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Free Enterprise 101

Why We Should Care About Free Exchange, Private Property, and Individual Liberty

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What is "Free Enterprise"?

Before the modern era, an economic history of the world is rather bleak – most people lived in poverty, and conditions did not really change over time. Property was largely communal and there was little market exchange; feudal properties, for example, were mostly self-sufficient. Serfs produced for themselves, and any surplus was delivered to the land-owning lord. No one in the production chain had much incentive to innovate or improve.

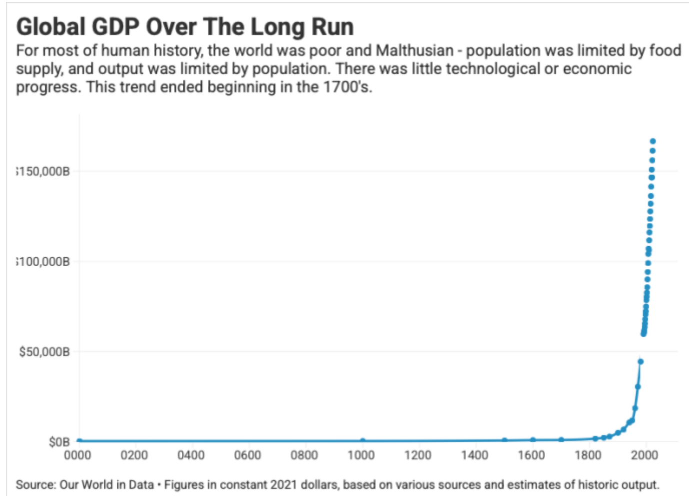

Figure 1

Between the beginning of civilization in Egypt in 4,000 B.C. and 1700 A.D., total global output did not change much and was intrinsically tied to population. When population grew, output grew linearly, but population growth was constrained by food supply – too many people led to starvation, since agricultural output was mostly fixed. In year 1, global GDP was approximately $248 billion; in 1700 it had risen to just $872B (+350%). But global population had risen about 600% - meaning output per person probably *fell* over the first 1,700 years of the common era.

> **"It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest.**
>
> **We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages."**
>
> Adam Smith, *The Wealth of Nations* (1776)

The rise of international trade and mercantilism first in the Italian states, like Venice, and later in England during the Elizabethan Era finally began to change incentives in the 1600's.[i] Suddenly, terms of trade became dominant, and both private merchants and states began seeking competitive advantages – through technology, market access, etc. – to maximize profits. These views would evolve into **Capitalism**: the legal and philosophical system that assigned private property rights, allowed their free exchange for profit, and incentivized productive innovation. Famously, in 1776 Adam Smith wrote *The Wealth of Nations*, which forcefully articulated the principle.[ii]

As a result, human prosperity began to rise rapidly, particularly in those places that embraced this new system. Global GDP grew about as much between 1700 and 1850 as it had over the prior 2,000 years. And the rapid accumulation of *capital* – property and wealth – and the incentive to put it to productive use gave rise next to the Industrial Revolution (beginning in England in the 1800's).[iii] The rest, as they say, is history.

Why is Policy So Important to this System?

We have already established that for most of human history, people lived in poverty, and improvement was slow or even non-existent. While the reasons for this are many, the importance of *policy* to them cannot be overstated: in the absence of trade and exchange, and the right of people to pursue their own happiness and keep the fruits of their own labor, there is little incentive to innovate.

Legal and political systems that define and protect these rights are historically rare, and their protections are precarious. It is important to guard against complacency and not take our modern condition – particularly the American condition – of high growth, high incomes, and near-constant technological improvement for granted.

> **"We joined together to make this request in order to prevent rental property owners from compounding the tragedy imposed on those who are already suffering...**
>
> **We are seeking to prevent people from being able to profit from the suffering of others."**
>
> John Savrnoch, *Santa Barbara District Attorney* (Feb. 6th, 2025)

At the extreme end, often legitimate but ultimately misguided concerns with the social change that accompanied the industrial revolution and free enterprise system birthed a competing ideology: Communism. In a throw-back to the feudal relationships of our human past, it proposes collective ownership of all property and using it for common rather than private purposes.[iv] Why misguided? Because a consequence of these kinds of policies and philosophies is the destruction of growth, the imposition of much greater social inequality, environmental decay, and a return to general poverty.

Following the Russian Revolution in 1917, the Chinese Revolution in 1927, and general Communist victory in the East by the end of the 1940's, roughly 40% of the world's population was living in a Communist country by 1950.[v] The dominant Communist power was the Soviet Union, which embraced industrialization, resource exploitation, and technical-industrial policy, but without the principles of free enterprise or individual liberty.

Figure 2

The result? Between 1946 and its collapse in 1991, Soviet per-capita GDP increased from $3,000 to $10,300 per year (constant 2011 dollars); over the same period, American output-per-capita went from $14,800 to $36,400 per year. And in that time two small and poor countries without any real natural resource endowment chose to buck their regional trends and embrace Western principles of free enterprise, private property, and individual rights – Singapore and Hong Kong. Both began level with the Soviet Union, with per-capita GDP's of about $3,600 in 1950. But by 1991 output-per-person in Hong Kong had grown to over $29,000 per year, and Singapore to over $23,600 per year.

In short: policy matters. Industrialization and natural resources are not enough.

What about within the United States?

While national policy matters, the American political system is unique because its 50 states set their own laws and rules and compete for people and capital. The Constitution guarantees the rights of those people and that capital to move freely between the states, unhindered.[vi] [vii] This makes the states "laboratories of democracy", provides incentives for states to be innovative and competitive policymakers, and rewards states that enact good policy relative to those that do not.

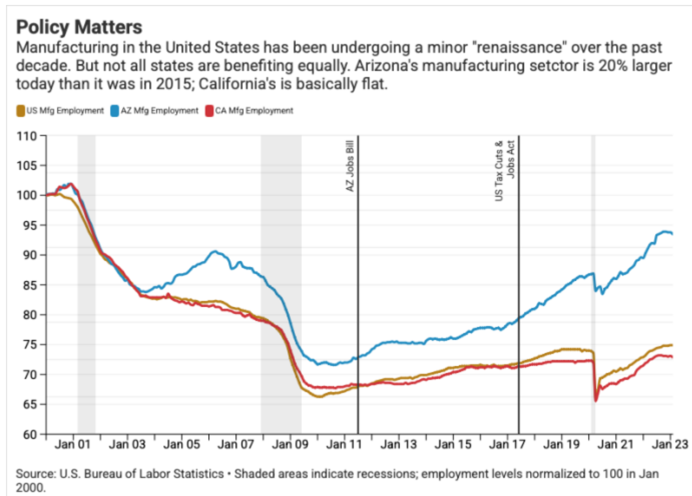

Figure 3

For example, manufacturing as an industry in the United States has been in slow decline for decades. Many economists had written it off as untenable in high-cost, high-regulation America. Despite consistent lip services by numerous politicians of both parties, the trend of slow decline in employment and output seemed irreversible. But beginning around 2017, something interest happened – U.S. manufacturing employment and output broke trend and started growing again. A combination of national policy changes, culminating with passage of the *Tax Cuts & Jobs Act*, had enabled real manufacturing sector growth in America. Over the next 3-4 years, U.S. manufacturers would add about half a million jobs. **But not every state enjoyed this manufacturing renaissance equally.**

Between 2017 and the 2020 pandemic, Arizona's manufacturing employment grew by 11%; nearby California – one of the largest, wealthiest, and resource-rich places on the planet – grew by less than 1%. Beginning with the 2011 *Jobs Bill*, Arizona had since the Great Recession deliberately chosen to compete for jobs and economic growth – through low taxes, fewer regulations, and a focus on individual freedom. As a result, its economy nearly doubled in size in just a decade, even as some of its neighbors – particularly those who have chosen another path, like California and more recently Colorado – have struggled to grow.

What Are the Policies That Matter?

The Growth in Colorado's Administrative State

On a per-capita basis, Colorado has over three times as many "mandatory" rules as Arizona - and has added over 10,000 new mandates in just the past five years.

	Arizona	Colorado
Population	7,431,340	5,877,610
5-year Annual Growth Rate	0.7%	0.6%
Top Individual Income Tax Rate	2.50%	4.25%
Administrative Regulation Count	65,824	165,994
Annual Growth Rate Since 2019	0.7%	2.2%
Rules per Thousand People	9	28
Enacted 'Job Killers'	0	22
Annual RGDP Growth Rate Since 2019	3.7%	3.3%

Source: CSI Colorado, QuantGov RegData, U.S. Census Bureau

Figure 4

In general, states have broad authority to regulate the lives of their citizens as it pertains to activity within that state. They also set their own taxes and can use tax policy as an instrument of general economic policy. CSI, for its part, has identified five major policy areas that states commonly use to either promote, or hinder, their free enterprise systems: Tax policy, Labor Market policy, Energy and Environment, general Regulatory policy, and Education policy – particularly when it comes to K-12 education.

And in general, states that do well in these areas (in terms of their promotion of the free enterprise system) tend to do well in terms of economic growth and opportunity. Change can happen quickly. Considering neighboring Colorado; for most of the 21st century, Colorado enjoyed *faster* growth than Arizona – between 2000 and 2015, Colorado's GDP grew at a 1.9% average annual rate, versus 0.7%/year in Arizona. More recently, though, Colorado's growth has slowed dramatically, and Arizona has now outpaced it in terms of population, employment, and average annual GDP growth.

While Arizona has continued its market-oriented transformation, Colorado since 2019 has gone in a very different direction: passing 22+ bills restricting its free enterprise system, adopting over 10,000 new rules, and in general choosing more taxes, more spending, and more restrictions.

Tax Policy

In general, "the power to tax is the power to destroy". While all governments rely on taxes to finance the provision of public services, states are free to choose the *level* of tax (and how many services they try to provide), and *what* they tax. A freedom-oriented tax structure should be as low as possible, and as fair as possible – treating all taxpayers the same and avoiding punishing success or rewarding failure.

Policy that works. Flat, low-rate income taxes. A progressive income tax punishes success, in that the more you earn, the more you pay (both in total and as a share of income). For lower-income people, highly progressive systems destroy any incentive to work – creating a permanent class of poor and dependent folks through no fault of their own (who end up trapped by a poorly-designed system).[viii] Arizona's flat 2.50% income tax – and the repeal of its 8.0% top rate on high-earners – will lead to 59,000 more jobs and $11.9 billion in additional state GDP over the next decade.

Policy that doesn't work. Punitive taxes that use the income tax code to punish success. By the slimmest of margins, Arizona voters passed Prop. 208 – which would have increased state income taxes on people earning over $250,000/year by 77%. Though ultimately it never took effect, this surcharge could have destroyed Arizona's ability to attract new high-earning migrants and investments going forward. California, with a top income tax rate of 13.3%, has lost over 200,000 residents a year to domestic migration as folks flee to lower-cost states.

Labor Market Policy

States have significant authority to regulate workplaces and their labor markets, often under the guise of workplace safety or consumer protection. For example, every state issues occupational licenses, which determine who can do certain jobs, and subject to federal minimum standards, states can set minimum wages, regulate shifts and hours, and regulate workplace safety.

Policy that works. Occupational licensing rules have grown rapidly and for decades. In the 1950's, fewer than 1% of workers were covered by an occupational license requirement; today it's closer to a third. These requirements reduce employment, limit economic growth, and raise consumer prices. In 2019, **Arizona became the first state in the country to recognize all occupational licenses issued anywhere in the country** by previously-licensed folks moving into the states. This minimum reform says that at the very least, a state can permit you to work in your profession of choice if you've already been licensed to do that job by another states, and remain in good standing there.

Policy that doesn't work. Last year, Michigan became the first state in decades to repeal right-to-work laws. Right-to-work protects the freedom of employers and employees to choose their relationship with organized labor. If an employee wants to join a union and one is available at their shop, they can. But they can't be *required* to as a condition of employment in right-to-work states. Right-to-work rules have been a key part of pro-growth states labor market strategy since federal law enabled them in 1947; CSI estimates that their repeal in Arizona could have an $11.8 billion annual economic cost.

Energy & Environmental Policy

Abundant, low-cost energy has been central to human prosperity, the success of the free enterprise system, and economic growth over the past two centuries. Today and in general, places with abundant and affordable access to energy are prosperous; those without aren't.[ix] On the other hand, the energy sector is often disproportionately targeted and affected by a state's environmental policies.

Policy that works. Energy and environmental protection regimes that balance costs and benefits, while recognizing the implications for electricity reliability that alternative energy sources (like wind and solar) can have, are key. For example, CSI found that while reliability has been falling and prices rising for electricity in the United States over the past decade, Arizona's prices remain relatively low, and reliability relatively high and stable. The cause? While the country has rapidly adopted intermittent "clean" energy sources, Arizona has been more measured in its adoption of them, while investing heavily in base-load sources like natural gas and nuclear.

Policy that doesn't work. "Net-zero" mandates with unrealistic timelines and a reliance on unproven technologies. Since 2011, Germany has been on "the road to a renewable future": shuttering coal and nuclear power plants, and investing heavily in wind and solar. Today, nearly half of the Germany electricity grid is wind, solar, and other renewable generators. Germany now pays three-times the global average rate for electricity, and prices are up about 50% in just the last five years. As a result, its industrial and manufacturing sectors – once a global powerhouse – has been in contraction for years, and is about 10% smaller today than it was before the pandemic.[x]

Regulatory Policy

States and governments through rulemaking and law have broad and general regulatory authority. They can dictate all kinds of things, from how often we take breaks at work, to how much water our washing machine uses to clean our clothes. Regulation is typically well-intentioned, but it can also be costly and have unintended consequences. In general, American workers today are safer, work less, and are better-compensated than workers anywhere have ever been. But federal and state regulators continue finding problems and adding more rules.

Policy that works. Rulemaking moratoriums and requirements that new rules meet cost-benefit standards can meaningfully reduce regulatory barriers. During his eight-year term as Governor, Doug Ducey maintained rulemaking and hiring moratoriums that resulted in the repeal or improvement of over 3,300 administrative rules, and a net reduction of 5,000 state employees. This creates fewer burdens to free-enterprise for individuals equivalent to a $180 million+ tax cut.[xi]

Policy that doesn't work. Setting untenably high minimum wage floors to "protect" workers. It is an iron law of economics that the more expensive something is, the less of that thing we tend to buy, all else equal. This is true with labor as with all things. Minimum wages price workers out, depriving them of the opportunity to sell their labor. This is especially true for younger and less-experienced workers who are just starting out but struggle to compete with better-educated, older, and more-experienced workers. CSI warned that a $15 minimum wage for tourism-related workers in Glendale could destroy up to a quarter of that city's entire economy, due to the concentration of this sector in Glendale and its need to compete with nearby cities.

Education Policy

For most states, K-12 education is a dominant policy area: it tends to consume the largest share of state and local budgets, and many states have a de facto monopoly on the primary education of their resident children through the public K-12 system. Even though the United States spends more on K-12 education than all but four other OECD countries, its performance in math lags most other OECD countries and it has recently seen its reading and literacy performance fall relative to its peers. In 2024, only about a quarter of U.S. 8th graders were Proficient in Math and Reading, according to the National Assessment of Educational Progress.

Policy that works. School choice policies inject competition and innovation into a sector that has been stagnant or even going backwards for decades. The traditional model of giving a local public school a monopoly on students that live nearby discourages innovation and removes a competitive incentive to do well. Evidence shows choice works – Private and Charter schools outperform traditional public schools in many metrics. More recently, **Arizona's experiment with universal ESA's enables over 85,000 (over half of whom come from middle-income households) kids to experiment with things like home- and micro-schooling**.

Policy that doesn't work. Charter schools are one of the country's oldest experiments with breaking the traditional District monopoly. Since Minnesota passed the first Charter school law in 1991, 45 states have enabled semi-autonomous schools to receive public funding and operate according to public educational rules and standards but independently from District schools, attracting their own students and applying their own approach to achieving results. However, many states give local school districts authority to approve opening new Charter schools; this is akin to letting Circle-K decide whether Quik Trip can open a new store. **Independent research has found that having an independent authorizer is highly correlated with Charter school market share.**[xii] Requiring school Districts to authorize new Charter schools is tied only with hard caps on school counts for limiting Charter school growth.

Free Enterprise Myths & Facts

Myth: The free-enterprise system leads to large and growing wealth inequality.

Fact: While it is true that individual opportunity and economic dynamism can create incredible wealth for some highly successful individuals, it is also true that general prosperity lifts the quality of life for all. For example, Canada has a significantly lower measured wealth inequality than the United States, but the median Canadian household has an annual income about 30% smaller than the median American household. And inequality is still lower in Western free-market economies than abroad. For example, China has an estimated Gini coefficient over 0.5 (highly unequal); the United States is above 0.4.[xiii]

Myth: The free-enterprise system incentives individuals to put their own needs ahead of others' needs by prioritizing profit over the well-being of others.

Fact: Free enterprise is the only system that incentivizes problem-solving and wealth creation through voluntary exchange. Free markets reward innovation and efficiency, and people can profit by meeting the needs of others.

Myth: Free markets lack adequate workplace protections and are unsafe for workers.

Fact: Like environmental care, workplace safety is costly to provide – and rich countries can provide more of it. The best predictor of wealth is the presence of free-market systems. For example, according to the U.S. Chamber of Commerce, there were 10.9 injuries for every 100 workers in America in 1972; today the figure is just 2.8.[xiv] Adjusting for the size of their labor forces, there are over three-times as many fatal workplace injuries in China as the United States annually.[xv]

Myth: Capitalist economies are bad for the environment.

Fact: Like other expensive goods and services, consumption of environmentalism – cleaning up the world around us – rises with income. That is to say, the richest countries on the planet are also the cleanest and have the strongest environmental protections. These are also the countries with the freest markets.

[i] https://www.oxfordreference.com/display/10.1093/acref/9780199207800.001.0001/acref-9780199207800-e-161?rskey=8AxRYq&result=172

[ii] https://www.ibiblio.org/ml/libri/s/SmithA_WealthNations_p.pdf

[iii] Wood, Ellen, *The Origin of Capitalism: A Longer View* (pg. 142-146), 2002.

[iv] https://www.britannica.com/topic/communism

[vi] https://www.law.cornell.edu/wex/privileges_and_immunities_clause

[vii] http://law2.umkc.edu/faculty/projects/ftrials/conlaw/statecommerce.htm

[viii] https://www.niskanencenter.org/work-disincentives-hit-the-near-poor-hardest-why-and-what-to-do-about-it/

[ix] https://visualizingenergy.org/what-is-prosperity-and-how-is-it-related-to-energy-use/

[x] https://www.reuters.com/markets/europe/german-exports-rise-industrial-production-falls-2025-02-07/

[xi] https://citizensforfreeenterprise.com/about-doug-ducey/

[xii] https://files.eric.ed.gov/fulltext/ED642566.pdf

[xiii] https://www.csis.org/analysis/how-inequality-undermining-chinas-prosperity

[xiv] https://www.uschamber.com/economy/the-facts-on-free-enterprise

[xv] https://www.safetynewsalert.com/worker-fatalities-how-does-china-compare-to-u-s/