

## Foreword



The *Economic Freedom of the World* (EFW) project begun in the 1980s by the Fraser Institute shows an enduring empirical relationship between economic freedom and prosperity, growth and improvements in human well-being. This study grows out of that work and seeks to measure the level of economic freedom within vast, diverse India.

While the economic freedom of India has notably increased since the introduction of market reforms in the early 1990s—a period that has also seen improvements in the country’s indicators of human development—India’s ratings remain low on the global index and have fallen somewhat in recent years. This year’s report highlights the importance of state-level policy improvements and experimentation to produce better economic and social outcomes, especially in light of the national government’s lack of interest or ability to continue reforms. Although the median economic freedom rating of the states of India has increased since 2005, the levels of economic freedom within the country vary greatly, with numerous states showing significant increases or significant declines in their ratings.

A chapter by Swaminathan Aiyar focuses on Bihar, the state with the lowest economic freedom rating that has nevertheless managed a remarkable improvement in its economic and social performance. Starting from a very low base, Bihar increased its economic freedom rating by a proportionately greater degree than the increase in the national average. It did so by, among other things, providing badly lacking public security. The resulting increase in growth and large fall in poverty were helped by the more liberal national policy environment set forth in the 1990s, showing that states can take advantage of the progress begun by the national government. Another chapter by Bibek Debroy meticulously enumerates how centralisation at the national level violates the Constitution and constrains the economic freedom of the states.

The Cato Institute is pleased once again to co-publish the annual *Economic Freedom of the States of India* (EFSI) report with the Friedrich Naumann Foundation and Indicus Analytics. We hope it will serve policy makers and interested laypersons as a guide to better policies.

— Ian Vásquez  
Director,  
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The *Economic Freedom of the States of India* (EFSI), 2013 report brings out once again the significant differences in economic governance between the states of India. It thus has focused attention on state-level reforms to improve inclusive economic growth. The Index is based on the Fraser Institute's *Economic Freedom of the World* (EFW) report. This was developed on the basis of ideas of Milton Friedman, Charles Buchanan, Douglass North, Michael Walker and others who wanted an empirically sound way to measure whether economic freedom would lead to better economic and social outcomes. This is indeed the case, as the annual study has clearly demonstrated, and the index has become an important contribution to the international policy debate. Its success has inspired researchers to come up with sub-national indices to capture the performance of sub-national institutions in China, Germany and elsewhere. The Friedrich-Naumann-Stiftung has been supporting the development of an Economic Freedom Index for the states of India for several years now. This index has become an important part of India's reform discourse.

The Indian Index is based on the three parameters: size of the government; legal structure and security of property rights; and regulation of business and labour. The Indian Index ranks 20 states of India for which data is available. The researchers have used published data from official sources or reputed institutions to produce the Index.

The researchers producing the Index are distinguished economists from India. Bibek Debroy and Laveesh Bhandari are known for their work in suggesting policy recommendations for Indian economic growth. The Cato Institute, a prominent and leading American think-tank based in Washington, DC, has been a partner in this endeavour for several years now. Swaminathan S. Anklesaria Aiyar, a well-known writer and commentator, is the third co-author representing Cato.

The Index shows the direct correlation between economic freedom and the well-being of citizens. As the World Index has shown a direct correlation between economic freedom and national indicators of human and material progress, the same correlation is also visible at the sub-national level. States in India which are economically more free are also doing better in terms of a higher per capita growth for its citizens, unemployment levels are lower in these states, sanitary conditions are better and the states also attract more investments.

Each report shines a spotlight on a different state. The current report focuses on Bihar, a place traditionally at the bottom of the table with regard to most indicators but a state that has seen some major reforms pushed by the state government. The question is if and to what extent these reforms have made a dent in Bihar's ranking.

Another focus in the current report is the changing relations between the central government and the states in India. The big question is whether

more decentralisation will lead to more creative and successful policy reform

The report is published through a joint effort of the Friedrich-Naumann-Stiftung für die Freiheit, the Cato Institute and the Academic Foundation, New Delhi. We would like to thank all the contributors, authors and partners for their enthusiasm and hard work that made this report possible. May it prove to be a useful instrument for research and debate for policymakers and academics alike.

— Siegfried Herzog  
Regional Director, South Asia,  
Friedrich-Naumann-Stiftung für die Freiheit