Calculating Economic Freedom

Laveesh Bhandari

Background

As discussed in the previous chapter, the term ‘economic freedom’ can have many connotations and depending upon which one is used the measurement of economic freedom would obviously differ. This Index of Economic Freedom (EFI) considers that ‘The key ingredients of economic freedom are personal choice, voluntary exchange coordinated by markets, freedom to enter and compete in markets, and protection of persons and their property from aggression by others.’

We recognise that this is not the only definition that can be used. An alternate definition would be something on the lines of ‘the unfettered ability of an individual to make economic choices’. For one, in developing countries such as India, family, community, and social constraints can also be held responsible for constraining an individual’s options. For instance, gender biases, caste biases and religious biases can seriously impede economic opportunities of those discriminated against. Such constraints work to nullify human rights and the ability to choose, and therefore, freedom in general. So, elements of social and civil freedom may also find a place in such a view of economic freedom. Such an approach would be on the lines of Amartya Sen’s ‘capability approach’; as it can be argued that the absence of poverty, poor health, and illiteracy promote the ability of individuals to take unfettered decisions.

But these are grey areas at best. The concepts of economic, political and social freedom can be integrated to form the concept of ‘human freedom’. According to Milton Friedman political freedom is ‘the mode of

1. I am grateful for the brave research assistance of Minakshi Chakravarty and Swati Vira.

representation in the political structure, the right to vote, the definition of democracy as the society in which the public servants—the people who determine public policy—are chosen by the votes of the citizens’ while social/civil freedom is ‘the freedom to speak, the freedom to assemble, the freedom to express your views’, that is, ‘human rights’.3 These, however, are not the same as economic freedom.

This study focuses entirely on economic freedom, following the approach of the *Economic Freedom of the World* (EFW) report in that, ‘an index of economic freedom should measure the extent to which rightly acquired property is protected and individuals are engaged in voluntary transactions.’4 In line with this and the previous IEF for Indian States published by the Rajiv Gandhi Institute for Contemporary Studies (RGICS) the index and related rankings of Indian states using the latest available data is constructed.

The areas for which the index is constructed derive from the *Economic Freedom of the World* report constructed by the Fraser Institute. This ensures that the economic freedom rating for Indian states has measures that are somewhat comparable with those of other countries. However, given Indian conditions and the sharing of responsibilities between the states and the Central government, only three of the five areas are found to be appropriate where state governments have powers to directly impact conditions and institutions (see Table 2.1). These are:

- Size of government: expenditures, taxes and enterprises.
- Legal structure and security of property rights.
- Regulation of labour and business.

### TABLE 2.1

<table>
<thead>
<tr>
<th>Areas under Central and State Government Control</th>
<th>Under Central Control</th>
<th>Under Common Control</th>
</tr>
</thead>
<tbody>
<tr>
<td>Law, order, justice and local governance</td>
<td>Administrative functions such as defence, foreign affairs</td>
<td>Inter-state interactions</td>
</tr>
<tr>
<td>Public health and environment</td>
<td>Labour, quality standards</td>
<td>Labour issues</td>
</tr>
<tr>
<td>Land and water</td>
<td>Railways, shipping, ports, airports, post &amp; telegraph</td>
<td>Education</td>
</tr>
<tr>
<td>Some types of taxes</td>
<td>Income tax, customs and excise</td>
<td>Environment</td>
</tr>
<tr>
<td>Infrastructure except national highways</td>
<td>Deals with the RBI, public debt</td>
<td>Power</td>
</tr>
<tr>
<td>Some aspects related to commerce &amp; industry</td>
<td>Natural resources</td>
<td>Shipping and inland waterways</td>
</tr>
</tbody>
</table>

The Index of Economic Freedom however is calculated for each of these categories, and then aggregated. Each category is important for indicating a specific aspect of economic freedom.

While the categories have been included in the index on the lines of the Economic Freedom of the World reports, the variables from the Economic Freedom of the World could not be replicated at the sub-national level in India. So proxies have been taken wherever possible that are more meaningful at the state level. Often data were unavailable, in which case those indicators had to be eliminated from the study. A detailed table that correlates the indicators used in Economic Freedom of the World and those included in the study is presented in the Appendix. The methodology adopted for creating the index is discussed in the following section.

This chapter first discusses the methodology briefly. It then takes up each of the areas under consideration, describes the variables used and the motivation, and then discusses the results. The last section of this chapter discusses the overall trends and what that signifies for economic growth for India.

Methodology in Brief

A relatively more detailed methodology is presented in the Appendix. Here we briefly outline the process. Since data needs to be comparable across time and geography, be credible and robust, and highly reflective of the conditions in different states, the following criteria have been identified in the selection of variables.

1. The data should be objective—that is, it should not be based on perceptions but on hard facts such that it is not sensitive to perceptions of the masses but should reflect conditions as they actually are.

2. The data should be available from highly respected, public and ideally government or semi-government sources—this would ensure that the ensuing discussion and debate should focus on the resultant performance of the states and not on the quality and credibility of the data.

3. The data should be available periodically and should be available from the same source for different states—this would ensure the credibility of the data and the continuity of the ratings.

Each of the variables that are constructed are normalised to correct for the differences in the size of the states. Hence normalisation is done
by dividing by population, area, a ratio or using it as a percentage of some aggregate so that it is neutral to the size of the state. Moreover, each data source needs to be available for a large enough number of states so that missing data points are minimised.

In line with the previous ratings for the Indian states, the range equalisation with equal weights has been chosen as the appropriate method. This is a multi-stage process. First, range equalisation is conducted on each variable across all states—this requires the subtraction of the minimum value from the value for each state and dividing the resultant with the difference of the maximum and minimum values. Range equalisation ensures that all variables lie between 0 and 1. Each of the new ‘range equalised’ variables are then aggregated with equal weights to create an index for each of the areas under consideration. Next, the indices of each of the three areas are aggregated to obtain a composite index using equal weights. Thus, four indices are generated on which basis each of the states is ranked.

Changes from the Past

As mentioned before, this Economic Freedom of the States of India 2011 is done on similar lines as in 2004 and 2005. However, there are a few changes in that—some measures used in the past such as number of special economic zones (SEZs) and also the share of unorganised workers in the total workforce are no longer used. There has also been a change in the base year of the state level GSDP figures released by the government of India, and also the sources of some of the variables have had to be changed. This has necessitated the redoing of the past ratings to ensure comparability. Hence this study has redone the ratings for 2005 and presents those as well as that of 2009.

Area 1: Size of Government—Expenditures, Taxes and Enterprises

Interference of the government in the functioning of the economy or a large role of the government as a producer and provider of services and goods or as a redistributor of resources reduces the level of economic freedom. Government revenue expenditure, administrative GDP, and a large employment in the public sector are therefore indicators of size of the government. Taxes on income, commodities and services, property and capital transactions, and other duties are indicative of the extensive role played by the government in the economy.

1) Inverse of Government Revenue Expenditure as a Share of Gross State Domestic Product (GSDP)

Higher revenue expenditure by the government is indicative of a large size of the government, and a rising share of government revenue
spending in GSDP is an indicator of lower economic freedom. Therefore, inverse of this ratio has been considered.

2) **Inverse of Administrative GSDP as a Ratio of Total GSDP**

Administrative GDP is the contribution of government services to the national product. The lower this ratio, the better is the level of economic freedom as the government’s role is lower; therefore the inverse of this ratio is used.

3) **Inverse of Share of Government in Organised Employment**

This is the ratio of employment with the government and quasi-government institutions to total organised sector employment. This ratio is a direct indicator of the size of the government. Inverse of the ratio is considered.

4) **Inverse of State Level Taxes on Income as a Ratio of GDP**

This is the ratio of income tax collected by the state to the GDP. The lower the state taxes on income, the higher will be the economic freedom. Therefore, the inverse of this ratio has been incorporated in the analysis.

5) **Inverse of Ratio of State Level Taxes on Property and Capital Transactions to State GDP**

This is the ratio of taxes on property and capital transactions to state GDP. High transaction costs and taxes tend to restrict the trade activities. Therefore, economic freedom is considered to be inversely related to level of taxation and the inverse of the variable has been taken.

6) **Inverse of State Level Taxes on Commodities and Services to GDP**

This is the ratio of taxes collected on commodities and services i.e., sales tax, service tax, excise, etc., to the GDP. Lower taxes on commodities would result in a higher freedom index, therefore the inverse of this ratio has been used.

7) **Stamp Duty Rate**

Stamp duty is defined as tax collected by the state by requiring a stamp to be purchased and attached on the commodity. Higher duties impose higher constraints on trade and economic activities and curb the economic freedom of agents. The inverse of this variable is taken to ensure that a higher level of economic freedom is reflected by a higher ratio.
Gujarat is a well known success story through much of the 2000s. It has been among the most rapidly growing states of India and has also attracted large investments. Moreover it has had major successes in agriculture, social welfare programmes, and water resource management. All of this is being achieved without an inordinate increase in the size of the government. But Jharkhand is another story. It also has achieved high economic growth but largely on the basis of a few large units in the mining and basic manufacturing sector. Its human development indicators are among the poorest in the country.\textsuperscript{5} And it is currently at the centre of a large leftist violent movement.

Other states such as Haryana are attracting significant investments in the services sector and in manufacturing. Proximity to Delhi, one of India’s fastest growing economic centres would have helped, but Haryana has been able to leverage it without too much increase in size of government. West Bengal is another state that is among the better performers in this area. However it is not clear whether that has been a good outcome overall; for instance, the number of civil policemen has

\textsuperscript{5.} India Today (2009).
dropped over the years. Though the size of the government has not increased as much as GSDP in recent years, whether West Bengal can sustain its position is questionable. Assam’s index values and rankings show that there has been significant improvement but here as well, the data shows many year-on-year variations—largely due to an economy that is highly dependent upon agriculture.

Andhra Pradesh has been improving steadily over the years; it’s GSDP growth has outpaced growth in both state-level taxes on income (such as professional taxes) as well as state government revenue expenditure; this despite the fact that government programmes have increased in scope and scale during the period. (See the next chapter for a detailed discussion on Andhra Pradesh.) Himachal receives greater funds from the Central government given its ‘special category status’ and this enabled it to charge lower state level taxes. Nevertheless Himachal Pradesh has been increasing its taxation partly to maintain and build infrastructure in a difficult mountainous terrain and therefore a significant fall in its rankings. Lastly, both Bihar and Rajasthan, among the worst performers in 2005 have improved significantly in 2009—each has benefited from economic growth without commensurate increase in the size of their government.

Overall there has been some improvement in this category with the average values increasing from 0.44 in 2005 to 0.47 in 2009.

**Area 2: Legal Structure and Security of Property Rights**

The efficiency of the government in protecting human life and property is measured by this category. Quality of the justice mechanism is measured by the availability of judges, by the completion rate of cases by courts and investigations by the police. The level of safety in the region is measured by the recovery rate of stolen property, and by the rate of violent and economic crimes.

**8) Ratio of Total Value of Property Recovered to Total Value of Property Stolen**

One of the key ingredients of economic freedom is protection of property. This measure is the ratio of total value of property recovered to the total value of property stolen. A higher value of this variable denotes efficiency of law enforcing agencies in protecting property rights and would therefore signify greater economic freedom.

**9) Inverse of Violent Crimes as a Share of Total Crimes**

This is the ratio of violent crimes, including murder, attempt to murder, etc., to total crimes under the Indian Penal Code. The inverse of
this ratio is considered, relating higher economic freedom to lower incidence of violent crimes.

10) Inverse of Cases under Economic Offences as a Share of Total Cases Registered

This is the ratio of economic offences (criminal breach of trust and cheating) to the total crimes reported under the Indian Penal Code. The inverse of this ratio is considered, as a lower incidence of economic offenses is indicative of better protection of property rights and therefore higher economic freedom.

11) Inverse of Vacant Posts of Judges in the Judiciary as a Ratio of Total Sanctioned Posts of Judges

This is the ratio of total vacant posts of judges in district/subordinate courts to total posts sanctioned. A high value of the ratio indicates that adequate infrastructure for getting justice is not in place. Therefore, the inverse of this ratio is considered.

12) Percentage Cases where Investigations were Completed by Police

This is the ratio of total cases where investigations were completed by the police to total cases registered for investigation by them. A higher value of this ratio indicates higher economic freedom as it indicates lower pendency of investigations.

13) Percentage Cases where Trials were Completed by Courts

This is the ratio of total trials completed by the courts to total cases awaiting or undergoing trial by courts. A higher value indicates higher economic freedom as it indicates lower pendency of cases.

Tamil Nadu retains its pre-eminent position; it is generally a much better governed state than all others and this is also reflected in its index value that is far ahead of all others. Madhya Pradesh is a distant second and scores high because of better police investigations as well as a lower share of economic offenses in total; however there has been no improvement over time in the state. Andhra Pradesh’s improvement has been quite marked largely because of improvement in terms of reduced vacancy of judges.

Gujarat’s ratings show a significant improvement over time; and this improvement has been on many fronts. The value of property recovered out of property stolen, cases under economic offences, vacant posts in the judiciary, and share of violent crimes all contribute to its improved position at number five.
TABLE 2.3
Legal Structure and Security: State Ratings and Rankings

<table>
<thead>
<tr>
<th>States</th>
<th>2005</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Area 2</td>
<td>Rank</td>
</tr>
<tr>
<td>Tamil Nadu</td>
<td>0.80</td>
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</tr>
<tr>
<td>Madhya Pradesh</td>
<td>0.63</td>
<td>2</td>
</tr>
<tr>
<td>Andhra Pradesh</td>
<td>0.48</td>
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<tr>
<td>Rajasthan</td>
<td>0.49</td>
<td>5</td>
</tr>
<tr>
<td>Gujarat</td>
<td>0.35</td>
<td>12</td>
</tr>
<tr>
<td>Chhattisgarh</td>
<td>0.48</td>
<td>6</td>
</tr>
<tr>
<td>Haryana</td>
<td>0.58</td>
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<tr>
<td>Himachal Pradesh</td>
<td>0.51</td>
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</tr>
<tr>
<td>Uttar Pradesh</td>
<td>0.41</td>
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<tr>
<td>Karnataka</td>
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<tr>
<td>Punjab</td>
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<tr>
<td>Kerala</td>
<td>0.35</td>
<td>13</td>
</tr>
<tr>
<td>Jammu &amp; Kashmir</td>
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</tr>
<tr>
<td>Uttarakhand</td>
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<tr>
<td>Jharkhand</td>
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<tr>
<td>Orissa</td>
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</tr>
<tr>
<td>Maharashtra</td>
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<td>16</td>
</tr>
<tr>
<td>Assam</td>
<td>0.14</td>
<td>19</td>
</tr>
<tr>
<td>West Bengal</td>
<td>0.20</td>
<td>17</td>
</tr>
<tr>
<td>Bihar</td>
<td>0.12</td>
<td>20</td>
</tr>
</tbody>
</table>

However many states have shown a fall in overall ratings—Haryana, Himachal Pradesh, Karnataka, Punjab, Jammu & Kashmir, Orissa, Maharashtra and West Bengal, all show significant fall in index values. This is worrisome as some of these states were among the poor performers in 2005 as well. Thus we find an increase in the variation among the states (standard deviation has increased from 0.17 to 0.19) and also a fall in the median index value from 0.39 in 2005 to 0.34 in 2009.

The ratings reflect that as Gujarat leaves behind its sordid past of communal violence and destruction, other states are unable to improve security of life and property in the manner required. This puts a serious question mark on the sustainability of high economic growth in such states.

Area 5: Regulation of Labour and Business

An entrepreneur needs to take many decisions that cannot cater to the sentiments of all the workers and management that his firm employs. Decisions such as rationalisation of employee base etc., are an essential component of efficient use of scarce resources. Constraints on exiting the
market seriously hamper an entrepreneur’s freedom. Labour laws for many decades have favoured the rights of the workers in the country. The number of strikes and industrial disputes that take place in the economy portray the amount of economic freedom in terms of the control that an entrepreneur has over his own business. Other areas where an entrepreneur may lack control over his own business is in terms of lack of adequate infrastructure and raw material. Such limitations severely constrain the entrepreneur’s ability to enforce decisions that may be beneficial for his business. High transaction costs are well known deterrents of trade and economic activity. They also contribute to black market transactions. The higher the costs in terms of licences, the more constraints they impose on carrying out trade and economic activity and therefore serve as restraints on economic freedom of agents. Corruption also translates into higher transactions costs.

14) Ratio of Average Wage of Unskilled Workers (Males) to Minimum Wages

This is the ratio of yearly average of daily wages for harvesting to minimum agricultural wages in the state. A higher than one ratio in a state indicates that the wages received by workers is higher than the specified minimum implying greater economic freedom both for the entrepreneur and labour.

15) Ratio of Average Wage of Unskilled Workers (Females) to Minimum Wages

This is the ratio of yearly average of daily female wages for harvesting to minimum agricultural wages in the state. A higher than one ratio in a state indicates that the wages received by workers is higher than the specified minimum implying greater economic freedom both for the entrepreneur and labour. This ratio is taken separately from that for males, as many times the market determined wages for unskilled female workers are said to be biased against them.

16) Inverse of Man-Days Lost in Strikes and Lockouts/Total Number of Industrial Workers

This is the ratio of man-days lost due to disputes (strikes and lockouts) to the total number of workers. A large number of man-days lost indicates the breakdown in arbitration and other consensus mechanisms. Lower the man-days lost, the better the economic freedom. Therefore, inverse of the variable is considered.
17) **Implementation Rate of Industrial Entrepreneurs Memorandum (IEM)**

IEM denotes the intention to invest in an industry. However, when there are bureaucratic or other delays, the rate of implementation is low. This indicator is the ratio of total amount invested to total amount proposed for investment through IEMs. A higher ratio implies larger economic freedom, thus depicting lower interference of government.

18) **Inverse of Minimum Licence Fee for Traders**

Traders are required to pay a minimum amount of fees for obtaining a licence from the government to indulge in market activities. Therefore, the higher the licence fees, the more restricted traders are while trading in the market. Inverse of the variable is taken to denote higher levels of economic freedom.

19) **Inverse of Power Shortage as a Percentage of Total Demand**

This is the ratio of power shortage to the total demand for power. Power shortage exists either due to low investment on the part of the government or due to low levels of private sector generation. Higher power shortage will tend to slow down the production process and thus would relate directly to inability of an entrepreneur to control his business. Again, inverse of the ratio is taken.

20) **Inverse of Pendency Rate of Cases Registered under Corruption and Related Acts**

This is the ratio of cases pending investigation from the previous year of cases registered under the Prevention of Corruption Act, 1988 and other related acts as a share of total cases registered under the same acts. Economic freedom is higher when justice is served promptly and therefore the inverse of the pendency rate is used.

21) **Persons Arrested as a Share of Total Cases being Investigated under Prevention of Corruption and Related Acts**

This is the ratio of the number of persons arrested under the Prevention of Corruption and other related acts as a share of total cases registered under the same acts. The higher the ratio, the higher is the level of economic freedom.
Gujarat has seen some improvement and retains its pre-eminent position. Andhra Pradesh has seen the most significant improvement in this measure (see chapter 3 for details). Its position is attributed to better performance on a range of variables—yearly market wages to minimum notified wages for unskilled workers, strikes and lockouts, and total cases registered in the Prevention of Corruption Act improved.

Karnataka is another state that has seen significant improvement in this measure and on the back of better performance in a range of variables—yearly wage to minimum notified wages, actual investment to investment proposed and total cases registered in the Prevention of Corruption Act, have all improved. Moreover its performance on ratio of industrial workers to strikes and lockouts has also enabled it to substantially improve upon its low ranking in 2005.

Uttar Pradesh had a low ranking in 2005 (at 19) and has improved upon it in 2009 (at 10)—one of the factors behind this is better performance in the variable registration of cases under Prevention of Corruption Act.
Madhya Pradesh’s position on the other hand has fallen as its high ranking in 2005 was achieved in part due to its exceptional performance in strikes and lockouts. This has since changed and the industrial climate has been worsening in the state leading to its fall. Jharkhand is another state that has performed poorly since 2005, but its poor performance has been in a range of areas—yearly wages to minimum notified wages, total industrial workers to strikes and lockouts, total cases registered in the Prevention of Corruption Act all have declined.

In the regulation of labour and business category, the median state value has declined from 0.33 in 2005 to 0.28 in 2009. What is worse, the states that had performed poorly in the past are the ones that have had the largest fall as well, again indicating worsening disparities in this component of economic freedom.

**Overall Ratings**

The overall ratings are a simple equal weighted average of the three ratings and the top three states are Tamil Nadu, Gujarat and Andhra Pradesh. These are followed by Haryana and Himachal Pradesh. Tamil Nadu has been a consistent performer—it was at the top in 2005 and retains that position in 2009. It has had a marginal improvement in its rating, up from 0.57 in 2005 to 0.59 in 2009 thus it continues its leading position but driven mainly by better legal and regulatory performance. Gujarat and Andhra Pradesh are 2nd and 3rd respectively and each has seen a considerable jump in both ranking and rating since 2005. In the case of Gujarat all round performance has enabled it to improve its rating from 0.46 in 2005 to 0.57 in 2009.

In the case of Andhra Pradesh as well the improvement from 0.40 to 0.51 has enabled it to achieve a rank of 3, up from 7 in 2009. Improvement continues for Andhra Pradesh on all fronts (in order of importance): Area 5—Regulation; Area 2—Legal Structure; and Area 1—Size of Government). Among the top 5, while Haryana Pradesh retains its 4th position, Himachal Pradesh has slipped from 0.48 to 0.43 in its ratings and from 3rd to 5th position in rankings.

Madhya Pradesh has fallen in overall terms, though its better performance in legal structure has compensated somewhat for its relatively poor performance in other areas. Punjab is another state that has performed poorly, its rating has fallen by 0.06 in the period under consideration.

As many as 12 states have seen a fall in their economic freedom rankings. The worse performers being: Madhya Pradesh, Uttarakhand, Punjab, Orissa, Himachal Pradesh and Maharashtra.
TABLE 2.5

Overall Economic Freedom Ratings: 2009

<table>
<thead>
<tr>
<th>States</th>
<th>2005 Overall</th>
<th>Rank</th>
<th>2009 Overall</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tamil Nadu</td>
<td>0.57</td>
<td>1</td>
<td>0.59</td>
<td>1</td>
</tr>
<tr>
<td>Gujarat</td>
<td>0.46</td>
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<td>0.40</td>
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<td>0.51</td>
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<td>Himachal Pradesh</td>
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<td>Madhya Pradesh</td>
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<td>0.42</td>
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</tr>
<tr>
<td>Rajasthan</td>
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<td>8</td>
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<td>Jammu &amp; Kashmir</td>
<td>0.34</td>
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<td>Kerala</td>
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<td>Maharashtra</td>
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<td>Punjab</td>
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<td>Chhattisgarh</td>
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<td>Orissa</td>
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<td>Assam</td>
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<td>Uttarakhand</td>
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</tr>
<tr>
<td>Bihar</td>
<td>0.25</td>
<td>20</td>
<td>0.23</td>
<td>20</td>
</tr>
</tbody>
</table>

Overall, the median value for economic freedom of the states of India has fallen from 0.38 to 0.36. This could be a temporary blip in the long-term trends, but needs careful watching. Though, the overall index figures have not improved much, some improvement on size of the government is being outweighed by fall in both legal structure and property rights as well as regulation of labour and business. In other words, the evidence is that economic freedom in India is not improving despite high growth in the intervening period.

As India opens its national markets to international investment and commodity flows, it cannot afford to constrain its own entrepreneurs from benefiting from the great opportunities that lie ahead. For this, economic freedom needs to be improved at the national, state and local levels.

A Discussion of Economic Freedom in the States of India

Overall the states of Madhya Pradesh, Orissa, Uttarakhand, Punjab and Himachal Pradesh have had a significant fall in their economic freedom ratings (a reduction of greater than 0.05 points). Others such as Maharashtra, Kerala, Bihar, Jharkhand, Karnataka, Uttar Pradesh, Assam and Chhattisgarh have had a moderate fall in their ratings (reduction of
between 0 to 0.05 points). While Haryana, Tamil Nadu, West Bengal, Rajasthan, Jammu & Kashmir have seen a moderate rise (improvement from 0 to 0.04 points); and Andhra Pradesh and Gujarat have seen a significant improvement (both by 0.11 points).

There is no linear pattern in the sense of some of the states that have had a large fall include top ranked states in 2005 such as Madhya Pradesh and Himachal Pradesh; whereas states such as Orissa and Uttarakhand were not among the top performers and have since worsened. At the same time, some of the improving states were at the top (Tamil Nadu) as well as among the lowest ranked (West Bengal ranked 18 in 2005).

<table>
<thead>
<tr>
<th>TABLE 2.6</th>
<th>Economic Growth and Economic Freedom in Indian States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Units</td>
<td>Rs.</td>
</tr>
<tr>
<td>States with Large Falls</td>
<td>267</td>
</tr>
<tr>
<td>Madhya Pradesh</td>
<td>88</td>
</tr>
<tr>
<td>Orissa</td>
<td>58</td>
</tr>
<tr>
<td>Uttarakhand</td>
<td>20</td>
</tr>
<tr>
<td>Punjab</td>
<td>81</td>
</tr>
<tr>
<td>Himachal Pradesh</td>
<td>19</td>
</tr>
<tr>
<td>States with Moderate Falls</td>
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</tr>
<tr>
<td>Maharashtra</td>
<td>317</td>
</tr>
<tr>
<td>Kerala</td>
<td>94</td>
</tr>
<tr>
<td>Bihar</td>
<td>66</td>
</tr>
<tr>
<td>Jharkhand</td>
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<td>Karnataka</td>
<td>125</td>
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<tr>
<td>Uttar Pradesh</td>
<td>210</td>
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<tr>
<td>Assam</td>
<td>43</td>
</tr>
<tr>
<td>Chhattisgarh</td>
<td>36</td>
</tr>
<tr>
<td>States with Moderate Rise</td>
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<tr>
<td>Haryana</td>
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</tr>
<tr>
<td>Tamil Nadu</td>
<td>168</td>
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<tr>
<td>West Bengal</td>
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<tr>
<td>Rajasthan</td>
<td>102</td>
</tr>
<tr>
<td>Jammu &amp; Kashmir</td>
<td>19</td>
</tr>
<tr>
<td>States with Large Rise</td>
<td>329</td>
</tr>
<tr>
<td>Andhra Pradesh</td>
<td>176</td>
</tr>
<tr>
<td>Gujarat</td>
<td>153</td>
</tr>
</tbody>
</table>
But both the states that have improved the most have seen improvements on a whole range of indicators—Gujarat and Andhra Pradesh. This suggests that improvements in economic freedom can be most dramatic when they impact most or all areas, and are not driven by excellent performance in just one or two areas.

The states that have worsened most in economic freedom experienced average annual GDP growth between 2004-05 and 2008-09 of 6.7 per cent. Those states that worsened moderately averaged 8.7 per cent growth. And the states that improved the most (Andhra Pradesh and Gujarat) averaged 10.5 per cent growth. This suggests strongly that more economic freedom translates into faster growth. The difference in growth rates between the worst and best states is striking.

**FIGURE 2.1**

*Change in EF Index and Economic Growth of the States (2005 to 2009)*

The figure above compares the change in the index value with annualised state-level GDP growth between 2004-05 and 2008-09. Both Andhra Pradesh and Gujarat have seen among the highest growth rates during the period. However some states such as Bihar, Chhattisgarh, Maharashtra and Karnataka also have seen significantly high growth in the latter part of the 2000s.

Short-term growth figures are known to vary widely. But Maharashtra and Karnataka have been known to be among the better governed states in India and have a long history of international and domestic investments in manufacturing and services. The growth of Bihar and
Chhattisgarh on the other hand is characterised by some sectors (construction in Bihar and mining and basic industry in Chhattisgarh) that have contributed to recent successes. It is not clear whether these can be sustained if overall economic freedom measures do not improve.

At the same time, the figure above also suggests that at least at the extreme points there is a strong link. States that have had a large fall in economic freedom indices do not have high growth, and states that have had a large improvement in economic freedom index have had high growth.