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# Free-Market Reforms Will Make Wisconsin Thrive

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By James Bohn



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Free Markets ▪ Opportunity ▪ Prosperity



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A PREFACE TO

# Free-Market Reforms Will Make Wisconsin Thrive

**E**veryone has his or her own idea about the good life, but everyone is more likely to reach it in conditions of prosperity. Here, economist James Bohn looks at what a wide body of research has determined that we generally need to do to make that prosperity attainable for all.

— *Badger Institute*

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## Introduction

**S**tate and local governments in the United States have wide latitude in setting economic policy. In the first half of the 20th century, the progressives chose an economic model for Wisconsin that called for high levels of taxation and government expenditure coupled with extensive regulation of business and labor. The progressives did so because they considered capitalism and market processes as morally unsound and obsolete.<sup>1</sup>

The progressives were wrong. Experience and research show that states in which individuals, businesses and entrepreneurs have greater freedom to work and invest grow more rapidly, have better labor market outcomes and attract more people than states that follow the progressives' economic model.

Wisconsin has moved away from the progressives' economic model during the past few decades. Still, there is a long way to go.

## Economic Freedom and State Growth

The concept of economic freedom provides a convenient way to express where states stand on a continuum between those whose economic policies are the most market-oriented and those that are the least. States with less economic freedom are those that more actively use instruments of government power — taxation, expenditures, law and regulation — to determine economic outcomes. In states with greater economic freedom, voluntary action and market processes are relatively more important; individuals, entrepreneurs and businesses have greater discretion to use their money, talents and resources as they see fit.

### ***Economic Freedom Indices***

Economists have developed several measures of economic freedom at the state level. The two most widely used are the economic freedom indices developed by the Fraser Institute and the Cato Institute.<sup>2</sup> Though the methodologies and data used to compute the two indices differ, both consider a state's fiscal policies as well as its legal and regulatory framework.

Economic theory suggests that greater economic freedom should result in higher rates of economic growth. Free and competitive markets provide individuals and businesses with the ability and incentive to apply their skills and capital in the most profitable and productive manner. Competition and market processes also reduce the prevalence of unproductive activities. Empirical research confirms these predictions.

A large body of research has addressed the connection between economic freedom and growth as well as other measures of state economic performance, including unemployment rates, wage growth, entrepreneurship and investment.<sup>3</sup> A 2018 survey of 235 research papers on the connection between economic freedom and economic performance found that two-thirds associated greater economic freedom with better economic outcomes. Only one of the 235 papers associated greater economic freedom with worse results.<sup>4</sup>

Figure 1

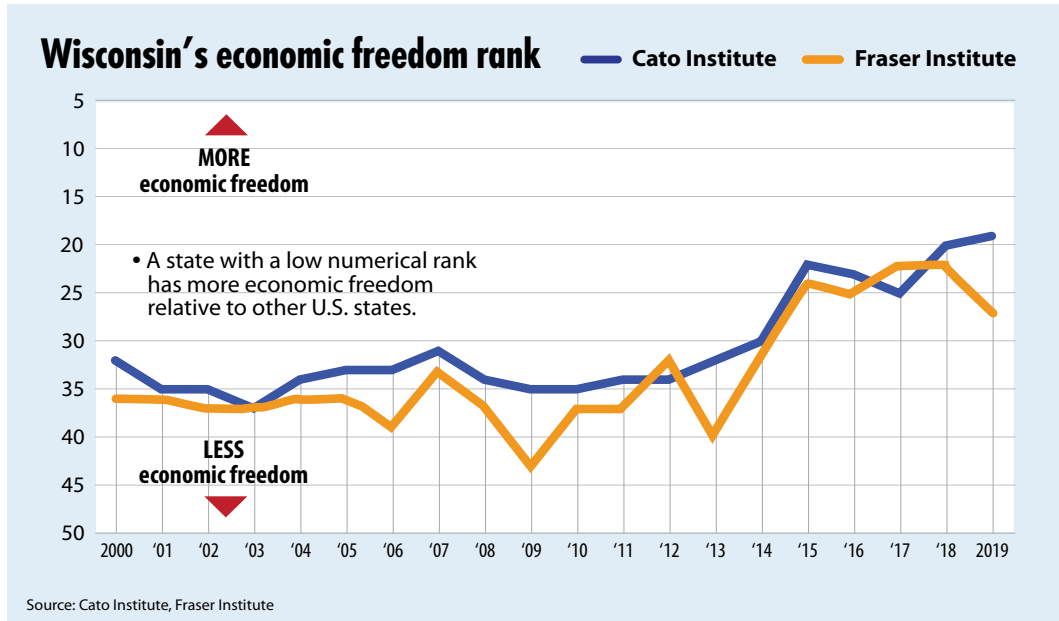


Figure 1 shows Wisconsin's economic freedom ranking from 2000 to 2019, the latest year for which rankings are available.<sup>5</sup> Wisconsin was ranked 27th in economic freedom by the Fraser Institute in 2019 and 19th by the Cato Institute. New Hampshire is the top state in terms of economic freedom in the index constructed by the Fraser Institute, while Florida received the top ranking by the Cato Institute.<sup>6</sup> New York State was ranked 50th in economic freedom by both Fraser and Cato.

The rise in Wisconsin's economic freedom ranking from 2010 through 2018 coincided with the administration of Gov. Scott Walker. Wisconsin's state and local tax burden as a share of personal income dropped from fifth highest in 2010 to 14th highest in 2018, according to data from the Tax Foundation.<sup>7</sup> Labor freedom increased with the 2015 enactment of right-to-work legislation and the decline in union density in the state. Research shows that right-to-work states grow more rapidly and attract greater investment by firms in the manufacturing sector than forced unionization states.<sup>8</sup>

The Badger State has moved a long way from the progressive economic model. Wisconsin's economic freedom ranking near the middle of the states indicates that its fiscal and regulatory policies are closer to the norm than they were 20 years ago. Still, Wisconsin's middling ranking suggests that opportunities exist to implement additional reforms to state tax and regulatory policies to make it more competitive and boost economic growth.

## Catching Macroeconomic Tailwinds

### *Reshoring and Headquarter Moves*

Wisconsin can benefit from two trends that are reshaping the American economy. One is the movement of production activities from overseas to locations in the U.S. This includes both reshoring of activities that American companies had previously sent overseas and investments by foreign companies in the U.S. The other trend is the movement of company headquarters and operations from high-tax and high-cost states to states that have more business-friendly systems for taxation and regulation.

Interest in reshoring has surged in the past two years. Bloomberg reports that references to reshoring in company presentations during the second quarter of 2022 was 1,000% higher than in the first quarter of 2020.<sup>9</sup> A 2021 survey by Thomas, an industrial data and publishing company, found that 83% of manufacturers reported that they were “likely” or “extremely likely” to reshore, up from 54% in 2020.<sup>10</sup>

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**No state exists in a vacuum. Business is mobile. State and local tax and regulatory policies weigh heavily in location decisions. With so much commercial activity on the move, now is a good time for Wisconsin lawmakers to enact measures to make Wisconsin more competitive.**

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The surge in interest in reshoring and foreign investments in the U.S. is driven by several factors, including increased trade and political tensions with China, the war in Ukraine, increased difficulties in managing complex supply chains and reductions in the cost advantage of low-wage countries due to automation. Reshoring and foreign investments are revitalizing the American manufacturing sector. The Reshoring Initiative reports that reshoring or foreign direct investment projects announced in 2021 will create a record 262,000 new manufacturing jobs in the U.S.<sup>11</sup>

Corporate relocations are also on the upswing. States with low levels of economic freedom are hemorrhaging corporate headquarters and operations; those with high economic freedom are gaining. Researchers Joseph Vranich and Lee Ohanian examined the exodus of corporations from California (ranked 48th in economic freedom by Cato and 49th by Fraser). They find that the frequency of corporate exits is increasing and that moves are motivated by California’s high tax rates, poor regulatory climate and declining standard of living. Major manufacturing and financial companies have announced moves out of New York and Illinois (ranked 37th in economic freedom by Cato, 33rd by Fraser).<sup>12</sup> Within the past year, both Boeing and Caterpillar announced exits from Illinois, as did Citadel, the state’s largest hedge fund.<sup>13</sup>

### *Tax Policy and Regulation*

Research indicates that tax and regulatory policy strongly influences business location decisions.<sup>14</sup> The literature shows that high personal and corporate tax rates depress a wide range of measures of state economic performance, including employment growth, output, wage levels and investment.

An important recent study by professors Xavier Giroud and Joshua Rauh complements the works that examine economic activity at the aggregate level. Giroud and Rauh use establishment-level microdata to examine how high corporate and personal tax rates cause companies that operate in multiple states to reshuffle employment between operations in high- and low-tax states.<sup>15</sup> For C-corporations, which are taxed at the entity level via the corporate income tax, they find that an increase in a state’s corporate tax rate or a decline in corporate tax rates in other states in which the firm already does business causes companies to reduce employment and investment in higher tax states and increase employment at existing operations in lower tax states.

They find that the top personal tax rate has the same effect for S-corporations, for which business income is taxed on owners’ personal tax returns. Their study provides further evidence of the importance of tax competition between states and how firms hire and fire workers in response to state tax policy.

Tax policy also plays into location decisions for corporate headquarters. Research shows that companies tend to migrate to locations with low corporate tax rates and away from those with high corporate tax rates.<sup>16</sup> The arrival of a corporate headquarters brings many benefits to the host city and state. Headquarters staff tend to be highly compensated, which increases the state and local tax base. Corporate relocations also typically result in increased demand and opportunities for local providers of professional services and real estate and may bring additional philanthropic resources to the host community.

No state exists in a vacuum. Business is mobile. State and local tax and regulatory policies weigh heavily in location decisions. With so much commercial activity on the move, now is a good time for Wisconsin lawmakers to enact measures to make Wisconsin more competitive.

Wisconsin’s Demographic Challenges

Market-oriented economic reforms would also help address Wisconsin’s longer-term demographic challenges. As shown in Table 1, Wisconsin’s population is expected to grow very slowly over the next two decades. Moreover, the share of Wisconsinites between the

Table 1

Prime working age population of Wisconsin and the U.S. 2020-2040						
	Wisconsin			U.S.		
	Total population	Population age 25-54	Percentage age 25-54	Total population	Population age 25-54	Percentage age 25-54
2020	5,837,176	2,183,264	37.40%	332,527,548	128,246,873	38.57%
2040	5,997,137	2,218,810	37.00%	379,392,779	146,179,539	38.53%
Growth 2020-2040 (percent)	2.74%	1.63%		14.09%	13.98%	

NOTE: Projections based on 2018 population estimates

Source: University of Virginia, Weldon Cooper Center for Public Service, Demographics Research Group, [www.demographics.coopercenter.org](http://www.demographics.coopercenter.org)

ages of 25 and 54, typically considered one's prime working years, is already below the national average and is expected to decline further by 2040.

The decline in the share of prime-age workers will be a drag on Wisconsin's economy. Those workers have higher rates of labor force participation than older or younger adults. Adults in their prime working years also tend to be net taxpayers: They pay more in taxes than they consume in services, thus their presence strengthens state and local government finances. The prime working years are also the period in life in which entrepreneurship peaks.<sup>17</sup>

Studies of interstate migration patterns in the U.S. show that states with higher levels of net in-migration have better employment opportunities, lower living costs, lower taxes, a warmer climate and, in general, more economic freedom.<sup>18</sup> With the exception of the Wisconsin winter, all of these drivers of interstate migration are within the control of state policymakers.

The expansion of the recognition of occupational licenses issued by other states would help attract more adults in their prime working years to Wisconsin. The cost to obtain a license in another state and potential breaks in employment from administrative delays is a significant deterrent to interstate moves by adults in licensed occupations.

Recent research by professors Janna Johnson and Morris Kleiner shows that workers in occupations that are subject to state-specific licensing exams are 36% less likely to move across state borders than workers in occupations that are either licensed on a national basis or do not require a license.<sup>19</sup> The Badger Institute's work on occupational licensing illustrates the benefits to Wisconsin from universal licensure recognition and other licensing reforms.<sup>20</sup>

## Conclusion

The evidence is clear: Free-market economic policies at the state level work. States that allow individuals and firms greater ability to work, invest and spend their money as they see fit experience more rapid output growth, have better labor market outcomes and attract more investment than states where government has a larger role in determining economic outcomes. Free-market economic policies and the results they produce draw migrants from other states.

Wisconsin has come a long way toward shedding the legacy of its progressive past. Wisconsin's fiscal and regulatory policy mix is closer to the norm among the 50 states than even a decade ago, but there is a clear need for additional reforms. Indeed, the case for market-oriented reforms now is made stronger by forces that are reshaping the world and national economy. States that are best positioned to benefit from the rise in reshoring, foreign investment and corporate relocations are the ones that have more sound fiscal and regulatory policies in place.





## Badger Institute takeaways

States with more economic freedom (lower taxes and less onerous regulatory policies) grow more rapidly than states with less economic freedom. During the past decade, Wisconsin moved from the bottom third to the middle third of the 50 states in terms of economic freedom. Still, additional reforms are necessary to make Wisconsin more competitive and increase economic growth. These include:

- **Implementing tax reform to attract more business investment, including investment by domestic companies that are reshoring foreign operations and foreign direct investment.**
- **Keeping the regulatory reforms of the previous decade in place, including the right-to-work statute, and implementing additional measures to reduce the costs of doing business in Wisconsin.**
- **Reducing barriers to in-migration to Wisconsin, including through reforms to occupational licensing requirements.**

## About the Author



**James Bohn** is an economist with over 30 years of experience in government, business and academics. Most recently, he served as an assistant vice president and senior professional with the Federal Reserve Bank of Boston. Bohn holds a doctorate in business economics from Harvard University and is a CFA charterholder. He resides in the Milwaukee area.

## Endnotes

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<sup>4</sup> Dean Stansel and Meg Patrick Tuszynski, "Sub-national Economic Freedom: A Review and Analysis of the Literature," *Journal of Regional Analysis and Policy*, 48:1 (2018) 61-71.

<sup>5</sup> Rankings use an as of date in the past due to the time necessary to collect and analyze economic and policy data in each jurisdiction covered by the studies.

<sup>6</sup> The Cato Institute ranks New Hampshire as having the third highest level of economic freedom among the 50 states. Florida is in third place in the Fraser Institute's ranking.

<sup>7</sup> Tax Foundation, "State and Local Tax Burdens, Calendar Year 2022," [taxfoundation.org/publications/state-local-tax-burden-rankings/](https://taxfoundation.org/publications/state-local-tax-burden-rankings/). Wisconsin's state and local tax burden as a share of personal income in 2000 was the second highest in the nation. Only New York's was higher.

<sup>8</sup> Richard Vedder, Joseph Hartge and Christopher Denhart, "The Economic Impact of a Right-to-Work Law on the Wisconsin Economy," *Badger Institute*, 28:1 (February 2015); Thomas J. Holmes, "The Effect of State Policies on the Location of Manufacturing: Evidence from State Borders," *Journal of Political Economy* 106:4 (1998) 667-705.

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<sup>11</sup> Reshoring Initiative, "2021 Data Report: Essential Product Industries Drive Job Announcements to Record High," <https://www.reshorennow.org/>

<sup>12</sup> David Roeder, "Ken Griffin Pulling Citadel Out of Chicago," *Chicago Sun-Times*, June 23, 2022, [chicago.suntimes.com/business/2022/6/23/23180173/ken-griffin-citadel-leave-chicago-miami](https://www.chicago.suntimes.com/business/2022/6/23/23180173/ken-griffin-citadel-leave-chicago-miami); Jack Kelly, "Wall Street Banks and Tech Companies are Fleeing New York and California," *Forbes*, Dec. 14, 2020, [forbes.com/sites/jackkelly/2020/12/14/wall-street-banks-and-tech-companies-are-fleeing-new-york-and-california/?sh=86a9b29661a9](https://www.forbes.com/sites/jackkelly/2020/12/14/wall-street-banks-and-tech-companies-are-fleeing-new-york-and-california/?sh=86a9b29661a9)

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<sup>14</sup> The report by the Badger Institute and Tax Foundation outlining tax reform options for Wisconsin contains a review of the literature on the effects of high state corporate rates and top state personal tax rates on economic activity.

<sup>15</sup> Xavier Giroud and Joshua Rauh, "State Taxation and the Reallocation of Business Activity: Evidence from Establishment-Level Data," *Journal of Political Economy*, 127:3 (2019) 1262-1316.

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<sup>17</sup> Dane Stanger and Daniel Spulber, *The Age of the Entrepreneur: Demographics and Entrepreneurship*, Ewing Marion Kauffman Foundation, (2013) [i4j.info/wp-content/uploads/2013/05/i4jDaneStanglerDemographicsandEntrepreneurship-1.pdf](https://www.i4j.info/wp-content/uploads/2013/05/i4jDaneStanglerDemographicsandEntrepreneurship-1.pdf)

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