2014 IPA Economic Freedom Index

Dr Julie Novak
Senior Fellow

Institute of Public Affairs
THE VOICE FOR FREEDOM
70 YEARS: 1943-2013

January 2014

Julie Novak[1]
Senior Fellow
Institute of Public Affairs

with a contribution by Wolfgang Kasper

[1] The author wishes to thank, in no particular order, Sinclair Davidson, Jason Potts, Wolfgang Kasper, John Roskam, Alan Moran, Chris Berg, and James Paterson for their feedback on earlier drafts of this paper. The author thanks Vivienne Crompton, David Jancik and Pat Hannaford for their assistance in deriving the total number of pages of subordinate legislation for each jurisdiction. Vivienne Crompton is thanked for editing a draft version of this paper. Responsibility for all remaining errors or omissions resides with the author.

Contents

Executive summary

- This paper presents estimates for the first ever economic freedom rankings of the six Australian states.
- An economic freedom index is constructed, from a scale from 0 to 10, across four dimensions:
  - government expenditure;
  - taxation;
  - government dependency; and
  - regulatory environment.
- The higher the overall index value, the more economically free a jurisdiction is in relative terms.
- To the greatest extent practicable, the fiscal and regulatory activities of all levels of Australian government are incorporated into the index.
- With an overall economic freedom index score of 8.25, Western Australia is ranked as the relatively freest jurisdiction in Australia in 2011.
- By contrast, Tasmania is ranked as the relatively least free jurisdiction of the six Australian states, with an economic freedom index score of 3.57.
- The economic freedom 'league table' ranking for 2011 is presented in the following table:

Australian economic freedom index values and rankings, 2011

	Government expenditures	Taxation and debt	Government dependency	Regulatory environment	Overall economic freedom	Report card rank
WA	9.90	6.60	9.17	7.34	8.25	A
NSW	6.28	3.27	6.93	5.82	5.58	B
Vic	5.88	2.58	7.29	4.33	5.02	C
SA	3.59	3.40	4.21	8.80	5.00	D
Qld	3.66	4.04	6.71	0.00	3.60	E
Tas	0.00	5.47	0.00	8.81	3.57	F

The formula used to calculate index values is: (Vmax - Vi) / (Vmax - Vmin) x 10. Vmax is the largest value found within the indicator component, Vmin is the smallest, and Vi is the observation to be transformed.

- A preliminary empirical analysis suggests that there is a positive association between the growth in gross state product per capita across the states and an increase in the economic freedom index.
- Politicians and bureaucrats in every state, including those lagging behind in the economic freedom index, should conduct economic reforms that cut the size of government, deregulate the economy, and reduce the extent of personal dependency upon government.

1 Introduction

> 'If I am right in laying down, as the fundamental principle of Liberalism, that each individual should have secured to him the most absolute liberty, subject to such restrictions only, as are necessary to secure equal liberty to all, then it follows that the state should take no steps to curtail the liberty of any class, merely because it will confer an immediate advantage upon another class, even though that other class happen to be much larger or more influential politically than the former.' (Bruce Smith, [1887] 2005, *Liberty and Liberalism*, p. 162)

Economic freedom, or the ability of individuals to justly and non-coercively acquire, use and dispose of property as they each see fit, has long represented an animating principle of Western societies. The experience of history, and not to mention empirical studies, affirm the notion that greater levels of economic freedom tend to be associated with increasing economic prosperity and improved social wellbeing.

Despite these benefits, governments have long engaged in activities to restrict economic freedom through excessive taxation, public spending and debt which misallocate scarce resources; providing social security benefits which quell incentives to work and save in the productive sector; and imposing regulatory burdens restricting the exercise of entrepreneurship by private sector economic agents.

Australian governments at all levels interfere with our economic freedoms on a daily basis. In the absence of information it is difficult for taxpayers and citizens to determine which government is imposing policies more egregious to maintaining economic freedom, and the detrimental flow-on effects for long term economic and social improvements.

There is a need to fill in this information gap with an Australian economic freedom index.

This study contributes to the burgeoning economic freedom literature by providing rankings of relative economic freedom for the six Australian states in 2011. Indeed, this study is the first of its type for Australia, and follows many years of quantitative research undertaken by the likes of the Fraser Institute and Heritage Foundation comparing Australia's economic freedom ranking with that of other countries.[2]

An economic freedom index is developed which is composed of indicators pertaining to the level of expenditure, taxation and other fiscal activities, the extent of direct dependency by the population on governments for their income, and the regulatory environment maintained by governments.

The indicators are derived from statistics of state and local government activities (where available) and, given the extensive federal involvement in Australian fiscal and regulatory affairs, the statistical information is then supplemented by data on commonwealth government activities depending on

[2] James Gwartney, Robert Lawson and Joshua Hall, 2012, *Economic Freedom of the World: 2012 Annual Report*, Fraser Institute: Vancouver; Terry Miller, Kim R Holmes and Edwin J Feulner, 2013, *2013 Index of Economic Freedom*, Heritage Foundation: Washington DC.

availability and applicability. The information used to construct the indicators, and ultimately the economic freedom index value, is drawn from publicly available sources and may be replicated by interested parties for their own purposes.

There already exist several sub-national economic freedom indexes for other advanced economies. Most notable are the Fraser Institute's annual *Economic Freedom of North America* report,[3] and studies undertaken in recent years by the Friedrich Naumann Foundation-Liberales Institut (Germany), Centro Luigi Einaudi (Italy) and the Pacific Research Institute (United States).[4]

Studies have also emerged which include economic freedom considerations alongside a broader suite of personal freedom indicators. For example, the Mercatus Center *Freedom in the 50 States* ranks the relative freedom of the US states using numerous economic, fiscal, personal and regulatory freedom indicators.[5]

While this study does not assume the more comprehensive approach to quantifying relative personal freedom rankings, similar to that of the Mercatus Center research, in many respects it still provides a more comprehensive account of factors likely to affect economic freedom than most other available economic freedom indexes. In particular, the inclusion of government dependency and regulatory environment variables can be regarded as advances in this respect.

As noted above, international rankings of economic freedom are now well established. Australia has ranked favourably in terms of the international economic freedom rankings in recent years, typically within the top five of rankings in terms of overall relative economic freedom scores. The economic freedom rankings of the Australian states published in this study should be taken as being complementary to the existing international rankings, and not supplanting them.

---

[3] Avilia Bueno, Nathan J Ashby and Fred McMahon, with Deborah Martinez, 2012, *Economic Freedom of North America 2012*, Fraser Institute: Vancouver.

[4] Ying Huang, Robert E McCormick and Lawrence J McQuillan, 2004, *Economic Freedom Index: 2004*, Pacific Research Institute: San Francisco; Gabrielle Guggiola and Giovanni Ronca, 2007, *La libertà economica nel mondo, In Europa, in Italia*, Centro Luigi Einaudi: Turin; Clemens Fuest, Roman Bertenrath and Patrick Welter, 2010, *Wirtschaftliche Freiheit in den deutschen Bundesländern*, Friedrich Naumann Stiftung and Liberales Institut: Cologne.

[5] William P Ruger and Jason Sorens, 2011, *Freedom in the 50 States: An Index of Personal and Economic Freedom*, George Mason University, Mercatus Center: Arlington, VA.

2 An economic freedom index for the Australian federation: Methodology

A range of indicators have been collated for the purpose of developing index values for various categories of economic freedom for the six Australian states (New South Wales, Victoria, Queensland, Western Australia, South Australia, Tasmania). The index values for each component area are then used to inform the overall economic freedom index score for each jurisdiction.

It is important to stress at the outset that the index values provided in this paper do not, and nor are they intended to, indicate the absolute degree of economic freedom which exists in each state. In any event, there remain significant debates among classical liberals and libertarians regarding the most appropriate size and scope of government, which are not addressed in this paper in detail.[6]

The index presented here provides a relative ranking of the Australian states across four broad dimensions, or components, of economic freedom. Specifically, a higher economic freedom score accorded to a given jurisdiction implies that it is relatively more free compared with the others.

Another important issue is that compared with most other federal systems of government, Australian federalism offers limited fiscal and policy autonomy for state and local governments.

As a consequence of various economic, legal, political and social factors, the power to raise taxation revenues at least since the Second World War are relatively centralised in favour of the commonwealth government.

Whereas numerous proposals have been made during the post-war period to decentralise taxing powers back to the state-local public sector, the general tendency within the Australian federation has been the transfer of additional expenditure, regulatory and other policy responsibilities to the commonwealth. The result of this process has led to some commentators referring to Australia as effectively lacking a genuine federalist system.[7]

Given the extensive degree of centralisation of public sector activities in Australia it is deemed necessary to incorporate federal variables into the index wherever applicable, and subject to data availability (including data to impute values of commonwealth government activity across the states). This inclusion is necessary to the extent that the activities of the commonwealth government impinge on the degree of economic freedom enjoyed within each state.

---

[6] Some scholars most closely aligned to the anarcho-capitalist tradition in libertarian thought, from Gustave de Molinari to Murray Rothbard and Hans-Hermann Hoppe, consider it at least conceptually feasible for private sector entities to provide for basic protective services such as defence and policing. Many classical liberals, by contrast, appear to subscribe to the 'minarchist' tradition in liberal philosophy, which restricts government activities to protective functions only. Others who have self-identified themselves as classical liberals have, on occasions, enunciated more expansive views regarding the appropriate duties and responsibilities of government.

[7] Dan Mitchell, 'Federalism Spreads to the United Kingdom', International Liberty blog, http://danieljmitchell.wordpress.com/2010/12/05/federalism-spreads-to-the-united-kingdom/.

The resultant indicators, components and overall index values can be construed as representing an 'all-government' representation of relative economic freedom among the six jurisdictions.

There are essentially two methods employed in the sub-national economic freedom index literature to generate index values, and thereby rankings, for jurisdictions. One method, adopted by the Fraser Institute's *Economic Freedom of North America* project, uses a zero to ten scale for every indicator and component. In this case, zero corresponds to a relatively low level of economic freedom and ten corresponds with a relatively high level of economic freedom.[8]

Finally, in an effort to avoid subjective value judgments about the relative importance of each indicator to overall relative economic freedom, each indicator was equally weighted and each component was equally weighted.

The following indicators should not necessarily be construed as those which will definitively be used in subsequent editions of this index. In similar vein to other economic freedom indexes, the estimation methodology employed here may be occasionally altered by a host of factors, most importantly the availability of new data. To the greatest extent possible, future changes to the index methodology would be backdated to provide a consistent economic freedom index series over time.

The following sections provide descriptions of each indicator utilised for each component of economic freedom.

2.1 Component 1: Government expenditures

Most classical liberal economists and philosophers agree that some necessarily limited degree of government is required. It can facilitate the protection of individuals from aggression from internal and external forces, and enables them to acquire, use and dispose of physical and intellectual properties without theft or other undue acts of confiscation. Activities within this category typically undertaken by the public sector include the financing and provision of defence, law enforcement, judicial services, and foreign affairs.

At a stretch, some liberals also consider that governments could expediently finance and provide some goods and services, again of a limited range, which may not be otherwise provided profitably

[8] The formula used in the Fraser Institute study is: (Vmax - Vi) / (Vmax - Vmin) x 10. Vmax is the largest value found within the indicator component, Vmin is the smallest, and Vi is the observation to be transformed. Bueno, Ashby and McMahon, with Martinez, 2012, *Economic Freedom of North America 2012*, op. cit., p. 57.
Another approach, used in a 2011 study by Ruger and Sorens, entails taking, for each jurisdiction on each indicator and component, the number of standard deviations from the mean, to reveal interjurisdictional differentials in economic freedom index values. For variables for which lower raw numbers are preferred, the formula under the Ruger-Sorens approach is: -(Vi - V(mean)) / stdev(V) where Vi is the observation to be transformed, V(mean) is the mean value for all values, and stdev(V) is the standard deviation for all values. The Fraser Institute approach is adopted in this paper, nonetheless the Ruger-Sorens formula was also applied to provide consistency checks, particularly for relatively high and low economically free jurisdictions in the small sample. Checks of the two ranking methodologies found no discernible differences in overall state rankings.

in sufficient quantum by the private sector. For example, this category of public sector activity has traditionally included economic infrastructure, such as road, bridge, rail and port facilities.

In effect, all that the maintenance of economic freedom in the modern world necessitates is that government fiscal activities are of sufficient size and scope to ensure adequate, but minimal, levels of protective and productive activities.[9]

However, in practice, as government continues to expand their functions beyond these core activities, and accordingly extend their spending, taxation and borrowings, the ability of the private sector entities to grow further becomes diminished. Consumer choices also become more restricted as growth in government fiscal activities progressively crowd out feasible non-governmental output alternatives.

2.1.1 Indicator 1A: General government sector final consumption expenditure, percentage of gross state product

One of the many elements of government intervention in an economy is its role as a consumer of scarce resources. This not only deprives the private sector of direct consumption possibilities, but diverts resources away from individuals and businesses which could otherwise be used to expand their production.

Government final consumption expenditure consists of expenditure, including imputed expenditure, incurred by the general government sector on both individual consumption goods and services and collective consumption services.[10]

Consumption expenditure data for the state and local general government sectors are publicly provided for each state, as is expenditure by the commonwealth government allocated to each state on the basis where spending activity occurs.[11] As discussed above, given the extensive fiscal role of the commonwealth in each jurisdiction the figures used in the development of this indicator comprise both state-local and commonwealth consumption expenditures.

The greater the level of general government consumption expenditure within a given jurisdiction relative to the size of its economy (as indicated by gross state product (GSP)), the lower the relative economic freedom score received by that jurisdiction.

[9] James M Buchanan, 1975, *The Limits of Liberty: Between Anarchy and Leviathan*, University of Chicago Press: Chicago. However it should be noted that it is not inconceivable for the private sector to perform numerous activities, including on behalf of the public sector, as a consequence of technological changes (e.g., radio transponders and satellite GPS), financing innovations (e.g., user charging) and other factors which deepen private market capabilities.

[10] Australian Bureau of Statistics (ABS), 2012, *Australian System of National Accounts: Concepts, Sources and Methods*, Third Edition, ABS: Canberra.

[11] Some commonwealth consumption expenditures are allocated to each state by the ABS in accordance with population or employment shares. ABS, Ibid..

2.1.2 Indicator 1B: General government sector subsidy and transfer expenditure, percentage of gross state product

Governments also acquire fiscal resources from the population to redistribute to politically favoured groups. These groups may include other levels of government, business corporations, not-for-profit organisations and individuals.

Information on the amount of subsidies and transfers are provided for each level of general government by the ABS, through the annual government financial statistics publication.[12] Commonwealth government subsidy and transfer expenditures are attributed to each state on the following basis:

- Grants to state-local governments: Expenditures allocated on basis of state funding shares for general revenue assistance and specific purpose payments (including National Partnership Payments) in federal 'Final Budget Outlook' statements.[13]
- Grants to universities: Expenditures allocated on basis of state funding shares of commonwealth government grants to tertiary education institutions, as reported in higher education finance statistics produced by the Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education.[14]
- Other current transfers, and 'other' subsidies and transfers: Expenditures allocated on a per capita basis.

The greater the share of government subsidy and transfer expenditures to GSP within a given jurisdiction, the lower the relative economic freedom score received by that jurisdiction.

2.1.3 Indicator 1C: General government sector gross fixed capital formation, percentage of gross state product

Investment expenditures are undertaken by all levels of Australian government, which can potentially distort the allocation of capital by the private sector. Consistent with this, relatively greater levels of capital spending by governments will tend to reduce, or 'crowd out,' similar expenditures by private market participants.

The indicator used here is the ratio of gross fixed capital formation to GSP, by the commonwealth and state-local general government sectors. Although this analysis does not include capital spending by entities outside the general government sector, such as government trading enterprises, it is noted that the relative economic importance of such spending has declined over the past three decades, as a consequence of various privatisation and outsourcing initiatives.

[12] ABS, Government Finance Statistics, Australia, cat. no. 5512.0.

[13] Commonwealth of Australia, various years, *Final Budget Outlook*.

[14] Department of Industry, 'Higher Education Statistics', http://www.innovation.gov.au/HigherEducation/HigherEducationStatistics/Pages/default.aspx.

The greater the level of general government gross fixed capital formation within a given jurisdiction relative to GSP, the lower the relative economic freedom score received by that jurisdiction.

2.2 Component 2: Taxation and debt

Governments compulsorily acquire taxation revenue from individuals, businesses and other entities in order to fund the production and provision of certain goods and services. However by their very nature taxation represents a diminution of private property rights and, as the level of taxes increase, they more intensely restrict private production and consumption choices.

Relatively high levels of taxation, in particular, distort market signals and hamper the rational allocation of scarce resources. Distortionary taxation reduce the incentives for economic agents to engage in productive behaviours, such as the exercise of entrepreneurship, saving and investment, and working. All of these effects conspire to retard economic growth.

Another means through which governments finance their activities is through borrowing from domestic and external capital markets. The commonwealth and state governments sell their own bonds which raises loans with the promise to return bondholders the value of the principal plus interest on the coupon upon maturity. On the other hand, local government borrowings are coordinated by the financial investment arms of each state government or with the approval of the relevant state government minister.

It is important to recognise that the debt burden of governments represents future taxation, in that taxpayers in future generations are obliged to repay the debt proceeds raised by their resident governments. These additional tax burdens, in turn, reduce the economic opportunities available to a community and thus dilute economic freedom.

2.2.1 Indicator 2A: Direct taxation revenue, percentage of gross state product

Direct taxes are generally defined as those which may be adjusted in accordance with the individual characteristics of the taxpayer.[15] The direct taxes used in the development of this indicator include personal and corporate income taxes imposed by the commonwealth government, and payroll taxes imposed by the states.

The ABS presents statistics which break down taxation revenues collected by state and local governments in each jurisdiction. Aggregate taxation data for the commonwealth government is also presented, however the ABS does not provide a state-by-state split of this information.

This paper imputes commonwealth government revenues acquired from personal and corporate income taxation according to the following methodology:

[15] Anthony B Atkinson and Joseph E Stiglitz, 1976, 'The Design of Tax Structure: Direct versus Indirect Taxation', *Journal of Public Economics* 6: 55-75.

- State-level data for personal income tax (net of deductions), on a residence basis, were obtained from the Australian Taxation Office (ATO).
- The allocation of corporate income taxes by state was made on the basis of each state's share of national gross operating surplus (less general government activities and ownership of dwellings).
- Fringe benefits tax and superannuation guarantee charges were allocated to each state on a per capita basis.

The direct tax revenue data were then expressed as a share of GSP for each state. The greater the direct taxation revenue to GSP ratio within a given jurisdiction, the lower the relative economic freedom score received by that jurisdiction.

2.2.2 Indicator 2B: Indirect taxation revenue, percentage of gross state product

Australian governments also impose a range of indirect taxes, levied on certain transactions irrespective of the circumstances of sellers or buyers. These include taxes on property, the provision of goods and services, and the use of goods and performance of activities.

The ABS taxation revenue statistics collection includes information about state land taxes, stamp duties on land transfers and other financial transactions, taxes on gambling, insurance and motor vehicles, and other taxes. Local taxes on the unimproved value of land are also included in this indicator.

Several commonwealth indirect taxes are assigned to each state using the following formula:

- GST revenue was attributed to each state on the basis of national household consumption expenditure (less spending on food, education and health care) shares.
- Customs duties were attributed to states using state shares of total merchandise imports.
- Crude oil and LPG excises was attributed to each state by converting data on barrels produced into a volumetric measure of production of crude and LPG (in tonnes), drawing upon data published by the Australian Petroleum Production and Exploration Association (APPEA).[16]
- Other excises were attributed to each state using state shares of alcoholic beverage and tobacco consumption.

In a similar fashion to direct taxation, total indirect taxes were expressed as a share of GSP. The greater the indirect taxation revenue to GSP ratio within a given jurisdiction, the lower the relative economic freedom score received by that jurisdiction.

2.2.3 Indicator 2C: General government sector gross debt, percentage of gross state product

[16] Australian Petroleum Production and Exploration Association, 'Industry statistics', http://www.appea.com.au/industry-in-depth/industry-statistics/.

Data on the level of gross debt for the Australian state and local public sectors are sourced from ABS government finance statistics. Commonwealth government gross debt data is attributed to each state on the basis of each jurisdiction's share of commonwealth total expenditure.[17] This data is then deflated by the gross state product of each jurisdiction.

The index score for this indicator implies that the greater the gross debt to GSP ratio within a given jurisdiction, the lower the relative economic freedom score received by that jurisdiction.

2.3 Component 3: Government dependency

A feature of modern democratic government is the significant numbers of individuals and families who depend upon subsidies and other government payments for their incomes. These include the salaries paid to public sector employees, and welfare benefits provided in the form of income, housing, child support, student aid and other assistance.

The degree of dependency upon government is extensive, and the taxes raised to fund the enormous array of governmental payments deprive affected individuals of some income required for their own self reliance, diluting economic freedom in the process.

Some minimal level of public sector administration is necessary for a functioning system of constitutional government operating under the rule of law. However, the costs associated with growing public sector employment are coercively financed by the taxpaying public working within the private sector. Compounding this, growing employment opportunities in the public sector tends to draw labour away from private opportunities.

Finally, public policy bureaucrats are employed to advise and administer taxation and regulatory policies which restrict the scope for exercising economic freedoms, while inefficient services provided by public sector workers crowds out private and non-government services and distorts resources allocation.[18]

The welfare state also encourages a sense of dependence by recipients upon the subsidies and other payments provided by the government. It also depresses incentives that could encourage welfare recipients to participate in the productive sector of the economy. The tendency towards dependency by welfare state beneficiaries can span over long time periods, even stretching across generations within families.

The most notable aspects of discouraged economic participation rendered by the welfare state include the lower levels of engagement in labour markets, as well as lower levels of home and private property ownership.

---

[17] Calculated as the sum of final consumption expenditure, expenditure on subsidies and transfers, and gross fixed capital formation.

[18] Julie Novak, 2012, *Razor Cuts, Not Paper Cuts: A Framework for Rightsizing Commonwealth Government Employment*, Institute of Public Affairs, Occasional Paper.

Another aspect of the welfare state, as part of the broader impetus towards government dependency that it delivers, has been the substantial elimination of voluntary and charitable activities. These used to be undertaken by religious orders, unions, mutual aid societies, neighbourhood associations, and business philanthropists. What remains of the non-government charitable sector has generally been co-opted into the broader welfare state system through extensive government grants.

In addition, the growth of the welfare state is associated with changing cultural attitudes towards private sector entrepreneurship. This is typified by a growing acceptability of the sentiment that it is appropriate, and indeed moral, to confiscate part of the incomes of business owners and others earning their own income, to support those in need.

2.3.1 Indicator 3A: Total public sector employment, percentage of population

Data on total public sector employment is provided by the ABS. The coverage of this data is reasonably comprehensive, comprising employment in all public sector entities except for defence forces, employees based outside Australia, workers' compensation employees not on the public payroll, and office holders of public sector organisations not paid a salary.[19]

The ABS allocates state and local government employment data by jurisdiction on an annual basis, and performs a similar allocation with regard to commonwealth government employment data. This data is then deflated by the size of the estimated labour force within each jurisdiction.[20]

Similar to the other indicators presented thus far, the greater the share of public sector employment within the total labour force of a given jurisdiction, the lower the economic freedom score of that jurisdiction.

2.3.2 Indicator 3B: Social security payment recipients, percentage of population

Governments have long extended subsidies and other payments to certain individuals, which encourage dependence by recipients upon government support and reduce the disposable incomes available to those coerced to finance the welfare state.

The Department of Families, Housing, Community Services and Indigenous Affairs maintains information on the number of recipients of commonwealth social security payments directed to individuals by state.[21]

---

[19] ABS, Employment and Earnings, Public Sector, Australia, 2011-12, cat. no. 6248.0.55.002.

[20] ABS, Labour Force, Australia, cat. no. 6202.0.

[21] Department of Families, Housing, Community Services and Indigenous Affairs (FAHCSIA), various years, *Income support customers: A statistical overview*, FaHCSIA: Canberra.

These include recipients of the Age Pension, Disability Support Pension, Sickness Allowance, Widow B Pension, Wife Pension, Carer Payment, Austudy and ABSTUDY payments, Newstart Allowance, Partner Allowance, Mature Age Allowance, Widow Allowance, Parenting Payment (Single and Partnered), and Special Benefit.

This compilation of the numbers of people reliant upon public sector payments is not exhaustive, as it excludes cash or in-kind assistance provided by the commonwealth government to families and other groups. The data also excludes state and local government cash and in-kind social assistance, although the receipt of commonwealth social security payments is often a criterion for the receipt of state-local payments.

For this indicator, the greater the share of social security payment recipients within the total estimated resident population of a given jurisdiction, the lower the economic freedom score of that jurisdiction.

2.3.3 Indicator 3C: Social security cash benefits, percentage of gross household income

Another indicator of the extent of government dependency is the share of government social security payments in the total income of a household, with a greater share of government payments to total income implying relatively greater dependence upon government and therefore a greater reluctance on the part of household members to seek their incomes from private sector activities.

The ABS state accounts provides annual estimates of social assistance benefits in cash to residents, incorporating commonwealth and state payments such as scholarships, maternity, sickness and unemployment benefits, child endowment and family allowances, widows' age, invalid and repatriation pensions.[22] The quantum of these expressed are expressed as a percentage of total gross household income earned in each jurisdiction.

The greater the percentage share of social security cash benefits to income of a given jurisdiction, the lower the economic freedom score of that jurisdiction.

2.4 Component 4: Regulatory environment

Government regulations entail a host of pervasive effects upon economic freedom, affecting the ability of individuals and businesses to utilise property and other resources in accordance with their own needs and circumstances.

In addition to the direct tax costs of maintaining regulatory administrations, regulations are usually associated with the imposition of a series of compliance costs upon regulated individuals and businesses. These can range from the costs of filing paperwork to labour retraining and capital refurbishment costs to comply with regulation, as well as project delay costs associated with waiting

[22] ABS, Australian System of National Accounts: Concepts, Sources and Methods, Third Edition, cat. no. 5216.0.

for regulatory approval.[23] Regulatory compliance costs can divert scarce resources to other uses not otherwise preferred by those subject to the regulation, diluting economic freedom in the process.

Regulations diminish economic freedom by restricting the scope for private sector entrepreneurship to those production possibilities permissible under regulation, constraining the capacity for entrepreneurial discovery and insight to promote economic development.[24] This entails nothing less than an artificial hindering of the most important facets of economic conduct: the utilisation of human knowledge and exercise of creativity.

In addition to changes in government expenditure and taxation policy, changes in regulatory policy can reduce investments and other productive activities by limiting the ability of entrepreneurs to confidently establish how future policies will affect their property rights.[25] This hampers innovation by discouraging productive risk-taking behaviours in the marketplace.

In many instances, regulation encourages wasteful rent seeking behaviour whereby regulated individuals and businesses have increased incentives to seek regulatory favouritism through lobbying government ministers and officials.[26]

When regulations restrict entry into markets and interfere with the freedom to engage in voluntary exchange and the alteration of property rights, they unduly restrain individuals from discovering new opportunities to create wealth and jobs, and accordingly reduce economic freedom.

2.4.1 Indicator 4A: Number of pages of primary legislation passed or assented

A common, albeit imperfect, measure of regulatory burden is the number of pages of legislation passed during a period of time.[27] Drawing upon commonwealth and state legislation websites, it is

---

[23] Productivity Commission, 2007, *Performance Benchmarking of Australian Business Regulation*, Research Report, Melbourne.

[24] Bruce L Benson, 2004, 'Opportunities Foregone: The Unmeasurable Costs of Regulation', *The Journal of Private Enterprise* 19 (2): 1-25.

[25] Robert Higgs, 1997, 'Regime Uncertainty: Why the Great Depression Lasted So Long and Why Prosperity Resumed after the War', *The Independent Review* 1 (4): 561-590.

[26] Tullock, Gordon, 1967, ‘The Welfare Costs of Tariffs, Monopolies and Theft’, *Western Economic Journal* 5: 224-232; Krueger, Anne O, 1974, ‘The Political Economy of the Rent-Seeking Society’, *The American Economic Review* 64: 291-303.

[27] There is no necessarily unambiguous relationship between the number of pages of legislation and the number and extent of regulatory obligations that economic agents need to comply with. In addition, comparability of the number of pages of primary legislation passed or assented is compromised by the manner in which Acts are published. Mulligan and Schleifer suggest that the estimation of the number of kilobytes of unannotated legislation may be a feasible alternative measure of the extent of the regulatory burden. While this approach would control for variations in legislative publication standards, this approach has not been pursued for this study. See Mulligan, Casey B and Schleifer, Andrei, 2003, ‘Population and Regulation’, Working Paper, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=485722.

possible to obtain a time series of the number of pages of primary legislation for each calendar year.[28]

Data concerning pages of local laws for Australian local governments are unavailable for most local government authorities, or are presented in an inconsistent manner for those (typically metropolitan councils) that present such information. Therefore, local government information was excluded from this indicator.

The quantum of primary legislation pages for the commonwealth are equally attributed to each state, on the basis that commonwealth regulations are applicable across Australia regardless of location. To this is added the number of pages of state primary legislation to provide a total for each jurisdiction.

The greater the numbers of pages of primary legislation passed by a given jurisdiction, the lower the economic freedom score of that jurisdiction.

2.4.2 Indicator 4B: Number of pages of subordinate legislation passed or assented

Australian governments also impose a range of subordinate legislation, providing further specification of regulatory conditions in accordance with the objectives stated in primary legislation. A larger volume of subordinate legislation passed implies further restrictions upon relative economic freedoms.

A count of the number of pages of subordinate legislation passed or assented in each calendar year by federal and state parliaments was undertaken. Consistent information on local government subordinate legislation is unavailable, and therefore is not included in this study.

Similar to the techniques used to estimate the quantum of primary legislation, subordinate legislation pages for the commonwealth are equally attributed to each state, on the basis that commonwealth regulations equally apply across the country. To this is added the number of pages of state subordinate legislation to provide a total for each jurisdiction.

The estimated number of pages of subordinate legislation passed is not an exhaustive count, as it excludes notices, determinations, rulings, proclamations, instruments, orders, codes, declarations, guidelines, standards and other forms of 'grey letter' law.

The greater the numbers of pages of subordinate legislation passed by a given jurisdiction, the lower the economic freedom score of that jurisdiction.

[28] The estimates used in this paper represent a 'gross' count of legislation, in that it incorporates new, amended and repealed legislation.

2.4.3 Indicator 4C: Number of pages of primary and subordinate legislation per legislative item

The complexity of regulation also has important implications for economic freedom, with increasingly complex regulatory settings infringing upon the ability of individuals and enterprises to engage in productive activities.

A proxy measure for the extent of regulatory complexity is the average number of pages of primary and subordinate legislation per legislative instrument (specifically, Acts and regulations).[29] This measure was estimated for the commonwealth and states using the pages count for indicators 3A and 3B, as noted above, and data on the number of Acts and regulations passed each calendar year.

The number of commonwealth primary and subordinate legislation pages, per instrument, was equally apportioned to each state. To this is added the number of pages per instrument to provide a total for each jurisdiction.

The greater the numbers of pages of subordinate legislation, per legislative item, passed by a given jurisdiction, the lower the economic freedom score of that jurisdiction.

Additional statistical information used to derive the index scores is provided in Appendix A.

[29] This analysis does not incorporate other measures which explicitly account for the ‘quality’ of regulation imposed by governments.

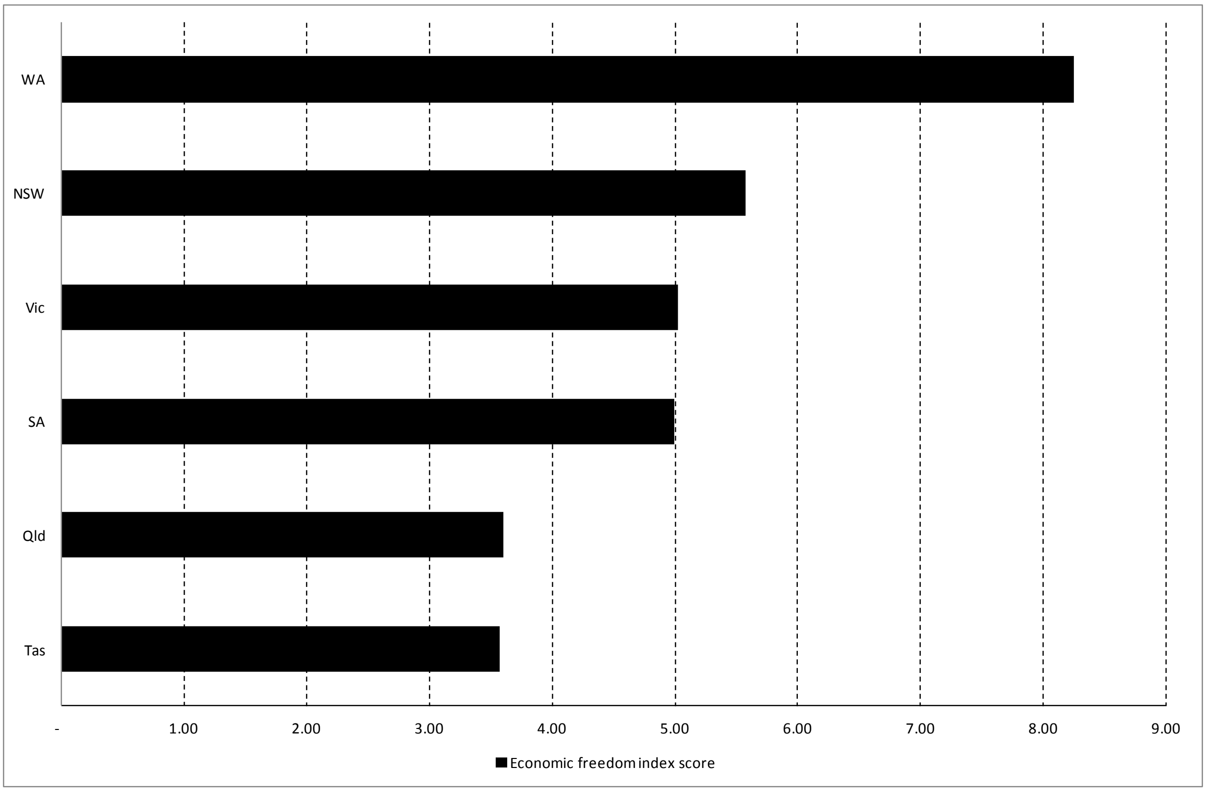
3 Economic freedom index results and analysis

3.1 Index results

Using the methodology outlined in the previous section, it is possible to derive an economic freedom index for the six Australian states, for 2011. The overall index reflects the weighted average of values for the component areas of government expenditures, taxation and debt, government dependency, and the regulatory environment.

Table 1 provides a summary of index values for overall economic freedom for each jurisdiction. Western Australia is assessed to have been the relatively most economically free jurisdiction in Australia in 2011.[30] WA was followed by New South Wales, South Australia, Victoria, Queensland and, finally, Tasmania as the relatively least free jurisdiction.

Figure 1: Summary of Australian economic freedom rankings, 2011



The formula used to calculate index values is: (Vmax - Vi) / (Vmax - Vmin) x 10. Vmax is the largest value found within the indicator component, Vmin is the smallest, and Vi is the observation to be transformed.

Further information on the components informing the derivation of the overall economic freedom index values is provided in Appendix A. The raw data used in the calculation of indicators is provided in Appendix B.

---

[30] Statistical testing for the presence of an outlier (viz. Western Australia) among the economic freedom index scores was undertaken. The result of the Grubbs' (extreme studentised deviate) test indicated that WA was not a significant outlier.

3.2 What explains the index results?

Despite a relatively heavy fiscal burden posed by commonwealth, state and local taxes and debts, **Western Australia** has been ranked as the relatively freest jurisdiction in Australia. This finding was established on the basis of the state's markedly lower government spending and dependency rates.

New South Wales was assessed as the second freest Australian state, due to relatively low government spending and dependency upon governments for incomes. However, there is some room for improvement to lower taxes and public debts as well as the annual flow of legislation.

Victoria was ranked as the third freest jurisdiction in relative economic freedom terms. This state ranked relatively highly with regard to government expenditure and government dependency categories. However, relatively high taxes and a high rate of legislative passage reduced the overall relatively economic freedom score for the state.

Victoria was followed by **South Australia** on the economic freedom 'league table.' The state passed a small share of the total legislation passed in Australia in 2011, and was ranked in the middle with regard to the burden of taxation and debt. However, relatively high levels of government spending and dependency compromised South Australia's ability to improve its freedom ranking.

In 2011 **Queensland** was the second lowest rated state with regard to the Australian economic freedom rankings. The state rated well against other jurisdictions in terms of maintaining a relatively lower tax and debt burden, and smaller degree of personal income dependency upon government. This was more than offset by the highest rate of passage of legislation of all the states (suggestive of regulatory activism by policymakers), and a somewhat high level of government consumption expenditure.

Tasmania was ranked as the relatively least free state in the Australian federation. Low rates of legislation enactment and taxes-debt represented positive attributes of Tasmania's performance. However, high rates of government dependency and public sector spending have posed as significant factors weighing down the state's ability to provide an economically free environment to work and invest.

3.3 The effect of economic freedom on economic performance

A voluminous literature has emerged over the past two decades, or so, alluding to the beneficial effects of relatively greater economic freedom on aspects of economic performance. A catalogue of academic research alluding to the beneficial effects of economic freedom can be found at the Fraser Institute economic freedom website.[31]

[31] See http://www.freetheworld.com/papers.html.

In this section, a 'fixed effects' pooled least squares regression analysis is undertaken of the relationship between the change in GSP per capita and the change in the economic freedom index, from 2001 to 2011.[32] The annual change in GSP per capita of the states (*gsppc*) is used as the dependent variable, whereas the annual change in the economic freedom index (*free*) represents one of the independent variables.

Other variables, such as changes in the share of private gross fixed capital formation (less dwellings expenditure and ownership transfer costs) to GDP (*prinv*) and in senior secondary schooling apparent retention rates (*edu*), were also included in the regression. These variables are employed to account for the widely held hypotheses that economic growth is influenced by the accumulation of physical and human capital.

The unemployment rate in each state (*unem*) is included in the regression analysis, to account for the possibility that annual changes in GSP per capita are affected by fluctuations in the business cycle. A time trend variable is also included. All variables have been expressed in natural logarithms, so that first differences approximate their growth rates.

The results of the regression analysis are provided in Table 1. The sign of the coefficient for the economic freedom variable accorded with *a priori* expectations, and was found to be statistically significant at the five per cent level. The value of the coefficient suggests a ten percentage point increase in the economic freedom index increases the growth rate of Australian GSP per capita by about 0.2 per cent.

[32] Fixed effects estimation, in this case, is used to control for unobserved heterogeneity between the states which are time invariant.

Table 1: Results of regression analysis

Dependent variable: *gsppc* (growth in GSP per capita)			
Independent variables	**Variable description**	**Coefficient value**	**p-value**
free	Change in economic freedom index value	0.023857***	0.0066
prinv	Change in private investment to GSP ratio	0.019413***	0.0034
edu	Change in senior secondary schooling apparent retention rate	0.057474**	0.0212
unem	Change in unemployment rate	-0.058213***	0.0000
constant	Intercept term	0.027630***	0.0000
Total pool (balanced) observations	60		
Adjusted R-squared	0.770234		
F statistic	20.77828		
Durbin-Watson statistic	2.293803		

*** Statistically significant at 1% level. ** Statistically significant at 5% level. * Statistically significant at 10% level. Coefficient of the trend variable is not reported in this Table. Cross-section weights and cross-section SUR (PSCE) standard errors applied.

Admittedly the regression results are indicative by nature, given that only 60 observations are utilised in the pooled regression. As additional data becomes available over time, additional empirical investigations into the growth implications of economic freedom for Australia will be conducted.

4 The importance of economic freedom in a globalised world (Wolfgang Kasper)[33]

4.1 Secure property and discovery

'Freedom,' wrote Prussian philosopher Immanuel Kant in a letter to a correspondent, 'is special because it brings out the best in people.' In most circumstances, freedom indeed promotes and buttresses other universally accepted, fundamental values that define the good society - peace, justice, equity, security, the conservation of a liveable environment and prosperity. These are abstract, high-level aspirations, the measuring rods by which we normally judge the quality of social and political life. In policy debates, they serve as the 'ultimate stopping points:' When it can be shown that a particular policy violates this constellation of objectives, public debate ought to stop, for who would argue for injustice, strife or material misery?

Wise evaluation of proposed policies of course takes into account that trade-offs and conflicts exist between these fundamental objectives. Populists, who single out just one fundamental objective, in reality advocate the costly neglect of all others. Their policies sooner or later make costly policy reversals inevitable. For example, the pursuit of nature conservation at the expense of all other objectives will destroy freedom, security and material well-being. Within the constellation of fundamental values, freedom holds a special place – as Locke, Voltaire, Kant and other great minds, who built the intellectual foundation of the modern age, fully appreciated. It is complementary to all the other fundamental values most of the time, at least over the longer term.

Economic freedom is a key component in overall freedom. It covers secure individual property rights, as long as these have been lawfully acquired, and their free, unfettered use within the rule of law. In other words, it is the freedom to exercise one's property rights without hindrance, as long as this does not harm the rights of others[34]. Property is thus not the mere physical possession of an asset. Rather, rightful ownership establishes an open-ended bundle of rights, some of which may not be exercised or may not even have been discovered yet.[35] Property rights can of course be established not only in things, such as land and capital goods, but also in ideas (intellectual property) and one's own labour and skills.

[33] It is intended that each edition of the IPA economic freedom index will include a 'guest chapter' written by a prominent Australian academic, or other figure, with expertise in economic freedom issues. Given his substantial expertise in the field, the IPA selected the first of these to be prepared by Wolfgang Kasper, *emeritus* Professor of Economics, University of New South Wales, Australia. Wolfgang Kasper thanks Julie Novak, John Roskam and Alan Moran for comments on a draft version of this chapter, and retains exclusive responsibility for judgments and errors.

[34] In a genuinely free economy, the party claiming harm has to prove in court that someone else's property use has indeed caused what is defined by the laws of the land as harm. Mere assertions or allegations do not suffice. Also note that contemporary legislation often reverses the burden of proof, for example obliging property owners to prove that they do not harm the environment. Such reversals of the burden of proof deprive rightful owners of some of their rights and amount to an abridgement of a traditional core element of procedural justice, the presumption of innocence.

[35] Wolfgang Kasper, Manfred E Streit, and Peter J Boettke, 2012, *Institutional Economics: Property, Competition, Policies*, Edward Elgar: Cheltenham, p. 185-218.

Property can be used passively and actively. Thus, a landowner may use his property passively by excluding everyone else from using his land. Another may make active use of the land by planting crops, but may also grant a right of way to a neighbour and sell the right to hunt to yet other parties. As circumstances change, he may sell a mineral exploration right to a company, or discover that he can profit from selling certain usage rights to a developer who plans a tourist venture. Indeed, humanity's economic history can be seen as the accumulation of many millions of such discoveries of property-right uses and their combination with the property rights of others through voluntary contracts.

Little wealth is created when individual property rights are not protected or when the freedom of contract concerning property uses is severely curtailed.[36] Why plant a crop when everyone can appropriate the yield? Why cultivate a herd when everyone can slaughter the animals? Why risk mineral exploration, when governments inhibit the combination of exploration rights with someone else's expertise, labour and capital? Wealth and job creation thus depend on a framework of the right kind of rules, which we call 'institutions' that protect property and its uses.[37]

Property is normally protected by shared habits and customs, because everyone realises that theft and plunder produce general poverty. Thieves are thus punished spontaneously by members of society, for example by reprimand, retaliation and ostracism. We call rules, which evolve within society on the basis of experience and which are spontaneously enforced, '*internal institutions'*. Only when private property was widely respected and protected, could the human race embark on wealth creation.[38] Property was the very basis of the 'Neolithic revolution' – the gradual transition from mere nature exploitation by hunter-gatherers to wealth creation by agriculturalists and pastoralists. This, arguably the most important of all revolutions in history, first occurred in upper Mesopotamia some twelve millennia ago, when wheat, olives and grapes were first cultivated. Later, property rights and farming were discovered independently in north-eastern Thailand (rice), New Guinea (tubers, bananas), Central and South America (maize, beans, potatoes).

Using property costs resources: Passive ownership may require the installation of locks, fences, land-titles registries, Neighbourhood Watch, or computer codes (exclusion costs); active property uses inflict numerous costs, for example searching for potential contract partners who may want to combine their property rights with some of yours, or the costs of negotiating and monitoring contract fulfilment and resolving conflicts over contract fulfilment (transaction costs).

To begin with, private property was respected and, if necessary, spontaneously protected in small groups, so that all could prosper.[39] This is how the law emerged long before there were governments. As

---

[36] Tom Bethel, 1998, *The Noblest Triumph: Property and Prosperity through the Ages*, St. Martin's Press: New York.

[37] Institutions are defined here as rules whose violations attract sanctions. Common English usage of the term 'institution' is often confusing. Churches, banks, universities and insane asylums are not institutions as defined here, but organisations, i.e. more or less durable combinations of production factors for the purpose of generating certain outcomes.

[38] Elinor Ostrom, 2005, *Understanding Institutional Diversity*, Princeton University Press: Princeton.

[39] Peter T Bauer and Amartya Sen, 2004, *From Subsistence to Exchange*, Princeton University Press: Princeton; Ostrom, op. cit.

Friedrich Hayek remarked in his famous work *Law, Legislation and Liberty*: 'Law is older than legislation.'[40] Over time, these internal institutions were frequently reinforced by authorities, which emerged in the wake of the Neolithic revolution: priests, kings, and magistrates. Certain individuals or groups claimed political powers to codify, clarify and enforce existing customs, often claiming the monopoly to use violence. Hammurabi (1727-1686 BC) in Mesopotamia and Moses (ca. 1225 BC) in Palestine were such lawgivers.

In the literature, formal rules, which are laid down and enforced by political leaders, are called '*external institutions*'. People accepted political authority and formal rules because most experienced greater security, were able to produce more, survived in greater numbers and were able to discover new uses of what they owned. Reliably enforced institutions are particularly important for the search of knowledge about new, untested property uses, which is always risky. After all, costs have to be incurred in knowledge search first, before it can be known whether the knowledge is at all useful. Will a costly new oil well produce a bonanza, or yet another disappointment? Will a new product find a market?

The competitive market economy is a daily process of evolution by intelligent human selection. It frequently also inflicts costly losses on would-be innovators. Risking (often massive) knowledge-search costs therefore requires a spirit of enterprise and a high degree of confidence that hoped-for rewards will not be taken away. This is why a framework of known, reliable rules that establish secure property rights is essential to innovation and hence material progress. If successful innovators must fear nationalisation or face 'super-profit taxes', they will be disinclined to risk their scarce resources to search for new uses of their assets, skills and knowledge. The poor protection of private property rights explains why so little technical and material progress occurred during most of history and why many societies still remain poor.[41] This is not obscure economic theory, but straightforward common sense.

Our present-day external (government-made) institutions are normally the hard-won outcome of political trials and errors. Political and economic agents may have struggled to resolve bitter conflicts and learnt from bitter experiences – only think of Western rules of religious tolerance that were forged during centuries of religious strife. Such institutions, anchored in shared values, constitute a society's most valuable asset in promoting people's fundamental aspirations: They reduce transaction costs (enhancing competitiveness and prosperity), avert or mitigate conflicts (promoting justice, peace and security) and promote individual autonomy (supporting freedom and prosperity). Since good institutions raise everyone's productivity potential, one is justified to call a society's rule system its 'institutional capital'. Those who have no first-hand experience of other, less successful societies may be unaware just what precious possession time-tested, shared institutions are!

[40] Friedrich A Hayek, 1973, *Rules and Order*, *Law, Legislation and Liberty*, Volume 1, University of Chicago Press: Chicago, p. 72; also see Bruce Benson, 1998, 'Economic Freedom and the Evolution of Law', *Cato Journal* 18 (2): 209-232.

[41] Amartya Sen, 1999, *Development as Freedom*, Anchor Books: New York; Bauer and Sen, op. cit., Hernando de Soto, 2001, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*, Basic Books: New York; Daron Acemoğlu and James Robinson, 2012, *Why Nations Fail: The Origins of Power, Prosperity, and Poverty*, Random House: New York.

4.2 Economic freedom, prosperity, political and civil freedom - A virtuous circle

Economic freedom is not only a crucial component in overall freedom, but – as has been repeatedly the case – is also the foundation, on which civic and political liberties are subsequently built. The merchants and craftsmen of the trading cities of post-Medieval Europe were offered economic (and sometimes religious) freedom by feudal rulers long before the emergence of democracy and acceptance of most of the general civil liberties we now take for granted.[42] Some rulers even allowed traders to create their own laws and courts, so that they could rely on their own, self-created rules. These became known as 'Law Merchant' (*lex mercatoria*). Merchants no longer depended on the often corrupt, tardy and biased courts of the kings. The rulers, who self-constrained their own opportunism in these ways, did so of course not out of deep philosophical insights or empathy with the oppressed, but to attract wealth-creating, tax-paying merchants and craftsmen.

Gradually, a relatively free middle class emerged who demanded overall freedom and constitutional government. It was achieved by the 'citizens of property,' who had the wherewithal to obtain civic and political liberties. Paupers could not have attained this on their own. In the late eighteenth and nineteenth centuries, the prospering inhabitants of North America and Australasia also secured decent levels of overall freedom. Formally protected property rights and capitalism thus became the trailblazers of modern democracy.[43]

Since the 1960s, a similar dynamic has been unfolding in East Asia. Small, insecure autocracies on Asia's fringe enhanced economic freedom and implemented rule-bound administrations to attract internationally mobile capital, knowledge and multinational enterprises to promote economic development. They offered tax concessions and made land and infrastructures cheaply available. The autocrats of the emerging 'Asian Tiger' countries were after greater prosperity, a bigger tax take and improved security, but the unintended by-product was the rapid rise of a middle class that agitated for greater political and civil freedom. The process has since spread throughout East Asia, even into China.

4.3 Freedom and the Jekyll-and-Hyde nature of government

Economic freedom has by now been improved in many parts of the world, but it is far from secure.[44] Over recent years, we have had to witness instances of costly backsliding in rich and poor countries alike. One therefore has to ask: Is economic freedom endangered by (a) powerful fellow citizens, for example criminals, monopolies and cartels, or (b) government bodies with coercive powers?

As mentioned, government originally came about because ordinary people wanted protection from opportunistic fellow citizens, thugs, fraudsters, foreign aggressors and the like, and political agents

[42] Eric Jones, [1981] 2003, *The European Miracle*, Cambridge University Press: Cambridge; Douglass C North, 1990, *Institutions, Institutional Change and Economic Performance*, Cambridge University Press: Cambridge; Kasper et al., op. cit., p. 427-435.

[43] Milton Friedman, 1962, *Capitalism and Freedom*, Chicago University Press: Chicago.

[44] James Gwartney, Robert Lawson, and Joshua Hall, 2012, *Economic Freedom of the World*, *2012 Annual Report*, Fraser Institute: Vancouver.

provided helpful external institutions. Meantime, shared and reliably enforced institutions have become central to the productive and peaceful cooperation among the many.

Our high living standards now depend on an almost invisible spider web of institutions that support this cooperation. The division of labour and innovation have increased in previously unimaginable ways. Production has also shifted increasingly from primary and secondary industries to services, where the right rules of the game matter even more. As a consequence of these trends, the costs of transacting business have risen steeply to nowadays more than half of all costs of producing and distributing the national product.

But not all rule systems are of equal usefulness in ordering the complex cooperation in the economy, hence in setting the level of transaction costs. If the rules become confusing and are poorly enforced, transaction costs soar. The static and dynamic efficiency of the economy then suffers, and the production of many goods and services no longer promises a profit. Lines of production are then discontinued; plants are closed. It is then all too easy for politicians and union leaders to blame 'the high dollar' or 'unfair overseas competition;' few think of artificially high government- and union-made transaction costs.

Governments thus have great influence over transaction costs. If they concentrate on protecting life, limb and property (*protective function of government*) and do so in steady, transparent ways, the transaction costs of coordinating people's business will remain low and the agency costs, which governments incur for providing protection and which they have to finance by taxes, will also remain low.

The ruling elites, however, often exceed what is necessary for protection and then pose immediate dangers to individual freedom and property. The rulers and 'violence professionals' have frequently used their powers against the very citizens and their property, which they were meant to protect. After all, they are like all humans: opportunistic and easily corrupted by power. When ruling elites reject codes that bind them, they replace the rule of law with kleptocracy and the arbitrary misrule of men. Why not plunder more to expand the size of the ruling class and enhance its living standards at the expense of ordinary folk? Why not confiscate or decree 'haircuts' for bank depositors and superannuation savers to shore up failing political strategies? Why not seek bribes from affluent individuals in exchange for political favours? Why not elbow private initiative aside to produce goods and services in government-owned and bureaucrat-run monopolies (expanding *productive government*)?[45]

Officials have long been adept at monopolising production activities that promise easy revenue – from the salt and tobacco monopolies of yesteryear to broadband socialisation today. As most government activities are run along administrative lines and without the promise of a profit commensurate to risk-taking, they often consume more resources than what value they create (not value-adding, but value destruction). As governments grew and became more complex, expert bureaucrats frequently made themselves the real masters of government. The bureaucracy is now often able to self-promote itself, inflating staff numbers and upgrading job classifications ('classification creep'). Tenured bureaucrats nowadays often take decisions that suit them, and elected politicians serve as mere front men to be blamed when things go wrong.

[45] James M Buchanan, 1975, *The Limits of Liberty*, University of Chicago Press: Chicago.

Like no other system of government, electoral democracy has opened an additional avenue for expanding the government's share in the economy: Why not confiscate the property rights of some and redistribute them to others to buy popular support and re-election? When the government's visible hand 'corrects' the distribution of incomes and wealth which results from competitive market activity (*redistributive government*), this is of course in direct conflict with the government's primary protective function. It cannot at the same time be a credible protector of private property and a major confiscator and redistributor thereof![46]

From the beginning, government has thus had a Jekyll-and-Hyde character: Ever since the Neolithic revolution, mankind has had to live with the blessing of protective government and the curse of excessive productive and redistributive government. This moved Edmund Burke to lament: 'The Thing! The Thing itself is the abuse!'

In the face of this moral dilemma, it is tempting to deny the problem altogether by assuming that the rulers and their agents are benevolent. The public-choice school of economics, as well as worldwide experiences, have shown how unrealistic it is to assume that selfish ordinary people become selfless knights in shining armour when entrusted with public office.[47] Alternatively, some consider government an unmitigated evil and advocate anarchy. This is a cheap, escapist cop-out. While fine theories have been formulated to show that all human coordination in a complex macro society might be possible without any recourse to collective action and governance, the reality is that such a utopia has never been realised in practice. Even in the small community that the Bounty mutineers set up on Pitcairn Island, murder and mayhem were terminated only when a para-political authority was created.

Alas, mankind is condemned to live with the mixed blessing of government. Analysing its size and functions in the best interests of *all* citizens should therefore be the core task of all social science, including economics: Under what private and political institutions can ignorant, fallible, forgetful, lazy, opportunistic producers and buyers cooperate to generate the best material welfare for everyone? The real task is to think hard about what functions need to be entrusted to government and how government authorities can be kept from overstepping the mark. Moreover, as circumstances evolve, the role and size of government has to be re-examined time and again. Rule systems must therefore not be allowed to rigidify, even if the old rules protect those who have attained advantageous socio-economic positions and wish to employ established institutions to conserve them. It is one of the essential lessons of history that institutional rigidity paves the way for the decline and fall of civilisations. Like a mother's job, the task of cultivating freedom-supporting rule systems is therefore never quite done.

4.4 Globalisation gives primacy to markets and institutional creativity

The broad sweep of history shows that the gradual improvement of private property rights and their free use has been central to the initially slow, then accelerating rise of productivity and living standards, first

[46] Buchanan, Ibid..

[47] James M Buchanan and Gordon Tullock, 1962, *The Calculus of Consent: Legal Foundations of Constitutional Democracy*, University of Michigan Press: Ann Arbor; Buchanan, Ibid.; James M Buchanan, 1991, *Constitutional Economics*, Basil Blackwell: Oxford.

in the West and in recent decades in many places beyond. From the late eighteenth century onwards, new technologies and new ways of productive cooperation between owners of capital, skills and knowledge gave rise to the industrial revolution. Since then, we have seen wave upon wave of innovation, the emergence of new industrial countries and prospering, freer communities. Enormous improvements in transport and communications have helped to spread modern industry and commerce, to exploit scale economies and to ensure that markets transcend national borders. The communications revolution of the past half-century has promoted the 'transport of ideas' around the globe. And the ideas that have had most impact in previously remote corners relate to the rules how best to use property rights. Institutional innovation has improved the 'software of development', which allows people to draw greater benefit from the 'hardware of development' – their labour, skills, capital goods, technical knowledge and natural resources.

Globalisation is reflected in a huge increase in international factor mobility. It has been more important than trade in forcing official rule makers to overcome their usual cognitive barriers and enhance the rules so that they become more advantageous to the citizens' wealth.[48] As tightly knit, smoothly functioning exchange networks and multinationals operate across national borders, business people now make regular locational choices between different jurisdictions. Industry location is now decided primarily by where the local, immobile production factors support profitable production.[49] Footloose owners of internationally mobile knowledge, capital and firms shop around to combine with the most advantageous immobile production factors – land, labour, which is often organised by unions, work practices, and government-provided rule systems. Yes, government administration is a production factor! Those politicians and bureaucrats, who produce reliable, easily-understood rules and enforce them reliably and expediently, raise the productivity of all other production factors, as we saw above. On the other hand, cumbersome and corrupt government administrations that hamper the expedient combination of property rights and make knowledge search more risky, are nowadays readily shunned.

To give an example, rigidities in Australian labour markets and work practices have prevented Pilbara ores and Queensland coal to be processed into steel for world markets in an Australian location, because capital-intensive steelworks have to work reliably 24/7. As never before, the need to attract and retain mobile capital, knowledge and enterprises is of course an irritant to vested interests. Local landowners, union leaders and government agents often resent that they can no longer extract monopoly rents and have to incur the transaction costs of competing. Some of them therefore insist on the 'primacy of politics' over free private choices in markets.[50] Entrenched, self-seeking political and union elites may not even comprehend that globalisation now forces unions and government administrators to compete internationally. Institutional reform therefore often has to wait till a younger generation of political entrepreneurs replaces the *ancien régime*, offering reform programs.

---

[48] Herbert Giersch, 1993, *Openness for Prosperity*, MIT Press: Cambridge; Kasper et al., op. cit., p. 440-451.

[49] Giersch, Ibid., Wolfgang Kasper, 1994, *Global Competition, Institutions, and the East Asian Ascendancy*, Center for Economic Growth: San Francisco; Wolfgang Kasper, 2008b, 'Spatial Economics', in David Henderson, ed., *The Concise Encyclopedia of Economics*, Liberty Fund: Indianapolis, p. 73-76.

[50] The term 'primacy of politics' became the political slogan of the radical Jacobins in the French revolution. Later it was postulated by socialists, ranging from Marx to Lenin and the National Socialists of the Third Reich. Revealingly, it is now frequently postulated by European leaders and the European Commission.

All too often, political establishments seek salvation from the need to compete with other governments and unions by creating transnational governance networks, in reality cartels of political powerbrokers. Australians should take note of European Union's 'rulers' and regulators' cartel' and its consequences – growing popular resentment and the rejection of democratic politics by large sections of the electorate. As the growing density of ill-understood EU regulations has raised the transaction costs of making active uses of property, Europe's capital owners now frequently confine themselves to passive uses of their property – a key factor why 'Old Europe's' economic performance disappoints.

Transnational polit-cartels also disenfranchise citizens elsewhere. In an attempt to outflank globe-spanning market networks and avoid interjurisdictional competition, national governments have formed cartels, such as the G-5, G-8 and G-20 groups, with which the Australian government eagerly cooperates. Advocates of world government are trying to shift political decision-making powers to distant UN bodies. They praise political cartelisation as 'harmonisation,' lambast political competition as 'social dumping' and a 'race to the lowest common denominator,' and brand business-friendly institutional innovations by national governments as signs of political disloyalty. But all these deals erode national sovereignty and abridge the decision-making powers and responsibilities of elected parliaments.[51] Most importantly, they prevent the competitive discovery of possibly new and productive institutional innovations. Conservatives may applaud; genuine classical liberals and protagonists of growth and job creation are horrified.

The desire for a protected, cosy market niche or a monopoly – whether in business or government – is understandable. It preserves established socio-economic positions and averts the need for costly and risky knowledge searches. But, to repeat, it is bad for the wealth of nations! Competition – whether economic rivalry for market share and political rivalry in creating attractive institutions – serves important socio-political purposes.[52] It keeps social structures robust and can thus prevent the decline of entire economies and civilisations. Competition should therefore be considered a public good of the highest order.[53]

The question for Australia's political and administrative leaders is whether to emulate the princes of the small European jurisdictions, who constrained their powers and rivalled with their counterparts to attract wealth-creating merchants and industrialists, or to pursue the inward-looking power games of Ming and Ch'ing dynasty China, Habsburg-Burbón Spain and the late Ottoman Empire.[54] These regulation-tortured economies stagnated and declined. Eventually, the political regimes fell. Australians would to my mind be well advised to make the 'location Australia' as internationally attractive as possible, similar to what the

[51] John Fonte, 2011, *Sovereignty or Submission - Will Americans Rule Themselves or be Ruled by Others?*, Encounter Books: New York.

[52] Wolfgang Kasper, 2008a, 'Competition', in David Henderson, ed., *The Concise Encyclopedia of Economics*, Liberty Fund: Indianapolis, p. 73-76.

[53] Manfred E Streit, 1996, 'Competition among Systems as a Defence of Liberty', in Hardy Bouillon, ed., *Libertarians and Liberalism: Essays in Honour of Gerard Radnitzky*, Avebury Publishing: Aldershot, p. 236-252; Peter Bernholz, Manfred E Streit, and Roland Vaubel, eds., 1998, *Political Competition, Innovation, and Growth - A Historical Perspective*, Springer: Berlin; Peter Boettke and Peter T Leeson, 2004, 'Liberalism, Socialism, and Robust Political Economy', *Journal of Markets and Morality* 7 (1): 99-111.

[54] Jones, op. cit.

officials of Hong Kong, Singapore, South Korea and Taiwan did a generation ago, when they streamlined business approval procedures, opened one-stop shops for investors, abolished price regulations, liberalised markets for capital and labour, created expedient commercial courts, and made macroeconomic stability a top priority. Since 1980, Australian governments have taken many steps in the right direction – and the outcome has been as expected: a more robust economy. However, the lure of political power and rent-seeking is never far away. Inner circles of powerbrokers and coteries of faceless men (and women) can be ruthless in avoiding political competition and clever in pretending that they only act 'in the national interest.'

4.5 Universal rules help wealth creation

Politicians and administrators, who want to promote microeconomic reforms in order to win the interjurisdictional competition, can find guidance in long-term economic history and legal-economic analysis. These sources show that institutions aimed at securing economic freedom and attracting internationally mobile job and wealth creators, must have the following qualities:

- The rules must be *general and abstract*, i.e. they must not be case-specific and must not discriminate between different individuals and industries.[55] Keep the tax code non-discriminatory, avoid industry-specific subsidies and resist dishing out favours to political cronies!
- The rules must be *simple and certain*. Simple laws are readily understood; and the consequences of rule violations can be clearly known if consistently and expediently enforced. Simplify the tax code and development approvals! Give businesspeople consistent and unconditional replies to their inquiries and ensure that regulators and courts act promptly. Avoid all *ad hoc*ery! Do not change the ground rules after every election!
- The rules must be *open*, i.e. they must always offer guidance in future eventualities. Owners of property rights must be able to make spontaneous, confident decisions, because the laws apply to the future as they did in the past. When new market opportunities beckon, entrepreneurs cannot wait until government committees come up with new rule books.
- Finally, the rule system must be *coherent and non-contradictory*. A logical order among individual rules makes the institutional system more effective. The institutions are much less effective if, for example, business can operate freely in product and capital markets, but faced numerous restrictions in labour markets, as was for example the norm in Australia in the late 1980s and is now again the case.

These institutional qualities are described in the literature as 'universality.' It enhances freedom and makes rule compliance and hence governance easier.[56] Institutional systems that embody these universal qualities are neither conducive to license, not do they lead to a 'race to the bottom.' Instead, they signal a commitment to what should be the primary objective of government, protecting life, limb and property. A universal rule system creates confidence, lowers the transaction costs of doing business and encourages owners to commit their resources to knowledge search. It fosters structural flexibility in

[55] Hayek, op. cit., p. 50.
[56] Kasper et al., op. cit., p. 133-135.

industry and underpins a robust economy.[57] A universal order is therefore good for international competitiveness, as well as economic growth, security, justice and internal peace

4.6 Competitive federalism is creative and citizen-friendly

Interjurisdictional competition should not be confined to the international sphere. It can be of great and lasting benefit if applied within nations. In federations, many domains of governance should be entrusted to the states, and within states to local governments. That such subsidiarity can be of long-term benefit becomes evident when one examines most of the successful, durably prospering, free democracies, Many are genuine federations, for example the United States of America, Australia, Germany, Canada and Switzerland.[58] Many, traditionally unitary nations have in recent decades also decentralised, for example Spain, the United Kingdom, France, India and Indonesia.

How should a federal system be designed to promote institutional discovery procedures and empower the citizens? The following elements constitute the essentials of competitive federalism:

- *Subsidiarity:* Political and administrative decision making is delegated to the lowest possible level of government, so that collective choices are made by political and administrative agents who are as close as possible to the communities they are meant to serve. Collective decisions will then be better informed by what happens on the ground, and decision makers will be critically monitored by concerned citizens. Decisions can then be tailored to diverse local conditions, and different states may try different strategies to deliver services. Eventually, the best method will win. Alas, we often observe a drift of decision powers further and further away from local communities to more distant, less accountable authorities.
- *Rule of origin*: Any good or service that is produced legally in one part of the federation must be automatically admitted for sale in all parts of the federation. In other words, untrammelled free trade between states must be guaranteed.
- *Exclusivity*: Each task of government is assigned exclusively to one level of government. Overlaps and duplications only cause costly bureaucratic turf wars and counterproductive blame games. The voters must always know which government bodies and which elected politicians are responsible for delivering a particular service. For example, there should be only one department for health or education, either at the federal or the state level. COAG meetings will then no longer be about blame games for failing hospitals or schools.
- *Fiscal equivalence*: Each government should be exclusively responsible for financing the tasks that is has been assigned or has volunteered to fulfil. Equivalence balances public spending schemes with the opprobrium for raising taxes. This would put a brake on the relentless growth of public expenditures. When vertical and horizontal transfers of funds are banned (or at least strictly limited), politicians and administrators can undertake spending programs only if these can be financed by taxes and fees levied in their own jurisdiction or by borrowing. Most politicians and bureaucrats will of course be opposed, especially in notoriously mendicant states. Fiscal equivalence will also do away

[57] Boettke and Leeson, op. cit., Kasper, 2008a, op. cit..

[58] Pseudo-federations, such as the Soviet Union or Mexico, do not count. There, the formal constitution was, or is, overruled by centralist practice, and property rights protection has been typically weak.

with politically motivated, often arbitrary and invariably disruptive changes in the Grants Commission's distribution of the (now federally levied) GST. Equivalence will thus promote universality in the rules governing federal-state relations: States will be able to plan ahead with more certainty and feel less subservient to Canberra Centre.[59] The various governments should be fairly free how to design their tax regimes.

- *Prohibition of subsidy wars*: A constitutional rule must proscribe the use of taxes or funds borrowed by state governments to bribe mobile producers with subsidies to attract them away from other states. If a state offers a subsidy to a particular producer, it has to offer the same to all comers. This would avoid counterproductive zero-sum games and mounting public debts. This prohibitive rule is analogous to the ban of discrimination under the 'Most Favoured Nations Clause' in the rulebook on international trade.[60]

Only political activities that bring with them important economies of scale and savings from central standardisation should be entrusted to the central government. Under competitive federalism, the central government would thus be exclusively responsible for foreign affairs, national defence, monetary policy, border protection from illegal immigration, as well as the design and enforcement of standard road and air traffic rules and nation-wide public health standards. Matters that have nation-wide external effects or involve high costs for operators, who frequently transit from one state to the other, should also come under the purview of the central government. Infrastructures of trans-regional importance might be a central-government responsibility, while local infrastructures should be the exclusive responsibility of state governments. As a consequence, the federal government would have much less to do and could therefore perform better with available resources in an era of intensifying taxpayer resistance and growing scepticism about the merits of big government.

The various states would design their own business regulations, development policies, public health-care and education systems. They would design and implement most environmental, product- and labour-market regulations and fund most social-welfare policies, always of course within their financial means. The states would experiment with a diversity of administrative solutions to collective problems. Queensland might, for example, replace the traditional direct funding of schools and hospitals by handing vouchers for education and elective surgery to eligible voters and taxpayers. Tasmania might experiment with closing down more industries to protect the environment and create 'green jobs.' The voters would

[59] It must be noted in this context that massive vertical and horizontal transfers are the intergovernmental equivalent of the grand social-democratic redistribution experiment of the twentieth century, which has been a worldwide failure. Governments of the Left and the Right are now reduce transfer payments and emphasise self-reliance. Enhancing fiscal equivalence will be part of this trend to self-reliance. It will ensure that political elites and electorates develop a more realistic interest in cultivating their own tax bases by growing their economies. The massive federal-state transfer machine in Australia makes it easy for political opportunists to oppose to economic growth and rely instead on horizontal or vertical hand-outs. Kasper et. al., op. cit., p. 352-360.

[60] This is only a thumbnail sketch of the ground rules of competitive federalism, meant to elicit renewed discussion. For more detail see Kasper (1995 and 1996). As of 2013, I would not change anything of substance in what I put forward in these two Institute of Public Affairs publications. Kasper, Wolfgang, 1995, *Competitive Federalism, Promoting Freedom and Prosperity*, Institute of Public Affairs, States' Policy Unit: Perth; Kasper, Wolfgang, 1996, *Competitive Federalism Revisited: Bidding Wars, or Getting the Fundamentals Right?*, Institute of Public Affairs, States' Policy Unit: Perth.

in each case be able to observe the consequences of these public choices and then vote accordingly. Such diversity of course inflicts transaction costs, but over the long-term we would discover the most citizen-friendly style of government. Citizens would feel empowered and find themselves in the rightful position of principals vis-à-vis the agents of government.

In an era when democracies teeter under the weight of popular apathy, rejection and cynicism, this is an important consideration. The current situation in the mature democracies reminds students of history of how the legitimacy of rulers tends to be undermined by communications revolutions and, when poorly handled, ends in costly, protracted conflicts: The Gutenberg communications revolution of the Reformation age encouraged sceptical, divergent opinions and fostered the formation of new micro-centres of power; eventually, it led to the wars of religion in regimes, which mishandled necessary institutional reforms. And the sceptical ideas of the Enlightenment that were promulgated by the new medium of the French *Encyclopédie* led eventually – because ignored by the ruling elites – to the Rule of Terror. At the present, the internet again spreads doubts and divergent opinions and creates new power alliances. Will the ruling elites realise this time round that they must search for new solutions to problems which are turning so many citizens rebellious?

The concept of competitive federalism could become one helpful discovery mechanism, but it is of course attacked by political and bureaucratic elites, government-funded 'non-government' organisations and the media, which sing from the statist songsheet. The arguments against competitive federalism are the same that one hears against international political competition: Cooperation is virtuous; competition is disloyal and selfish. Competitive federalism is said to unduly constrain the freedom of politicians to act in the public interest, however defined. It is also argued that competitive federalism is costly, but no policy reform is cost-free. Over the long term, it is more costly to cling rigidly to the old ways. Indeed, all arguments that have ever been adduced to defend business monopolies and autocratic governments have also surfaced in the debate about competitive federalism. Yet, the fundamental fact remains that competition between state and local governments preserves free markets and encourages the widest possible creative use of private property.[61]

Competitive federalism is of course no panacea, but every approximation to it controls officialdom and cronyism and gives economic freedom of individual workers and property owners a better chance. Competition between state and local governments also strengthens the overall competitive capacity and robustness of the 'location Australia' in the world at a time when we have to stand our ground in fiercely competitive global markets

4.7 Yardsticks educate us about good government

As the world evolves, institutions often have to do the same. From the viewpoint of liberal institutional economics, the arguably biggest problem is: How can we ensure that a society's internal and external institutions evolve so that the members of society are best able to pursue their diverse, self-chosen purposes? The challenge is less problematic with regard to internal institutions, as they adapt continually

[61] Weingast, Barry R, 1995, 'The Economic Role of Institutions, Market Preserving Federalism and Economic Development', *Journal of Law, Economics and Organization* 11 (1): 1-31.

in decentralised ways in the light of experiences. External (government-made) institutions are different: Many individuals may well know that given external institutions hinder their trade and prevent new uses of their property. Yet, political inertia may persist for a variety of causes: The political agents may remain ignorant about the benefits of reforming the rules. They may simply not know or not care. They may not even care whether they wreck private welfare. They may treat the pleas of mere miners, industrialists, builders and merchants with contempt, as they are ideologically biased against profit-making activities. They may arrogantly claim political primacy. They may also be influenced (and bankrolled) by vested interests with a stake in protecting past socio-economic structures.[62]

Never underestimate the ignorance of political elites and their advisors! To cite just one example: the political-bureaucratic cognition problem was glaringly obvious to many in Australia during the 1970s. Yet, the political and industrial elites and the press were wedded to a traditional protectionist-interventionist rule set, which was emaciating this country's growth potential. It took over a decade till the penny dropped and some microeconomic reforms were implemented.

Economic openness at least ensures that trade deficits, capital flight and the exodus of businesses signal competitive weaknesses caused by inappropriate external rules. Reactionary political, union and industry leaders may then still react by shouting: 'Good riddance!' But the ongoing exodus of owners of capital, knowledge and enterprises will eventually change minds, and a new majority of political and bureaucratic opinion will emerge.

In the face of political-administrative inertia, much depends on the clarity, with which institutional shortcomings can be connected to economic outcomes. Economics Nobel Prize laureate Milton Friedman kept telling us that political agents and electorates learn the right lessons faster when the facts can be measured and the performance of various external rule systems can be compared. Quantification is extremely useful in educating us, for example, about how various administrations help or hinder ordinary people in realising their fundamental aspirations, in particular freedom and prosperity. If cause and effect are quantified and connexions logically induced from reality, this fosters understanding of what reformed institutions and governance practices can achieve.

This is why comparative information about institutional settings in the various states of the Australian Commonwealth, as presented in this pioneering volume, will prove invaluable to our understanding of how we should shape Australia's most important asset – our shared institutional infrastructure.

[62] Streit, op. cit.; Kasper et. al., op. cit., p. 440-450.

5 Conclusion

During the 1980s and early 1990s several economists, including the great twentieth-century economist Milton Friedman, were actively involved in a broad project aiming to develop a measure of economic freedom.

This project was inspired by the desire to quantify the relationship between economic freedom, however quantified, and economic performance, confirming the age-old classical liberal inclination that prosperity is synonymous with economic environments that are conducive to personal choice, voluntary exchange, freedom to compete in markets, and the protection of people and properties.

Since the early forays into investigating the feasibility of defining and estimating economic freedom, numerous studies have flourished that provide comparable inter-country and inter-regional freedom indexes. Further, an academic literature has emerged which, in general terms, confirms a positive association between economic freedom and dimensions of economic, and even social, performance.

This paper provides the first estimates of economic freedom for the six Australian states, complementing international studies that have estimated the relative freedom for Australia as a whole against other nations. In so doing, it is hoped that this publication serves as a modest contribution to the international economic freedom literature.

In broad terms, the results of this paper indicate that jurisdictions in which governments spend and tax less, enact fewer regulations, and have fewer people depending upon the state for their incomes will be relatively freer than others.

Across the indicators used to inform the overall development of the economic freedom index, Western Australia was found to be the most relatively free jurisdiction in 2011. At the other end of the scale, jurisdictions such as Tasmania, Queensland and South Australia, with relatively larger fiscal or more frequent regulatory activities undertaken by all levels of government, were the least free in relative terms.

It is not implausible to suggest that Australians had benefited substantially from the introduction of economic reforms from the early 1980s to the late 1990s. These reforms aimed to reduce the direct interference of political actors in economic affairs across a range of factor and product markets, and instil a greater sense of policy certainty to inspire private sector confidence to engage in productive routines.

However there have been worrying signs of slippage in the broad policy objective to substitute collective for private action and decision making in the economic realm. Indeed, some relatively minor exceptions aside, the general tendency observed within the Australian federal system over the past few years has been a widespread political reticence to engage in reforms reducing the extent of governmental interference in economic affairs.

Government expenditures and public sector debts have rapidly escalated, reducing the effective field in which private sector economic actions may be undertaken. The extent to which the population has become dependent upon government for their incomes continues to increase, courtesy of growth in government bureaucracy and welfare recipients.

All levels of government have imposed economically damaging taxes, including on carbon dioxide emissions and mineral commodities, as well as new surcharges on income tax. Finally, the freedom of individuals to engage with each other in labour, financial and product markets have been progressively restricted through fast growth in regulatory edicts issued by parliaments and bureaucracies.

To a certain extent, Australia as retained a favourable position in global economic freedom rankings due to the greater eagerness with which some other developed countries, such as the United States, have debauched their own freedoms through an enlargement in the relative size and scope of government. However, if our own recent trend of complacency concerning the need to retain high levels of economic freedom continues, this will lead to progressively fewer opportunities for ordinary Australians to improve living standards for themselves and their families.

The relative rankings of the Australian states on the economic freedom index illustrate significant variations in the discipline of politicians and bureaucrats around the country to abstain from economic activities. As the rankings clearly indicate, not all political actors are equally disciplined to allow regional economies to remain free, and therefore not all Australians enjoy the same degree of economic freedoms.

Our future prosperity and employment opportunities depend on how well enterprising and resourceful Australians are free to explore new economic ideas to satisfy consumers here and abroad. The recent Australian tradition of maintaining a relatively high degree of economic freedom should be maintained, and all levels of government should pull their weight in an agenda to remove restrictions upon the capacity of individuals to exercise their freedoms in the economic realm.

It is hoped that the publication of this index will inspire genuine economic reforms in all states, and not just those lagging in the relative economic freedom stakes, thus empowering all individuals with greater freedoms to produce, distribute and exchange in the servicing of others.

Disaggregated economic freedom index scores, 2011

	Overall index	C1	C2	C3	C4	I1A	I1B	I1C	I2A	I2B	I2C	I3A	I3B	I3C	I4A	I4B	I4C
NSW	5.58	6.28	3.27	6.93	5.82	6.74	5.67	6.81	3.57	2.32	4.03	8.08	5.55	6.88	8.69	1.71	7.24
Vic	5.02	5.88	2.58	7.29	4.33	5.93	5.59	6.84	4.13	0.15	3.54	10.00	6.30	5.73	6.26	3.68	3.18
Qld	3.60	3.66	4.04	6.71	0.00	5.93	4.40	1.01	8.22	4.02	0.00	7.51	6.61	5.62	0.00	0.00	0.00
WA	8.25	9.90	6.60	9.17	7.34	10.00	10.00	10.00	0.00	10.00	10.00	7.98	10.00	10.00	6.29	7.49	8.46
SA	5.00	3.59	3.40	4.21	8.80	4.68	3.68	2.78	9.40	0.00	0.90	5.80	2.52	3.01	9.38	7.27	10.00
Tas	3.57	0.00	5.47	0.00	8.81	0.00	0.00	0.00	10.00	4.07	2.51	0.00	0.00	0.00	10.00	10.00	6.69

Columns prefixed by letter ‘C’ are for each component. Columns prefixed by letter ‘I’ is for indicators of each component.

Economic freedom index score data, 2001 to 2011

Component 1 Size of government

Indicator 1A General government sector final consumption expenditures, percentage of gross state product

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
NSW	15.39	15.34	15.43	15.36	15.44	15.57	15.34	15.23	15.92	15.86	16.01
Vic	16.13	16.12	16.28	15.97	16.12	16.68	16.25	16.32	17.09	17.51	17.63
Qld	17.39	16.65	16.76	16.72	16.07	15.20	15.35	15.57	15.26	16.62	17.21
WA	14.85	14.60	14.35	14.02	13.85	12.59	12.26	12.03	11.99	12.62	11.16
SA	18.51	18.37	17.92	17.77	18.45	18.42	18.50	17.76	19.10	19.45	19.02
Tas	22.79	22.92	22.30	22.02	22.52	22.83	22.22	22.37	24.73	24.55	25.21

Source: ABS, Australian National Accounts: State Accounts, cat. no. 5220.0.

Indicator 1B General government sector subsidy and transfer expenditures, percentage of gross state product

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
NSW	18.07	18.83	18.14	18.36	18.32	18.45	18.62	18.75	21.26	21.52	20.13
Vic	18.02	18.38	17.57	18.23	18.37	18.56	18.64	18.69	21.34	21.35	20.26
Qld	23.11	22.41	21.79	21.81	21.17	19.99	19.38	19.48	20.66	21.62	22.32
WA	18.89	18.99	18.38	18.46	18.56	16.65	15.26	14.79	15.31	15.69	12.64
SA	23.53	23.29	22.58	22.71	23.16	22.78	22.32	22.31	25.36	26.42	23.57
Tas	29.77	29.84	28.83	27.86	27.86	27.55	25.60	26.34	29.77	29.76	29.93

Source: ABS, Government Finance Statistics, Australia, cat. no. 5512.0; Commonwealth Budget Papers; Department of Education, Employment and Workplace Relations, Higher Education Statistics.

Indicator 1C General government sector gross fixed capital formation, percentage of gross state product

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
NSW	2.55	2.52	2.60	2.48	2.53	2.69	2.70	2.80	3.03	3.51	3.30
Vic	2.33	2.55	2.66	2.34	2.36	2.66	2.47	2.45	2.90	3.49	3.29
Qld	4.41	3.94	3.32	3.32	3.56	3.45	3.82	4.26	4.85	5.90	5.11
WA	2.89	2.55	2.20	2.33	2.47	2.28	2.21	2.55	2.36	2.86	2.30
SA	2.79	2.72	2.84	2.58	2.89	3.01	2.86	3.01	3.81	4.91	4.56
Tas	3.47	3.55	3.50	3.04	3.70	3.94	3.09	3.42	4.04	4.97	5.43

Source: ABS, Australian National Accounts: State Accounts, cat. no. 5220.0.

Component 2 Taxation and debt

Indicator 2A General government sector direct taxation, percentage of gross state product

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
NSW	18.07	17.42	17.80	18.00	18.60	18.60	18.11	18.20	17.05	15.74	15.89
Vic	18.99	17.58	17.83	18.06	18.85	18.79	18.39	18.14	16.80	15.59	15.67
Qld	17.02	15.91	16.92	16.90	17.53	17.52	16.97	17.04	15.64	14.07	14.11
WA	19.70	17.39	18.32	18.63	20.03	20.58	20.76	21.04	18.67	17.13	17.25
SA	17.25	16.30	16.84	16.67	17.53	17.49	16.77	16.22	14.87	13.82	13.65
Tas	18.53	16.82	17.32	17.24	17.69	16.89	16.22	15.71	14.35	13.10	13.43

Source: ABS, Australian National Accounts: State Accounts, cat. no. 5220.0; Australian Taxation Office, Taxation Statistics.

Indicator 2B General government sector indirect taxation, percentage of gross state product

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
NSW	9.74	9.90	10.27	10.15	9.71	9.57	9.69	9.51	8.75	9.08	8.98
Vic	11.45	11.51	11.80	11.88	11.19	11.14	10.95	10.84	10.48	10.42	10.26
Qld	8.87	9.08	9.92	10.27	9.61	9.10	8.93	9.14	7.83	8.54	8.36
WA	15.38	15.83	16.60	16.99	17.27	15.52	14.64	13.71	11.29	12.67	10.66
SA	10.19	9.83	10.44	10.57	10.78	10.51	10.28	10.26	9.97	9.82	9.69
Tas	9.44	9.39	9.72	9.54	9.56	9.34	8.98	8.97	8.90	8.76	8.68

Source: ABS, Australian National Accounts: State Accounts, cat. no. 5220.0; ABS, International Trade in Goods and Services, cat. no. 5368.0; Australian Petroleum Production and Exploration Association, Industry Statistics.

Indicator 2C General government sector gross debt, percentage of gross state product

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
NSW	16.40	14.33	12.47	11.27	10.90	10.22	9.67	9.46	13.60	17.79	20.11
Vic	15.54	13.74	12.02	10.25	9.78	9.26	8.80	8.50	13.14	17.78	20.82
Qld	17.77	15.36	13.85	11.76	10.67	8.66	7.83	9.27	12.96	20.17	26.03
WA	13.84	11.93	10.41	8.91	7.90	6.19	5.18	4.86	7.26	11.32	11.34
SA	20.61	18.41	15.71	13.41	12.22	10.88	10.79	10.12	14.95	21.16	24.71
Tas	30.98	27.74	19.36	15.53	13.44	10.70	9.21	8.82	13.84	18.67	22.35

Source: ABS, Government Finance Statistics, Australia, cat. no. 5512.0; Commonwealth Budget Papers.

Component 3 Government dependency

Indicator 3A Total public sector employment, percentage of population

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
NSW	14.45	14.59	14.41	14.47	14.48	14.57	14.40	14.56	14.63	14.86	15.12
Vic	13.24	13.60	13.48	13.80	13.78	13.86	13.27	13.49	13.95	13.98	14.21
Qld	15.92	16.30	15.54	15.59	15.23	15.33	15.23	15.24	15.38	15.33	15.30
WA	15.45	14.79	14.73	15.57	15.38	15.31	15.28	15.34	15.50	15.55	15.52
SA	15.56	15.10	15.09	15.96	16.29	16.45	16.10	16.46	16.09	15.95	15.78
Tas	19.41	19.86	19.31	19.90	20.04	19.76	19.96	19.72	20.51	19.96	20.10

Source: ABS, Wage and Salary Earners, Public Sector, Australia, cat. no. 6248.0.

Indicator 3B Individual social security payment recipients, percentage of population

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
NSW	19.34	19.58	19.50	16.32	19.45	19.16	18.77	18.78	19.54	19.85	19.84
Vic	19.69	19.82	19.68	19.58	19.45	19.08	18.55	18.37	19.01	19.15	19.06
Qld	20.22	19.91	19.77	19.23	19.03	18.25	17.44	17.10	18.10	18.59	18.74
WA	17.98	18.32	18.27	17.80	17.35	16.54	15.43	14.99	15.61	15.52	15.25
SA	23.58	23.57	22.72	22.51	23.08	22.69	22.20	22.03	22.44	22.73	22.96
Tas	27.86	25.96	25.99	25.87	26.25	25.26	24.72	24.41	24.99	25.30	25.55

Source: Department of Families, Housing, Community Services and Indigenous Affairs, Income Support Customers: An Overview.

*Indicator 3C	Social security cash benefits, percentage of gross household income*

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
NSW	9.07	9.23	9.04	9.37	9.05	8.88	8.59	8.36	10.27	8.86	8.48
Vic	10.14	9.93	9.65	10.20	9.89	9.74	9.45	9.09	11.42	9.90	9.27
Qld	11.11	10.89	10.98	11.20	10.58	10.19	9.59	9.32	11.22	9.82	9.41
WA	9.78	9.25	8.97	9.20	8.87	8.63	7.85	7.16	8.24	7.01	6.48
SA	12.09	11.76	11.70	12.13	11.99	11.99	11.67	11.06	13.43	11.71	11.19
Tas	15.46	14.94	14.42	14.89	14.19	13.57	13.02	12.52	15.27	13.30	13.11

Source: ABS, Australian National Accounts: State Accounts, cat. no. 5220.0.

## Component 4	Regulatory environment

*Indicator 4A	Number of pages of primary legislation passed or assented*

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
NSW	11,726	7,849	7,107	9,194	7,847	9,685	9,333	9,041	9,092	9,614	8,561
Vic	11,318	6,370	10,243	12,350	10,873	12,496	9,552	10,051	10,919	13,183	9,326
Qld	12,595	7,716	9,888	8,014	8,642	10,524	11,039	10,731	12,514	12,064	11,301
WA	8,528	5,942	8,296	10,562	7,178	9,900	8,424	9,612	7,950	9,749	9,318
SA	8,655	4,806	5,490	6,953	6,633	7,477	8,333	7,039	7,901	6,874	8,342
Tas	10,647	5,646	6,464	7,922	7,958	8,657	7,150	8,060	7,104	8,147	9,095

Commonwealth legislation, applicable in each state, added to each jurisdiction's total.

Source: Commonwealth and state legislation websites.

Indicator 4B Number of pages of subordinate legislation passed or assented

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
NSW	8,133	7,572	7,390	8,236	7,762	9,072	7,408	7,266	7,824	7,585	7,658
Vic	7,071	5,601	6,178	8,294	6,204	8,789	7,022	5,960	9,045	5,662	7,176
Qld	7,131	7,316	8,723	8,798	6,403	9,830	7,104	10,808	8,250	7,983	8,076
WA	5,918	5,108	5,915	6,918	5,101	8,151	6,977	4,683	6,917	6,129	6,244
SA	6,403	5,107	5,867	7,150	5,248	8,246	6,766	6,433	7,609	6,151	6,297
Tas	6,017	5,046	5,394	6,589	4,582	7,502	5,470	4,795	6,550	5,430	5,630

Commonwealth legislation, applicable in each state, added to each jurisdiction's total.

Source: Commonwealth and state legislation websites.

Indicator 4C Number of pages of primary and subordinate legislation per legislative item

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
NSW	39	32	30	34	31	37	34	38	35	36	38
Vic	46	36	45	52	49	57	44	49	55	62	45
Qld	49	36	42	39	37	48	42	51	54	50	51
WA	34	27	34	39	30	36	34	40	32	41	36
SA	30	22	23	28	26	31	30	32	32	30	33
Tas	40	31	31	36	41	39	34	35	37	36	39

Commonwealth legislation, applicable in each state, added to each jurisdiction's total.

Source: Commonwealth and state legislation websites.