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The State of Economic Freedom in India 2013

Bibek Debroy and Laveesh Bhandari

Background

Man is born free, but is everywhere in chains, said Jean-Jacques Rousseau. This report is based on the philosophy that freedom is both precious in itself and a path to prosperity. It is the latest in our series of reports measuring economic freedom in different states of India. *Economic Freedom of the States of India* (EFSI), 2013, uses data relating to 2012.

Economic freedom isn't the only kind of freedom: political liberties and civil rights are also aspects of freedom. Unlike some other studies, this report seeks to measure economic freedom alone. It draws on and adapts a methodology already established in *Economic Freedom of the World* (EFW), an annual publication of the Fraser Institute (co-published in the United States by the Cato Institute), that has been brought out since 1996. This is in line with the methodology used in our reports for earlier years. The full details of the methodology are given in the Appendix II.

Table 1.1 shows how India scores in the EFW 2013 report, based on data up to 2011. Economic freedom in India rose from an index score of just 5.15 in 1980 to a peak of 6.72 in 2005 (on a scale from 1 to 10), but then declined a bit to 6.24 in 2010, before recovering marginally to 6.34 in 2011. India ranks only 111th out of 152 countries in the EFW list, having slipped from 76th position in 2005. Clearly its government has attached a low priority to improving economic freedom.

Of the five parameters making up the EFW scores, India has seen dramatic improvement only in one—freedom to trade internationally—where the score has gone up from 3.00 in 1980 to 6.26 in 2011. In regulation of credit, labour and business, its score has improved more slowly but steadily, from 5.68 to 6.76. In other parameters, India has fallen from peaks achieved earlier. In size of government, it is down to 6.35 from a peak of 7.42 in 2005; in legal structure and security of property rights, it is down to 5.68 from a peak of 6.51 in 2005; and in access to sound money, it is down to 6.67 from a peak of 6.88 in 2000. Despite this lack of clear commitment to economic

Table 1.1

India's Scores in Economic Freedom of the World

	1980	1985	1990	1995	2000	2005	2009	2010	2011
Summary rating	5.15	4.83	4.89	5.76	6.32	6.72	6.31	6.24	6.34
Size of the government	5.00	4.50	4.88	6.26	6.83	7.42	6.33	6.37	6.35
Legal structure and security of property rights	5.78	4.92	4.39	5.87	5.99	6.51	5.78	5.55	5.68
Access to sound money	6.29	6.61	6.63	6.50	6.88	6.84	6.55	6.42	6.67
Freedom to trade internationally	3.00	2.40	2.67	4.50	5.51	6.07	6.20	6.28	6.26
Regulation of credit, labour and business	5.68	5.70	5.87	5.66	6.40	6.74	6.68	6.70	6.76

Source: *Economic Freedom of the World 2013* (unadjusted series), p.89.

freedom, India's economic performance was very good between 2003 and 2010, but has decelerated sharply since. India's GDP growth was 9.2 per cent in 2010-11 but has more than halved to just 4.4 per cent in the second quarter of 2013, and its GDP in the full fiscal year will probably be well below 5 per cent. There are many reasons for this deceleration, but one of them must be the decline in economic freedom.

The good news is that economic freedom in the states of India has improved even as it has decreased in India as a whole. In other words, state capitals have done more to improve economic freedom than New Delhi has. This is a good, important structural feature of the economy. The median value of the economic freedom index for states initially declined from 0.38 in 2005 to 0.36 in 2009, but then rose to 0.43 in 2011.

Gujarat has shown by far the best performance in economic freedom. Its score has risen from 0.46 in *EFSI* 2005 to 0.65 in *EFSI* 2013, by far the biggest increased among states (see Table 1.2). It has improved its ranking among

Table 1.2

Overall Economic Freedom Ratings for Indian States

States	2005		2009		2011		2013	
	Overall	Rank	Overall	Rank	Overall	Rank	Overall	Rank
Gujarat	0.46	5	0.57	2	0.64	1	0.65	1
Tamil Nadu	0.57	1	0.59	1	0.57	2	0.54	2
Andhra Pradesh	0.40	7	0.51	3	0.51	6	0.50	3
Haryana	0.47	4	0.47	4	0.55	4	0.49	4
Himachal Pradesh	0.48	3	0.43	5	0.52	5	0.47	5
Madhya Pradesh	0.49	2	0.42	6	0.56	3	0.47	6
Rajasthan	0.37	12	0.4	7	0.43	8	0.46	7
Chhattisgarh	0.33	16	0.33	15	0.41	11	0.44	8
Karnataka	0.36	13	0.34	13	0.42	9	0.43	9
Kerala	0.38	10	0.36	10	0.42	10	0.42	10
Maharashtra	0.40	9	0.36	10	0.39	13	0.42	11
Jammu & Kashmir	0.34	15	0.38	8	0.46	7	0.41	12
Punjab	0.41	6	0.35	12	0.39	12	0.40	13
Uttarakhand	0.33	17	0.26	19	0.38	14	0.39	14
Odisha	0.37	11	0.31	17	0.34	17	0.36	15
Uttar Pradesh	0.35	14	0.34	13	0.35	16	0.36	16
West Bengal	0.31	18	0.33	15	0.32	18	0.35	17
Jharkhand	0.40	8	0.38	8	0.31	19	0.33	18
Assam	0.30	19	0.29	18	0.36	15	0.32	19
Bihar	0.25	20	0.23	20	0.29	20	0.31	20

Table 1.3

Areas under Central and State Control in India

<i>Under State Control</i>	<i>Under Central Control</i>	<i>Under Joint Control</i>
Law, order, justice, local governance	Defence, foreign affairs	Inter-state interactions
Public health, agriculture	Quality standards for public services	Labour issues
Land and water	Rail, ports, airports, posts, national highways	Education
Sales tax, many minor taxes	Income tax, customs and excise taxes	Environment
Local infrastructure	Money, banking, public debt	Power, roads
Some aspects of commerce and industry	Natural resources	Shipping, inland waterways

states from fifth position in 2005 to top position today, and its score of 0.64 is well clear of the others—Tamil Nadu comes second some distance behind with 0.57, which is no higher than its score back in 2005. Bihar remains at the bottom of league, but its score has improved significantly from 0.25 to 0.31, and this improvement in percentage terms is heartening. Chapter 2 examines Bihar's economic performance in greater detail. Jharkhand remains the one state where economic freedom has fallen substantially, from 0.40 in 2005 to 0.33 in 2011.

Our economic freedom index draws on EFW's methodology, and this means that our ratings from Indian states are to some extent comparable to country ratings of EFW. However, given Indian conditions and the manner in which responsibilities are shared between New Delhi and the states (see Table 1.3), only three of the five parameters used by EFW can be adapted for our purposes. In these three areas, the states have enough powers to directly impact outcomes, and so can be rated. The three areas are:

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

While the categories have been included in the index on the lines of the EFW reports, the variables from the EFW 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 EFW and those included in the study is presented in Appendix III. The methodology adopted for creating the index is discussed in the following section.

This chapter discusses the outline of the methodology initially. Further, it takes up each of the areas under consideration, describes the variables

used and the motivation, and finally discusses the results. The last section of this chapter discusses the overall trends and its significance for economic growth in India.

Methodology in Brief

A detailed methodology is presented in the Appendix II. Here we briefly outline the process. Since data need 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 selection process of relevant variables.

1. The data should be objective: This signifies that the data should not be based on perceptions but on hard facts so that it is not sensitive to perceptions of the masses, but should reflect the existing factual conditions.
2. Data should be available from highly accepted, 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 constructed is normalised to correct for the differences in the size of the states. Hence normalisation is done through 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 method with equal weights has been chosen as the appropriate method. This is a multi-stage process. The first stage of range equalisation is conducted on each variable across all states—this requires subtraction of the minimum value across states from the observation value for each state and dividing the resultant with the difference between the maximum and minimum values. Range equalisation ensures that all variables lie between 0 and 1. In the next stage, each of the new 'range equalised' variables is aggregated with others using 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 and the states are ranked based on each of these indices.

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 relatively 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 Indian 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 larger government size and is thus an indicator of lower economic freedom. Therefore, the 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 the 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. The 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 state GDP. 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 the 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 state GDP. Lower taxes on commodities

would result in a higher freedom index score. Hence, the inverse of this ratio has been used.

7) *Inverse of 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.

Based on these parameters, the ranking of different states in regard to 'size of government' is shown in Table 1.4.

Haryana ranks first in relation to size of government. It has also been one of the most rapidly growing states of India, and has attracted large investments in the services sector and in manufacturing. Proximity to

Table 1.4
Size of Government: State Scores and Rankings

States	2005		2009		2011		2013	
	Area 1	Rank	Area 1	Rank	Area 1	Rank	Area 1	Rank
Haryana	0.50	7	0.63	3	0.75	1	0.74	1
Gujarat	0.56	2	0.69	1	0.74	2	0.69	2
Maharashtra	0.52	4	0.53	6	0.68	3	0.68	3
Himachal Pradesh	0.58	1	0.48	10	0.56	10	0.62	4
West Bengal	0.52	4	0.58	4	0.61	7	0.62	5
Andhra Pradesh	0.39	12	0.49	8	0.58	8	0.59	6
Jharkhand	0.56	3	0.67	2	0.50	14	0.59	7
Assam	0.41	11	0.51	7	0.63	4	0.58	8
Punjab	0.49	8	0.54	5	0.61	6	0.58	9
Tamil Nadu	0.46	9	0.47	11	0.57	9	0.57	10
Jammu & Kashmir	0.31	20	0.43	14	0.63	5	0.54	11
Rajasthan	0.34	18	0.44	12	0.50	15	0.54	12
Kerala	0.51	6	0.49	8	0.54	12	0.53	13
Bihar	0.38	16	0.44	12	0.54	11	0.52	14
Odisha	0.32	19	0.38	15	0.44	18	0.50	15
Karnataka	0.38	15	0.36	16	0.48	16	0.49	16
Uttarakhand	0.39	13	0.25	20	0.45	17	0.48	17
Chhattisgarh	0.37	17	0.32	19	0.53	13	0.47	18
Uttar Pradesh	0.45	10	0.33	18	0.40	20	0.38	19
Madhya Pradesh	0.39	14	0.35	17	0.42	19	0.38	20

Delhi, one of India's fastest growing economic centres, would have helped, and Haryana has been able to leverage this without much increase in the size of its government. However, after a big improvement between 2005 and 2011, there has been a marginal decline.

Gujarat is a well-known success story through much of the 2000s. Moreover, it has had major successes in agriculture, social welfare programmes and water resource management. As in Haryana, all of this is being achieved without an inordinate increase in the size of the government. Maharashtra is another state that is among the better performers in this area; the size of the government has not increased as much as economic growth in recent years.

While the top three states have retained their position since 2011, Himachal Pradesh has emerged as one of the top performers in 2013. It has moved up from 10th rank in 2011 to 4th rank in 2013. Assam's index values and rankings which showed significant improvement in 2011, moving up to 4th rank, have again slipped back to 8th rank in 2013. Primarily the high growth of revenue expenditure in comparison to the slow growth of GSDP of the state led to the significant decline in index values.

Jammu & Kashmir and Chhattisgarh had a major set-back this year. Other states which followed suit are Madhya Pradesh, Bihar, Punjab, Uttar Pradesh and Kerala. In all of these states, growth in GDP has not been commensurate with the increase in the size of the government.

Overall there has been some improvement in this category in the period 2005-2011 with the average index values increasing from 0.44 in 2005 to 0.47 in 2009 and to 0.56 in 2011. However, in 2013 there has been a marginal decline in the index value to 0.55. Significant increases in taxes on property and capital transaction compared to slow growth of GDP in most of the states has led to this decline.

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. The 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 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 (IPC). 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 total crimes reported under the IPC. The inverse of this ratio is considered, as lower incidence of economic offences 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 of Cases where Investigations were Completed by the 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 of Cases where Trials were Completed by Courts*

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

Based on these parameters, the scores and rankings of the states in Area 2 are shown in Table 1.5.

Madhya Pradesh is one of the best governed states in this respect, and this is reflected in an index value that is well ahead of all others (see Table 1.5). Better police investigations as well as a lower share of economic offences to total incidences of crime keep the state ahead of others. However, compared to the previous year, there has been a low rate of recovery of

Table 1.5
Legal Structure and Security: State Ratings and Rankings

States	2005		2009		2011		2013	
	Area 2	Rank	Area 2	Rank	Area 2	Rank	Area 2	Rank
Madhya Pradesh	0.63	2	0.62	2	0.83	1	0.62	1
Tamil Nadu	0.80	1	0.90	1	0.64	2	0.55	2
Rajasthan	0.49	5	0.54	4	0.53	3	0.55	3
Andhra Pradesh	0.48	7	0.56	3	0.49	5	0.50	4
Chhattisgarh	0.48	6	0.52	6	0.43	7	0.47	5
Punjab	0.42	9	0.34	10	0.38	11	0.43	6
Jammu & Kashmir	0.35	14	0.32	13	0.29	14	0.39	7
Haryana	0.58	3	0.45	7	0.42	8	0.39	8
Gujarat	0.35	12	0.54	4	0.52	4	0.39	9
Uttar Pradesh	0.41	10	0.39	9	0.38	10	0.37	10
Karnataka	0.45	8	0.34	10	0.36	12	0.35	11
Himachal Pradesh	0.51	4	0.42	8	0.41	9	0.33	12
Kerala	0.35	13	0.34	10	0.45	6	0.31	13
Odisha	0.37	11	0.23	16	0.26	15	0.26	14
Uttarakhand	0.28	15	0.29	14	0.31	13	0.24	15
Jharkhand	0.19	18	0.24	15	0.17	16	0.20	16
Maharashtra	0.26	16	0.19	17	0.15	19	0.16	17
West Bengal	0.20	17	0.15	19	0.16	18	0.14	18
Assam	0.14	19	0.17	18	0.17	17	0.13	19
Bihar	0.12	20	0.11	20	0.08	20	0.12	20

the value of property stolen. This has resulted in a significant decline of its index value. Tamil Nadu remains in 2nd position. It used to be the top state in 2005 and 2009, when its index scores were as high as 0.80 and 0.90 respectively. Its score is now down to 0.55. This is a widespread problem: more than half the states have shown a declining trend, a sign of growing misgovernance and deteriorating economic freedom.

Rajasthan, Gujarat, Andhra Pradesh, have shown some improvement in their ratings compared with 2005. However, this improvement has not been steady, and there has been significant volatility. Gujarat, which on many parameters is a well-governed state, has shown a steep fall in its score to just 0.39.

Looking at changes since 2011, Bihar, Jammu & Kashmir and Punjab have shown the most improvement. However, despite substantial improvement in police investigations in Bihar, the state continues to be at the bottom of the league, a sad commentary on its low base. Punjab's index scores

have been rising over time, and these have been reflected in a sharp improvement in its ranking from 11th position in 2011 to 6th position today. This improvement is mainly on account of a higher rate of recovery of stolen property, a lower ratio of violent crimes to total crime and higher rate of completion of court cases.

On the other hand, Madhya Pradesh, Kerala and Uttarakhand have suffered a significant decline in their index values since 2011. Poor police investigations and low rates of recovery of stolen property are factors leading to this decline.

Ten of the 20 states have fared worse in this 2013 report than in 2011, and overall too there is a marginal decline. This is especially worrisome for some states like West Bengal and Assam, which were among the poorest performers in 2011 too.

The ratings tell a sombre story: the states have been unable to improve security of life and property in the manner required. This puts a serious question mark against the sustainability of high economic growth in such states.

Area 3: Regulation of Labour and Business

An entrepreneur needs to take many decisions that may be opposed by his workers and managers. Decisions such as the right-sizing of employees are essential for efficient use of scarce resources. Constraints on worker exit can seriously hamper an entrepreneur's freedom. Labour laws for many decades have favoured excessive security for workers (in companies with more than 100 employees, no worker can be sacked save with permission from the State Labour Ministry). The number of strikes and industrial disputes is a parameter that reflects 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 relate to inadequate infrastructure. High transactions costs are well-known deterrents to efficient trade and economic activity, and can also contribute to black market transactions. The higher the cost of business in the form of licences and clearances, the more they constrain economic freedom. And, of course, corruption is a widespread problem that translates into higher transactions costs and lower economic freedom.

The following are the parameters we measure to determine economic freedom in relation to the regulation of labour and business.

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

This is the ratio of the yearly average of daily wages for crop harvesting to minimum agricultural wages in a state. A value greater than one

means that effective wages are higher than the minimum wage, implying undistorted labour markets and hence greater economic freedom both for the entrepreneur and worker.

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

Since discrimination against females is widespread, and seriously affects economic freedom, we measure this ratio separately for females and males.

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 high ratio indicates a breakdown of arbitration and other consensus-promoting mechanisms. The fewer the man-days lost, the better is economic freedom. Hence we measure the inverse of this ratio.

17) Implementation Rate of Industrial Entrepreneurs Memorandum (IEM)

An IEM denotes an intention to invest in an industry. However, when there are serious bureaucratic or other delays, the rate of implementation is low. We measure the ratio of sums actually invested to the total proposed through IEMs. A high ratio implies fewer bureaucratic hurdles and hence more economic freedom. However, in many cases investors are known to simply sign IEMs to keep Chief Ministers in good humour, without any serious investment intent. To that extent, the implementation rate of IEMs may not reflect speed of clearance.

18) Inverse of Minimum Licence Fee for Traders

Traders are required to pay licence fees for market activities. The higher the license fees, the more restrictive are trading conditions and entry into business. The inverse of this ratio has been adopted in this report, since a higher inverse of the ratio denotes more economic freedom.

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

Power shortages are caused either by low investment by the government (which is by far the largest generator of electricity) or by low levels of private sector generation. Power shortages slow down industrial production, and in fact all business activity. This constrains the ability of entrepreneurs to control their businesses. Again, the 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 and other related acts as a share of total cases registered under the same acts. Economic freedom is higher when justice is prompt. Hence, the inverse of the pendency rate is used.

Based on these parameters, the rankings of different states in relation to Area 3 are shown in Table 1.6.

Gujarat has consistently been the best state in this area. It has also recorded the maximum improvement in index score since 2011, and its score of 0.87 is far ahead of Tamil Nadu (0.51) which occupies 2nd position. A host of factors have contributed to Gujarat's continuing improvement. A sharp decline in man-days lost due to strikes and lock-outs, higher market

Table 1.6

Regulation of Labour and Business: State Ratings and Rankings

States	2005		2009		2011		2013	
	Area 3	Rank	Area 3	Rank	Area 3	Rank	Area 3	Rank
Gujarat	0.47	1	0.49	1	0.67	1	0.87	1
Tamil Nadu	0.46	2	0.41	3	0.51	3	0.51	2
Himachal Pradesh	0.36	7	0.38	5	0.63	2	0.46	3
Uttarakhand	0.31	12	0.24	14	0.40	9	0.46	4
Karnataka	0.24	17	0.32	8	0.43	8	0.44	5
Maharashtra	0.41	6	0.35	6	0.36	10	0.43	6
Kerala	0.28	15	0.25	12	0.27	15	0.42	7
Andhra Pradesh	0.33	10	0.48	2	0.45	6	0.40	8
Madhya Pradesh	0.46	3	0.27	11	0.44	7	0.40	9
Chhattisgarh	0.14	20	0.14	20	0.28	14	0.39	10
Haryana	0.32	11	0.34	7	0.47	5	0.34	11
Odisha	0.43	5	0.31	9	0.33	11	0.33	12
Uttar Pradesh	0.18	19	0.3	10	0.28	13	0.32	13
Jammu & Kashmir	0.35	8	0.39	4	0.48	4	0.30	14
Bihar	0.26	16	0.15	19	0.24	17	0.30	15
Rajasthan	0.28	14	0.22	16	0.25	16	0.29	16
West Bengal	0.20	18	0.25	12	0.24	19	0.29	17
Assam	0.34	9	0.19	17	0.28	12	0.26	18
Jharkhand	0.45	4	0.24	14	0.24	18	0.20	19
Punjab	0.30	13	0.18	18	0.22	20	0.19	20

wage rates compared with minimum wage rates, and a decline in pendency of cases are some major factors.

Kerala is another state that has sharply improved its index value, from 0.27 to 0.42 in two years. A significant increase in the market wage rate is a major reason. This state in past decades used to push minimum wages far ahead of market realities. But growing prosperity in the last decade has sent market wages well above the minimum wage.

On the other hand, Himachal Pradesh and Jammu & Kashmir have suffered a significant decline in their index values in 2013 compared with 2011. Power shortages are contributory factors. However, new hydroelectric projects in these states should alleviate the problem.

Uttar Pradesh was second-worst in 2005 (at 19th position) and has now improved to 13th position. It has shown a much improved performance in registration of cases under the Prevention of Corruption Act.

Jharkhand occupied a high 4th position back in 2005, but has crashed now to 19th position. It has performed badly on several parameters, notably wage rates, industrial strife, and cases registered under the Prevention of Corruption Act.

Overall, the average index value for all 20 states declined from 0.33 in 2005 to 0.30 in 2009, but has now improved to 0.38 in 2013. Himachal Pradesh, Andhra Pradesh, Madhya Pradesh, Haryana, Jammu & Kashmir, Assam, Jharkhand and Punjab experienced a decline in their index after 2011, while others showed an improvement.

Overall Ratings

The overall ratings for states are simple equally weighted averages of the ratings in the three areas. The top three states are Gujarat, Tamil Nadu and Andhra Pradesh. These are followed by Haryana, Himachal Pradesh and Madhya Pradesh (see Table 1.7). Gujarat has not only stayed on top but significantly improved its overall rating from 0.46 in 2005 to 0.65 in 2013, driven mainly by better legal and regulatory performance. Tamil Nadu is well behind in 2nd place with a score of 0.54. It used to be in top position in 2005 (with a score of 0.57) as well as in 2009 (0.59), but has since deteriorated, and fallen behind Gujarat. Andhra Pradesh has moved up from 6th rank in 2011 to 3rd rank in 2013, not because of any improvement in its index value but because some other states (Himachal Pradesh, Haryana and Madhya Pradesh) suffered a significant fall.

As many as seven states have suffered a fall in their economic freedom ratings in 2013 compared with 2011. The worst performers in 2013 are Bihar, Jharkhand, Assam and West Bengal. While Bihar, Jharkhand and West Bengal had shown some positive growth in their index ratings since 2011,

Table 1.7

Overall Economic Freedom Ratings

States	2005		2009		2011		2013	
	Overall	Rank	Overall	Rank	Overall	Rank	Overall	Rank
Gujarat	0.46	5	0.57	2	0.64	1	0.65	1
Tamil Nadu	0.57	1	0.59	1	0.57	2	0.54	2
Andhra Pradesh	0.40	7	0.51	3	0.51	6	0.50	3
Haryana	0.47	4	0.47	4	0.55	4	0.49	4
Himachal Pradesh	0.48	3	0.43	5	0.52	5	0.47	5
Madhya Pradesh	0.49	2	0.42	6	0.56	3	0.47	6
Rajasthan	0.37	12	0.4	7	0.43	8	0.46	7
Chhattisgarh	0.33	16	0.33	15	0.41	11	0.44	8
Karnataka	0.36	13	0.34	13	0.42	9	0.43	9
Kerala	0.38	10	0.36	10	0.42	10	0.42	10
Maharashtra	0.40	9	0.36	10	0.39	13	0.42	11
Jammu & Kashmir	0.34	15	0.38	8	0.46	7	0.41	12
Punjab	0.41	6	0.35	12	0.39	12	0.40	13
Uttarakhand	0.33	17	0.26	19	0.38	14	0.39	14
Odisha	0.37	11	0.31	17	0.34	17	0.36	15
Uttar Pradesh	0.35	14	0.34	13	0.35	16	0.36	16
West Bengal	0.31	18	0.33	15	0.32	18	0.35	17
Jharkhand	0.40	8	0.38	8	0.31	19	0.33	18
Assam	0.30	19	0.29	18	0.36	15	0.32	19
Bihar	0.25	20	0.23	20	0.29	20	0.31	20

Assam has gone further down. Other states with declining index values in this period are Tamil Nadu, Himachal Pradesh, Haryana, Madhya Pradesh and Jammu & Kashmir. Bihar has not been able to break out of the bottom position it has always held, but its score has improved significantly, from 0.25 in 2005 to 0.31 in 2013.

Compared with 2005, Gujarat has shown the steepest growth. On the other hand, Jharkhand, Madhya Pradesh, Tamil Nadu, Punjab and Odisha have experienced declines in index value.

Overall, the median value for economic freedom of the states of India decreased from 0.38 in 2005 to 0.36 in 2009 but improved in 2013 to 0.43. The overall increase is due mainly to improvements in Area 1 (Size of government) and Area 3 (Regulation of labour and business).

As India opens its national markets to international investment and commodity flows, it cannot afford to constrain its own entrepreneurs.

Table 1.8

Economic Growth and Economic Freedom in Indian States

States	GSDP at 2004-05 Price (₹ '000 crore) in 2004-05	GSDP at 2004-05 Price (₹ '000 crore) in 2011-12	Annual % Growth	Index Values of 2005	Rank in 2005	Index Values in 2013	Rank in 2013	Change in EF Index (2005 to 2013)	Change in Rank (2005 to 2011)	Position in 2005
States with Large Decline	392	731	9.3%							
Jharkhand	60	96	7.0%	0.40	8	0.33	18	(0.07)	10	High
Tamil Nadu	219	433	10.2%	0.57	1	0.54	2	(0.03)	1	High
Madhya Pradesh	113	201	8.6%	0.49	2	0.47	6	(0.02)	4	High
States with Moderate Decline	199	329	7.5%					-		
Punjab	97	156	7.1%	0.41	6	0.40	13	(0.01)	7	High
Himachal Pradesh	24	42	8.3%	0.48	3	0.47	5	(0.01)	2	High
Orissa	78	131	7.7%	0.37	11	0.36	15	(0.01)	4	Low
States with Moderate Rise	826	1,468	8.6%					-		
Uttar Pradesh	261	422	7.1%	0.35	14	0.36	16	0.01	2	Low
Haryana	96	178	9.3%	0.47	4	0.49	4	0.02	-	High
Maharashtra	415	787	9.6%	0.40	9	0.42	11	0.02	2	High
Assam	53	80	6.0%	0.30	19	0.32	19	0.02	-	Low
States with Large Rise	1,228	2,185	8.6%					-		
West Bengal	209	329	6.7%	0.31	18	0.35	17	0.04	(1)	Low
Kerala	119	210	8.4%	0.38	10	0.42	10	0.04	-	Low
Bihar	78	144	9.2%	0.25	20	0.31	20	0.06	-	Low
Uttaranchal	25	59	13.1%	0.33	17	0.39	14	0.06	(3)	Low
Karnataka	167	286	8.0%	0.36	13	0.43	9	0.07	(4)	Low
Jammu & Kashmir	27	41	5.8%	0.34	15	0.41	12	0.07	(3)	Low
Rajasthan	128	228	8.6%	0.37	12	0.46	7	0.09	(5)	Low
Andhra Pradesh	225	405	8.8%	0.40	7	0.50	3	0.10	(4)	High
Chhattisgarh	48	85	8.5%	0.33	16	0.44	8	0.11	(8)	Low
Gujarat	203	400	10.1%	0.46	5	0.65	1	0.19	(4)	High

Economic freedom needs to be improved at the national, state and local levels.

Economic Freedom and Fast Growth

The biggest improvements in overall economic freedom scores during the period under consideration (see Table 1.8) have been registered by Gujarat (0.19 points), Chhattisgarh (0.11 points) and Andhra Pradesh (0.10 points). All three have also registered high levels of growth in state GDP, averaging

10.1 per cent in Gujarat, 8.5 per cent in Chhattisgarh and 8.8 per cent in Andhra Pradesh during the period 2004-05 and 2011-12.

The fastest growth has been recorded by the small hill state of Uttarakhand (annual rate of 13.1 per cent), but this cannot be ascribed to the moderate rise in its economic freedom score by 0.06 points. Rather, its breakneck growth occurred largely because the central government gave an excise duty holiday for all manufacturing units set up in the state till 2010, supposedly to compensate it for its hilly terrain. This was a classic case of bad policy. Industries rushed into the state to take advantage of the tax breaks, but almost all set up shop in the thin strip of plains in the south of the state, and virtually none went to the hilly regions. With the end of the tax break, growth in the state is going to slow rapidly, and it will have to look to better policies for powering its future growth. Bihar has been among the fastest growing states, averaging 9.2 per cent growth between 2004-05 and 2011-12. Its freedom score has improved only moderately by 0.06 points. But in percentage terms, this is a significant improvement of almost 25 per cent from a very low base. Besides, our indicators do not capture some of the improvements in economic freedom in Bihar due to the reduction of gangsterism and taming of Maoism, and the consequent improvement in the investment climate (see Chapter 2 on Bihar's performance).

The worst performance in economic freedom comes from Jharkhand, with a decline in score of 0.07 points. It has also been the fourth slowest growing state, averaging just 7.0 per cent. It used to be part of the composite Bihar state till 2000, and when that was split, Jharkhand found itself with all the coal, iron ore, major industrial cities and the bulk of tax revenue of the old composite state. Yet because of better policies and more economic freedom, Bihar has grown fast while Jharkhand (with gross mis-governance and falling economic freedom) has grown less rapidly.

The slowest growing state has been Jammu & Kashmir (5.8 per cent per year). Its economic freedom score has improved by 0.07 points, but the state continues to be dogged by terrorism. A similar tale can be told of Assam, the state with the second slowest growth (6.0 per cent). Its economic freedom score has risen a smidgeon, by 0.02 points. But it suffers from multiple insurgencies (from groups like the United Liberation Front of Assam and Bodoland People's Party) and high corruption, which hamper progress. Other states such as Punjab, Tamil Nadu and Odisha have had a moderate fall in their ratings (0 to 0.02 points). On the other hand, Rajasthan Kerala, Karnataka, West Bengal, Haryana, Maharashtra, Himachal Pradesh and Uttar Pradesh have seen moderate improvements (ranging from 0.01 to 0.09 points).

The states that have improved the most have improved in a wide range of indicators. This drives home the points that improvements in economic freedom require wide-ranging reforms, not just excellent performance in one or two areas.