Study: States need economic freedom to benefit from natural resources

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(PhysOrg.com) -- States with small governments, low taxes and labor market freedom enjoy greater benefits from natural resource development than states with large and intrusive government policies, according to a new study by a Florida State University researcher.

"The size of government and level of regulation are two of the cornerstones of economic freedom," said Joab Corey, the study's author and a lecturer in Florida State's Department of Economics and the Gus A. Stavros Center for the Advancement of Free Enterprise and Economic Education. "When it comes to resource development, research shows that states with higher levels of economic freedom enjoy greater benefits from resource development."

Louisiana, New Mexico, North Dakota, South Dakota and Wyoming are singled out as states with high levels of economic freedom that have benefited from resource development. On the other hand, Alaska, Montana and West Virginia have failed to fully benefit from their natural resources, due in part to government policies that limit economic freedom, according to Corey's peer-reviewed study, "Development in U.S. States, Economic Freedom, and the 'Resource Curse.' " The Fraser Institute, a leading free-market think tank, released the study, which can be accessed at http://www.fraserinstitute.org/commerce.web/product_files/Economic-Freedom-and-Resource-Curse-CA.pdf.

The study offers an empirical analysis weighing the economic growth rates of resource-dependent states against the Economic Freedom of North America index to determine the level of economic freedom required for states to benefit from natural resource development. Research suggests that in regions lacking policies consistent with free markets, private-property rights and a stable and fair legal system, natural resource dependence can weaken economic growth — a phenomenon known as the "resource curse."

The study points out that resource-rich states with low levels of economic freedom may suffer from the "resource curse." Of the eight most resource-dependent states, Alaska, Montana and West Virginia have an economic freedom rating below 6.22, the critical level necessary to benefit from natural resource development. Conversely, Louisiana, New Mexico, North Dakota, South Dakota and Wyoming all have an economic freedom rating above the 6.22 threshold, and each state averages a growth rate 0.84 percentage points higher than Alaska, Montana and West Virginia for the period 1986-2005. The economic freedom index operates on a scale of 1-10, with 10 being the freest.

"Compounded annually over many years, this gap in growth rates will create a significant difference between living standards in the states with a higher level of economic freedom and those with a lower level," said Fred McMahon, director of the Fraser Institute's Center for Global Mining Studies.

A comparison of Wyoming and West Virginia, the nation's top producers of coal, best illustrates this dichotomy. While both states are among the nation's most resource dependent, Wyoming is much more so, with coal accounting for nearly 34 percent of gross state product (GSP) compared to West Virginia's 14 percent. However, Wyoming boasts an economic freedom rating of 6.5, which puts it above the critical threshold to overcome the "resource curse." As a result of its higher level of economic freedom, Wyoming enjoys a per-capita GSP more than

$24,000 higher than that of West Virginia, where the economic freedom score is only 5.3.

"Sound economic institutions are indispensable to economic growth, and this rings especially true in resource-rich states," Corey said. "These states need less government involvement in the economy, lower taxes, and freer labor markets to truly benefit from natural resource development."

Provided by Florida State University

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