



First in Freedom Index

February 2015

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	Contents
3	Key Facts
4	First in Freedom Index
5	First Steps on a Journey
6	Philosophy Grounded in Empirical Study
8	Figure 1: Findings on Links Between State/Local Tax Policies and Economic Performance
9	Figure 2: Findings on Links Between State/Local Spending and Economic Performance
10	Figure 3: Findings on Links Between School Reform Variables and Student Outcomes
	The Manifest Benefits of Freedom
12	Understanding the First in Freedom Index
13	How States Rank in Freedom
14	Figure 4: Overall Freedom Ranking
15	Figure 5: Fiscal Freedom Ranking
16	Figure 6: Educational Freedom Ranking
	Red States, Blue States, and Freedom
17	Figure 7: Regulatory Freedom Ranking
18	Figure 8: Health Care Freedom Ranking
	First in Freedom Rankings and Other Indicators
19	Conclusion
21	Endnotes
22	Appendix: Methodology

The cover image is a Charlotte statue of Captain James Jack, who reportedly delivered the Mecklenburg Resolves to the Continental Congress in Philadelphia in 1775.

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Key Facts

- Overall, North Carolina ranks 23rd in the nation and 5th among the 12 states of the Southeast. Florida holds the #1 slot on the FFI, followed by Arizona, Indiana, South Dakota, and Georgia.
- The least-free state is New York, which is joined in the bottom five by New Jersey, California, West Virginia, and Kentucky.
- North Carolina's best showing is fiscal policy. Before the 2013 tax reform, North Carolina ranked among the worst states in the nation in tax climate. North Carolina now ranks 16th in the nation in fiscal freedom and 3rd in the Southeast, behind only Florida and Virginia.
- On educational freedom, North Carolina ranks 18th in the nation and 5th in the Southeast. Strong protections for homeschooling were helpful here, as was the passage of opportunity scholarships in 2013. But North Carolina ranks below the national average in public school choice.
- When it comes to regulatory freedom, our state ranks 36th in the nation and 8th out of the 12 Southeastern states. Although North Carolina's right-to-work law, absence of state-level minimum wages, and recent tort reforms have been helpful, our state has relatively weak protections against eminent domain abuse and relatively strict occupational-licensing laws.
- The state's worst showing is in health care freedom, where North Carolina ranks 46th in the nation and dead last in the Southeast. The main culprits are our poor rankings on certificate-of-need laws and state benefit mandates on private health plans.
- If North Carolina completely abolished its certificate-of-need regulations, our ranking on health care freedom would rise to 25th and our overall FFI ranking would rise to 16th.
- Adopting the strong land-use and property-rights protections of neighboring South Carolina would raise North Carolina's regulatory freedom ranking to 16th and our overall FFI ranking to 19th.
- If North Carolina matched Colorado in public-school choice, our educational freedom ranking would rise to 13th and our overall FFI ranking to 15th.

During the 2014 legislative session, the North Carolina General Assembly dealt with a range of consequential and controversial issues. So it's understandable why one change in state policy drew little press or public attention: starting in mid-2015, North Carolina motorists will be able to choose an alternative to the current "First in Flight" license plate to adorn their cars and trucks. The new plate will bear the motto "First in Freedom" and an image symbolizing North Carolina's key role in the American Revolution.

The phrase speaks to an old and venerable tradition of North Carolinians standing up for liberty. In May 1775, a group of Mecklenburg County leaders met in Charlotte to fashion a response to escalating tensions between the American colonies and the government of King George III. As they gathered for the meeting, news arrived in town of the battles of Lexington and Concord a month earlier in Massachusetts. Worried and angered, the Mecklenburg leaders decided to set up their own institutions of government. In a document later published as the Mecklenburg Resolves, they stated that British military action had resulted in the colonies entering "a state of actual rebellion" and that "all laws and commissions confirmed by or derived from the authority of the King and Parliament are annulled and vacated, and the former civil constitution of these colonies for the present wholly suspended." Some believe that the Mecklenburg committee went further still, issuing a formal Declaration of Independence on May 20, the first of its kind in America. But even if the Mecklenburg Resolves was the only document approved by the delegates, it was still a startling and courageous act of resistance against tyrannical government and deserves the veneration still evident on the state flag and state seal of North Carolina.

The revolutionary fervor was hardly limited to Mecklenburg. Political leaders in counties and towns across North Carolina expressed their resolve to fight for liberty over the subsequent months. By April 1776, they met as the Fourth Provincial Congress in Halifax to decide what North Carolina's position should be at the upcoming Continental Congress in Philadelphia. Three of the leaders of Mecklenburg's May 1775 action of defiance – Robert Irwin, John Phifer, and John McKnitt Alexander – were members of that Fourth Provincial Congress. In the resulting Halifax Resolves, the assembled state leaders decided to instruct the North Carolina delegation in Philadelphia to pursue formal independence from Britain – the first such decision in America. The date of the Halifax Resolves, April 12, is the other date honored on the North Carolina seal and flag.

Based on these events of 1775 and 1776, there is a good case to be made that the future Tar Heel State led the way on American independence. But that was more than two centuries ago. The challenges facing our economy, our families, our liberty, and our tradition of constitutional government are serious and immediate. Again, it is time to act. At the John Locke Foundation, we believe it is time for North Carolina to reclaim its heritage and resume its leadership in the cause of liberty. It is time for our state to become “First in Freedom” once more.

First Steps on a Journey

The past four years have brought dramatic changes in North Carolina public policy. Conservatives committed to the principles of free enterprise and limited government have risen to political power in the General Assembly, the executive branch, and more than half of the state’s 100 counties. They’ve reduced and restructured North Carolina’s taxes. They’ve reformed its byzantine regulatory process. They’ve embraced the concepts of competition, private investment, and consumer choice in public services such as education and transportation.

These dramatic changes certainly haven’t gone unnoticed. Both in North Carolina and across the country, the state’s surprising successes in conservative reform have drawn an unsurprising set of critics: liberal politicians, labor unions and other special interests that thrive on government largesse, left-wing grantmakers and the activists they fund, campus radicals (ranging from the tenured to the teen-aged), and media commentators whose rising resentment seems inversely proportionate to their declining fortunes and dwindling influence. For the most part, however, these critics haven’t really engaged North Carolina’s new conservative leaders in substantive discussion about philosophical ideas or empirical research. Instead, they have rallied, protested, launched personal attacks, and attempted to defeat the conservatives in elections. In a free society, they have every right to choose such tactics, of course. But one unfortunate consequence is that North Carolina’s recent wave of free-market reforms is now thought of primarily as a political struggle rather than a public-policy debate.

For a quarter of a century, the John Locke Foundation has committed itself to facilitating and participating in substantive policy debate. We agree with North Carolina native Richard Weaver’s famous observation that “ideas have consequences.” JLF is devoted to exploring challenging ideas, expanding the public’s knowledge about policy issues, and applying the findings of rigorous

research to bear on practical problems of state and local government. Ours has always been a long-term plan. We envision a North Carolina of responsible citizens, strong families, and successful communities committed to individual liberty and limited, constitutional government. To transform this vision into reality, JLF employs research, journalism, and outreach programs to transform North Carolina government by applying the principles of competition, innovation, personal freedom, and personal responsibility.

As we have pursued our mission over 25 years, we have often been critical of North Carolina's existing public policies. But we have always accompanied these criticisms with specific, practical alternatives. Even when non-conservatives held the reins of power in the state, we persisted in making our case for reform – and sometimes we succeeded. Bipartisan majorities in the General Assembly created charter schools and reduced income taxes during the 1990s, for example. Democratic governors adopted budget efficiencies and reorganized state agencies in ways recommended by JLF. Counties and municipalities contracted out public services and strengthened user-pay financing for government-run enterprises.

Contrary to the claims of our critics, we do not reflexively oppose all government programs. JLF recognizes the critical importance of core public services in making North Carolina a safer, more prosperous, and more attractive place to live. What we really seek is a better balance between the public sector and private institutions of family, faith, community, and enterprise. Over the past four years, conservative leaders have sought to restore that balance. For the most part, we have agreed with the difficult decisions they've made. Now, as JLF enters its next quarter century of work, we hope to inspire current and future leaders of our state to go farther, to go bolder. We believe the long-term goal should be to make North Carolina the freest state in America. And we believe that measuring incremental progress toward that goal is both feasible and necessary.

Philosophy Grounded in Empirical Study

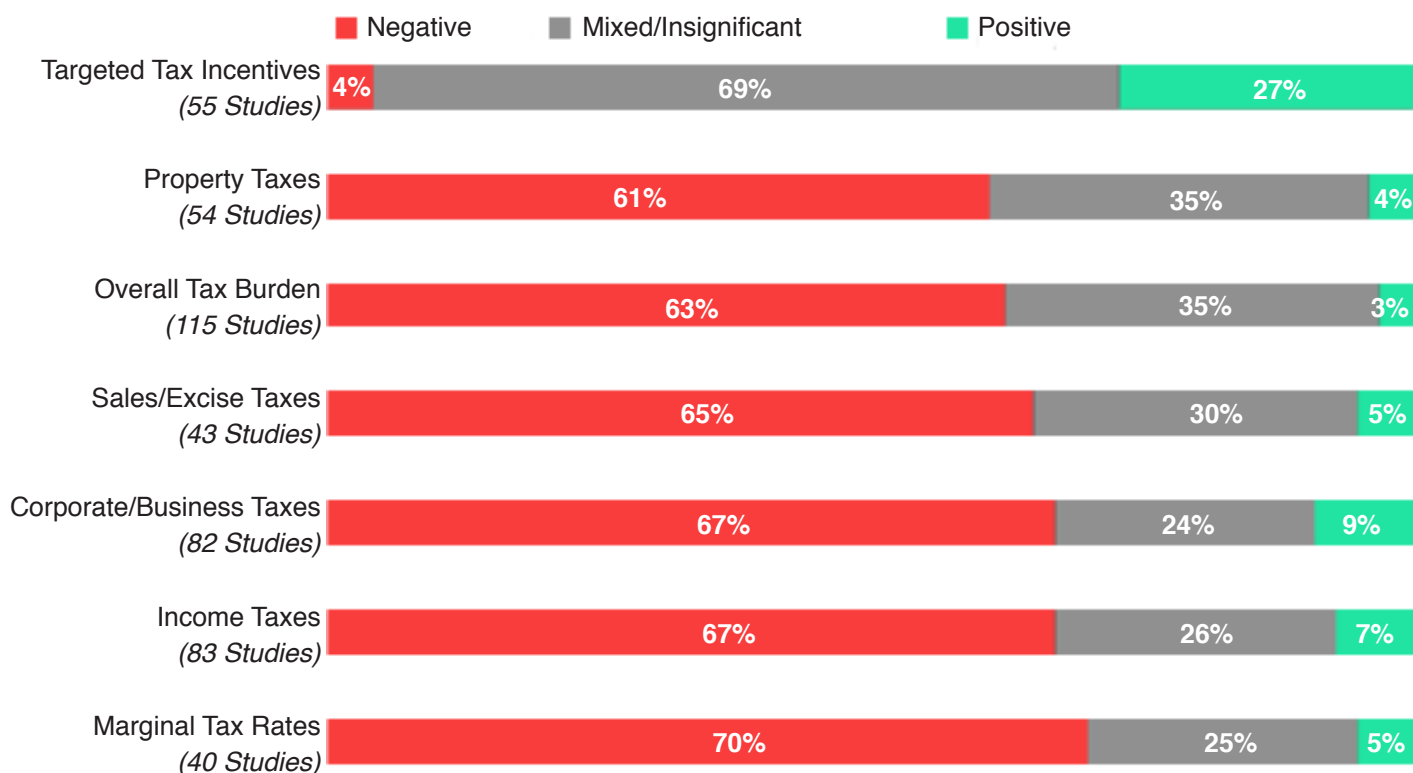
That's why we have produced this report. To make our state First in Freedom will require further reductions and reforms in taxes, particularly those affecting savings and investment. It will require further reductions in government spending, particularly in income-transfer programs, and further reforms of the state bureaucracy and budget process. It will require more changes to North Carolina's regulatory system, including fewer restrictions on entrepreneurs

and professionals and greater legislative oversight of rulemaking. It will require more choice and competition in the delivery of tax-funded education and health care services.

These policies form a consistent governing philosophy of maximizing freedom. They also reflect the findings of the latest scholarly research on state and local government, which has established that places with smaller, less costly, less monopolistic governments tend to experience higher rates of economic growth and social progress. All other things being held equal, states with lower, less punitive tax and regulatory burdens tend to attract more investment capital, entrepreneurs, and highly productive professionals, resulting in more job creation and higher income growth. All other things being equal, state education systems that offer the greatest freedom to choose among district-run public schools, chartered public schools, private schools, and home schools tend to produce the highest test score gains, graduation rates, and post-graduation outcomes. All other things being equal, states that allow the broadest choice and competition in the delivery of medical services and health plans tend to have both lower costs and healthier citizens.

The research backing up these statements has been discussed at great length in previous publications. Readers may wish to start with two books published by JLF: *Our Best Foot Forward* (2012), which analyzed the recent history of North Carolina's economy and presented an investment-based plan for rejuvenating it, and *First in Freedom* (2013), which provided dozens of specific recommendations made by JLF policy analysts for the new McCrory administration and General Assembly.

In 2014, JLF updated its analysis with two Spotlight briefing papers that summarized the findings of a large body of peer-reviewed studies published in scholarly journals during the past 25 years. The initial paper, "Lower Taxes, Higher Growth: Scholarly Research Reveals Economic Benefits of Fiscal Restraint," was released in April 2014.¹ It synthesized the findings of 681 studies published in peer-reviewed academic or professional journals since 1990. Each study examined at least one relationship between a state or local policy and a measure of economic performance such as total employment, job creation, income growth, population growth, or business starts. Many of the studies contained multiple input and output variables, so as a whole they produced nearly 1,400 empirical findings about economic growth policy at the state and local level.

Figure 1: Findings on Links Between State/Local Tax Policies and Economic Performance

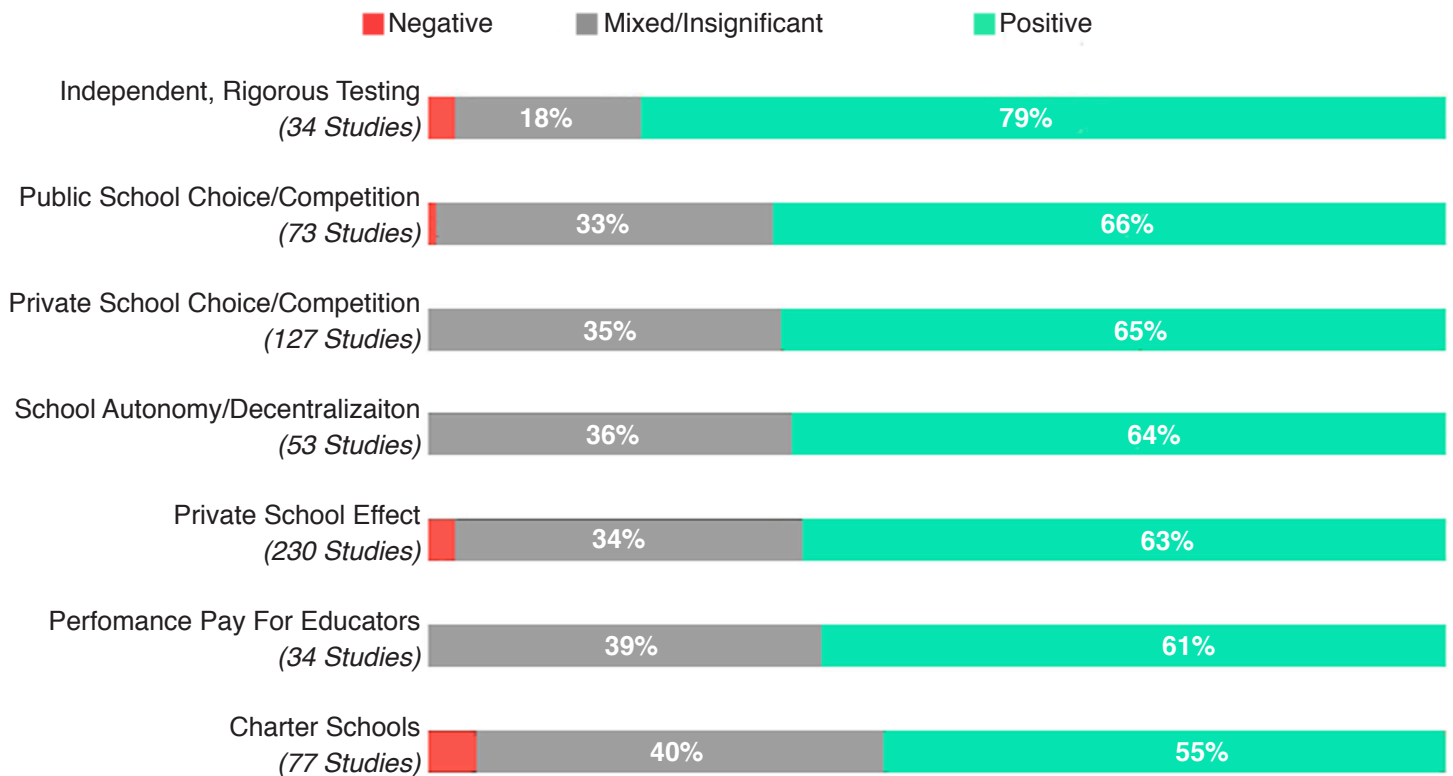
The main findings on fiscal policy are summarized in Figures 1 and 2. In the case of tax policy, most forms of state and local taxation have statistically significant and negative associations with economic growth. That is, the lower the tax, the better off the economy is, all other things being equal. The main exceptions are targeted tax incentives such as per-job tax credits and enterprise zones. States and localities that reduce their tax burdens in this selective fashion do not appear to experience net economic benefits. The April report also examined studies of state and local regulatory policies such as occupational licensing, permitting, zoning and housing codes, minimum wages, and emissions caps. In 68 percent of the 160 peer-reviewed studies on the subject, higher levels of regulation were associated with lower rates of economic growth.

On the spending side of the equation, only government expenditures on public safety have a consistent positive association with economic growth in most studies (58 percent). For other categories of spending, the relationships are mixed or statistically insignificant. And for expenditures on transfer programs such as Medicaid and cash assistance, the relationship is statistically significant but negative in 68 percent of the studies. These studies don't tell us that education, transportation, and other state programs are valueless, of course. What they tell us is that there is no strong correlation between how much governments spend and the quality of the services produced. States with lower-than-average expenditures can produce better-than-average services. And high-expenditure states can feature awful services.

Figure 2: Findings on Links Between State/Local Spending and Economic Performance

A month after releasing the Spotlight on economic-growth research, JLF published “Educational Freedom Works,” which offered a similar analysis of scholarly research on school reforms.² The report synthesized findings from 888 articles published in peer-reviewed journals or by the National Bureau of Economic Research since 1990. These papers explored relationships between educational inputs or policies (such as per-pupil expenditure, average teacher salary, class size, performance pay, and school choice) and student outcomes (such as test scores, dropout rates, and college attendance). The findings on several high-profile school reforms are summarized in Figure 3.

JLF’s survey found 116 studies that explored the link between per-pupil spending and student outcomes. Higher spending was associated with higher student performance only 32 percent of the time, after adjusting for student background and other factors mostly or entirely outside the control of schools. Similarly, of the 90 studies examining the link between average teacher salaries and student outcomes, 56 percent found mixed or statistically insignificant results. Weak or nonexistent benefits were also found for other common policies such as paying teachers on the basis of years of services or degrees held. Structural reforms of the education system fared far better. The use of rigorous standardized testing was associated with subsequent gains in student performance in 79 percent of peer-reviewed studies. Outcome gains were also found for programs promoting parental choice within district-run public schools (66 percent), private school choice and competition (65 percent), school autonomy and decentralization (64 percent), and charter schools (55 percent).

Figure 3: Findings on Links Between School Reform Variables and Student Outcomes

In a key respect, the two Spotlights offer complementary findings. According to the economic-growth literature, states with highly educated populations – measured in high school diplomas, college degrees, and average test scores – tend to enjoy higher rates of economic growth. And according to the school-reform literature, the more parental choice and competition there is, the higher a state’s educational attainment is likely to be, all other things being equal. Thus, policymakers can expect to boost their future economic growth when they embrace educational freedom alongside fiscal and regulatory reform. Similarly, there is a growing body of empirical research that links health care freedom – greater choice for patients and competition among providers – with less-expensive and more effective medical care. Because the health of the population is also an explanatory factor in economic growth (the causal arrows point in both directions), market-based health care reform is another policy that is valuable on its own terms while also complementary to fiscal and regulatory freedom as a strategy for true economic development.³

The Manifest Benefits of Freedom

It stands to reason that if individual variables such as marginal tax rates, the regulatory burden, and parental choice affect economic and social outcomes, then broad indexes of such variables would likely correlate with economic and social outcomes, as well. When it comes to economic freedom – including both fiscal and regulatory variables – we don’t have to guess at such a relationship. In recent years, scholars have published dozens of studies probing the links

between state scores on economic freedom indexes and state economic growth. In the vast majority of cases, the relationship has proven to be positive and significant.

The Economic Freedom of North America (EFNA) Index produced by the Canada-based Fraser Institute is the most-studied measure of state-level economic freedom in the scholarly literature. A 2014 paper in the journal *Contemporary Economic Policy*, for example, used nearly three decades of state-by-state data for the EFNA Index and employment measures. “Our findings show a strong relationship between economic freedom and labor market outcomes,” the authors concluded, “with more economic freedom being associated with lower unemployment rates and higher labor force participation rates and employment-population ratios.”⁴ A 2011 paper in the *European Journal of Political Economy* also compared state scores on the EFNA Index to long-run trends in state economic growth, after adjusting for other factors. “There is a significant positive relationship between economic freedom and growth,” the authors found, demonstrating “the importance of constraining excessive government expenditure within the economy and minimizing the tax burden.”⁵

One possible mechanism for economic freedom boosting growth is making a state more attractive to out-of-state business executives, investors, professionals, and other job creators. In a 2007 *Southern Economic Journal* study, economist Nathan Ashby found that states ranking high on the EFNA Index tend to experience high rates of in-migration, which in turn confer broader economic benefits.⁶ The authors of a 2012 paper published in the *International Journal of Economics and Finance* focused on inflows of financial rather than human capital, finding that states ranking high on the EFNA Index tended to attract higher rates of foreign direct investment.⁷ Another potential causal mechanism is entrepreneurship. States with higher rates of successful business start-ups tend to outperform other states in job and income growth over time. A 2009 paper published in *Small Business Economics* is one of several studies showing a link between EFNA scores and entrepreneurship rates.⁸

While the Fraser Institute’s measure is the oldest and most often studied, scholars have recently begun using another economic-freedom index, from George Mason University’s Mercatus Center, to explore similar issues. One of the attractions of the Mercatus “Freedom in the 50 States” index is its broader set of variables regarding regulatory policy and personal freedom, including such matters as health insurance mandates, property rights, and parental choice in education. According to a 2013 study published in the *American Journal of*

Entrepreneurship, states with high scores on the overall Mercatus index had higher rates of business starts. When the data were disaggregated, however, fiscal policy proved to be more important than the regulatory variables.⁹ A 2010 paper in the *Journal of Regional Analysis and Policy* found that scoring high on the Mercatus index tended to predict higher migration into a state among people in their 20s and 30s.¹⁰

Yet another index, from the Tax Foundation, ranks states according to the competitiveness of their tax codes. While focused solely on taxes, this State Business Tax Climate Index (SBTCI) also combines several different variables – and has also been the subject of empirical study. A 2007 study by scholars at the Brookings Institution, for example, used the Tax Foundation’s measure as one variable in a broader analysis of state growth rates. It found that states ranked high on the SBTCI tended to have higher rates of employment growth.¹¹ In 2013, the *Journal of Regional Science* published a comprehensive study of various state indexes. Comparing state rankings against growth in state employment, wages, and gross domestic product, the authors found “the strongest and most robust evidence” for the economic effects of rankings on two state indexes: the SBTCI and Fraser’s EFNA.¹²

Overall, there have been 37 studies of economic freedom and state economic growth published in scholarly journals since 1990 (including several published after JLF’s original survey of the literature in early 2014), of which 29 found a positive, statistically significant relationship and eight found no link. Not a single study found that ranking high in economic freedom was associated with lower economic performance. Although more research would be welcome and the causal relationships among the variables are probably complex, the currently available evidence is strongly suggestive that freedom and economic growth are closely connected. If North Carolina policymakers want to maximize job creation, income growth, and economic opportunity for its citizens over the coming years and decades, they should place a higher priority on reducing the size and scope of government, promoting choice and competition in services such as health care and education, and protecting personal freedom from encroachment.

Understanding the First in Freedom Index

Another reasonable conclusion to draw from the body of research discussed above is that if North Carolina policymakers wish to compare the extent of our fiscal, regulatory, health care, and education reforms to those of competing

states, there is compelling empirical support for employing the measures produced by the Fraser Institute, the Mercatus Center, and the Tax Foundation. That's why, in this report, JLF has used all or parts of all three indexes, along with other data, to produce our First in Freedom Index (FFI). The overall rank for each state is derived from scores in four different categories: fiscal freedom, educational freedom, regulatory freedom, and health care freedom. Each of those categories, in turn, is composed of state scores on several different variables.

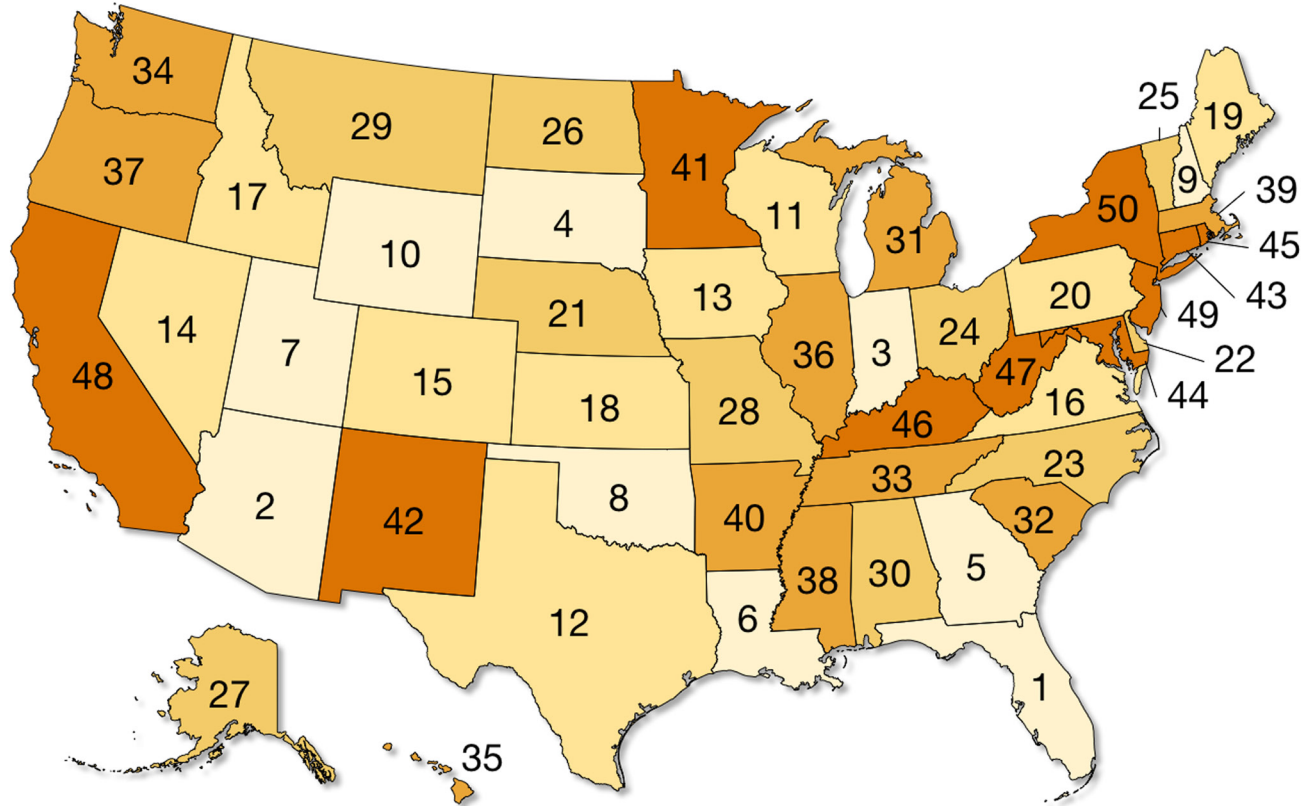
The methodology behind our FFI project is discussed extensively in the Appendix. To understand how North Carolina and other states fare in the index, however, it will be helpful to keep two things in mind. First, most of the following discussion centers on state rankings, not state scores. In some cases, differences in state rank may reflect only small differences in scores. In other cases, the scores may be so widely distributed that the real-world difference between ranking 10th and ranking 11th is substantial. Readers seeking more information about a specific ranking, category, or variable are encouraged to consult the Appendix or contact JLF.

Second, while some of the datasets used in the index are updated every year, others are produced on a more occasional basis by government agencies, trade associations, think tanks, and other researchers. Thus a state's ranking on the 2015 First in Freedom Index reflects data from multiple years. It is quite possible that the effects of enacting (or rescinding) public policies in 2013 or 2014 do not yet show up in the data employed by this index. This is an inevitable constraint for state-by-state indexes spanning many different areas of interest. Future versions of our index will serve to capture such effects.

How States Rank in Freedom

The results of the John Locke Foundation's initial First in Freedom Index can be seen in Figure 4. Overall, North Carolina ranks 23rd in the nation and 5th among the 12 states that make up the U.S. Commerce Department's Southeast region. Florida holds the #1 slot on the FFI, followed by Arizona, Indiana, South Dakota, and Georgia. The least-free state is New York, which is joined in the bottom five by New Jersey, California, West Virginia, and Kentucky.

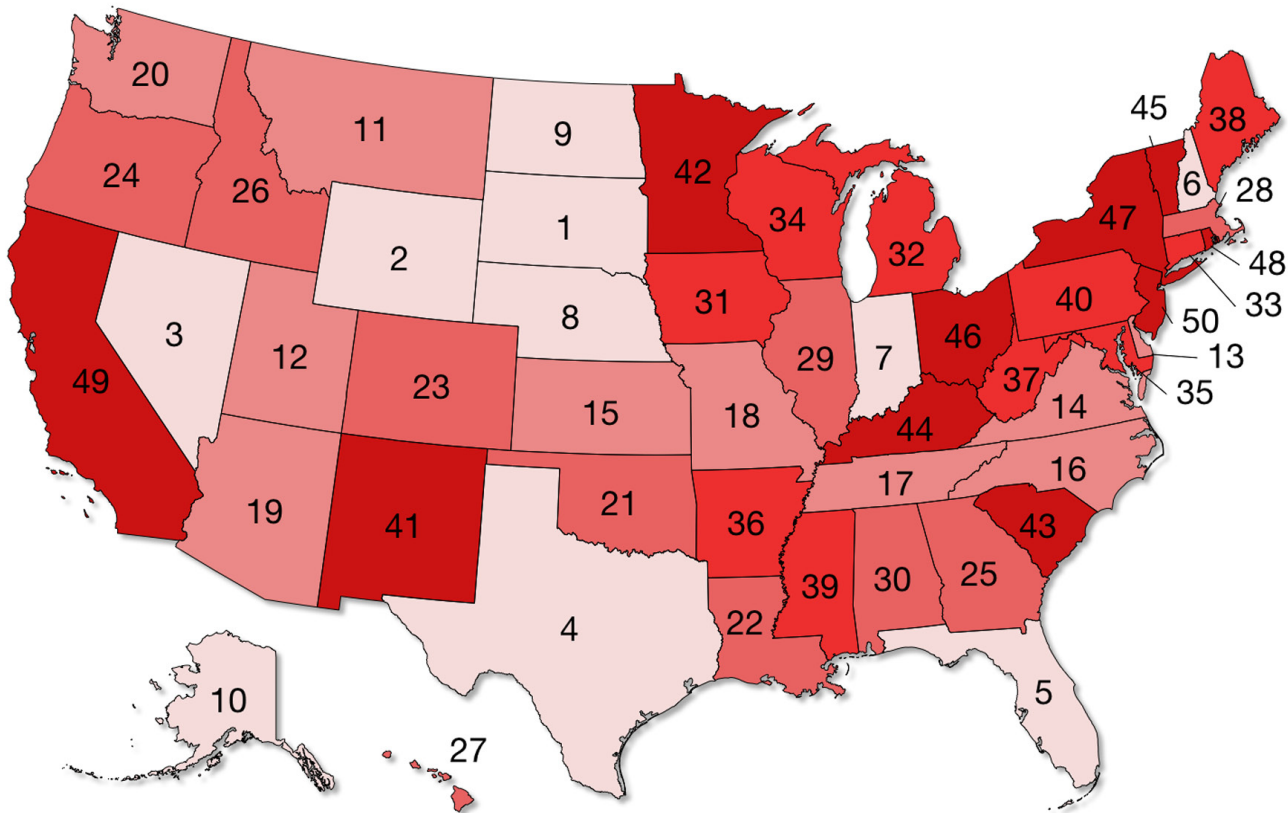
Among the four categories that make up JLF's index – fiscal freedom, educational freedom, regulatory freedom, and health care freedom – North Carolina's best showing is fiscal policy (see the map presented as Figure 5).

Figure 4: Overall Freedom Rankings

Here is a case where recent legislation has made a big difference. Half of the fiscal-freedom score is based on the Tax Foundation’s business tax climate index, which takes income, sales, businesses, property, and payroll taxes into consideration. Before the 2013 tax reform, North Carolina ranked among the worst states in the nation in tax climate. If the tax reform bill hadn’t passed, it is likely that North Carolina’s total ranking on fiscal freedom would have been close to the national average, at best, and among the worst in our region. Instead, North Carolina now ranks 16th in the nation in fiscal freedom and 3rd in the Southeast, behind only Florida and Virginia.

On educational freedom (mapped as Figure 6), North Carolina also does fairly well with a ranking of 18th in the nation and 5th in the Southeast (behind Florida, Georgia, Louisiana, and Virginia). North Carolina’s strong protections for homeschooling (2nd in the nation) were helpful here, as was the passage of opportunity scholarships in 2013, which raised the state to 16th in the nation in private-school choice. But North Carolina ranks below the national average in public school choice. One reason is that most other states give families more ability to choose from among public schools in both their home and neighboring districts.

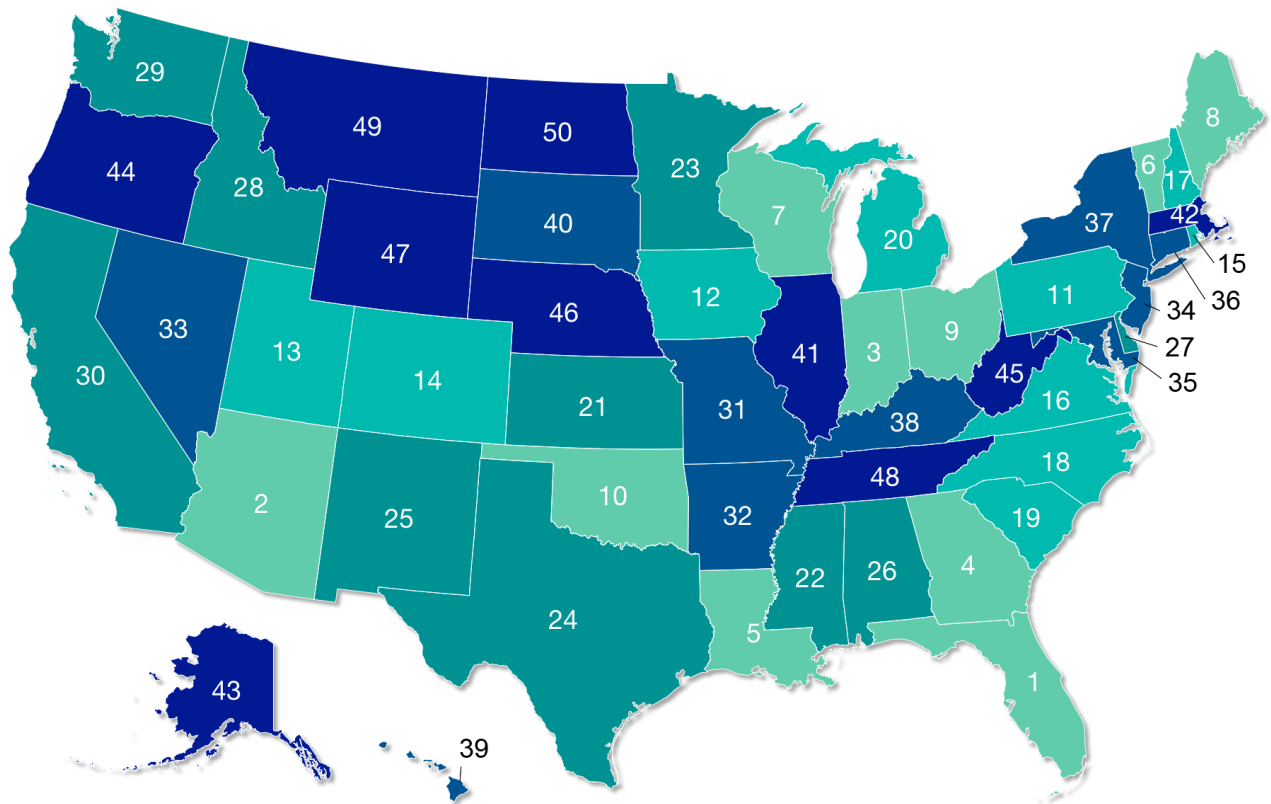
When it comes to regulatory freedom (mapped as Figure 7), North Carolina has plenty of room for improvement. Our state ranks 36th in the nation and 8th out of the 12 Southeastern states. Although North Carolina’s right-to-work

Figure 5: Fiscal Freedom Rankings

law, absence of state-level minimum wages, and recent tort reforms have been helpful, our state has relatively weak protections against eminent domain abuse and other encroachments on property rights (36th) and relatively strict occupational-licensing laws (37th). We also rank poorly in regulatory policy regarding auto insurance (50th) and homeowners insurance (39th).

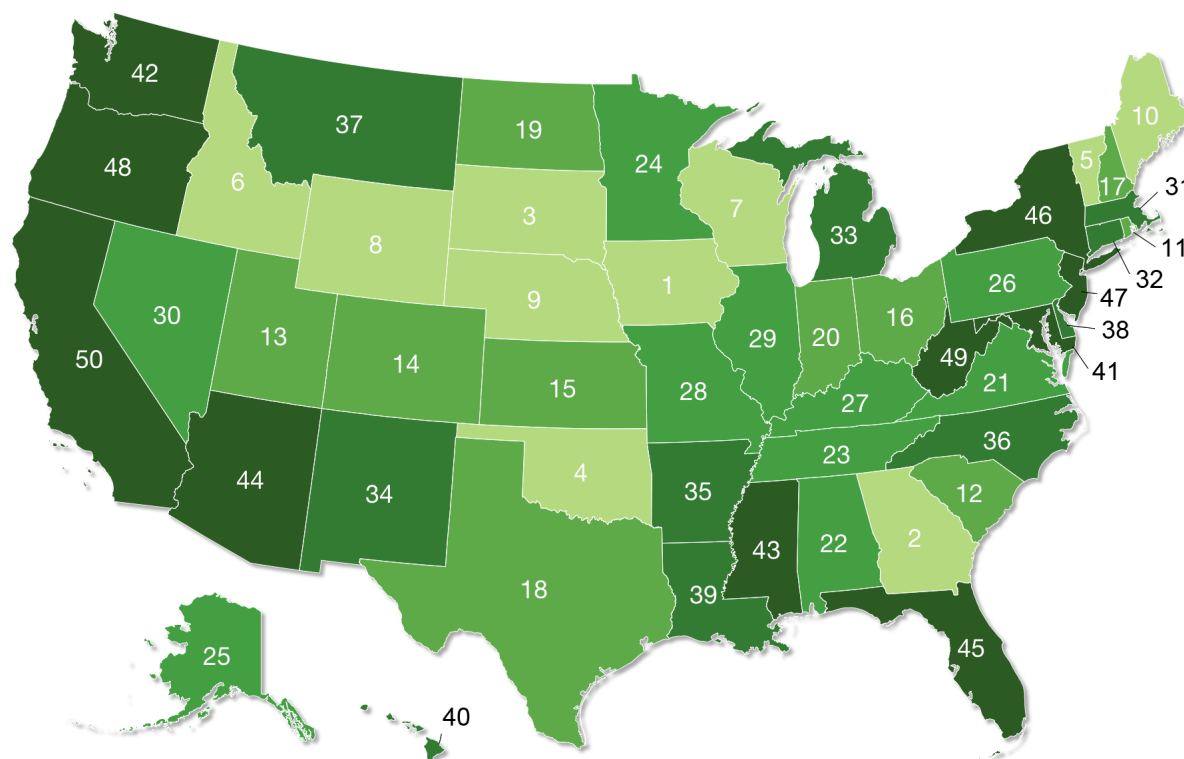
The state's worst showing is in health care freedom (Figure 8), where North Carolina ranks 46th in the nation and dead last in the Southeast. The main culprits are our poor rankings on certificate-of-need laws (48th), which restrict choice and competition among hospitals and other medical providers, and state benefit mandates on private health plans (33rd), which limit consumer choice and drive up insurance premiums.

Again, keep in mind that some of the FFI variables, particularly those regarding regulatory policy, have a lag time of several years. Some of the source data come from 2012 or even earlier. So these measures have yet to be affected by legislation that the North Carolina General Assembly (or other state legislatures) may have enacted in 2013 or 2014. As JLF continues to produce the FFI in future years, these policy changes may have the effect of moving North Carolina up in the rankings even if the legislature pursues no additional reforms. On the other hand, we may find that other states have already taken steps over the past two years to move ahead of us on one or more freedom rankings.

Figure 6: Educational Freedom Rankings

Given this caveat, however, North Carolina policymakers can still use JLF's First in Freedom Index to draw important lessons and set policy priorities for the 2015 legislative session and beyond. According to our estimates, for example, if North Carolina completely abolished its certificate-of-need regulations, as 13 other states already have, our ranking on health care freedom would rise to 25th (from the current rank of 46th) and our overall FFI ranking would rise to 16th (from the current rank of 23rd). Similarly, adopting the strong land-use and property-rights protections of neighboring South Carolina would raise North Carolina's regulatory freedom ranking to 16th (from the current 36th) and our overall FFI ranking to 19th.

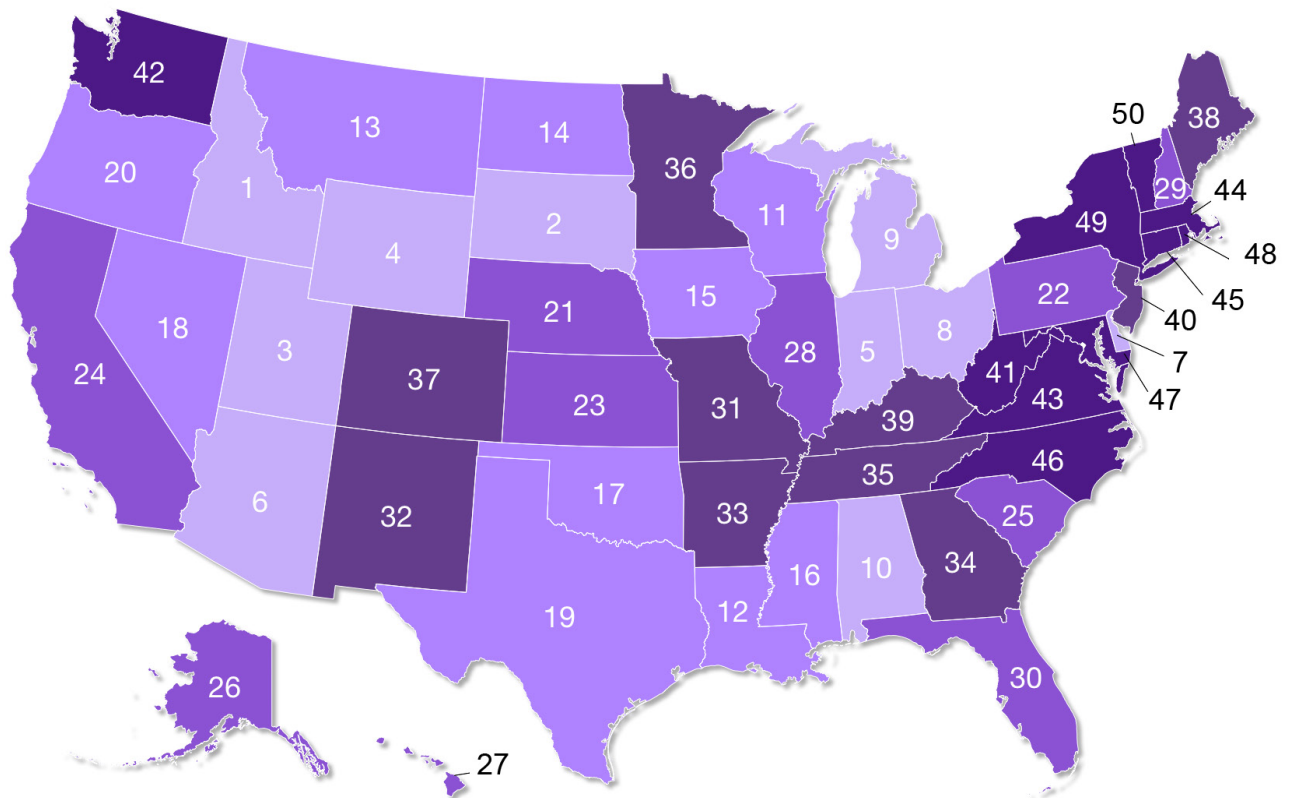
Colorado has the nation's least-restrictive licensing laws for citizens entering new occupations. Emulating their approach would move North Carolina up to 20th in regulatory freedom and 19th in overall FFI ranking. Colorado also ranks high when it comes to public school choice, thanks to its strong charter-school law, options for digital learning, and public-school enrollment policies that favor parental preference over central-office student assignments. If North Carolina matched Colorado in public-school choice, our educational freedom ranking would rise to 13th (from the current 18th) and our overall FFI ranking to 15th.

Figure 7: Regulatory Freedom Rankings

Red States, Blue States, and Freedom

During the past several election cycles, it has become fashionable to identify Red states, Blue states, and Purple states based on the partisan preferences of voters. It turns out that these classifications of political culture may also have a bearing on freedom-enhancing policies. Of the 10 states with the highest FFI rankings, seven of them – Arizona, South Dakota, Georgia, Louisiana, Utah, Oklahoma, and Wyoming – are deeply Red. That is, they have Republican-controlled state governments, GOP majorities in their congressional delegations, two Republican U.S. senators, and vote reliably Republican for president. At the other end of the list, seven of the 10 states with the lowest FFI rankings are either true Blue or lean Democratic: New York, New Jersey, California, Rhode Island, Maryland, New Mexico, and Massachusetts.¹³

There are notable outliers in particular categories, however. Delaware is one of only seven states in the country that are true Blue – having a Democratic-controlled state government, Democratic majorities in the U.S. House, two Democratic senators, and reliably Democratic votes for president. Yet Delaware’s FFI ranking is 22nd, one step above our state’s rank. It scores particularly high on fiscal freedom (13th) and health care freedom (7th). North Carolina would do well to emulate Delaware’s approach to mandated benefits on health insurance (3rd) and relatively low government spending as a share of GDP (11th).

Figure 8: Health Care Freedom Rankings

Two other true Blue states rank far higher than North Carolina does in a different category, regulatory freedom. They are Vermont (5th) and Rhode Island (12th). Vermont imposes some of the nation’s least-burdensome regulations on utilities (1st) and insurance markets (2nd), while Rhode Island compares favorably on occupational licensing (8th). Two Democratic-leaning Purple states, New Hampshire (9th in overall FFI) and Pennsylvania (21st), also offer instructive lessons for North Carolina. New Hampshire has one of the nation’s best tax climates (7th). Pennsylvania scores well on property rights (5th) and occupational licensing (10th).

FFI Rankings and Other Indicators

As discussed above, academic researchers have found statistically significant relationships between the amount of freedom in a state and desired outcomes such as economic growth or test score gains. Because the effects of state policies often take many years to appear – as lower-taxed jurisdictions attract new entrepreneurs, investors, and high-value professionals, for example, or school competition leads to new and better educational options – the best studies use lagged variables and other techniques to gauge the possible effects of public policies.

For a newly constituted index such as FFI, then, it wouldn’t be valid to compare state freedom rankings derived from, at most, four-year-old data against economic or social trends that extend back much further in time. States

ranking low in freedom in, say, 2004 might have changed their policies and thus boosted their ranking by 2014. Furthermore, rigorous examination of the potential relationships between state freedom and social outcomes would require sophisticated regression equations to control for other causal factors such as geography, climate, natural resources, or industrial mix.

Still, if readers want a preliminary snapshot of the issue, here are some interesting comparisons:

- The 10 states with the highest FFI rankings have had a 2.3 percent annual average growth rate in inflation-adjusted gross domestic product since 2011, while the 10 states with the lowest FFI rankings have posted average annual GDP growth rates of 1.5 percent.¹⁴
- The 10 states with the highest FFI rankings in educational freedom have average National Assessment for Educational Progress (NAEP) scores for low-income 4th-graders that are two points higher in reading and one point higher in math than the average NAEP scores for low-income 4th-graders in the 10 states with the lowest educational-freedom rankings.¹⁵
- The 10 states with the highest FFI rankings in health care freedom have average health-care costs of \$6,533 per person, according to the most recent data from the Kaiser Family Foundation. The 10 states with the lowest health care freedom have average health-care costs of \$7,689 per person, or 18 percent more than those of the 10 freest states.¹⁶

Again, these are just preliminary snapshots of statistical associations. They do not necessarily constitute proof of a causal relationship. For example, perhaps the leaders of states with fast-growing economies find it easier to build political constituencies for tax cuts and regulatory relief. Growth might precede rather than follow economic freedom, in other words. Moreover, the degree of economic or personal freedom is never the only factor at play. Some states with relatively low rankings on educational freedom might still produce higher-than-average test scores due to other policies such as rigorous academic standards, school autonomy, and financial rewards for high-performing teachers. To address these concerns would require the use of sophisticated regression analysis and lagged variables. The point here is simply that, at first glance, JLF's new First in Freedom rankings are certainly consistent with the findings of scholarly research going back decades that indicate impressive economic and social payoffs for states that embrace freedom as a policy priority.

Conclusion

To say that North Carolina should be truly First in Freedom is not to say that the state must reach that goal overnight. It will likely take years to build political momentum for reform and work out the details of workable, sustainable policies to advance fiscal, educational, regulatory, and health care freedom in our state.

North Carolinians are a practical and patient people as long as they have a clear sense of where their leaders seek to take them. In other words, gradual steps are fine as long as the long-term goal is both ambitious and consequential. It might also be valuable for North Carolina policymakers to announce intermediate goals – mileposts along the road to our ultimate destination, you might say. For example, North Carolina currently ranks 16th in fiscal freedom. Making the top 10 would require us to pass Montana, Utah, Delaware, Virginia, and Kansas. On educational freedom, North Carolina currently ranks 18th. Making that top 10 list would require us to pass Pennsylvania, Iowa, Utah, Colorado, Rhode Island, Virginia, and New Hampshire. Having these intermediate goals in mind could serve to sharpen the debate about the state's policies and priorities.

Over the past four years, North Carolina has clearly been headed in the right direction. Still, we have a long way to go. The journey won't be an easy one. There will be challenging obstacles and obstinate opponents. But the destination will be worth it. As the ancient Athenian statesman Pericles put it: "Freedom is the sure possession of those alone who have the courage to defend it." In this case, what we need are leaders who have the courage to reclaim it. Let's make North Carolina First in Freedom once more.

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Appendix: Methodology

To construct the 2015 First in Freedom Index, researchers from the John Locke Foundation selected, standardized, and weighted quantitative and qualitative data from state, national, and international sources.

Overall, there are over 60 variables in four major public policy areas used to calculate the 2015 First in Freedom Index.

- Fiscal Policy, including taxes and government spending is 50 percent;
- Education Policy, including public and private school choice is 20 percent;
- Regulatory Policy, including land use, occupational licensing, and tort reform is 20 percent; and
- Healthcare Policy, including health insurance is 10 percent.

Washington, D.C., U.S. territories, and related jurisdictions were not included due to data limitations.

Variables and Calculations

A project of this type requires different types of data drawn from various sources. Conventional numerical or quantitative data, such as expenditures or tax rates, are relatively easy to compare among states. Letter grades, point systems, yes/no (dichotomous) variables, range of condition (non-dichotomous) variables, and other types of metrics presented various challenges.

To begin the process of standardizing variables of different types, all figures were converted to positive values, excluding any negatives or zero. If a dichotomous scale was used, they were all converted to 1s and 2s. For example, we converted dichotomous variables related to local rent control laws by assigning a 2 to yes and a 1 to no. Similarly, data that came in the form of grades were assigned a numerical value – F=1; D=2; C=3; B=4; A=5. Point systems, non-dichotomous variables, and other types were scored accordingly.

As the above suggests, all ranges of values were organized so that lower values always represented “less freedom” and higher values represented “more freedom.” In cases when the opposite was true, the values in the data set were inverted, while maintaining the original ratios from state to state.

The mean or average was calculated for each variable and then divided into five ($5/\text{mean of } x_1, x_2, \dots, x_{50}$) to obtain a scaling factor. The scaling factor produced by this calculation was multiplied by each state’s original value (for that series of variables only) to produce a raw score. Weights were then applied to these raw scores and were ranked accordingly.

Weighting and Ranking

The variables within each category were not weighted equally. Rather, each category and its constituent variables were weighted based on the perceived impact it has on economic, educational, and personal freedom. Within each component are weighted sub-indexes to more precisely measure the impact of the law or policy on individual liberty.

As with most weighting schemes, the decision to weight some variables more highly than others was a deliberate, albeit somewhat arbitrary, decision. There is no research consensus indicating that a list of attributes and policies, proportioned in a specified way, signify that one state is freer than others. Nevertheless, there are certain policies that most free-market advocates would agree advance freedom for individuals and families. A state with a truly free system of schools, for example, will provide the means to allow all parents to choose the school that best meets the needs of their children. These opportunities should extend to those families who choose private, as well as district and public charter, schools.

After weighting each variable, the values were ranked from lowest (least free) to highest (most free). Values for multiple variables were summed for each subcategory, each policy area, and across all four policy areas.

Fiscal Policy

Fiscal Policy consists of four sub-variables: tax burden, consumption expenditures by government, subsidies, and social insurance payments. Each sub-variable is rated on a 10-point scale and then weighted at twenty-five percent, three, four, and three percent respectively. The total weighted score for all sub-variables are what constitute the overall fiscal ranking which encompasses thirty-five percent of the total First in Freedom Index.

Tax Burden

We chose to use the Tax Foundation's State Business Tax Climate Index to measure tax burden, because it is an indicator of which states' tax systems are the most hospitable to business and economic growth. While many economists will disagree on how individuals and businesses react to taxes, in 1956 Charles Tiebout suggested that if citizens were faced with an array of communities that offered different types or levels of public goods and services at different costs or tax levels, then all citizens would choose the community that best satisfied their particular demands, revealing their preferences by "voting with their feet." This study along with many others shows overwhelming evidence that business and individual decisions are significantly impacted by tax rates. The tax rates included in the State Business Tax Climate Index are only levied at the state level, and thus are controlled and amended only through decisions by state lawmakers making it a significant portion of a state's fiscal policy ranking.

Category and Variable Weights

Variables and Subvariables	Weight
Fiscal Policy	50.0%
Tax Burden	25.0%
<i>Individual Income Tax</i>	8.0%
<i>Sales Tax</i>	5.4%
<i>Corporate Tax</i>	5.2%
<i>Property Tax</i>	3.7%
<i>Unemployment Insurance Tax</i>	2.8%
General Consumption Expenditures by Government as a percentage of GDP	5.0%
Transfers and Subsidies as a percentage of GDP	10.0%
Social Insurance Payments as a percentage of GDP	10.0%
Education Policy	20.0%
Private School Choice	9.5%
<i>Voucher Law</i>	2.0%
<i>Voucher Students as share of school-age population</i>	1.0%
<i>Voucher Funds per school-age child</i>	1.0%
<i>Tax Credit Law</i>	2.0%
<i>Tax Credit Students as share of school-age population</i>	1.0%
<i>Tax Credit Funds per school-age child</i>	1.0%
<i>Education Savings Accounts</i>	0.5%
<i>Private Share</i>	1.0%
Public School Choice	8.5%
<i>Digital Learning Now! Report Card</i>	1.0%
<i>Charter School Law</i>	2.0%
<i>Charter School Share</i>	1.0%
<i>Voluntary Intradistrict Open Enrollment</i>	1.0%
<i>Mandatory Intradistrict Open Enrollment</i>	1.0%
<i>Voluntary Interdistrict Open Enrollment</i>	1.0%
<i>Mandatory Interdistrict Open Enrollment</i>	1.0%
<i>Expanding Teaching Pool</i>	0.5%
Home School	2.0%
<i>Home School Share</i>	1.0%
<i>Home School Law</i>	1.0%
Regulatory Policy	20.0%
Land Use	7.0%
<i>Regulatory Takings</i>	0.3%
<i>Wharton Residential Land Use Regulation Index</i>	3.0%
<i>Local rent control</i>	3.5%
<i>Eminent domain reform</i>	0.2%

Note: Percentages may not sum to 100.0% due to rounding.

Labor Market	3.5%
<i>Minimum wage</i>	0.5%
<i>Right-to-work</i>	2.0%
<i>Workers' compensation coverage regulations</i>	0.3%
<i>Workers' compensation funding regulations</i>	0.3%
<i>Short-term disability insurance</i>	0.1%
<i>Paid family leave insurance</i>	0.1%
<i>Employer verification of legal residency</i>	0.1%
<i>Smoker protection regulations</i>	0.1%
Utilities	1.5%
<i>Telecommunication deregulation</i>	1.0%
<i>Cable legislation for state issued franchise companies</i>	0.5%
Occupations	3.5%
<i>Employment-weighted licensure</i>	1.0%
<i>Summed fees for all occupations licensed</i>	0.1%
<i>Summed education/experience requirements for all occupations licensed</i>	1.0%
<i>Summed exam requirements for all occupations licensed</i>	0.4%
<i>Nurse practioners independent practice</i>	0.7%
<i>Member of Nurse licensure compact</i>	0.1%
<i>Dental hygienists initiate treatment</i>	0.1%
<i>Physician Assistants prescribe controlled substances</i>	0.1%
Tort	3.0%
<i>Freedom from tort abuse</i>	3.0%
Insurance Regulations	1.5%
<i>Member of interstate insurance product regulation compact</i>	0.3%
<i>State rate filing requirements personal auto insurance</i>	0.5%
<i>State rate filing requirements homeowners insurance</i>	0.5%
<i>State insurance rate classification prohibitions</i>	0.2%
Health Care Policy	10%
Age adjusted community rating, group	1.5%
Tobacco adjusted, group	0.4%
Age adjusted community rating, individual	0.5%
Tobacco adjusted, individual	0.4%
COBRA continuation	0.2%
Group conversion coverage, small firms	0.2%
Group conversion rating limits	0.2%
Financial incentives to providers banned	0.2%
Small group rate review	0.7%
Individual rate review	0.5%
Standing referrals mandated	0.2%
Certificate of Need Laws	3.0%
Heath insurance mandates index	2.0%

While taxes are a significant portion of the fiscal component in the Index, they are not the sole indicator of freedom within the component. The Fraser Institute publishes, *The Economic Freedom of North America*, of which we incorporated variables from their size of government component. Fraser used two ratings, the subnational and the all-government because the index includes Canada. At the all-government level, the index captures the impact of restrictions on economic freedom by all levels of government (federal, state/provincial, and municipal/local). At the subnational level, it captures the impact of restrictions by state or provincial and local governments. We chose to use the subnational level because the First in Freedom Index is focused on state freedom variables and not federal.

We chose to use the three variables from this component because we felt they were a good representation of government decisions that effect personal economic freedom. Below are the three sub-variables and how they are measured along with explanations of why they are good measures for freedom.

General Consumption Expenditures by Government as a Percentage of GDP

Weighted at three percent of the total fiscal index, government consumption and expenditures are measured as total expenditures minus transfers to persons, transfers to businesses, transfers to other governments, and interest on public debt. While government can fulfill useful roles in society by providing protection and public goods, there is a tendency for government to undertake unnecessary activities as it expands. Once government expands into the provision of private goods, goods that can be produced by private firms and individuals, it restricts consumer choice and, thus, economic freedom. In other words, government spending, independent of taxation, by itself reduces economic freedom once this spending exceeds what is necessary to provide a minimal level of protective and productive functions.

Transfers and Subsidies as a Percentage of GDP

Weighted at four percent of the total fiscal index, transfers and subsidies include transfers to persons and businesses such as welfare payments, grants, agricultural assistance, food-stamp payments, housing assistance, and so on. When the government taxes one person in order to give money to another, it separates individuals from the full benefits of their labor and reduces the real returns of such activity. These transfers represent the removal of property without providing a compensating benefit and are, thus, an infringement on economic freedom. Put another way, when governments take from one group in order to give to another, they are violating the same property rights they are supposed to protect.

Social Insurance Payments as a Percentage of GDP

Weighted at three percent, social insurance payments by Employment Insurance, Workers Compensation, and various pension plans are included in this component. When mandatory government programs replace private, voluntary arrangements for retirement, or disability insurance, economic freedom is diminished.

Fiscal Sources

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Education

The Educational Freedom ranking includes 18 variables. Eight of the variables rank state spending and participation in private school choice programs, such as tax credit scholarships, vouchers, and Education Savings Accounts (ESA). Eight of the variables examine public school choice, including virtual schools, charter schools, open enrollment, and expanding the teaching pool. The final two variables rank states based on the percentage of school-aged children in home schools and legal restrictions to homeschooling. All variables represent the latest data available from their respective sources.

Before we settled on the current methodology for First in Freedom’s education index, we consulted available indices of school choice and educational freedom. The excellent studies discussed below greatly informed the development of our index.

While the fiscal and regulatory sections of First in Freedom rely heavily on the Mercatus Center’s “Freedom in the 50 States,” we believe that the Mercatus ranking relied too heavily on variables dealing with homeschool and private school regulations. The Mercatus ranking includes six homeschool variables (curriculum control, law, notification requirements, recordkeeping requirements, standardized testing, and teacher qualifications); four private school variables (approval required, teacher licensure, registration, and curriculum control); two variables related to compulsory attendance (schooling years and mandatory kindergarten); and one school choice variable (tax credit/deduction). Individually, these variables are sound indicators of educational freedom, but collectively, they fail to capture the full scope of educational options afforded to states’ school-age populations.

In 2005, Andrew Coulson of the Cato Institute created the Market Reform Metric (MRM) that ranked the quality of school choice reforms and the size of the market for schooling. To that end, Coulson’s goal was to quantify “the predicted share of enrollment in the private sector, the predicted “marketness” (or market quality) of private schools that accept vouchers or subsidies from the state (if vouchers or subsidies are included in the proposal), and the predicted marketness of private schools that do not accept vouchers.” Regrettably, MRM never became a permanent component of Cato’s education policy work, but his thoughtful discussion of input variables and methodology was useful for establishing the parameters for First in Freedom.

Since 2011, The Brookings Institution has produced the Education Choice and Competition Index (ECCI). Published annually, the ECCI provides “an informative and consumer-relevant measure of the degree of choice and competition within the geographical boundaries of large school districts.” The Brookings index uses thirteen variables, mostly taken from National Center for Education Statistics data, to determine the availability and quality of choices available to parents in the 25 largest school districts in the nation. School districts are awarded points based on meeting predetermined criteria within each variable. Researchers tallied the points for each district and calculated a grade by dividing totals by the total points available. Similar to the MRM, the Education Choice and Competition Index allowed us to consider alternative input variables and methodologies, particularly those made available by the U.S. Department of Education.

Private School Choice

The eight variables in this category account for 9.5 percent of the total. Three variables are related to the quality and scope of voucher and town tuitioning programs. Another three variables assess the quality and scope of tuition tax credit scholarship programs. Education Savings Accounts (ESAs) and percentage share of private school students round out the category.

To determine the quality of the voucher and tax credit laws, we relied on comprehensive evaluations published by the Center for Education Reform. Voucher and tax credit enrollment were calculated as a share of the school-age (5-17) population for the state. Similarly, the voucher and tax credit variables are not raw dollar amounts but expenditures per school-age child. Given that Arizona is the only state that has an Education Savings Account, we did not examine the quality of the law, enrollment, and expenditures. Rather, Arizona received credit for having an ESA and all other states did not.

Public School Choice

Even if all parents were allowed to exercise private school choice at public expense, the majority of them would choose to send their children to a public school. But even those who do should be given a wide range of choices within the public system, including virtual schools, charter schools, and open enrollment opportunities both within and between school districts.

The variables in that category account for 8.5 percent of the total. The Digital Learning Now! Report Card was used to determine quality of the virtual school options. The Center for Education Reform provided an evaluation of states’ charter school laws. Education Commission of the States provided information on the presence of mandatory and optional intra- and inter-district open enrollment programs. Finally, we relied on the National Council on Teacher Quality’s grades for expanding the teaching pool to gauge states’ restrictions on entering the teaching profession.

Homeschools

Two variables, each weighted at 1 percent, inform the homeschool category. As with the private and public school choice categories, we estimated the percentage share of students who are homeschooled in each state. In addition, the Home School Legal Defense Association (HSLDA) maintains a state-by-state database of the regulatory burden imposed by home school laws. According to the HSLDA, homeschool laws range from “no notice” to “high regulation.” States may also be “low” and “moderate” regulation states, depending on state notification, testing, curriculum, and inspection requirements.

The rationale for including both variables is straightforward. The homeschool share represents the current health of the homeschool movement in each state. The amount of regulation imposed by each state’s homeschool law determines the capacity for growth in the future. Even states that have a relatively high proportion of homeschoolers may find that their homeschool law thwarts continued growth by discouraging prospective homeschool families who are weary of overregulation by the state.

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Regulation

The Regulatory Freedom ranking comprises six sets of variables. They concern measures of regulations over land use, the labor market, utilities, occupational freedom, torts, and insurance. With the exception of torts, each major category of variables consists of several subvariables.

These categories are pulled from the Mercatus Center’s “Freedom in the 50 States.” We have assigned different weights than used in the Mercatus rankings; however, we were impressed by the consideration given and variables used by Mercatus.

While there is necessarily some arbitrariness in assigning the subvariables’ individual weights, they were calculated within the categories according to their various proportions of overall regulatory costs in order to keep the scores balanced. For example, in the Labor Market category, Right-to-Work laws have a much higher regulatory impact than laws protecting smokers from discrimination in the workplace, and this difference is reflected in the much higher calculated weight.

Regulation Sources

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Healthcare

The health care variables selected from the Mercatus Center’s First In Freedom index measure how many states enforce certain health care regulations and the stringency of each state’s regulation. The selected variables have been weighted based on their overall impact on personal freedom for consumers, health care providers, and insurers.

Much of the Mercatus data preceded passage of the Patient Protection and Affordable Care Act (ACA). Since Congress passed the ACA into law on March 23, 2010, the regulatory landscape has changed dramatically. Some of the Mercatus variables measure regulations that were once optional for states but have now been superseded by federal legislation, e.g., the individual health insurance mandate. Prior to the law, Massachusetts was the only state that required all citizens to purchase health insurance. Since January 1, 2014, the ACA has mandated nationwide that all individuals purchase health insurance. Failure to comply triggers a tax, with some exceptions.

Due to the federal health law's additional unhealthy requirements, the individual mandate and the following variables have been excluded from this analysis: "mandate free" or "mandate light" health insurance policies, laws that mandate direct access to specialists, mandated external review for certain types of grievances, and banning of elimination riders. Again, states can no longer choose whether to enforce or forgo these regulations.

As the federal health law has to an extent eliminated states' authority to decide which health insurance regulations to enforce, relax, or repeal altogether, the law has also narrowed state regulatory flexibility by enforcing uniform compliance standards. For example, insurance commissioners in some states previously had the freedom to set their own age-adjusted community rating limits, so premiums for individuals could vary based on their age groups. Premiums could also be risk-adjusted based on policyholder health status. Due to new federal requirements, insurers can now only price insurance products such that the highest premium costs no more than three times the lowest premium charged any policyholder.

In some cases, the ACA's uniform regulatory requirements are less stringent than what many states enforced prior to the law's passage. Despite the federal health law now mandating that insurers grant women access to OBGYN specialists without requiring a referral, 42 states already enforced this regulation and some plans extended richer coverage options for women.

Although the Affordable Care Act restricts freedom to a greater degree for insurers, medical providers, and policyholders, some decentralization still exists at the state level. In Virginia, employers with fewer than 20 workers have the choice whether to extend COBRA continuation coverage to any employee, and his dependents, who either loses his job or is transitioning to employment elsewhere. Ten states do not enforce this regulation upon small firms. Meanwhile, the duration period varies for the remaining states that do mandate continuation policies for small business workers. North Carolina has employers offer COBRA coverage for up to 18 months.

States also maintain flexibility as to how they conduct their annual rate review processes for individual and small group health insurance market plans - where insurers gain approval for the costs of their products from the state insurance commissioners. Rate review processes vary across the nation, with some being more robust than others.

States may require the Department of Insurance to approve all rates submitted by carriers, while others require prior approval for only certain products or products sold by specific carriers, such as Blue Cross and Blue Shield. Wisconsin interestingly does not enforce a tedious rate review process due to having a highly competitive insurance market.

Another critical variable are Certificate of Need (CON) laws. These regulations require that medical providers must ask permission from state bureaucrats to build or expand an existing health facility or update major medical equipment. While CON was originally mandated by the federal government as a way to cut down on underused services and incentivize access to health care in underserved areas, it was deemed ineffective by Congress in the late 1980s. States now have the option to regulate medical services, supplies, and infrastructure. Those with strict CON parameters suppress competition, making health care more expensive for patients as well as limiting patient choice

Certificate of Need laws, age adjusted community rating for group coverage and each state's health insurance mandates index have been weighted the most heavily, since they directly burden medical providers, employers, and patients.

Healthcare Resources

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About the John Locke Foundation

The John Locke Foundation was created in 1990 as an independent, nonprofit think tank that would work “for truth, for freedom, and for the future of North Carolina.” The Foundation is named for John Locke (1632-1704), an English philosopher whose writings inspired Thomas Jefferson and the other Founders. The John Locke Foundation is a 501(c)(3) research institute and is funded solely from voluntary contributions from individuals, corporations, and charitable foundations.

The John Locke Foundation envisions a North Carolina of responsible citizens, strong families, and successful communities committed to individual liberty and limited, constitutional government.

The John Locke Foundation employs research, journalism, and outreach programs to transform government through competition, innovation, personal freedom, and personal responsibility. JLF seeks a better balance between the public sector and private institutions of family, faith, community, and enterprise.

“To prejudge other men’s notions before we have looked into them is not to show their darkness but to put out our own eyes.”

JOHN LOCKE (1632–1704)

Author, Two Treatises of Government and Fundamental Constitutions of Carolina



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