Living Above Our Means

2013 Annual Report • O'Neil Center for Global Markets and Freedom • SMU Cox School of Business

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The William J. O'Neil Center for Global Markets and Freedom was founded in 2008 with an initial grant from William J. O'Neil, a 1955 SMU business school graduate, and his wife Fay C. O'Neil. Its broad mission is the study of why some economies prosper and others do poorly, focusing on two critical issues for the 21st Century economic environment—globalization and economic freedom. The center's programs promote understanding of how capitalism works among the general public, policy makers, business managers and the next generation of business leaders. To these ends, the O'Neil Center teaches SMU Cox students, conducts economic research, publishes economic reports, sponsors conferences and educates the public through the media and speeches.

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A Message from the Dean

The title of this year's O'Neil Center annual report taps into the anxiety that afflicts many Americans—we're "Living Above Our Means." With incomes flat or declining, with good jobs still hard to find and Washington drowning in debt, many of us worry that current living standards can't be maintained and future generations won't live as well as we do.

Mass psychology will always be fuzzy—it may or may not reflect reality. Questions about America's living standards need to be addressed with facts and evidence, and O'Neil Center director W. Michael Cox and his co-author Richard Alm provide them. Their examination of the drivers of consumption for nearly 100 countries finds reason to worry about the long-term viability of Americans' living standards.

Cox and Alm contend that today's Americans are living well off the capital stock built by past generations—but we're not taking good care of the free enterprise system that built the capital in the first place. It's a thought-provoking essay, a fitting bookend to "Rebuilding America's Middle Class," last year's annual report, which examined U.S. schools and found we aren't taking good care of our intellectual capital.

Our prosperity depends on physical and intellectual capital. So Americans should find these two O'Neil Center essays sobering and a catalyst for change.

When I came to SMU Cox in 1997, I saw the need for a center to study why some economies, regions and states prosper while others remain poor. It's perhaps the most important issue in economics, with great relevance to our business students. The center came to life through a dialogue with Bill O'Neil, who shared my vision and helped make it a reality with a generous donation in 2008. He's the subject of the Q&A interview on Page 17.

In its first five years, the O'Neil Center has established itself at SMU Cox, teaching students, hosting annual conferences, researching and publishing articles, engaging the media, producing videos and online resources and giving talks around the world. A review of this year's activities starts right after the interview with Bill O'Neil.

Albert W. Niemi, Jr.
Dean, Cox School of Business

Living Above Our Means

By W. Michael Cox and Richard Alm

Some countries live quite well—an average American, for example, consumes $32,720 a year, the highest among the world's major countries. Most U.S. families own homes and cars or trucks, and they can afford to buy color televisions, refrigerators, cell phones, air-conditioners, computers, Internet access and a lot more.

Americans take such abundance for granted, but it must seem an impossible dream in Bangladesh and many countries in Africa, where millions of people struggle to put food on the table and keep a roof overhead on less than $3 a day—not even $1,000 a year.

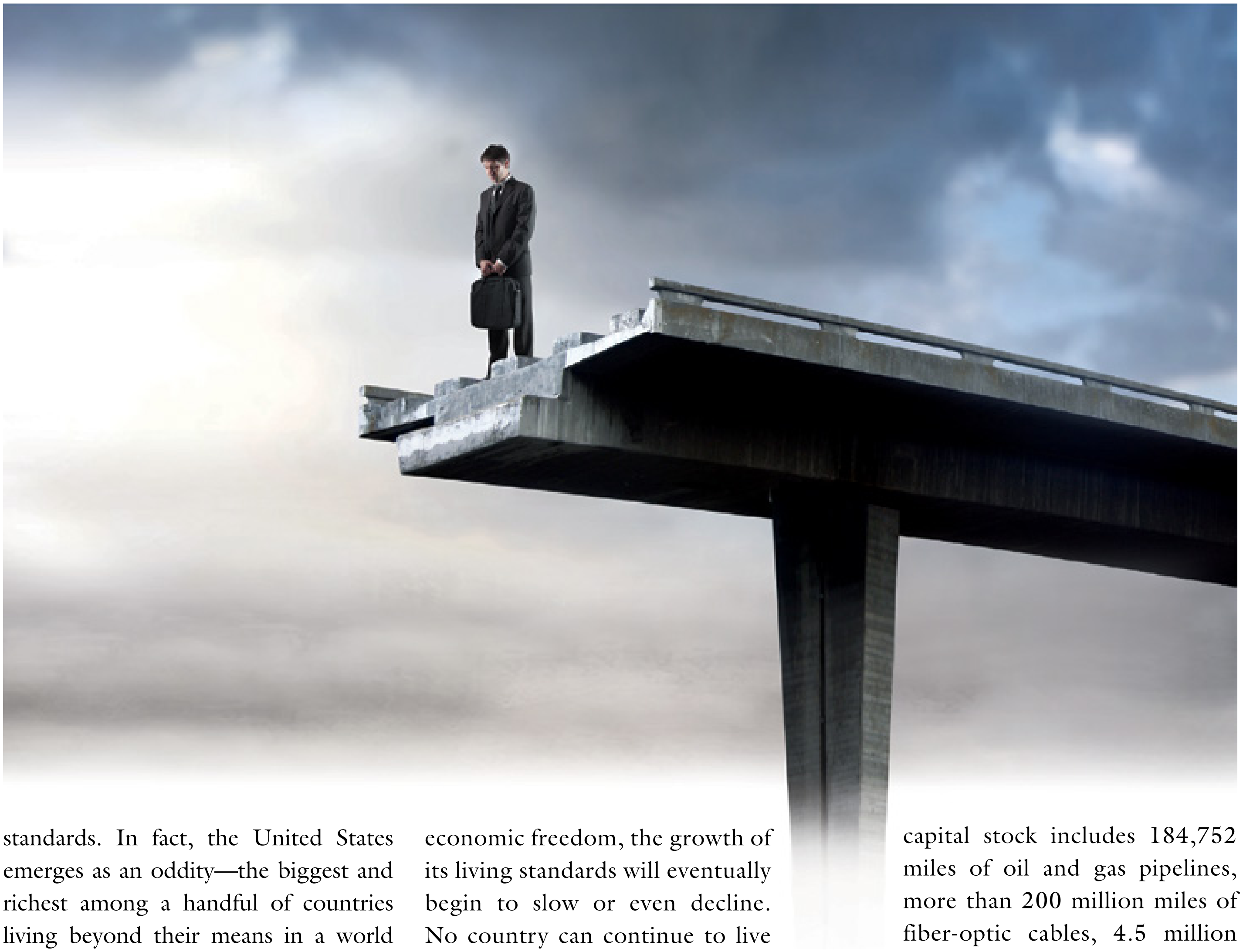
Large and persistent gaps between rich countries and poor ones are for the most part a direct result of differences in capital, both physical and intellectual. The United States has amassed a great stock of capital, and most of its citizens enjoy the good life. Bangladesh has precious little capital, leaving its people poor.

Both physical and intellectual capital are products of human effort and ingenuity, expensive and time-consuming to build. Yesterday's decisions and investments forged the capital stock that determines today's consumption. What we add to the capital stock today will largely determine how well tomorrow's Americans live.

In building the capital stock, incentives are all important. Businesses will invest in physical capital when they expect to reap a profit; individuals will invest in intellectual capital when they expect to land higher paying jobs. High rates of return will encourage savings and lending. More people will strive for these rewards when the economy grows strongly, property rights remain secure and governments hold their regulatory meddling to a minimum.

In short, the capital stock will grow more rapidly when nations commit to markets and economic freedom—the longer the better. High or rising economic freedom will encourage greater capital formation, planting the seeds of better living standards in the future. Where economic freedom falters, countries will find it difficult to maintain their capital stocks, and consumption will suffer.

America's economic freedom has ebbed of late, providing reason to worry about the viability of U.S. living



standards. In fact, the United States emerges as an oddity—the biggest and richest among a handful of countries living beyond their means in a world where most countries seem poised to consume more in the future.

Living above our means carries the same connotation for countries as it does for individuals or families. When prospects diminish, households often maintain established consumption levels for some time, living off wealth built up in the past. Of course, reality eventually sets in, forcing a choice between belt-tightening and bankruptcy.

With a large capital stock in place, most Americans still live reasonably well, thanks to the country's past economic success—but the day of reckoning can be put off only so long. If the United States doesn't restore its economic freedom, the growth of its living standards will eventually begin to slow or even decline. No country can continue to live above its means forever.

Capital Cornucopia

Americans go about their business every day, rarely noticing the physical capital that supports one of the world's highest levels of consumption per capita. Yet it's all around us—from more than 4 million miles of roads and highways to the 242 million motor vehicles that drive on them *(see Exhibit 1)*.

Bridges and dams, airports and railroads, hospitals and hotels—they're found in nearly every corner of America. A snapshot of the country's capital stock includes 184,752 miles of oil and gas pipelines, more than 200 million miles of fiber-optic cables, 4.5 million point-of-sale terminals and 310 million computers in use. The United States has the capacity to generate 1 trillion watts of electricity and store 898 exabytes of digital information. An inventory of the U.S. capital stock could go on and on for pages and still not be complete.

America's mammoth capital stock didn't fall as manna from heaven. Quite the contrary, it was created right here on Earth by companies and individuals operating in a capitalist system with incentives and opportunities to work, save, learn, invest, invent, innovate, employ, start businesses and create jobs—in short, all the activities that generate income and wealth.

The U.S. Department of Commerce puts the country's physical capital at $53.6 trillion, or more than three times the annual output of goods and services. To some, publicly funded megaprojects like the Interstate highway system and Hoover Dam may suggest a dominant role for government in building the capital stock—but that's just not so.

Public infrastructure helps keep the economy humming, of course, but the private sector has produced more than three-quarters of the nation's capital stock. This includes the business sector's buildings, equipment and intellectual property as well as the household sector's private residences and consumer durables like cars and trucks.

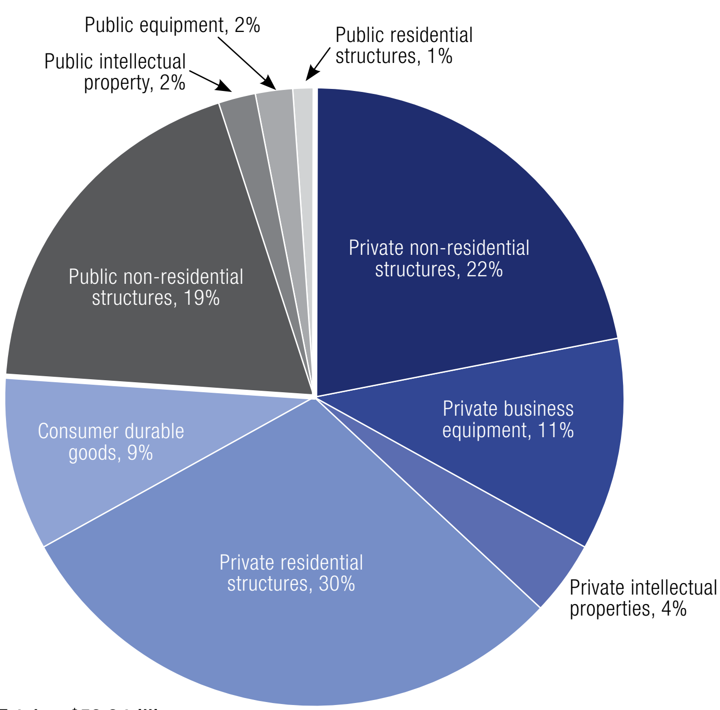
It's common to look at public spending on infrastructure as a gift from the politicians in Washington or state capitals, but the public capital stock, like its private complement, owes its existence to the vibrancy and vigor of American capitalism.

For starters, governments don't earn the money to pay for public goods; they get it from the private sector, which generates the incomes, sales and profits that governments tax and the financial wealth they borrow when selling bonds. Poor nations have lousy infrastructure because their

EXHIBIT 1

Taking Stock in America

Physical capital makes societies more productive, leading to higher living standards. The U.S. capital stock totals $53.6 trillion—77 percent of it created by a vibrant private sector; the rest of it is public (*left*). Transportation and information technology dominate our sampling of America's stock of capital goods (*right*).



Total: $53.6 trillion
Private: $41.1 trillion
Public: $12.5 trillion

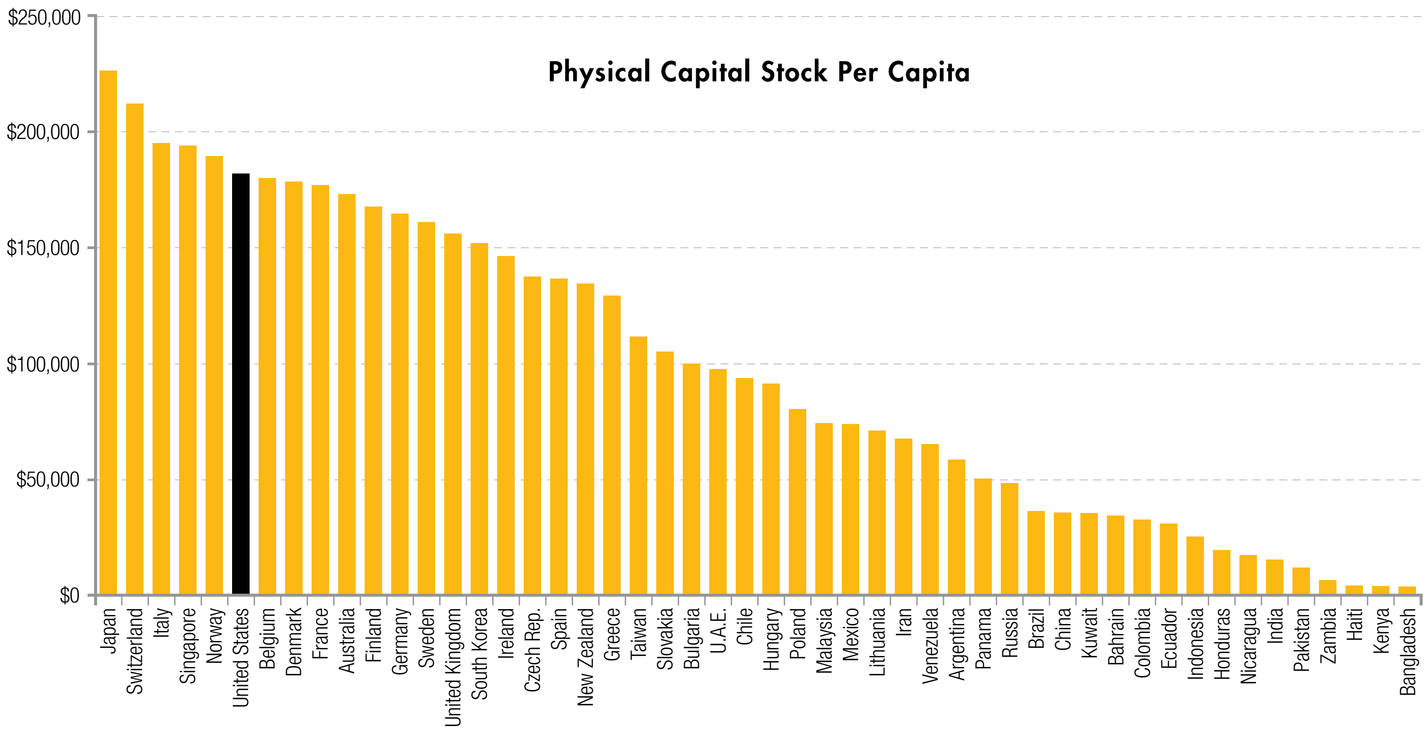
Capital Stock Category	Year	Number
Miles of roads	2010	4,077,756
Bridges	2010	604,474
Miles of railway	2010	214,000
Dams	2010	83,987
Navigable water channels	2010	25,320
Miles of oil and gas pipeline	2010	184,752
Electric power plants[1]	2011	10,266
Electric generation capacity (watts)	2010	1.04 trillion
Natural gas plants	2010	2,558
Water and sewage plants	2010	4,810
Airports	2010	19,802
Commercial aviation aircraft	2010	223,370
Active satellites in orbit	2014	514
Cell sites	2010	253,086
Miles of fiber optic cable	2010	200,000,000+
Landline telephone access lines	2007	424,000,000
Hospitals	2010	5,754
POS terminals	2010	4,508,802
ATMs in use	2010	425,000
Commercial bank offices	2010	94,399
Manufacturing assets ($2010)	2010	$7.43 trillion
Hotels and lodges	2010	51,015
Computers in use	2011	310,600,000
Data storage	2012	898 exabytes
Internet servers	2010	446,137
Commercial water vessels/barges	2010	40,512
Motor busses	2010	66,239
Demand response vehicles[2]	2010	68,621
Commuter rail vehicles	2010	6,927
Motor vehicles	2010	242,061,000

[1] Generation, transmission and distribution. [2] Taxis, vans, limos, etc.

EXHIBIT 2

Capital by Country

Through private and public investments, the United States has built up a capital stock per capita of more than $180,000, one of the world's largest. Haiti, Kenya and Bangladesh are among the countries with capital of less than $5,000 per person. Japan at the top has a capital stock per capita 52 times greater than Bangladesh at the bottom.



private sectors produce little wealth.

What about the raw materials, machinery and workers needed to build the publicly funded roads, bridges and dams? The private sector provides those, too. While public and private capital ultimately come from the same source, the incentives shaping government decisions are more likely to be political rather than economic, suggesting investment will be less efficient.

In sheer size, the U.S. capital stock ranks as the world's largest, although booming China has gained ground in recent years. On a per capita basis, however, Japan leads with $226,159, followed by Switzerland, Italy, Singapore and Norway *(see Exhibit 2)*. The United States ranks among the world's Top 10, with an average capital endowment of $181,769.

Many poor countries struggle with sparse road networks, unreliable electricity and other signs of deficient capital per capita. The citizens of Bangladesh, Haiti, Kenya and other countries have a capital stock per capita of less than $5,000, not enough to eke out a decent living. India is in only slightly better shape at $15,819. A generation ago, China was one of the capital-starved nations; now it's up to $35,811 per capita and climbing rapidly.

Explaining the great divide in physical capital requires looking at how nations differ in economic freedom—a concept that enterprising researchers now measure with consistency and precision. Inspired by Nobel laureate Milton Friedman, they created the *Economic Freedom of the World* report, a broad gauge of economic freedom *(see box, next page)*.

The report locates 153 countries between the poles of free markets and big government by compiling data on the size of the state, respect for property rights, the soundness of money, openness to free trade and burden of regulation. To make comparisons among countries easier, economic freedom scores are expressed as a single number—from iron-fisted central planning at 1 to Ayn Rand-style nirvana at 10.

Hong Kong, Singapore, New Zealand, Canada and Switzerland lead the world in economic

Measuring Economic Freedom

The Economic Freedom of the World (*EFW*) index grew out of a 1984 meeting of the Mont Pelerin Society, a group of respected academics and others who advocate human freedom.

A spirited exchange about whether the world was moving toward the dystopian vision depicted in George Orwell's novel *1984* drifted inconclusively on a sea of anecdotes, pointing to the need for a precise definition of economic freedom and a way to measure it.

At the invitation of Nobel Prize-winner Milton Friedman and his economist wife Rose, a group convened two years later to start designing a data-driven yardstick to compare economic freedom among countries and over time. A decade of research and testing passed before publication of the first *EFW* index in 1996.

Among the index's architects was Robert Lawson, now a professor in the O'Neil Center and a co-author of the annual *EFW* report, along with James Gwartney of Florida State University and Joshua Hall of West Virginia University.

The *EFW* isn't a three-man show. A network of scholars around the world helps collect statistical information on, at latest count, 153 countries. The database includes 43 components—top marginal tax rates, red tape involved in starting a business, inflation rates, private sector credit, hiring and firing regulations, tariff and non-tariff trade barriers and much more. Canada's Fraser Institute publishes the *EFW* report, joined by the Cato Institute in the United States.

In the end, all this data reduces to a single number for each country, revealing which countries rely most on markets, choice and competition and which countries are most likely to surrender their economic decisions to planners and bureaucrats.

The *EFW* index has proven its worth in hundreds of scholarly articles since 1996. For the journal *Contemporary Economic Policy*, Lawson and Hall surveyed more than 400 articles citing the *EFW* index, including 198 that used it as a key variable in an empirical analysis.

Over two-thirds of the studies found economic freedom associated with "good" outcomes, such as faster growth, better living standards and greater happiness. Some studies were mixed or uncertain. Only 4 percent found economic freedom to be associated with "bad" outcomes, such as increased income inequality.

Robert Lawson

freedom *(see Exhibit 3)*. Somewhat surprisingly, given its reputation as a bastion of free market capitalism, the United States finds itself lagging the leaders—but still ahead of most of the rest of the world. At the other end of the spectrum are Venezuela, Algeria, Niger and Argentina—their lack of economic freedom severely restraining incentives for capital formation.

A Third Capital Stock

Once built, capital goods last for years, perhaps decades or even centuries. So today's capital stock doesn't simply depend on today's economic freedom. At any point in time, a large part of the capital stock will be a legacy of yesterday's economic freedom. Countries that maintain pro-market policies for a long time are primed to accumulate far more physical capital than those that don't.

To give past economic freedom its due, we developed a concept that gauges countries' long-term consistency in favoring free markets over big government—the "freedom capital stock." In essence, legacy economic freedom becomes a third type of capital stock shaping countries' economic fortunes.

Like physical and intellectual capital, the freedom capital stock takes time to build and, if properly maintained, endures for years. We calculate it as the declining weighted average of each country's *Economic Freedom of the World* scores going back to 1970, putting greater emphasis on recent readings but recognizing how past policies still influence the well-being of consumers today. Scores range from 1 at the low end to 10 at the top.

Hong Kong and Singapore, two former British outposts in Asia, have the highest freedom capital stock, followed by the United States, Switzerland, Canada and the United Kingdom *(see Exhibit 4, top)*. Like other countries with high freedom capital stock values, they've maintained reasonably good economic policies for decades, sustaining an environment favorable to capital investment.

Ukraine, Russia and China have adopted market-oriented reforms in recent years, but they're still among the countries with relatively low freedom capital stock—a hangover from decades of communist central planning. Populism, the first cousin to communism, left Venezuela with a meager freedom capital stock.

"Countries that maintain pro-market policies for a long time are primed to accumulate far more physical capital than those that don't."

Our regression analysis confirms the power of the freedom capital stock, identifying it as one of just three significant factors in explaining the gaps among countries in capital stock per capita. The other two are average years of schooling and, somewhat surprisingly, tourist arrivals per 1,000 residents.

Free markets value education and job experience highly. In the United States, for example, a typical college graduate aged 45-54 earns nearly four times more than a high school graduate of the same cohort. A professional degree in law, medicine, architecture or other fields commands a premium of 93 percent over a bachelor's degree. Higher pay provides powerful incentives to stay in school and continue learning in the workplace.

Years of education don't directly measure educational achievement, but they serve as a reasonably good proxy for intellectual capital—what workers know that makes them more productive. Six countries average 12 or more years of schooling—Norway, New Zealand, the United States,

EXHIBIT 3

Economic Freedom by Country

Allowing market forces to work raises incomes and speeds up growth, earning countries high economic freedom scores. Relying on the heavy hand of government strangles economic activity and leads to low economic freedom scores. The United States has a high level of economic freedom, but it's not among the world's leaders.

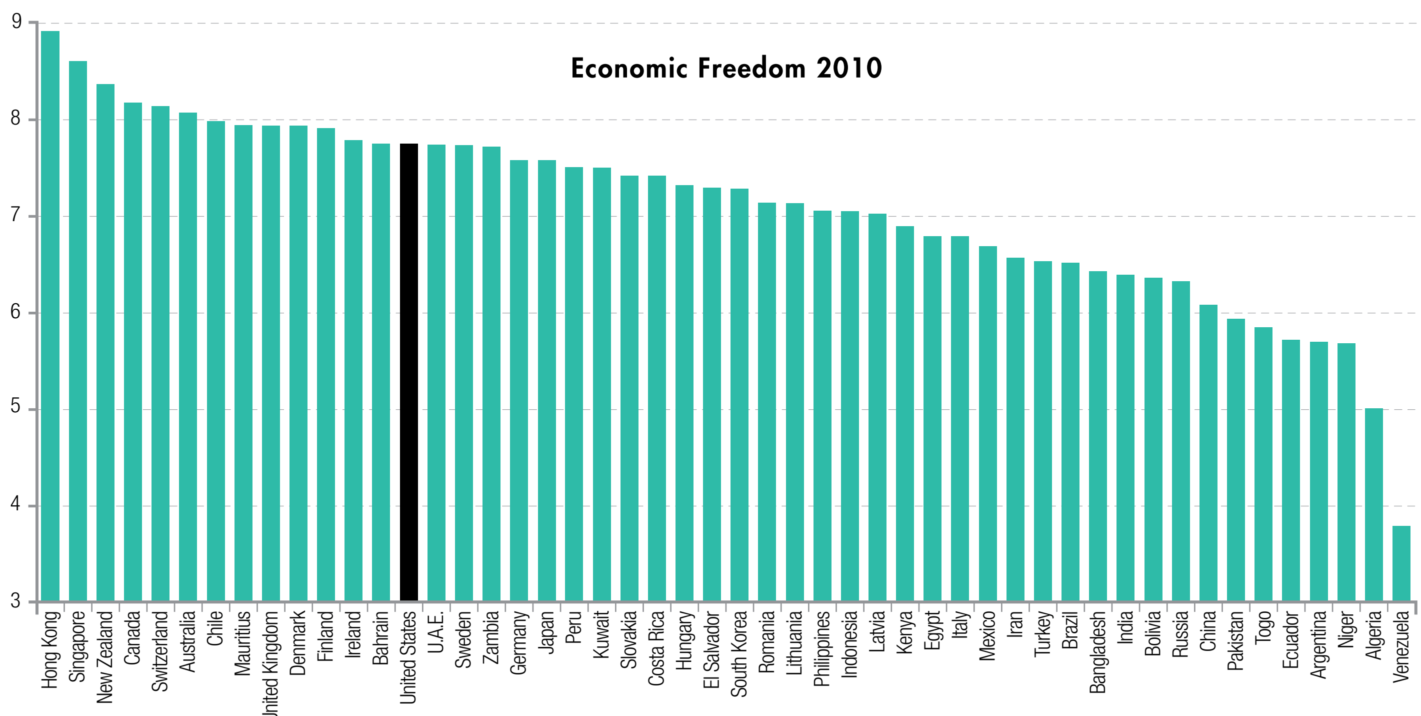
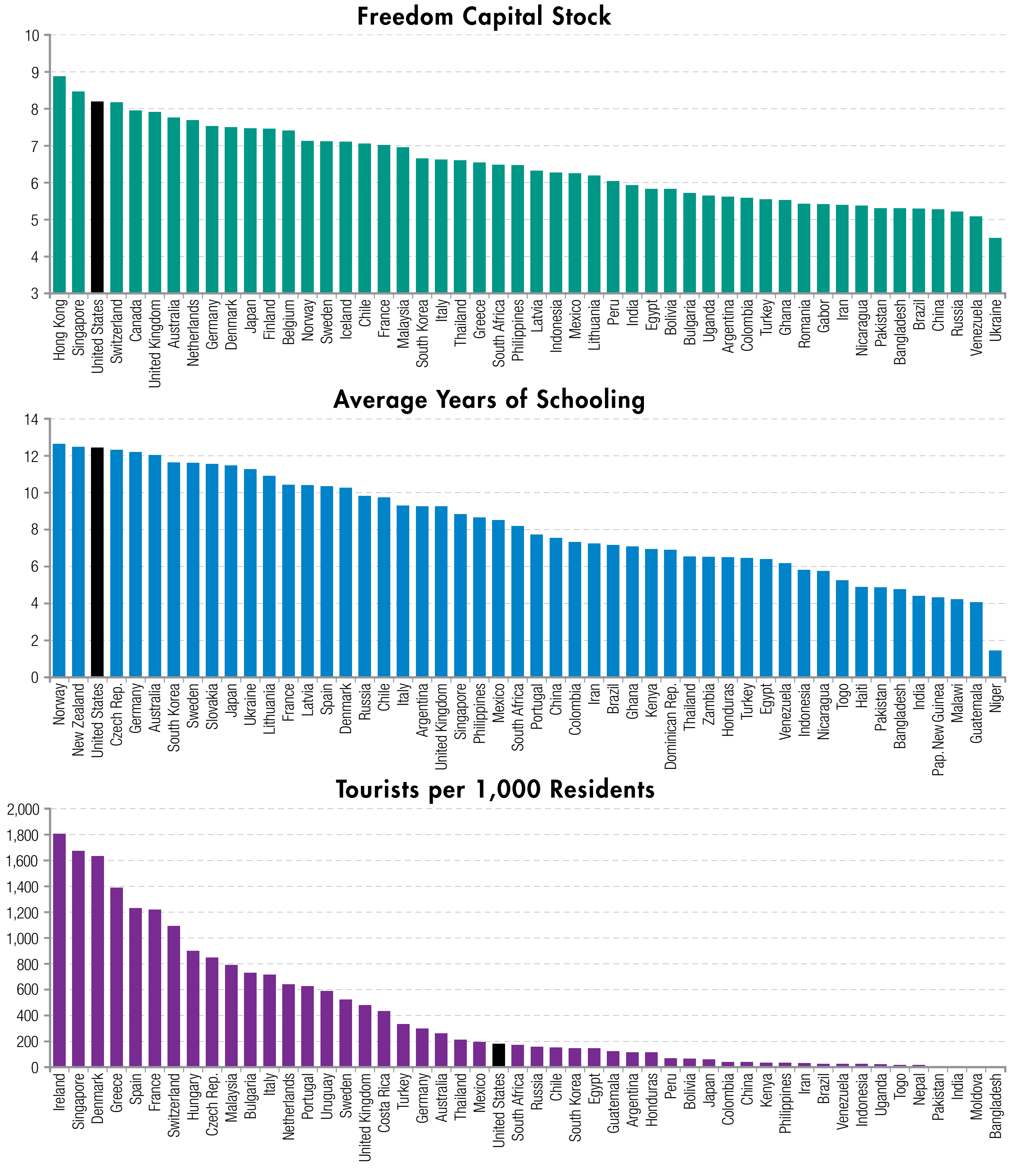


EXHIBIT 4

Building Blocks for Capital

An econometric analysis finds three factors that largely determine the differences among countries in capital stock per capita—the freedom capital stock (*top*), average years of schooling (*middle*) and tourists per 1,000 residents (*bottom*). The United States ranks highly in both freedom capital stock and average years of schooling.



the Czech Republic, Germany and Australia *(see Exhibit 4, middle)*. These countries also have high levels of physical capital.

By contrast, Haiti, Pakistan, Bangladesh, India, Papua New Guinea, Malawi and Guatemala are all below five years of schooling. The west African nation of Niger averages less than 1.5 years of schooling. Physical capital is also scarce in these countries.

The coincidence of intellectual and physical capital shouldn't be surprising. They're complementary inputs—more of one demands more of the other. For example, doctors, nurses and other highly educated medical professionals become more productive in hospitals with modern diagnostic equipment—MRIs, CAT scans, robotic surgery and the like. At the same time, it takes well-educated health-care workers to operate sophisticated medical machinery, so countries without them will find investing in the latest health-care technology a waste of money.

A successful tourism industry requires great dollops of capital investment. On the public side, visitors arrive at air and sea ports, travel around on roads and rails. On the private side, tourists need hotels, resorts, restaurants, rental cars and enjoyable places to spend their time. It costs a lot of money. Disney's Shanghai resort, for example, will represent a $5.5 billion investment by the time it opens for business in 2015.

Measured by foreign tourist arrivals per 1,000 residents, Ireland ranks among the global leaders at 1,800 visitors a year, along with Singapore, Denmark, Greece, Spain and France *(see Exhibit 4, bottom)*.

> **"In our analysis, a sustained legacy of economic freedom emerges as a potent force in building nations' capital stock."**

They've invested a lot in their tourism infrastructures, both public and private. Pakistan, India, Moldova and Bangladesh don't have highly developed tourist facilities, and they receive relatively few visitors.

The United States is an anomaly. It offers extensive, well-developed tourism and transport infrastructure, but it receives only 184 foreign visitors per 1,000 residents a year, about a tenth of Ireland's tourism business. Most likely, the U.S. domestic travel market is big enough to justify the country's extensive investments in tourism facilities. Since the September 2001 terrorist attacks, stricter visa requirements and other security precautions have made increasing international tourism a challenge for the United States.

Taken together, the differences among nations in freedom capital stock, years of schooling and tourism explain 75 percent of the variation in countries' capital stock per capita. Tourism makes only a small contribution, leaving freedom capital stock and years of schooling as the important drivers of physical capital per capita.

In our analysis, a sustained legacy of economic freedom emerges as a potent force in building nations' capital stock. It raises the capital stock per capita *directly* by forging a good investment climate over the long term. At the same time, it boosts physical capital *indirectly* by raising the incentives for education, a spur to capital investment.

Understanding why capital stock per capita differs among countries takes us a long way toward answering the essential question of the gulf between the "haves" and the "have nots"—why an American can consume an average of $32,720 a year while someone who lives in one of the world's poorest countries gets by on less than $3 a day.

Consuming Interest

Like the United States, Switzerland consumes an average of more than $30,000 a year, followed by Australia and Norway, both above $25,000 a year *(see Exhibit 5)*. Hong Kong, the United Arab Emirates, Japan, the major Western European countries and New Zealand consume at least $15,000 per capita.

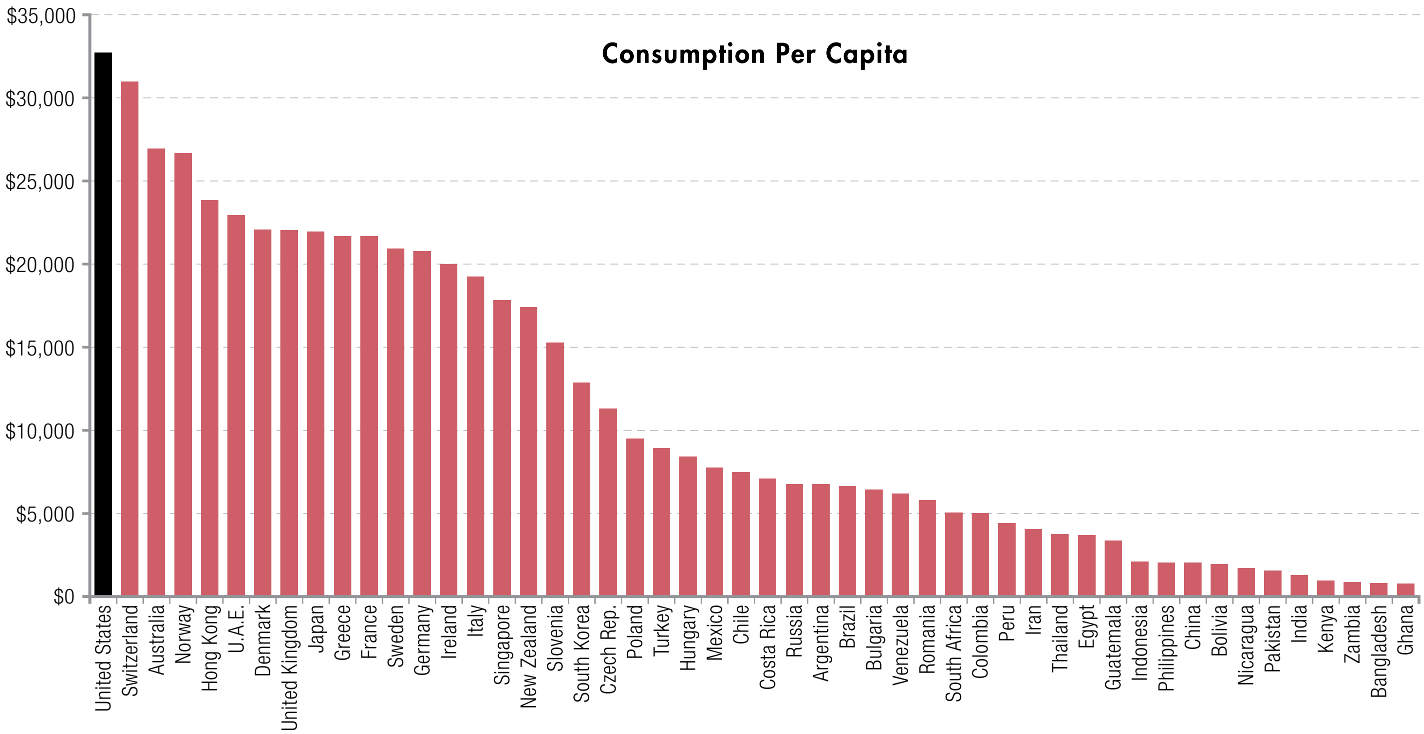
Countries spending between $15,000 and $5,000 a year include South Korea, Turkey, Russia and South Africa, joined by nations in Latin America and Central Europe. Some of the world's most populous countries are still consuming less than $5,000 per capita—China, India and Indonesia. Bangladesh and many countries in Africa are struggling with per capita consumption of less than $1,000 a year.

These low living standards were the norm for most of recorded history. An overwhelming number of our ancestors didn't consume much because they produced primarily with simple tools and muscle power, human as well as animal. Capital stock

EXHIBIT 5

Consumption by County

The United States leads the world's major countries with consumption per capita of nearly $33,000 a year. At the opposite end of the spectrum are residents of Zambia, Bangladesh, Ghana and other countries, whose consumption is just a small fraction of a typical American's.



per capita was paltry.

The arrival of the Industrial Revolution 200 years ago ignited history's first rapid accumulation of capital—in some countries more than others. Looking around the globe today, we see astonishing gaps in capital stock per capita, leading to just as astonishing differences in consumption per capita.

Bangladesh's low consumption per capita reflects its miniscule capital stock per capita *(see Exhibit 6)*. Both capital and consumption rise in tandem for most countries, including India, China, Argentina and Mexico. The United States and other wealthy countries have high levels of both consumption and capital stock per capita.

To identify the keys to consumption per capita, we ran a second regression, finding capital stock per capita an overwhelmingly important factor. Living standards also get a boost from economic freedom, measured by today's readings rather than the long-term perspective of freedom capital stock.

Today's freedom matters because it reflects the incentives for work, investment and all the other economic activities that contribute to GDP growth. Each country's legacy of economic freedom, of course, does influence consumption per capita, but its impact has been captured in our measure of the capital stock per capita.

Our analysis identifies a third significant factor that helps explain the differences in nations' living standards—energy production per capita.

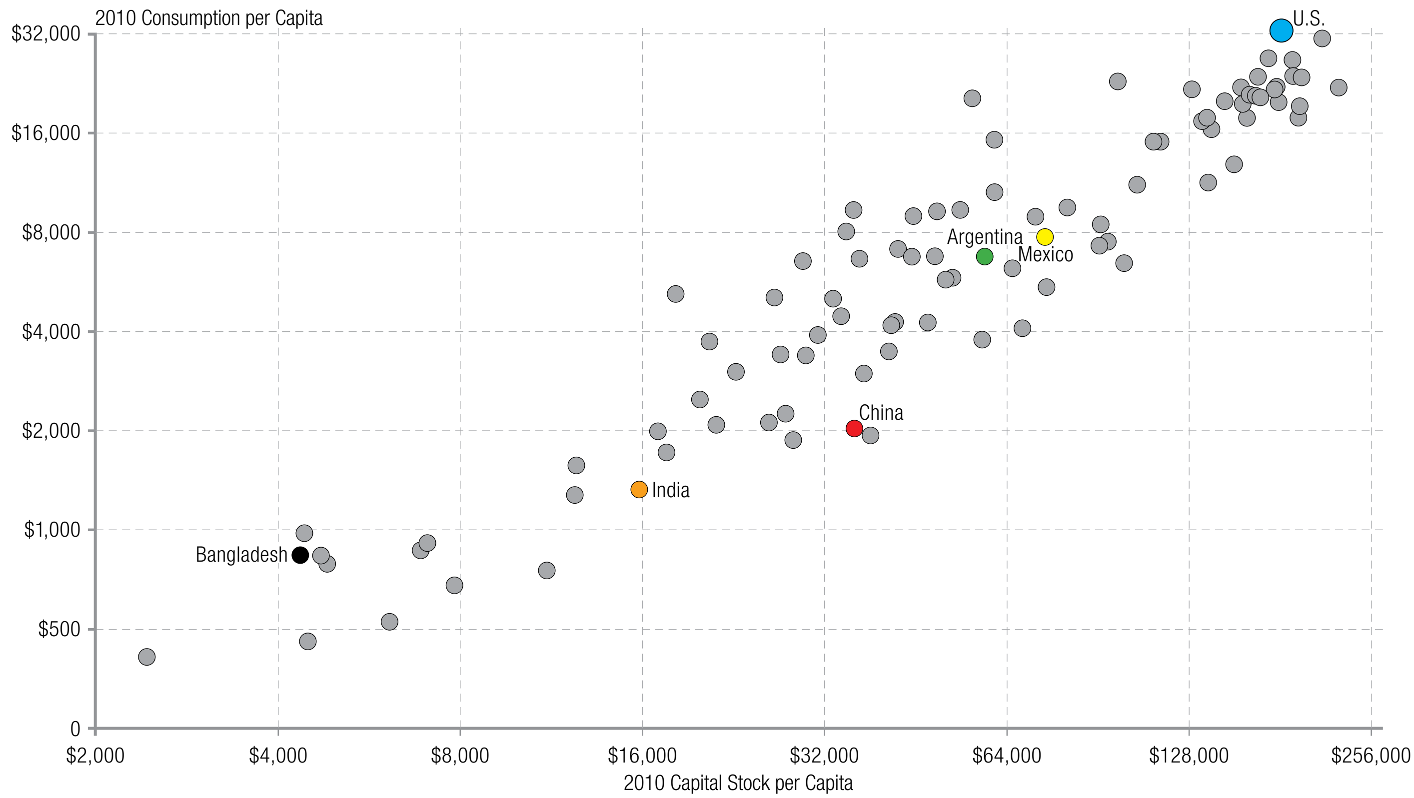
The transformation from muscle power to industrial capital brought with it more intensive use of natural resources, especially fossil fuels—coal, oil and natural gas. Modern economies literally run on relatively cheap, reliable energy supplies.

The world's leaders in energy production per capita include Kuwait, Norway, the United Arab Emirates (UAE), Bahrain and Canada *(see Exhibit 7)*. Only a small share of the energy these countries produce powers their domestic economies; instead, they export oil to pay for imports that boost consumption.

EXHIBIT 6

Capital and Consumption

A nation's capital stock per capita goes a long way toward determining its consumption per capita. Both capital and consumption rise from Bangladesh to India and China and on to Argentina and Mexico. The United States, with a high capital stock per capita, enjoys a high level of consumption.



The United States produces $238 in energy per capita—a figure that will surely rise with the surge in oil and natural gas output made possible by hydraulic fracturing, or "fracking." After the few big producers, average energy output falls off quickly, forcing most countries to rely on imports. Japan produces little energy, yet its large capital stock supports a high consumption level.

Norway, the UAE and some other top energy producers enjoy relatively high living standards. Not Russia or Venezuela—they're among also-rans in consumption per capita. Economists coined a shorthand description for their plight—"resource curse." When oil money gushes, some countries succumb to corruption and dole out subsidies, reducing incentives to work and grow the capital stock that will support higher living standards.

Average years of schooling didn't have a statistically significant and independent impact on consumption per capita—a somewhat surprising result given the strong correlation between education and income. It's not that intellectual capital doesn't influence consumption; instead, like freedom capital stock, it raises living standards by working in conjunction with physical capital, a fact verified by the strong link between years of schooling and investment in productive capital.

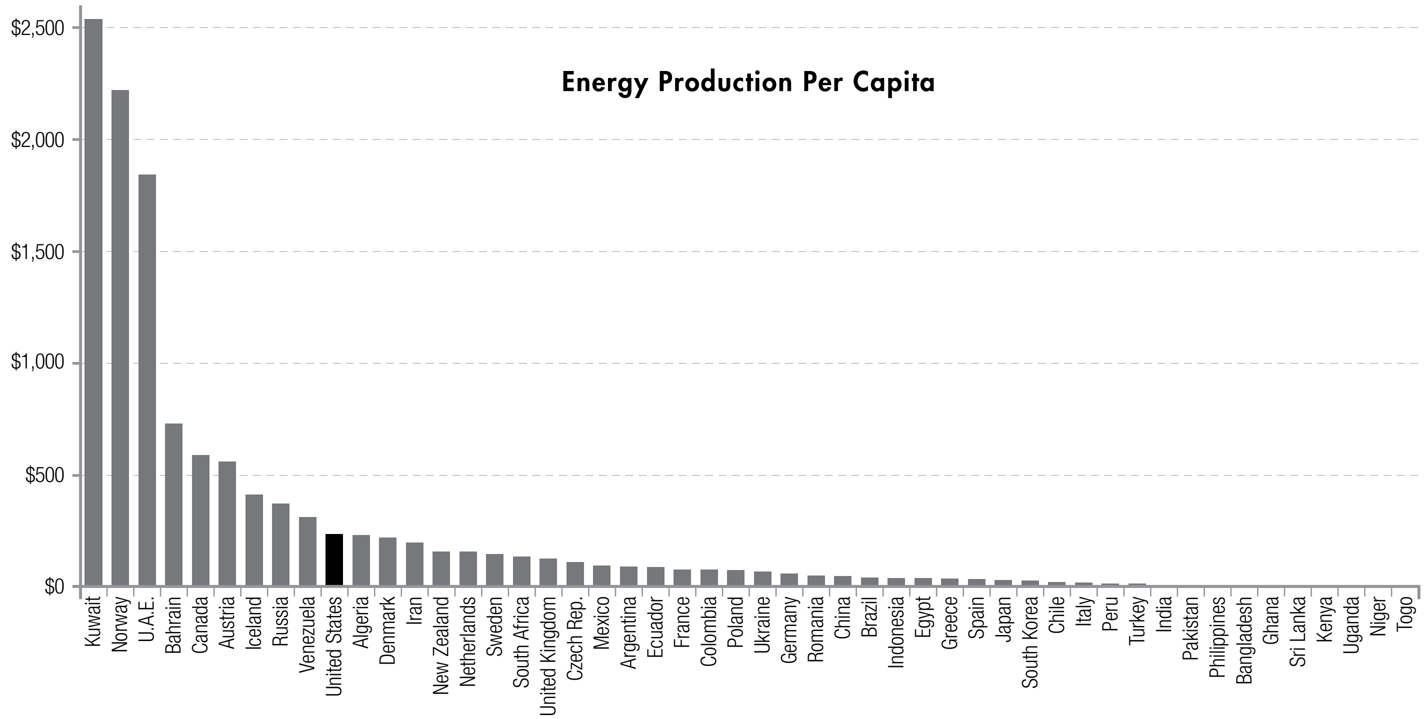
Taken together, capital stock, energy production and economic freedom explain more than 90 percent of the variation in consumption among nations. The contribution from energy production per capita is relatively weak. What's more, countries' energy output depends to a large extent on the accidents of geology—where organic matter settled to the bottom of ancient seas. Some non-carbon technology someday might transform the energy equation for countries like Japan, but it's not likely to happen any time soon.

In studying differences in consumption, the capital stock and economic freedom are more important, not just because of their greater impact on living standards.

EXHIBIT 7

Fueling Consumption

Energy production per capita is high in a handful of countries, providing a boost to consumption per capita. In most other countries, energy has only a small impact on consumption because of very low levels of energy production. New technologies and privatization promise to raise energy output—at least in some countries.



Unlike energy, the capital stock and economic freedom are malleable, arising within a country, shaped by its history, culture, values, economic policies and business climate. The capital stock and economic freedom are also inevitably intertwined—the size of a country's capital stock depends heavily on its legacy of economic freedom.

Above Our Means

Worldwide, economic freedom has been rising in recent decades, the result of market-based economic reforms, the demise of communism, a series of free-trade agreements, and political shifts in a number of countries. In 1985, the global average for the *Economic Freedom of the World* index was 5.33. It increased steadily to 6.58 in 2000; since then, progress has been more erratic, but the latest reading was 6.83 for 2011 *(see Exhibit 8)*.

Until 2000, the United States participated in the world's march toward greater economic freedom, its score rising from 7.6 in 1970 to 8.65 in 2000, when the country ranked second only to Hong Kong in economic freedom. Since then, U.S. economic freedom has been faltering, declining to 7.74 in 2011 and dropping the United States out of the Top 10 in the worldwide rankings.

Armed with measures of the capital stock and other economic fundamentals, we can calculate long-run expected consumption per capita for the 94 countries that have economic freedom scores back to 1970. Comparing expected to actual consumption tells us which countries are living below their means and which are above it—assuming they maintain today's levels of economic freedom over the next 40 years or so.

Because of the overall gains in economic freedom since 1970, 90 countries are consuming below their means, and they can look forward to rising living standards *(see Exhibit 9)*. After a long series of market reforms, China's actual consumption, for example, stands 56.3 percent below what its economic fundamentals warrant. To the west and south, India consumes 29.3 percent below its means. Just think of it: 2.5 billion people are likely to live much better in the decades ahead—a clear testament to the power of economic freedom.

Other countries consuming significantly below their means include Poland, Peru, Ukraine, Brazil, Bangladesh, Iran and Russia. They have the potential for better days ahead, based on continuing their current level of economic freedom.

Three countries are consuming slightly above their fundamentals—Switzerland at 2.2 percent, Netherlands at 2.5 percent and Iceland at 3.3 percent. These figures don't presage a drastic slowing in growth of consumption per capita. Venezuelans, on the other hand, can expect to see their living standards sharply constricted; today, their consumption is 51.3 percent above what could be sustained in the long term at currently depressed levels of economic freedom.

What about the United States? The economic fundamentals predict consumption per capita of $25,460 a year—a striking 22.2 percent below today's actual figure. We're living above our means, just as many Americans have sensed without any real proof—until now. Without any changes in underlying fundamentals, we can expect the average American's annual consumption to be $7,000 lower in the long term, compared to what it would have been without the recent erosion of economic freedom.

For Americans, the impact on living standards will most likely be gradual rather than sudden, perhaps manifested in sluggish income growth or masked by higher inflation. The

EXHIBIT 8

Trends in Economic Freedom

Since 2000, economic freedom has been declining in the United States and rising in the rest of the world (*top*). For most countries, recent economic freedom scores are above their long-term averages, represented by the freedom capital stock (*bottom*).

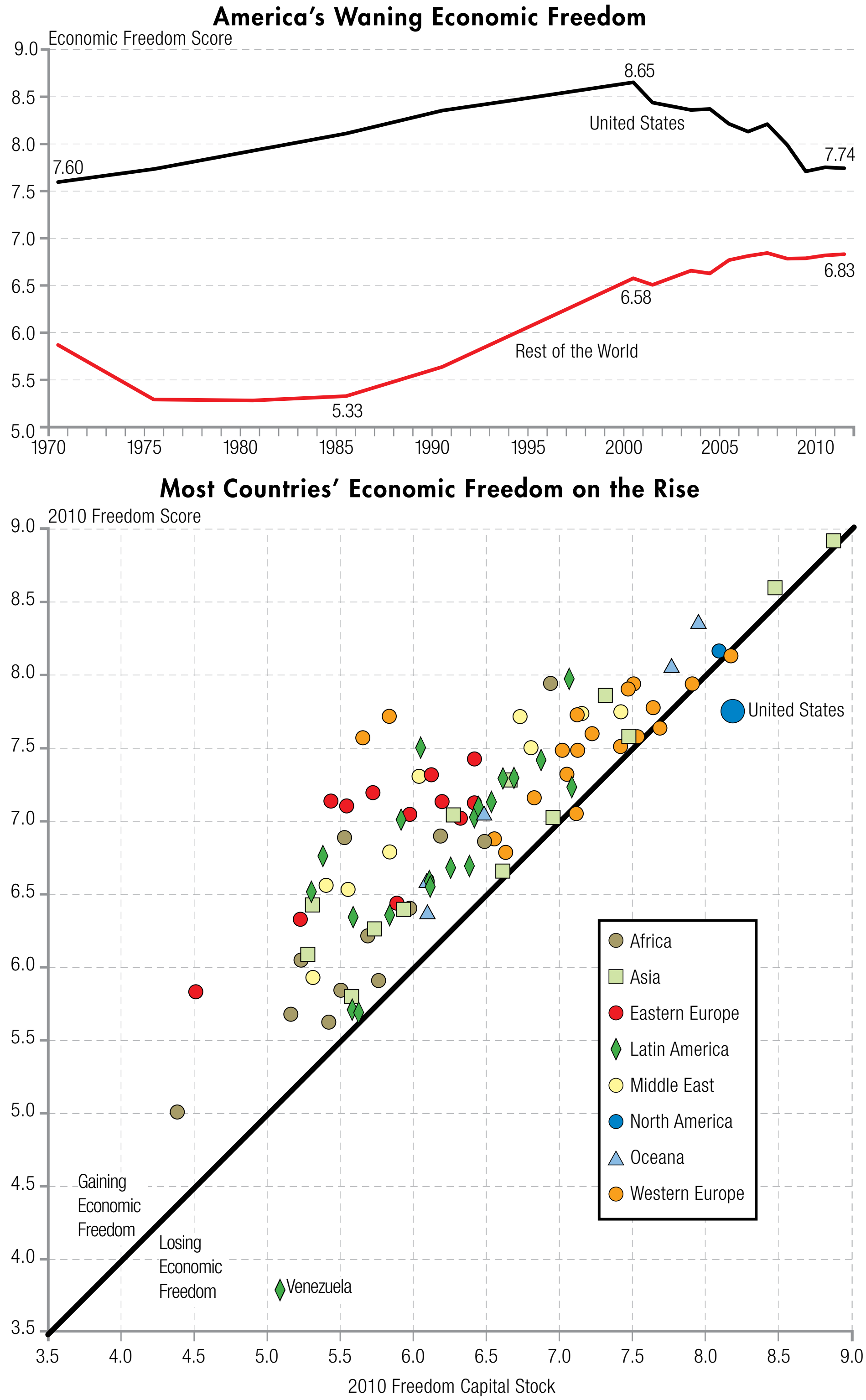
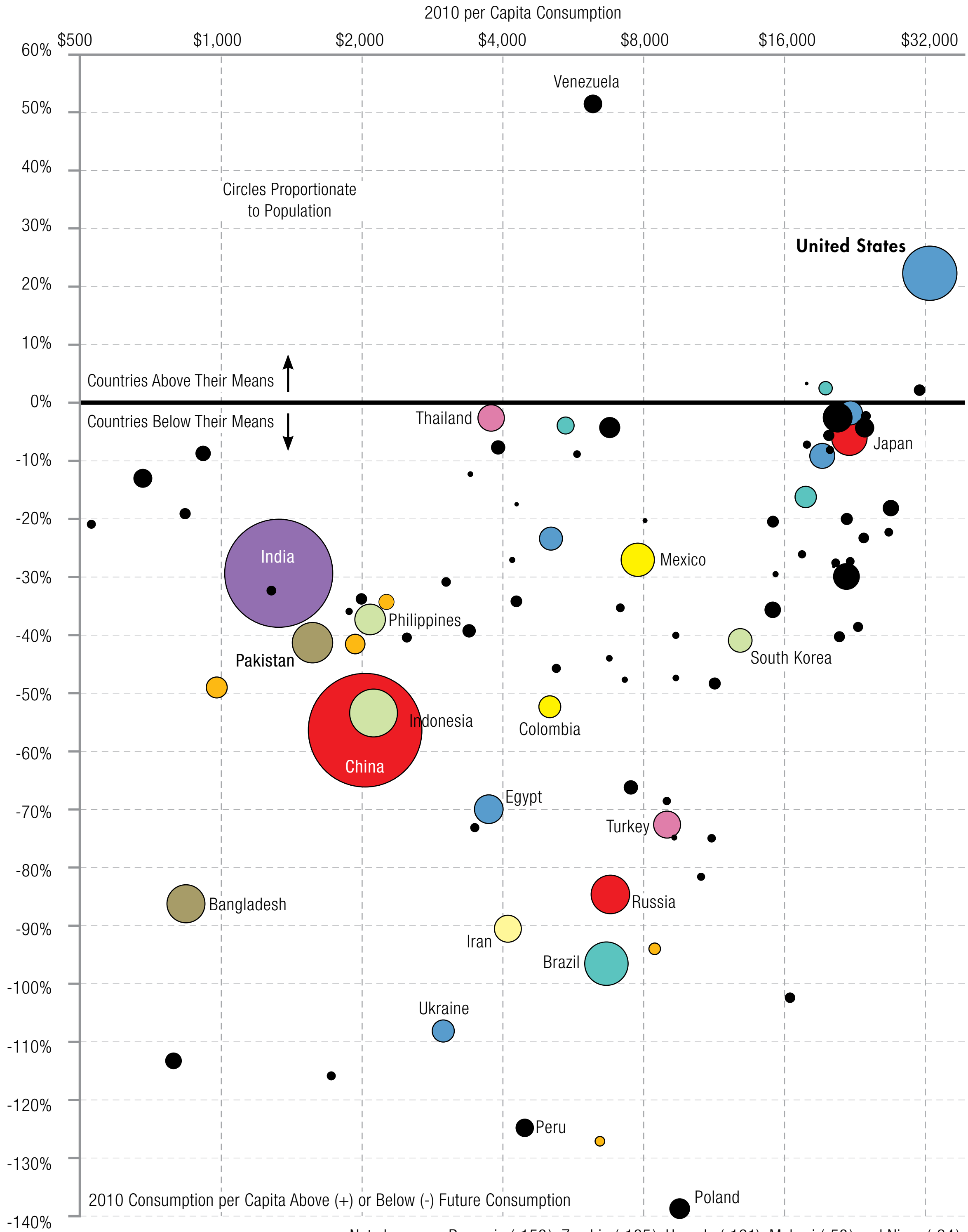


EXHIBIT 9

A Means Test that Matters

We estimate the long-term consumption per capita each country should achieve based on today's economic fundamentals. We then compare it to actual consumption per capita in 2010. Nearly all countries are living below their means, indicating they should see consumption rise. The United States, Venezuela and two other countries are consuming above their means.

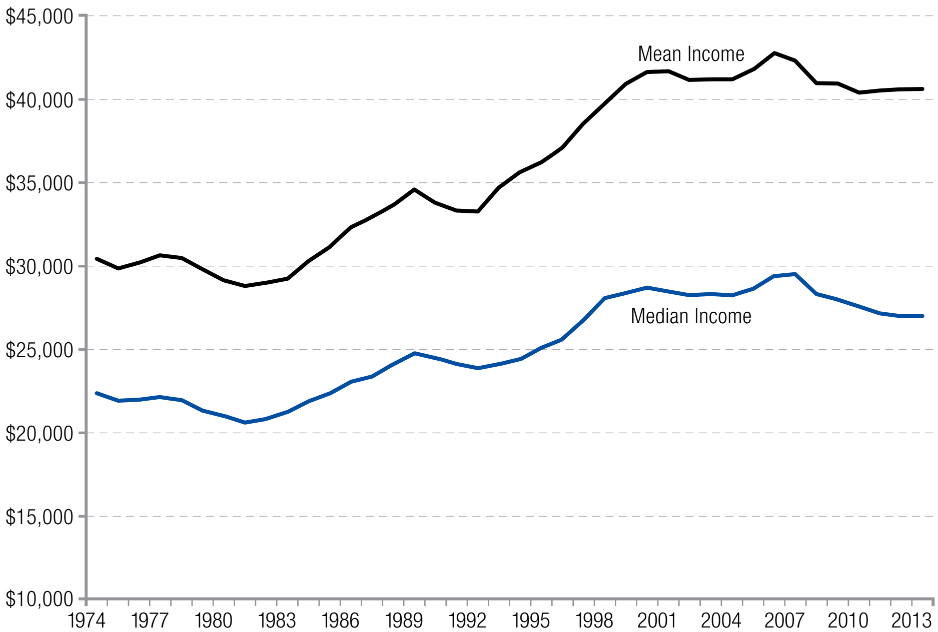


Not shown are Romania (-158), Zambia (-185), Uganda (-191), Malawi (-58) and Niger (-34). They are below either -140% on the vertical scale or $500 on the horizontal scale.

EXHIBIT 10

U.S. Income Ebbing

As economic freedom began to decline after 2000, income has declined, whether measured as average or median, making it harder for the country to maintain its consumption per capita.



country still has a large capital stock per capita, amassed over the decades of very high economic freedom, providing Americans a cushion to maintain living standards or even raise them at a slow rate.

If current levels of economic freedom persist into the future, however, incentives to build and maintain the U.S. capital stock will begin to deteriorate, eventually eating away at the growth of our consumption per capita.

Income data may already be signaling the ebbing of our capacity to consume. Both mean and median per capita incomes, which grew rapidly in the 1980s and 1990s, have fallen in the past decade *(see Exhibit 10)*. With less money to spend, Americans will find it increasingly difficult to maintain today's high living standards.

Finding Our Way Back

A Christmas Carol, Charles Dickens' classic paean to personal redemption, reaches its dramatic turning point when the spirit of Christmas Yet to Come shows Ebenezer Scrooge his bleak future. The grief-stricken old curmudgeon has the presence of mind to pose an eminently practical question: "Are these the shadows of the things that will be, or are they shadows of things that may be, only?"

Looking at the prospect of declining living standards, Americans might very well ask the same kind of eminently practical question. Are we condemned to consume less in the future, or can we take action to restore the country's upward trajectory?

The short answer is—yes we can, like Scrooge, change our destiny. The analysis presented in this report shows that maintaining a high level of economic freedom for the long term and improving the country's educational system will spur investment in the capital stock per capita. It also shows that building the capital stock and reversing the decline in economic freedom are key to achieving the highest living standards.

Our fate lies in our own hands. *We* determine our level of economic freedom. *We* decide how much to invest in building physical capital. *We* can insist on improving our schools through the choice and competition of the marketplace. If we do the right things, the country will see a return to the days of rapidly rising standards of living.

Foreboding about the future of America's living standards has historical precedent. The economy lay prostrate for much of the 1930s, with the pessimists declaring capitalism defunct. The oil shocks and inflation of the 1970s brought dismal predictions of a future marked by shortages of raw materials and food. In the 1980s, the intellectual fad was the unstoppable rise of Japan Inc. and the loss of U.S. competitiveness. Americans' fabled optimism usually shows up in hindsight.

Past pessimism proved unfounded. In uncertain times, the United States met the challenges at hand and continued to progress, largely because of its marvelously adaptable and resilient economic system. Unleashing American capitalism can work again, so it's vital that the United States restore its heritage of economic freedom—the sooner the better.

W. Michael Cox is director of the William J. O'Neil Center for Global Markets and Freedom (wmcox@cox.smu.edu). Richard Alm is writer in residence at the center (ralm@cox.smu.edu).

Notes and Data Sources

Exhibit 1:
Taking Stock in America

Pie chart: U.S. Department of Commerce, Bureau of Economic Analysis. Available at: bea.gov. Data are for 2012.

Table: U.S. Census Bureau, Statistical Abstract of the United States, various issues. Available at: census.gov and proquest.com. U.S. Army Corps of Engineers, National Inventory of Dams. Available at: geo.usace.army.mil. Center for Science and Democracy, Union of Concerned Scientists, UCS Satellite Database. Available at: ucsusa.org CRU, Optical Fibre and Cable Monitor. Available at: crugroup.com. The World Bank, World Development Indicators. Available at: worldbank.org. National ATM Council, Inc., U.S. ATM Industry. Available at: natmc.org. American Hotel and Lodging Association, 2011 Lodging Industry Profile. Available at: ahla.com. Computer Industry Almanac, Inc., Top 15 Countries in PCs In-Use. Available at: c-i-a.com. IDC, Digital Universe Study, sponsored by EMC. Available at: emc.com.

Exhibit 2:
Capital by Country

Scott L. Baier, Gerald P. Dwyer, Jr. and Robert Tamura. Available at: jerrydwyer.com. Data are for 2010. Selected countries.

Exhibit 3:
Economic Freedom by Country

The Fraser Institute, *Economic Freedom of the World*, 2013 Annual Report. Available at: freetheworld.com. Data are for 2010. Selected countries.

Exhibit 4:
Building Blocks for Capital

Top panel: The Fraser Institute, *Economic Freedom of the World*, 2013 Annual Report. Available at: freetheworld.com. Data cover 1970-2010.

Middle panel: Robert J. Barro and Jong-Wha Lee, "A New Data Set on Educational Attainment of the World, 1950-2010." Available at: barrolee.com. Data are for 2010.

Bottom panel: The World Bank, World Development Indicators—international tourism arrivals and population. Available at: worldbank.org. Data are for 2010. Selected countries.

Exhibit 5:
Consumption by Country

The World Bank, World Development Indicators—consumption and population. Available at: worldbank.org. Data are for 2010. Selected countries.

Exhibit 6:
Capital and Consumption

Same as Exhibits 2 and 4.

Exhibit 7:
Fueling Consumption

Energy Information Administration, International Energy Annual. Available at: eia.gov. Data are for 2010. Selected countries.

Exhibit 8:
Two Trends in Economic Freedom

Same as Exhibit 6.

Exhibit 9:
A Means Test that Matters

Same as Exhibits 2, 4, 6 and 7.
In calculating expected future consumption, we assume U.S. economic freedom levels off at its 2010 value for the next 40 years.

Exhibit 10:
U.S. Income Ebbing

U.S. Department of Labor, Bureau of Labor Statistics. Available at: bls.gov.

We thank O'Neil Center professor Robert Lawson for his help on this project.

Methodology

The discussion of consumption and capital stock relies on regression analysis performed by the authors. Using 2010 data for 94 countries, a regression with the capital stock per capita (K) as the dependent variable indicated a positive and significant coefficient for the economic freedom legacy variable (L), average years of schooling (S) and tourist arrivals per capita (T).

Each nation's economic freedom legacy (L) in 2010 was constructed as a declining-weighted average of current (year t = 0) and past (t = 1 to 40) levels of economic freedom (F), specifically $L_0 = \omega_0 F_0 + \omega_1 F_1 + \omega_2 F_2 + \ldots + \omega_{40} F_{40}$, where the $\omega_i = \lambda_i / (\lambda_0 + \lambda_1 + \lambda_2 + \ldots + \lambda_{40})$ sum to 1 and $\lambda_i = 0.95^i$.

With $(\log_2 K)^2$ as the dependent variable, the regression yielded coefficients (and t-statistics) of 36.393 (2.065) on the intercept, 13.273 (3.915) on L, 10.460 (7.741) on S and 4.391 (3.182) on $\log_2 T$. All coefficients were significant at the 99 percent level, with an adjusted R^2 of 0.761.

Using 2010 data for the same 94 countries with consumption per capita (C) as the dependent variable indicated a positive and significant coefficient for the capital stock per capita (K), economic freedom (F) and energy production per capita (E).

With $\log_2 C$ as the dependent variable, the regression yielded coefficients (and t-statistics) of 3.450 (7.456) on the intercept, 0.028 (18.720) on $(\log_2 K)^2$, 0.282 (3.466) on F and 0.053 (2.939) on $\log_2 E$. All coefficients are statistically significant at the 99 percent level and the adjusted R^2 is 0.906.

Earlier regressions that also included years of schooling (S) and tourist arrivals per capita (T) indicated no statistically significant explanatory power for either variable. The combined results indicate that schooling is significant in raising consumption only when it appears in conjunction with physical capital, not alone.

A Conversation with William J. O'Neil

A Legendary Investor's Quest for 'Boatloads of Opportunity'

Born in Oklahoma City and raised in Texas, William J. O'Neil graduated from Southern Methodist University with a business degree in 1955. After a stint in the Air Force, he joined a brokerage firm, quickly becoming its top performer. In 1963, O'Neil started his own firm—William O'Neil & Co. At age 30, he became the youngest person to buy a seat on the New York Stock Exchange.

Bill O'Neil's investment mantra is "buy the strong, sell the weak." He's a pioneer in using computers and large databases to uncover trends and hidden gems in the stock market. His stock market success led to three books on investing—*How to Make Money in Stocks* (1988), *24 Essential Lessons for Investment Success* (1998) and *The Successful Investor* (2003).

In 1984, O'Neil launched *Investor's Business Daily*, a newspaper heavy with financial news, stock market analysis and editorials. The newspaper also provides news and financial data on the Investors.com website.

O'Neil lives in Los Angeles, still involved in his investment firm and newspaper at age 81. He's donated money to the SMU Journalism Department, and his 2008 gift to the SMU Cox School of Business led to the creation of the William J. O'Neil Center for Global Markets and Freedom.

Q: How did you get started as an investor?

A: I began with nothing, really, and I did well to finally put together $500. That's what got it started—this was 40 or 50 years ago. I was investing in the stock market little by little, and finally I started to do some things right. If you start investing in the stock market, sooner or later you get into a new bull market and if you can buy the leaders, you can make a lot of money. I bought two leaders—Chrysler doubled and Syntex, a drug company, tripled.

Q: And you've done this over and over for decades?

A: Every cycle has new leaders—and it never stops. It helps to have charts so you can see which ones are emerging, but I never buy anything because of a chart; I buy because they've got a great product, the earnings are up 100 percent and sales are booming … that sort of thing. Every cycle has boatloads of new opportunities, so it's not that complicated as long as you save some money and do your homework.

Q: What kind of homework should investors be doing?

A: The first thing you want is some way to judge what kind of market you're in—a bull market, an uptrending market, or a bear market, a downtrending market. If you look at the past 50 years, you go through a bear market; it lasts a year, and all of a sudden you come out and go two or three years up, and there are some new leaders—the stocks that have the biggest percentage increases in earnings and sales, maybe a high return on equity and some new product.

William O'Neil

Every bull market has three or four new leaders, and usually they will do far more than just a doubling or tripling. If you do your homework, sooner or later you get into some. I would usually add a little more to it if it's working. If it's not working, and I'm beginning to lose money, I'll start cutting losses at 5, 6, 7 or 8 percent. I don't let anything go beyond that. When I'm wrong, my average loss is probably 4 or 5 percent; when I'm right, the gains are 20, 50 and 100 percent.

Q: Why did you start *Investor's Business Daily*?

A: We had done well in the market, and we understood it. I knew that almost half the people in America invested, and most of them didn't really know that much about it or they didn't study it that hard. I felt we could provide better and sounder information, and we could help people. If they take it, and they dig a little deeper and do some real homework, it's got to improve their performance.

2013: Year in Review

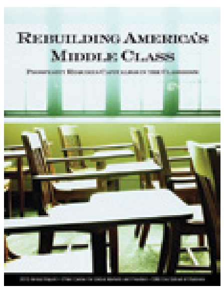
The William J. O'Neil Center for Global Markets and Freedom made education and its role in the economy a centerpiece of its activities in 2013.

The center's fourth annual report featured an essay titled *Rebuilding America's Middle Class: Prosperity Requires Capitalism in the Classroom,* written by director W. Michael Cox and writer in residence Richard Alm. It identifies the main cause of the American middle class' relative decline—public schools' relatively poor performance.

The O'Neil Center's annual conference focused on "Entrepreneurship in Education: The Key to Rebuilding America's Middle Class." Presentations covered the surprising growth of private schools in poor countries, innovative education at the grade school and university levels, the growth of U.S. charter schools and what education really signals to employers in the marketplace.

In a series of articles in Dallas' *D CEO* magazine, Cox and Alm put a Texas twang on the center's study of the economics of education. Based on the center's research, the articles showed that bigger budgets haven't improved Texas' schools (*see inside back cover*), that adjusting for ethnicity improves the state's national ranking in test scores and that low living costs mean that the real payoff from higher education is better in Texas than in other states.

O'Neil Center professor Robert Lawson and his co-authors produced the *Economic Freedom of the World* report for 2013. The 17-year-old research project provides an empirical measure of economic freedom in 153 countries, based on the size of government, legal system and property rights, sound money, freedom to trade internationally and the scope of the regulatory burden.



The report continued to find declining economic freedom in the United States. The country's *EFW* scores have been falling since 2000, when the country ranked second in the world. It was 17th in the latest edition, based on 2011 data (*see opposite page*).

"Increased government spending and regulation are partly to blame for the decline in the U.S. score, but the biggest cause is weaker private property rights and rule of law dating back to 2000," Lawson said.

The *EFW* index figures prominently in an upcoming movie. In November, Lawson traveled to Montreal for on-camera interviews for *Changing Lives: Economic Freedom in Action*, a film by the Free to Choose Network. It will be shown on PBS stations early in 2014.

The O'Neil Center launched a Youth Initiative to focus on a younger audience—roughly ages 16 to 30. "This is a demographic with a distorted view of capitalism taken from the media, politics and even their schools," Cox said. "The Youth Initiative will directly confront these misconceptions by developing programs to help the next generation of leaders understand and appreciate how free enterprise works to deliver progress around the world."

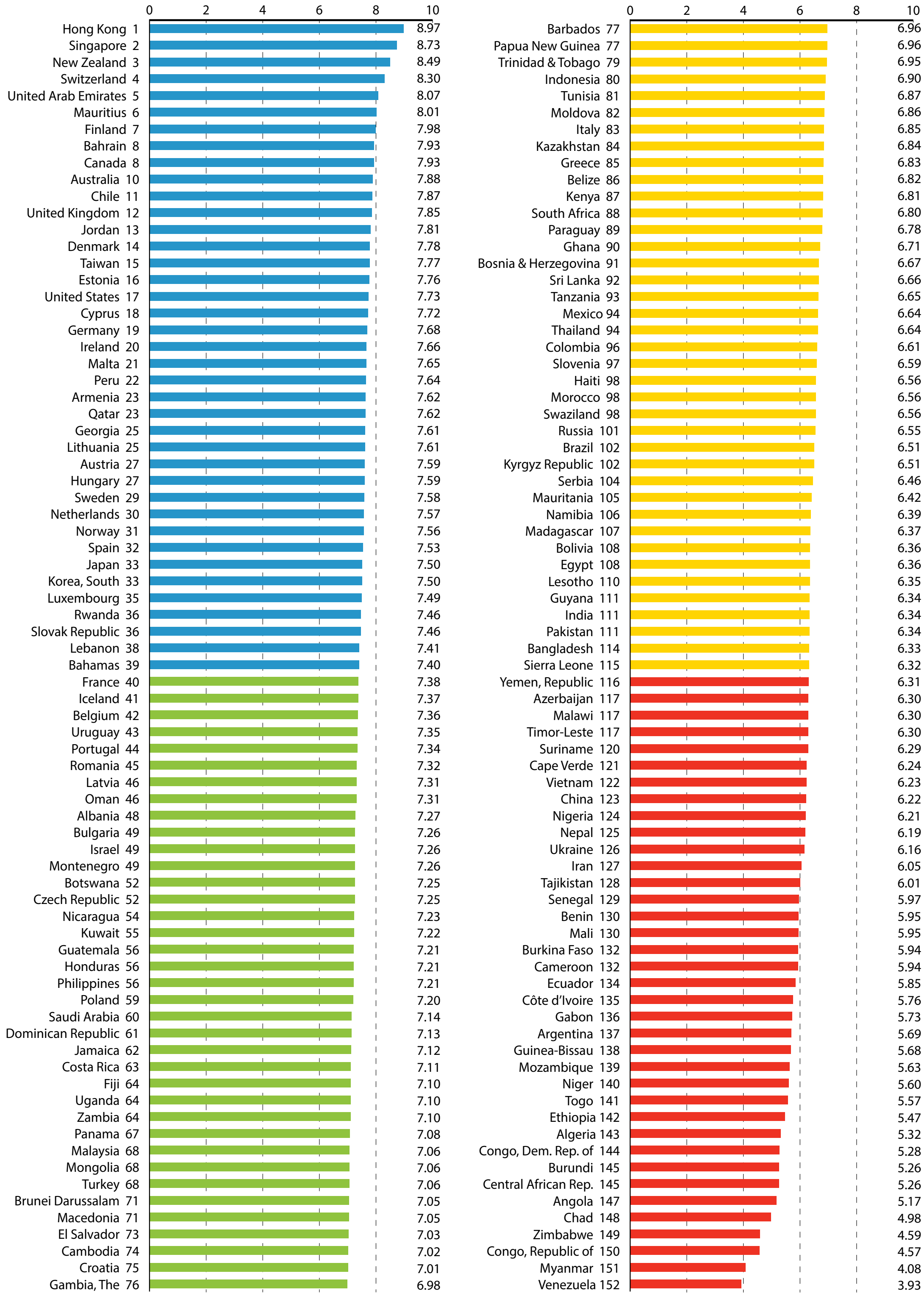
The initiative will develop videos and online resources based on O'Neil Center research and promote them through the electronic media favored by today's youth. It will also create Millennial Generation groups for the study and discussion of economic freedom, both on campus and off.

As part of the Youth Initiative, the O'Neil Center received a grant from Capital One Bank for a Liberty and Markets Reading Group to introduce some of the brightest SMU undergraduates to the ideas of free markets and economic liberty. Students will not get course credit for participating in the program; instead, they will receive a $1,000 stipend. The first reading group will meet in the spring semester of 2014.

Kathryn Shelton, an O'Neil Center research associate for three years, was named manager of the Youth Initiative. She organized a Dallas chapter of America's Future Foundation, a free market group, and gave guest lectures on economic freedom at the Episcopal School of Dallas and high schools in Cleburne.

The O'Neil Center created an advisory board in the fall of 2012, composed of local business, civic and philanthropic leaders and led by Jerry Fullinwider, its chairman. The board met twice in 2013. In February, it discussed the center's activities and funding needs. Highlighting the second meeting was a briefing by Dallas Federal Reserve Bank chairman

Exhibit 1.2: Summary Economic Freedom Ratings for 2011



Richard Fisher, who gave his views on monetary policy and the Texas economy.

Fullinwider, a Dallas oil and gas entrepreneur, was among the founders of the pro-free enterprise Institute for Humane Studies, now at George Mason University. On behalf of the Association of Private Enterprise Education (APEE), Lawson presented Fullinwider with the organization's Herman W. Lay Award in recognition of his five decades of philanthropy and service to the cause of economic freedom.

O'Neil Center Conference

In September, about 300 business leaders and students gathered at SMU's James M. Collins Executive Education Center for the O'Neil Center's fifth annual conference, focusing on how entrepreneurs are improving educational quality and creating new learning models for the Internet generation.

Cox led off with a presentation based on the annual report essay. According to Cox, education has become increasingly important as the United States transitions to a globalizing, knowledge-based economy. Our educational system, however, turns out too many students who are unprepared for jobs that pay middle class wages or above.

"The responsibility for the great hollowing out of America's middle class lies squarely at the feet of our public schools," Cox said.

Over the past 40 years, America has tried to fix its schools by spending more money. It hasn't worked—student test scores are stagnant to falling. The path to better schools—and a revival of the middle class—lies in applying the tried-and-true forces of capitalism: choice and competition. What put better and cheaper mobile phones in our pockets can make America's public schools among the world's best.

James Tooley

The conference's other speakers and their presentations were:

James Tooley, professor of education policy, University of Newcastle upon Tyne: An inspiring story about education emerges from the poorest communities of India, China, Ghana, Nigeria, Kenya and other developing countries. In all these places, Tooley found hundreds of private schools giving students a good education for a few pennies a day.

A hundred low-cost private schools operate in a Nairobi, Kenya, slum. A shanty town in Lagos, Nigeria, has 35 of them. In a rural Chinese province, Tooley located 586 low-cost private schools.

According to Tooley, parents are willing to pay to educate their children because government-run schools in poor countries are abysmal or non-existent. Teachers don't show up; when they do, they sleep rather than teach.

Tooley tested the students in these countries, finding that the low-cost private schools did a better job of teaching than public schools and even nonprofit private schools. "It's a really exciting picture," Tooley said, "a real praise of the profit motive in education."

Tooley believes that low-cost private schools will work in the United States to give poorer families an alternative to public schools by offering a good education for as little as $2,500 a year—a tuition working-class families can afford.

Jeff Sandefer, founder of Austin's Acton MBA and Acton Academy: The

Acton MBA is, to use Sandefer's words, a "Navy Seal program for entrepreneurs," and Austin's Acton Academy has been hailed as one of the nation's most innovative schools, teaching kindergarten through high school.

Sandefer has viewed the 21st Century disruptions in education from the trenches. He's come away believing that students don't learn well in a traditional system that emphasizes sitting still, regurgitating facts, submitting to authority and shutting down when bells ring.

"Engaged learners learn three times faster than normal kids, and they love it," Sandefer said.

Sandefer evoked Superman, Google, Alcoholics Anonymous and the Boy Scouts to illustrate his points.

Jeff Sandefer

Superman: Genius comes in many forms. "You have to believe that every child who enters the room is a genius who's going to change the world," Sandefer said. "If you believe they're going to be heroes and change the world, they believe it too, and they'll learn at amazingly fast rates."

Google: Teachers don't need to lecture. Students can find the information they need in Internet searches and online courses, freeing time for real-world apprenticeships and game-based quests that take them, for example, to Edison's lab.

Alcoholics Anonymous: Instead of rules imposed from above, students create their own covenants and contracts each year—the promises are clear; the consequences are clear.

Instead of grades, students track their own progress, creating a portfolio of goals, apprenticeships, online classes, books read and other activities. "When it comes time for college or a job, you can prove what you can do," Sandefer said.

Boy Scouts: Learning badges recognize students for independent learning, helping others reach a common goal, leading Socratic discussions and guiding projects.

Bryan Caplan, professor of economics, George Mason University: More years of schooling lead to higher incomes—our parents told us that, and economists produce the statistics to verify it. Caplan doesn't deny the data, but he's noticed that few jobs actually rely on knowledge of Shakespeare, foreign languages, music, art or, for that matter, trigonometry.

"Most classes teach no jobs skills at all," Caplan said. "Shakespeare. You learn English as it was spoken 400 years ago—not a very useful skill in the modern job market."

Bryan Caplan

Employers face a problem in making hiring decisions. With a pile of resumes, it's hard to tell in advance which applicants will make good workers. Some schooling raises productivity, but the real value of hiring workers with more years of education and diplomas lies in the signals of desirable traits in the labor market—innate intelligence, work ethic, conformity, willingness to persevere in accomplishing assigned tasks.

"The beauty of the signaling model is that it works even if students, workers and employers don't understand it," Caplan said.

Using education as a signal leads to overinvestment in education as more students parade off to campus to match their peers' labor market credentials. It also hurts the economy. If educated workers aren't more productive but are paid more, it becomes more expensive to turn out goods and services, lowering average consumption.

According to Caplan, the signaling model leads to two conclusions for education. Society should spend less subsidizing it. The emphasis should shift to vocational training—teaching true job skills.

Eugenia Toma, professor of public policy, University of Kentucky: Although publicly funded, charter schools operate free of the worst aspects of the educational bureaucracy and incorporate essential aspects that make markets work—choice and competition. Students and families choose where to enroll; schools that offer a good education will prosper, and those that don't will go out of business.

Eugenia Toma

Regulations vary widely from state to state, but the charters have been gaining ground amid frustration with traditional public schools. In 2013, about 41 states and the District of Columbia had established 6,200 charter schools, up from 500 in 1998. "It's not a huge revolution yet," Toma said.

Do charter schools work? According to Toma, studies are finding some positives, such as higher graduation rates. Charters require less public revenue. Schools that don't attract enough students fail the test of the marketplace, with more than 150 charters a year going out of business.

The number of charter schools probably will continue to grow. "It's purely voting with your feet," Toma said. "No one has to attend these schools, but families are choosing them, and they're choosing them over the alternatives, both in the private and public sector."

Videos of all presentations from the O'Neil Center's five conferences are available online at oneilcenter.org.

W. Michael Cox, Director, William J. O'Neil Center for Global Markets and Freedom

Albert W. Niemi Jr., Dean, SMU Cox School of Business

Dwight R. Lee, William J. O'Neil Endowed Chair in Global Markets and Freedom

Michael Davis, Senior Lecturer, SMU Cox School of Business

Articles and Presentations

Founded in 2008, the O'Neil Center continued to build its reputation as a voice for free-market economics in 2013.

Professor Dwight R. Lee cracked the *Wall Street Journal*'s prestigious op-ed page with "A Higher Minimum Wage—But Not for Interns in Congress." Politicians refuse to pay the minimum wage, Lee pointed out, but they'll try to raise it for the private sector.

Lee has been among the leading authorities in Public Choice, a branch of economics that analyzes incentives in the public sector and voting. In 2013, he edited a book titled *The Origins of Public Choice: The Legacy of Buchanan and Tullock* and contributed a chapter on *The Calculus of Consent,* the seminal work by Nobel laureate James Buchanan and Gordon Tullock.

Lee's "Reducing Income Inequality at the Expense of the Poor" appeared in *The Freeman*. He wrote three pieces for the Library of Economics and Liberty—"Socially Responsible Corporations: The Seen and the Unseen," "The Two Moralities of Ebenezer Scrooge" and "Do the Poor Vote Their Self-Interest?" Lee teamed with Alm to write "Don't Californize Texas" for *Regulation* magazine and "The Case for Abolishing Federal Taxation" for the *Journal of Private Enterprise*.

In *D CEO* magazine, Cox and Alm showed that CEOs' paychecks were actually higher in Dallas and Houston than in other major cities, once they made an adjustment for Texas' lower cost of living. For Bloomberg View, Cox and Alm wrote "Amend Texas Constitution to Hogtie Public Spending."

In a short essay for *Regulation* magazine, O'Neil Center professor Michael Davis took on the anti-fracking environmental utopianism evoked by the makers of the films *GasLand* and *GasLand II*.

Shelton co-authored two Heartland Institute articles with University of California-Irvine Professor *Emeritus* Richard McKenzie—"Why Student Loans Have Grown into a Policy Debacle" and "Food Stamps and the Fungibility of Money Lead to Unintended Outcomes."

The *Atlantic Economic Journal* published "Alchian and Allen Revisited: Law Enforcement and the Price of Weed," written by Lawson and a co-author. Lawson and Larisa Burakova, his Georgian co-author, completed *Georgia's Rose Revolution: How One Country Beat the Odds, Transformed Its Economy, and Provided a Model for Reformers Everywhere*, a book scheduled for publication in early 2014.

The annual APEE conference brings together free enterprise scholars from around the world. At the 2013 meeting in April, Lawson made two presentations based on his research—"Do Travel Visa Requirements Impede Tourist Travel?" and "Grouping Countries by Economic Freedom using K-Means Clustering."

At the same meeting, Alm presented a paper co-authored with Cox on "Economic Freedom and the Returns to Education." Lee participated in a panel on "Redeeming Economics" and gave a talk on "The Two Moralities of Ebenezer Scrooge," a twist on the Dickensian fable that takes issue with the demonizing of business owners and lenders.

Cox, Lee and Lawson have all been past presidents of APEE, and Lawson and Lee continue to serve on the association's board of directors. In 2013, APEE recognized Lawson's years of services with the Kent-

Robert Lawson, Jerome M. Fullinwider Endowed Centennial Chair in Economic Freedom

Richard Alm, Writer in Residence, William J. O'Neil Center for Global Markets and Freedom

Kathryn Shelton, Manager, Youth Initiative, William J. O'Neil Center for Global Markets and Freedom

SMU COX

Arthur Brooks

Aronoff Award. For decades, Lee had a scholarly collaboration with James Buchanan, who died early in 2013. In February at SMU Cox and at the Southern Economic Association in November, Lee led colloquiums evaluating Buchanan's work, while sharing warm reminiscences of his friend and colleague.

"You'd submit a paper to Jim one day," Lee recalled, "and he'd hand it back to you the next day with ideas and implications you never even thought of."

Cox remained an in-demand speaker, not only in the North Texas area but also in other parts of the country. In 2013, he delivered three dozen speeches to business and civic groups on such topics as the good news about Texas' economy and the importance of alternative investments at a time of slow growth. Lawson delivered 14 speeches on the economic freedom research, mostly to audiences of college students.

Cox starred in an online video on "How Nations Succeed," sponsored by the Fund for American Studies.

The O'Neil Center brought several guest speakers to the SMU campus. In February, Arthur Brooks, president of the American Enterprise Institute and author of *The Road To Freedom*, gave a powerful lecture on the morality of capitalism to an audience of 200 guests.

In October, Keith Hankins of the Arizona Center for the Philosophy of Freedom presented an O'Neil Center academic seminar title "A Skeptical Look at the Case for Property-Owning Democracy," a critique of John Rawls. Another seminar featured Samford University's Art Carden, who lectured on "The Bourgeois Era: Why Some Places Are Very Rich While Other Places Are Very Poor."

Teaching and Media

Being on the SMU campus gives O'Neil Center professors the opportunity to teach the business leaders of tomorrow. Lee and Lawson handled the microeconomic and managerial economics classes for all three SMU Cox MBA programs.

In addition to his summer markets and freedom class, Cox continued to teach the money and capital markets class for undergraduate business students. Each year, Davis teaches a wide range of courses—from one on decision-making under uncertainty to another on international finance.

SMU Cox Dean Al Niemi has been a part of the O'Neil Center since it was formed five years ago. In the fall semester, he taught his popular course on the evolution of American capitalism at the MBA level.

Cox continued to lead the business school's ongoing Women's Economics and Finance Series, giving presentations on topics such as the next age in American progress, how to make good money in a bad economy and how to fix America's schools.

Davis traveled to Europe with the Professional MBA students and to Asia with Full-Time MBA students as a part of the Global Leadership Program, an initiative designed to teach business leaders the economic, social, political and cultural forces impacting the way business is conducted in the global marketplace.

The media regularly sought the expertise of O'Neil Center faculty members. For television and print outlets, Davis covered a range of subjects related to the local, state and national economies. He opined on the demise of the Irving, Texas, company that sold Twinkies, the impact of illegal immigrants in Texas and Washington's budget battles between President Obama and Congress.

Cox continued to be a regular on Fox Business' national coverage of Federal Reserve activities, joining other commentators for an on-air discussion of the central bank's policy-making meetings and the subsequent press conferences by Chairman Ben Bernanke.

At the end of the academic year, both Cox and Davis were among SMU Cox's Top 10 professors in media interviews and citations. It's an honor they have won for four years in a row.

Not Making the Grade

When it comes to **Texas public schools**, taxpayers are paying more, but not getting more.

BY **W. MICHAEL COX AND RICHARD ALM**

Mid-1980s cell phones were 5-lb. bricks costing more than $4,000. Today's pocket-sized devices sell for $49 and allow users to make calls, access the internet, check email, take pictures, and a lot more. That's consumer nirvana—paying less and getting more.

The same cannot be said for public school funding. For decades, taxpayers have been paying more and getting the same old thing.

Andrew Coulson, director of the Cato Institute Center for Educational Freedom, found the nation's spending per student, adjusted for inflation, increased steadily from 1970 to 2009 (see top graph). America didn't get much for the money. Student performance, measured by reading, math and science test scores for 17-year-olds, has been flat.

Coulson's graph makes an important point: Spending more money hasn't improved the quality of education. Over the decades, U.S. students have fallen farther behind their counterparts in other countries.

In Texas, state-level education data isn't readily available, so we could only track trends in spending and student performance back to 1990. Over the two decades, per-student spending, adjusted for inflation, has risen nearly 50 percent. Meanwhile, reading scores for eighth graders have been flat, while math scores have risen slightly (see middle graph).

For the nation, enrollment in public schools has been flat over the past 40 years. Employment in education—teachers, yes, but administrators and support staff, too—nearly doubled.

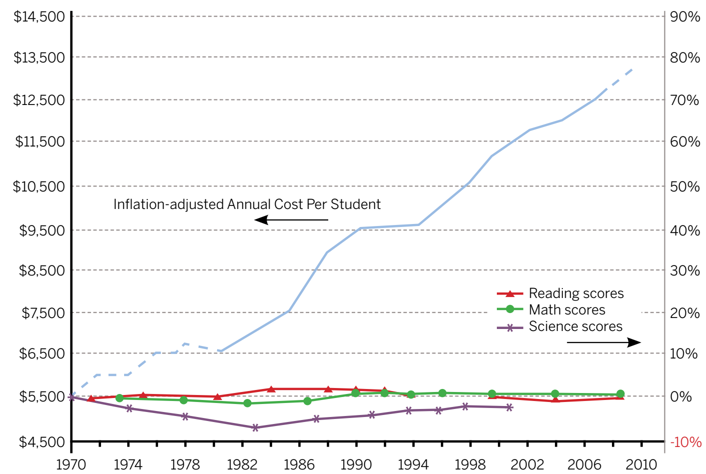
The Texas story is a bit different. Population growth has meant a growing number of students. However, school employment has risen even faster (see bottom graph).

Across the country, taxpayers haven't gotten much for throwing more money at education. Yet we cling to the idea that more spending will improve learning. Each report of stagnant test scores brings fervent pleas for more spending.

Which brings us back to the consumer nirvana of the cell phone. We pay less and get more because market forces drove down costs and spurred innovation. Public schools are monopolies, heavily regulated, unionized, and bureaucratic. Incentives to reduce costs or increase quality are stunted. The way to better education lies not in more spending, but in more competition within our public school systems.

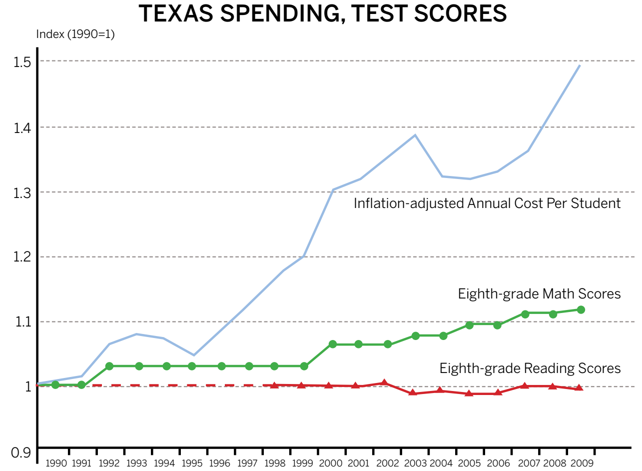
Cox is director of the William J. O'Neil Center for Global Markets and Freedom at Southern Methodist University. Alm is writer in residence at the center. Research associate Kathryn Shelton contributed to this article.

U.S. SPENDING, TEST SCORES



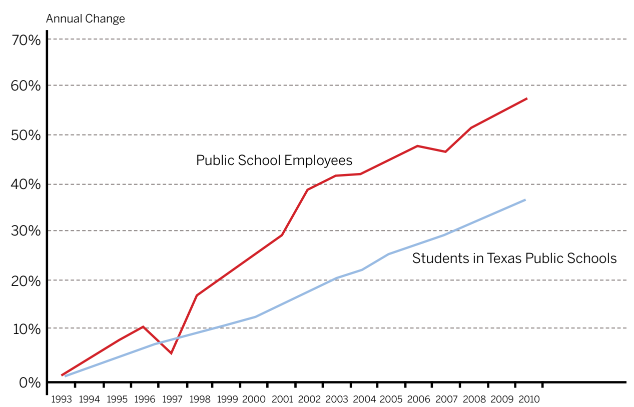
SOURCE: CATO INSTITUTE

TEXAS SPENDING, TEST SCORES



SOURCE: NATIONAL CENTER FOR EDICATIONAL STATISTICS

TEXAS SCHOOL JOBS, ENROLLMENT



SOURCE: NATIONAL CENTER FOR EDUCATIONAL STATISTICS

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