

Executive Summary

The *Economic Freedom of the States of India 2012* estimates economic freedom in the 20 biggest Indian states, based on data for 2011, using a methodology adapted from the Fraser Institute's *Economic Freedom of the World* annual reports. The main highlights of this study are as follows.

1. The top state in India in economic freedom in 2011 was Gujarat. It displaced Tamil Nadu, which had been the top state in 2009. Gujarat's freedom index score has been rising fast, and at 0.64 it is now far ahead of second-placed Tamil Nadu (0.56). Madhya Pradesh (0.56) is close behind in third position, Haryana (0.55) retains fourth position and Himachal (0.53) retains fifth position.
2. The bottom three states in 2011 were, in reverse order, Bihar, Jharkhand and West Bengal. In 2009, the reverse order was Bihar, Uttarakhand and Assam. Uttarakhand has moved up sharply from 19th to 14th position, and this improved freedom is reflected in its average GDP growth rate of 12.82 per cent in 2004-2011, the fastest among all states. This is an impressive achievement for a once-backward state.
3. Earlier the median score for economic freedom for all states had declined from 0.38 in 2005 to 0.36 in 2009. But it has now improved substantially to 0.41 in 2011. This is good news. Still the median score lags way behind Gujarat's 0.64, so other states have a long way to go.
4. The biggest improvement has been registered by Madhya Pradesh. Its freedom index score rose from 0.42 in 2009 to 0.56 in 2011, enabling it to move up from 6th to 3rd position. This improved economic freedom was associated with acceleration in its GDP

growth. This averaged 6 per cent per year from 2004-2009, but then accelerated to 9 per cent per year in 2009-2011.

TABLE
Economic Freedom of Indian States: Index Scores and Ranking, 2009 and 2011

	2011 Rank	2009 Rank	2011 Score	2009 Score
Gujarat	1	2	0.64	0.57
Tamil Nadu	2	1	0.57	0.59
Madhya Pradesh	3	6	0.56	0.42
Haryana	4	4	0.55	0.47
Himachal Pradesh	5	5	0.52	0.43
Andhra Pradesh	6	3	0.51	0.51
Jammu and Kashmir	7	8	0.46	0.38
Rajasthan	8	7	0.43	0.40
Karnataka	9	13	0.42	0.34
Kerala	10	10	0.42	0.36
Chhattisgarh	11	15	0.41	0.33
Punjab	12	12	0.39	0.36
Maharashtra	13	10	0.39	0.36
Uttarakhand	14	19	0.38	0.26
Assam	15	18	0.36	0.29
Uttar Pradesh	16	13	0.35	0.34
Orissa	17	17	0.34	0.31
West Bengal	18	15	0.32	0.33
Jharkhand	19	8	0.31	0.38
Bihar	20	20	0.29	0.23

5. The biggest decline in economic freedom has been recorded by Jharkhand, which slumped from 8th to 19th position. Its score declined from 0.38 to 0.31. Unsurprisingly, its GDP growth has averaged only 4.6 per cent in 2004-2011, one of the lowest among all states (see Table 1.8). Jharkhand has special problems as a heavily forested state suffering from Maoist insurrections. But such problems also afflict its southern neighbour, Chhattisgarh, which has jumped up from 15th to 11th position in economic freedom. The state has been rewarded with rapid GDP growth averaging 10.0 per cent per year in 2004-2011.
6. As many as eight states have registered a decline in rank. These include some of the most industrialised states, such as Tamil Nadu, Maharashtra and Andhra Pradesh. However, the situation is better than it sounds. Some of these states have improved their freedom scores (Maharashtra, Rajasthan), but nevertheless fallen in rankings, because other states have improved their scores even faster.

7. Seen over a longer time horizon, Punjab has fallen in economic freedom rankings from 6th position in 2005 to 12th position in 2011. Once among the most prosperous and fast-growing states, it has suffered relative decline. This cannot be explained either by Sikh militancy (which ended two decades ago) or tensions with Pakistan, two favourite explanations trotted out by the state's politicians. Punjab's travails arise mainly from high fiscal deficits and public debt, both arising substantially from the curse of free rural electricity given to woo farmers' votes. Perverse incentives and money laundering have driven land prices so high as to inhibit industrial investment. However, the recent opening up of trade with Pakistan promises to convert Punjab into India's gateway to Pakistan, and this could help accelerate the state's growth. Punjab's investment climate has positive features: Ludhiana is ranked the best city in India in ease of doing business by the *Doing Business* series of the IFC/World Bank. The state's shift from government monopolies to public-private partnerships (PPPs) has facilitated increased investment in power, roads, education and health.
8. This report includes a special chapter on economic freedom in agriculture. Indian agriculture is bound hand and foot, and cries out for freedom. Not only is the production and marketing of sugar subject to extensive central and state controls, even the production and pricing of by-products (molasses, electricity, ethanol, chemicals) are subject to multiple controls. Even packaging (in jute bags, not plastic bags) is controlled. Other crops suffering from a plethora of prohibitions and controls are rice, fruit and vegetables. Land and water, the primary inputs for agriculture, are also subject to many restrictions and controls. This lack of freedom hurts farmers and keeps them disempowered and poor.
9. A special chapter on the labour market highlights the lack of reform in labour laws, and their adverse impact on economic freedom and growth. Among the states, Maharashtra has the best labour regulation, followed by Karnataka and Punjab. The worst states are West Bengal, Kerala, Uttar Pradesh and Assam. Job growth is concentrated in self-employment, a lot in informal sectors like street hawking, since labour laws discourage hiring by corporations, and encourage capital intensity and minimisation of labour use. Rigid labour laws explain why India has failed to set up huge factories for labour-intensive exports, something that many Asian countries used as a launching pad for economic growth. India also needs to eliminate obsolete labour laws (such as those mandating manual

rather than electronic registers), and laws limiting hours of work for shops or female employment. If labour issues are shifted from the concurrent list to the states list, then those states wishing to reform can go ahead without waiting for central legislation, which is difficult in these times of political gridlock.