxes on Capital Investment



National Association of Manufacturers  
*2009 Competitiveness Redbook*

WV =	\$833,234	- 14 <sup>th</sup> highest
MD =	\$593,950	- 31 <sup>st</sup> highest
NC =	\$491,071	- 37 <sup>th</sup> highest
KY =	\$327,100	- 47 <sup>th</sup> highest
VA =	\$241,498	- 49 <sup>th</sup> highest
DE =	\$238,840	- 50 <sup>th</sup> highest

Firm with \$25m assets (\$12.5m machinery & equip., \$10m inventory, \$2.5m fixtures)

# North Korea vs. South Korea



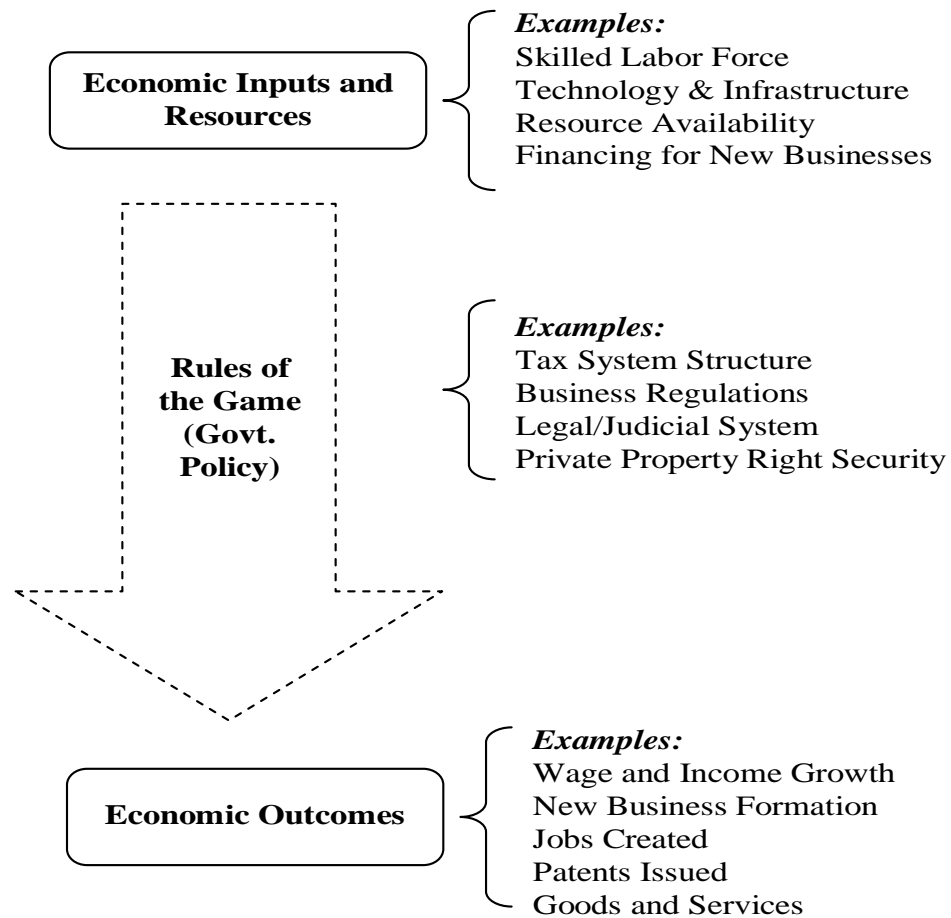
**Per Capita  
Income  
= \$1,800**

**Per Capita  
Income  
= \$24,200**



# Growth is a function of “inputs” AND “institutions”

Figure 2.1: Inputs, Institutions, and Outcomes



Source: Hall and Sobel (2006).



Spending to increase “inputs” won’t work unless the “oven” is turned on

# Route 50



# Wise use of Tax Money?



2

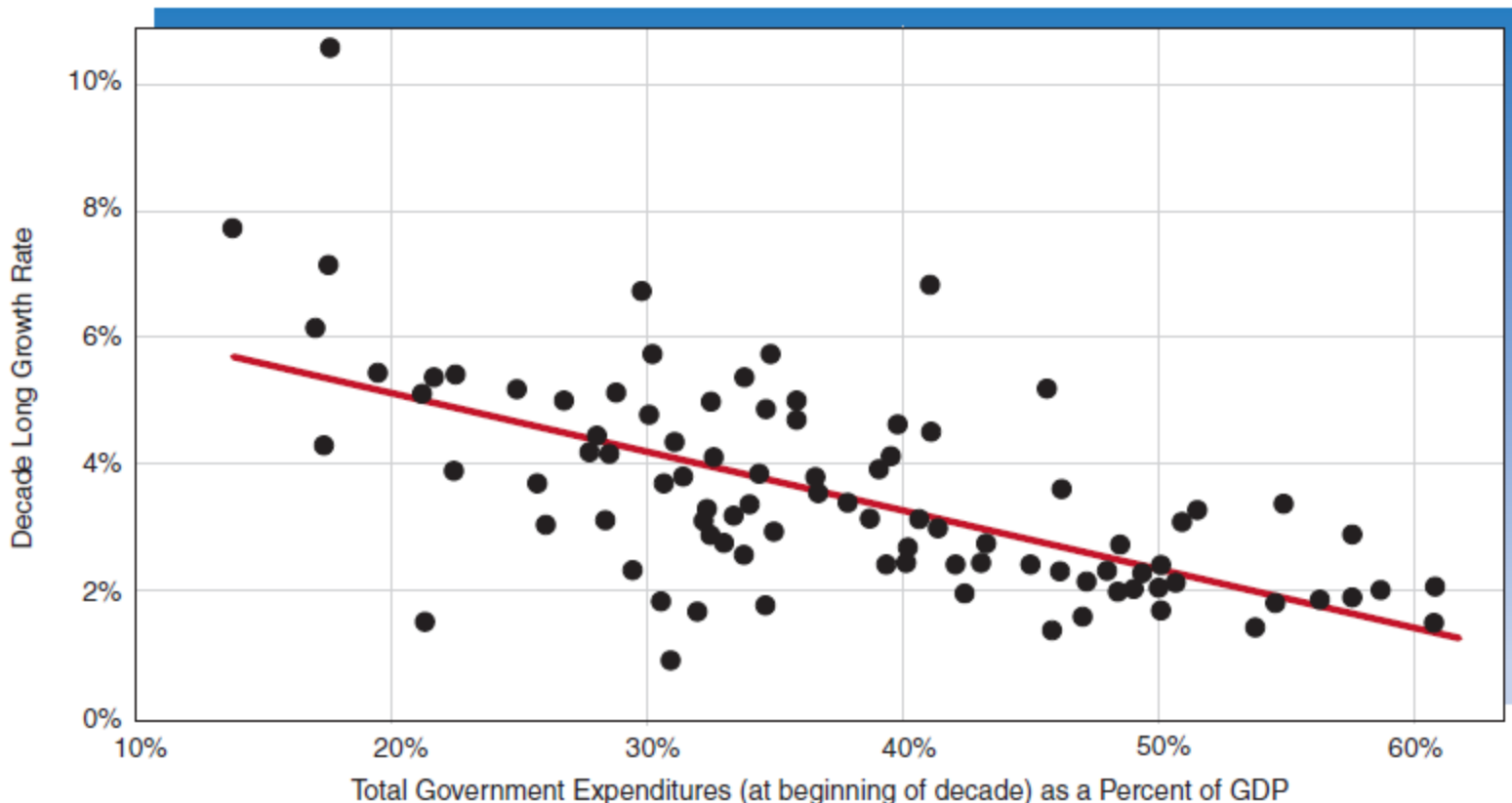
3



## EXHIBIT 8

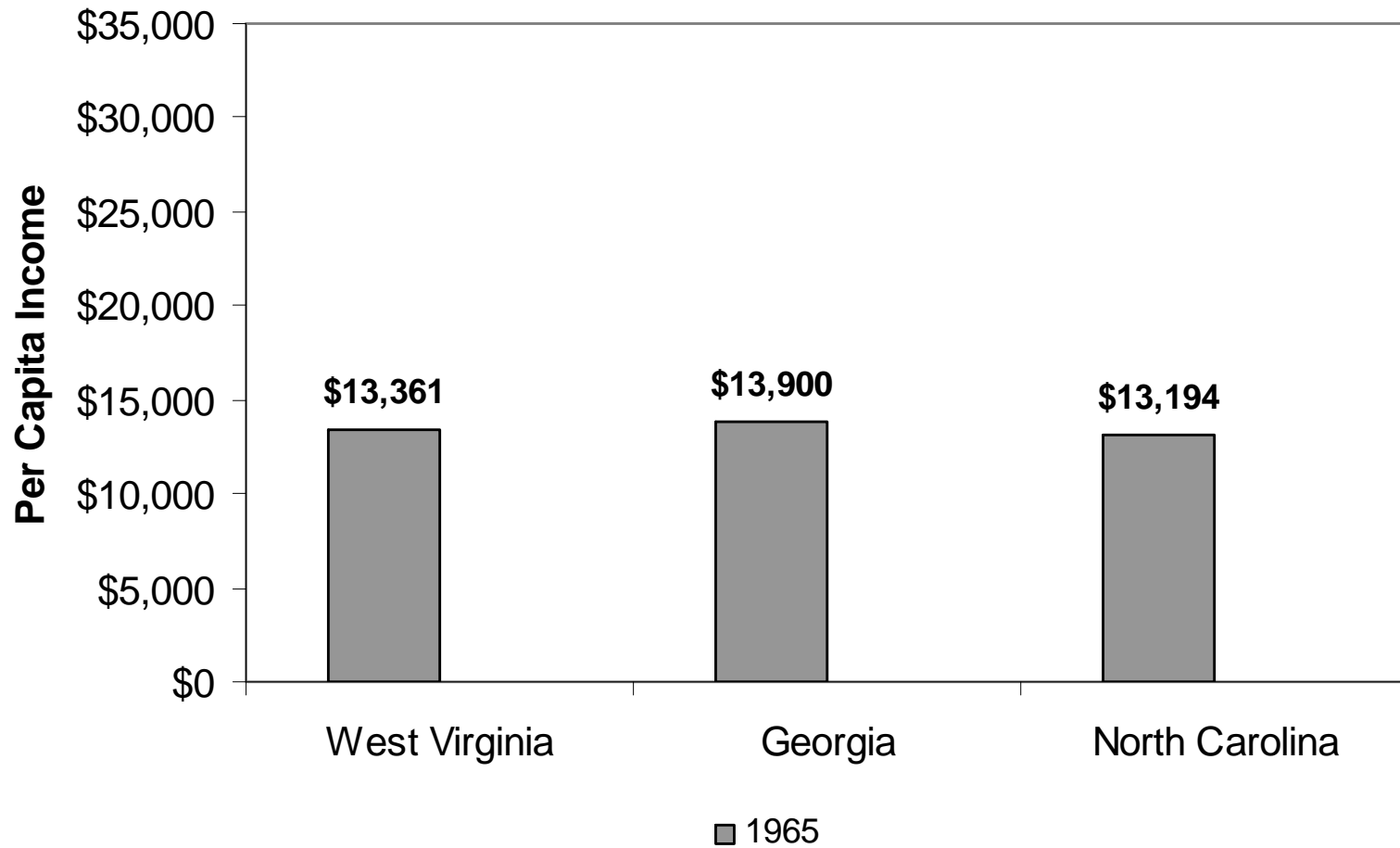
### Government Spending and Economic Growth among the Twenty-Three OECD Countries: 1960–1999

Here, we show the relationship between size of government and the growth of real GDP for the twenty-three longtime OECD members during each decade since 1960. The data indicate that a 10 percent increase in government expenditures as a share of GDP reduces the annual rate of growth by approximately 1 percent. The data also imply that the size of government in these countries is beyond the range that maximizes economic growth.



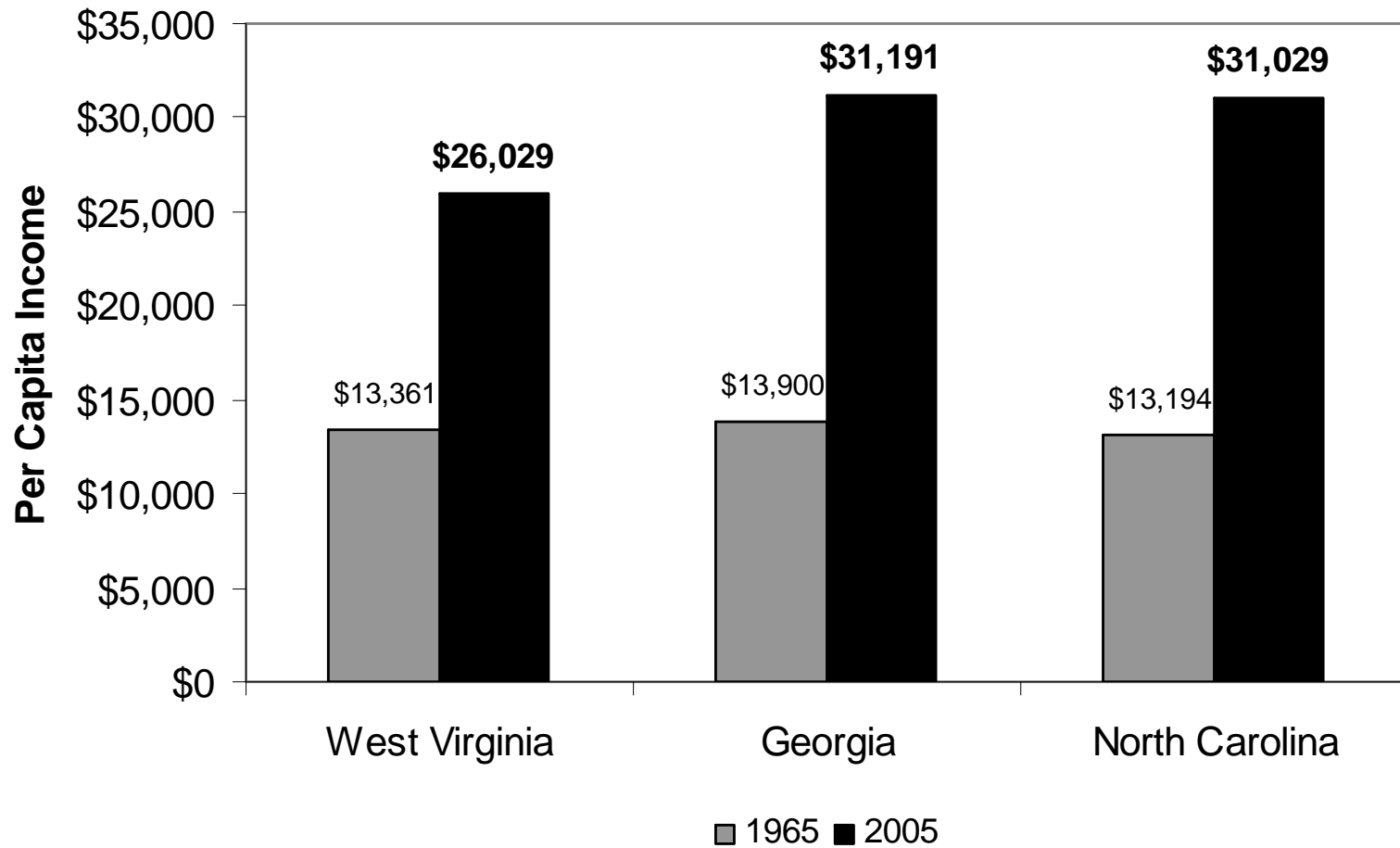
Source: OECD, *OECD Economic Outlook* (various issues); and World Bank, *World Development Indicators*, CD-ROM, 2001.

### Figure 1.3: State Growth Comparisons



1965 PCPI Ranks: WV=42, GA=41, NC=45

### Figure 1.3: State Growth Comparisons



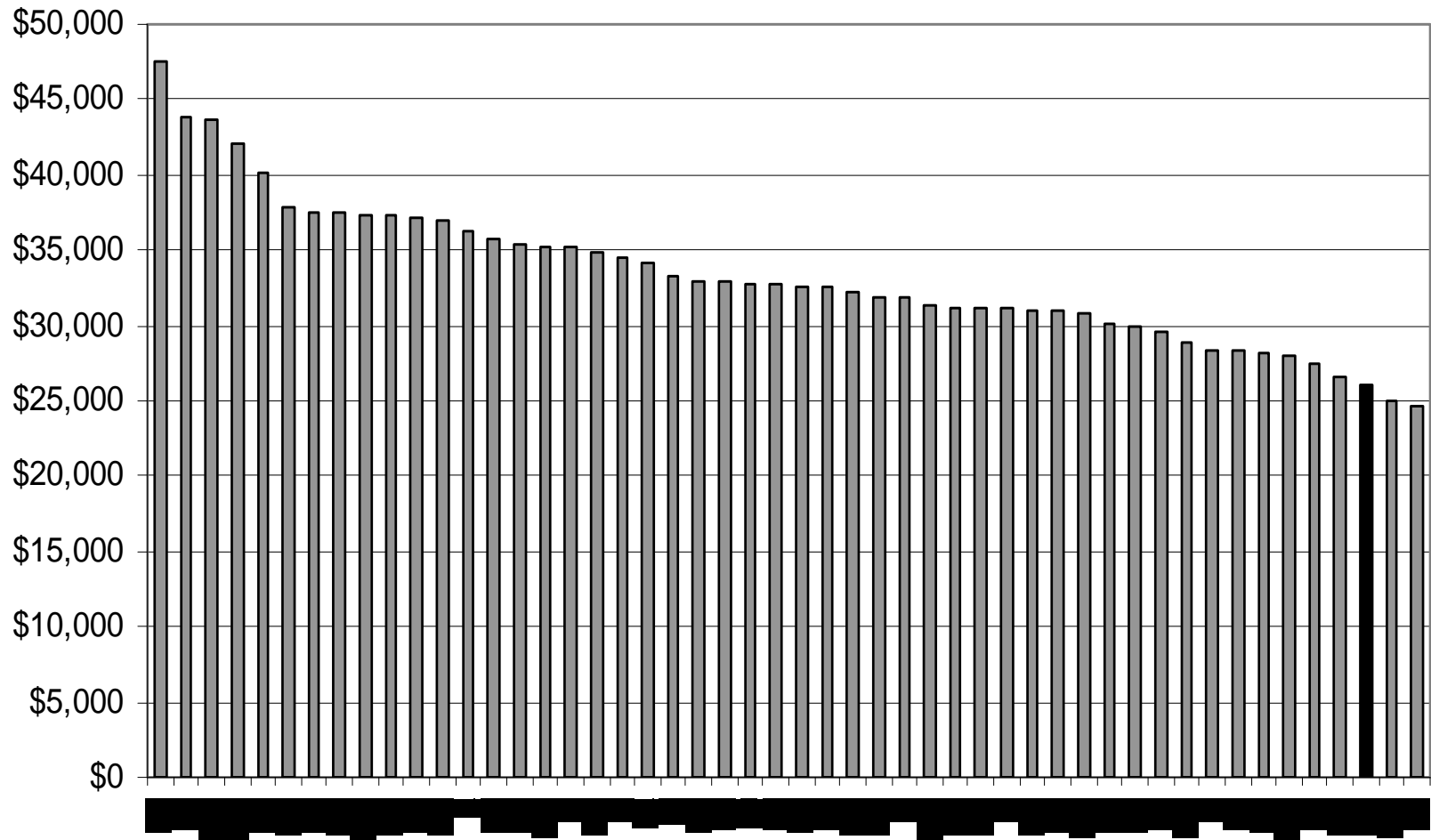
1965 PCPI Ranks: WV=42, GA=41, NC=45

2005 PCPI Ranks: WV=48, GA=33, NC=35

**Growth Rates: WV=1.4%, GA=2.0%, NC=2.2%**

# WV's PCPI: Rank 48th – 75% of U.S. Average

## Figure 1.1: Average Income by State, 2005





## You can see it at our state border



50 years ago Charleston WV and Charlotte NC had the same population and per capita income

West Virginia will soon be only one of two states with no city of 50,000 or more