THE CHALLENGE OF POVERTY

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" Free Enterprise was born with man and shall survive as long as man survives".

- A.D. Shroff
1899-1965
Founder-President
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INTRODUCTION

The two perceptive articles published in this booklet are of immense relevance in the backdrop of the current raging debate on the impact of liberalization and globalisation in the last decade on the Indian economy. These deserve close study by all serious students of the subject.

Dr. Otto Count Lambsdorff is an internationally renowned liberal. He was for seven years Minister of Economics in the Federal Republic of Germany. He has displayed great empathy for emerging countries like India and played an active role, as the Chairman of Friedrich Naumann Stiftung, an NGO devoted to spread of liberal values worldwide to assist worthy movements. Count Lambsdorff has drawn attention to the empirically well established link between liberal economic policies and poverty alleviation. There is a laudable urge to do something to help the poor directly through instruments of the welfare state. Though this may be necessary in a few extreme cases the moral impulse often suppresses the real issue of whether these reactions really tackle the root causes of poverty or create dependency and stifling the initiative of the poor themselves.

Swaminathan S. Anklesaria Aiyar, an articulate journalist, in his piece has very ably documented the impact of globalisation on developing countries and disabused the belief held in many circles that globalisation is the root of all economic and social ills faced by underdeveloped countries. He pointedly draws attention to the fact that developing countries that have seized the opportunities offered by globalisation have fared better than ever in history. China and India, which account for more than half the population of the developing world, have raised more than 350 million people above the poverty line in the last decade. Further those who have failed to link up with the world, mainly in Africa, have suffered the most. He also cites the fact that 20th Century globalisation is vastly different from the 19th Century colonizing globalisation. In contrast to the only 3% per annum growth recorded by the fastest growing countries, like USA and UK, in the 19th century the last 20 years have witnessed rates upto 10% annual growth in several countries (China for instance) creating far greater opportunities for the poor. In fact globalisation in recent years has shifted manufacturing jobs from high to low income countries.

31st October 2002

Minoo R. Shroff

President

Forum of Free Enterprise

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I

Dr. Otto Count Lambsdorff

Mass poverty remains a challenge to the global community. According to the World Bank, in 1998 1.2 billion people lived in absolute poverty, i.e. with an income of less than one $ a day, almost half of them in South Asia. Although poverty has decreased some what, it remains the biggest challenge to mankind. Poverty has a de-humanising effect. It keeps people from realising their inherent human potential, forces them into unequal relationships that severely limit their freedom, exposes them almost defencelessly to the predatory behaviour of others. The daily struggle for survival usually does not leave the poor time to participate in the political life of their community or nations, except in the service of a patron. Their interests go unrepresented and are consequently neglected.

Poverty is therefore a huge challenge for Liberals, both for their vision of humanity and their vision of a just liberal society. Liberals believe in the principle of freedom of the individual and a set of inalienable human rights. Extreme poverty is a daily attack on the right to life of an individual and therefore cannot be tolerated by liberals. Moreover, a person struggling for physical survival has very few choices in life where he or she

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could experience individual freedom. A realisation of individual liberty throughout society presupposes an alleviation of mass poverty. Poor people usually have no choice but to 'sell' their political rights to a patron who provides them with a modicum of security, a situation that seriously threatens democracy. Societies managed to transform themselves into real democracies only when poverty was reduced and such patron-client-relationships became less dominant.

Not coincidentally, liberalism has always laid great stress on stable private property rights, since private property is an important material safeguard of individual liberty. It has often been argued that the liberal concern with private property reflects the interests of the propertied classes, but that is only part of the picture. The liberal concern for private property also has to be seen as an objective of state policy: the state should enable all citizens, especially the poor, to acquire private property. Therein lies a substantial difference from socialist policies, which want the state to limit or even confiscate private property in order to finance transfer payments to citizens. Liberals are sceptical about the value of transfer payments as these introduce an element of dependency, while acquiring property increases financial autonomy and thus strengthens individual liberty.

There are, of course, instances where transfer payments in some form will be necessary, but liberal social policy will first explore whether there are instruments that help people to acquire more property rather than offering a new entitlement. Liberals will therefore prefer to force people to save money in individual retirement accounts or insurance schemes rather than forcing them to pay tax and distribute the money to people vested with some entitlement or another. The forced saving/insurance road allows operation by efficient private agencies, controlled by governmental regulation that might include a reinsurance requirement. The taxation/ redistribution approach necessitates the setting up of a huge welfare bureaucracy that will eat up a significant part of the resources. Note that in both cases the state assumes a responsibility to protect people from economic risks, but the instruments employed are different.

Similarly, the provision of many services need not be entrusted to a bureaucracy, but to the market, with poor people getting access to it via vouchers which would buy a place in a private school for their children or give them access to a private hospital. Unfortunately socialists seem to have somehow managed to convince most people that the creation of a huge welfare bureaucracy is the only ethically sound response to the challenge of mitigating poverty. This recourse to emotion serves to suppress reasonable debate about the effectiveness of alternative instruments. This is pernicious for the poor. If we look at the example of education, it is quite obvious that in order to achieve upward mobility, the poor need access to quality education. In many countries, by contrast, quality education is provided by private schools for the children of the rich and the state supplies education of highly dubious quality for the rest of the population. This neglect of the quality aspect of education perpetuates the disadvantage of poor people. Unfortunately, this lack of concern for the quality of education seems to be a worldwide political phenomenon, affecting countries like India and Bangladesh as well as US or Germany.

The question of how to give the poor better access to economic opportunities is another central issue. First and foremost, this requires a dynamically growing economy. It is again a socialist folly to exclude or at least downplay the issue of economic growth when dealing with the issue of poverty alleviation. This again is explicable only by the fixation of the left with entitlements and activist/interventionist bureaucracies - and by the uncomfortable fact, from the leftist point of view, that liberal economic policies, especially free trade, have been more successful at producing lasting growth - so much so that environmentalists attack liberalism and especially trade for producing too much economic growth!

Indeed, classical liberalism under which free trade flourished has been the most successful economic strategy in world's history. In the 19th century it put an end to famines in Europe, which hitherto had been seen as the inevitable lot of mankind. We forget that, for instance, in 18th century France we had nine famines that killed more than five percent of the population. When we see famines today, we will only find them under non-capitalist, non-liberal and non-free-market dictatorships such as North Korea. The era of free trade in the 19th century for the first time in human history made wealth for all possible. That the free market is the source of wealth today is unquestionably true. The data confirm this.

The Friedrich-Naumann-Foundation is one of around

52 co-publishers of an annual study called 'Economic Freedom of the World' which was originally masterminded by Nobel-Laureate Milton Friedman. The purpose of this study is the measurement and the comparison of economic freedom in 123 countries. Measurable indicators like the tax rate, the share of government in GDP or the amount of trade restrictions are used to find the place for each country in a comparative ranking. This is not of mere academic interest. The study has clearly demonstrated that there is a remarkable connection between economic freedom and economic growth. The heavier the burden of government of the individual the more stagnant becomes the economy.

Moreover it has been shown by correlating the results of "Economic Freedom of the World" with other criteria of "standard of living" rather than mere growth rates, that the freest countries of the world have less illiteracy, less corruption and a higher life expectancy than the unfree ones. This alone should be enough of an argument to say farewell to any form of economic collectivism.

But what does this study say about those "left behind"? We all hear that the gap between rich and poor countries is widening. This is actually true. In the third world there are poor countries with no or even negative growth rates, while most countries of the first world are - at least moderately - growing. But this will only be fully understood if, again, one correlates it with the degree of economic freedom. The result : the group of the poorest and least growing countries is almost identical with those who have not opened their economies and constantly interfere with the freedom of their people. Yes, there are people who are "left behind", but they are not the victims of free trade or globalisation. They are victims of their own governments!

A growth rate taken in aggregate, one could argue, does not say much about the internal distribution of wealth. In the industrialised countries, so the media say, the liberalisation of the economy may have created new jobs, but those were only unqualified trash jobs or "McJobs", as the pundits say in order to add the usual anti-American tone to the argument. The "working poor" is the new stereotype that is supposed to give some rhetorical ammunition for the crusaders against globalisation and free trade on the right and on the left. Even if this were true it still would be better than the exclusion of the less qualified from the labour market that is practised by the overinflated welfare states in Europe. But it is - at least in the way it is generally presented - not true at all. Not only did the new technologies provide jobs but created new and better ones.

Those countries that kept their markets fairly open saw an increased demand for highly qualified employees rather than one for low qualified workers. In the US 55 percent of the jobs created between 1983 and 1996 were highly qualified, about 32 percent required medium qualification, and only 18 percent were low quality jobs. If one looks at the distribution of income within countries, the poorest and economically most unfree countries also have bigger income inequalities than the economically free countries. Sometimes one just should take a look at the figures to find out what is behind the common stereotypes on economic freedom and global markets. On the global level, therefore, the conclusion should be to energetically continue with the multilateral liberalisation of trade under the auspices of the WTO, argues Professor Jagdish Bhagwati, a leading authority on trade issue, in a recent article titled "The poor's best hope" (The Economist, June 22, 2002). He chastises governments of developing countries for failing to see the harm that their long love affair with protectionism has done to their economies, and for the mistaken belief held by many of them that rich-country protectionism, wrong as that may be, justifies a continuation of their own protectionism. That means harming oneself twice over.

The positive link between liberal economic policies, economic growth and poverty alleviation is empirically well established. However, this connection is often pejoratively dismissed as "trickle-down effect", implying that most of the gains accrue to the rich while the poor get some crumbs.

When confronted with the reality of suffering by the poor, most people feel that a response that concentrates on economic policy reform is too abstract and too distant from the reality of the lives of the poor. There is an understandable and ethically laudable urge to do something, anything, to help the poor directly -through charity or through instruments of the welfare state. This is indeed necessary in some cases where people do not have any capacity to help themselves. But the moral impulse often suppresses the question whether these reactions really tackle the root causes of poverty, or whether they just alleviate the symptoms while creating dependency and stifling the initiative of the poor themselves. For many years the promotion of self-help initiatives has therefore been the preferred goal among organisations dispensing aid. Yet this begs one simple question: Why do the poor need the encouragement of outside agencies, often foreign ones, to do the obvious and help themselves?

Many of the answers can be found in the brilliant books of a Peruvian economist, Hernando de Soto. His starting point is the economic system that the poor of this world find themselves in, and he points out that the poor do not have access to the legal instruments and institutions that make a modern market economy efficient: rule of law, especially protection and enforcement of contracts, stable and safe property rights, simple but efficient regulation of markets. Instead, the poor are faced with a legal system that is overly complicated and inefficient. Even when courts are independent and professional, cases drag on for years. Government regulations are hideously complicated and intrusive, making any economic activity contingent on numerous approvals and signatures. They might control assets such as a piece of land in a slum, but these assets are not legally registered in their name.

De Soto and his team did a practical experiment: they tried to set up a simple textile workshop with one worker, following all the prescribed rules and regulations, without paying bribes. It took them almost one year, and the conclusion is stark: achieving legality is clearly impossible for any micro-entrepreneur. Here lies one of the biggest reasons for the size of the informal market.

These inhibiting regulations also extend to economic self-help initiatives of the poor: in many countries these are technically illegal, especially those dealing with micro-credit. These regulations are often meant to protect the poor from exploitation - in theory. In reality, they expose them to exploitation at the hands of the police and the bureaucracy whom they have to bribe in order to carry out the simplest economic activity. Whether they work as hawkers, rickshaw - pullers or microbus drivers, the poor have to pay to the powers that be in the police and bureaucracy. This also explains why outside involvement was necessary: it persuaded or pressured governments and their bureaucracies to allow - usually grudgingly - such activities to take place, at least on a limited scale. It is one of the less recognised achievements of foreign aid that it has helped to protect the growing self-help movement in the developing countries against attempts by the state apparatus to throttle it in its infancy.

The most serious problem, though, is the issue of property rights. In most countries of the South, property rights are either ill-defined, ill-protected or difficult to transfer. These countries do have systems of property rights, often very complicated ones, but they do not reflect the reality in which the poor live, and they are not at all efficiently managed. Many of the poor live in housing such as slums whose title is contested.

The inefficiency of the property market means that not enough land and housing is available for the growing number of people migrating to the cities. They therefore have to grab land, usually from the state that owns it, cannot make up its mind what to do with it and is usually unable to defend it. Such land grabs are organised by 'Informal Entrepreneurs', also known as slumlords, who organise the defences of illegal settlements and their political protection. The poor who live in these new slums pay rent to them, cast their votes as they are told and make up numbers at political rallies. It is obvious how this harms both democracy and economic development, but the poor have no choice.

The economic effects of this are nothing short of momentous: Assets such as houses, huts or land whose ownership is unclear or contested cannot be transformed into capital. The moment ownership of an asset is clearly defined and protected by the rule of law and its transfer can be done safely and efficiently, it can be used as collateral to raise money. The asset thus assumes a second, virtual life as capital. The poor on this globe are usually excluded from this: they control assets, but they do not have access to the legal instruments that turn their assets into property and thus capital. De Soto estimates the amount of unused or 'dead' capital caused by deficient property rights in the countries of the South to be in excess of 9 trillion $, and much of that is controlled, by the poor. No amount of foreign aid can match this potential for capital formation. Moreover, it would give the poor a much larger share of recorded wealth.

What emerges from this is the idea with which this article started: the best way to overcome poverty is helping the poor to get access to property. It turns out that in many cases, this could be done virtually free of cost: it just means recognising in law what is already a reality, namely control of assets. The poor in a slum already know who 'owns' which hut. All the state needs to do is record the fact and give it the effective protection of law. Formulating law should be seen, in De Soto's parlance, as a process of discovering the reality, and in this process the need for a variety of legal instruments might become apparent. To take one example, land held for centuries collectively by tribes can be integrated into a formal system of individual property rights by using not just natural but also legal personalities, e.g. cooperatives or share-based companies. We already have examples in Europe such as monasteries where the monks or nuns own land collectively and the monastery becomes the actor in the marketplace. If a tribe wishes to continue its age-old practice of collective land use, this would be an instrument to do so within a market-based economic system.

Recognising the property rights of the poor and defending them is not a technical but a political task. For too long, champions of the poor have ignored the issue of property rights, thinking this is only relevant for the rich. In the South, this is a fatal fallacy. The rich don't need protection of their property rights as much as the poor do, and the reality is one where the ill-defined and often undefended property rights of the poor get attacked or destroyed by the rich. Changing this is a political process, and it has to be ensured that in the transition to a stable and efficient system of property rights, the poor are not elbowed out by powerful groups such as slumlords. This will certainly happen if the process is handled only by bureaucrats and technocrats.

The task before us is therefore not one of devising new and better instruments of transfer payments to the poor. It is to recognise their rights of economic participation and to devise the appropriate legal instruments and institutions that allow them to leave the informal sector and access the formal sector – a birthright from which they have been excluded far too long.

II

GLOBALISATION AND POVERTY

Swaminathan Anklesaria Aiyar*

For some people, globalisation is a dirty word. It conveys the notion that rich multinational corporations are now sweeping through and dominating the whole world in a new form of imperialism. Anti-globalisers point to data that show that poverty has decreased very slowly, if at all, in the last decade since the collapse of the Soviet Union. In many parts of the world incomes have plummeted and so has life expectancy. They attribute this to the evils of unbridled capitalism sweeping across developing countries, freed from the trade and investment barriers that characterised earlier decades.

The facts are rather different. Developing countries that have seized the opportunities offered by globalisation have fared better than ever in history. China and India, which account for more than half the population of the developing world, have raised more than 350 million people above the poverty line in the last decade. But countries that have failed to climb on the globalisation bandwagon, mainly in Africa, have suffered the most.

This pattern also holds in ex-communist nations, sometimes called transition countries. When the Soviet

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* The author is Consulting Editor, Economic Times, New Delhi. This article draws heavily on the author's address to the Mont Pelerin Society in Goa in January 2002. The text is reproduced from "Liberal Times", 2/02, with kind permission of its Managing Editor.

Union and its east European empire broke up, all suffered major economic dislocation. The sudden disappearance of COMECON, the ruble-based trading bloc, is estimated to have caused GDP to drop by as much as 20 percent in the transition countries. However, while some kept going downhill for a long time, many others staged a big and impressive recovery. Those ex-communist countries that most quickly integrated with the global economy – Slovenia, Hungary, Poland, Estonia – came roaring back after the initial economic setback. Those that remained centralised, state-dominated autocracies in all but name – Uzbekistan, Kirghizstan, Belarus, Tajikistan – fared the worst.

A question of interpretation : However, one thing has become clear. Globalisation must not be interpreted to mean the mere absence of trade or investment barriers. General Mobutu in Zaire ran an ostensibly open economy, which was in fact a personal fief. His personal bank balance was said to be roughly equal to all the foreign aid Zaire received. Globalisation implies empowering the people of a country to participate in the global economy. It implies that countries have developed the policies, institutions, infrastructure and educational levels that enable its people to latch on to the opportunities created by globalisation.

It does not mean simply a high level of exports. The worst-run countries can export natural resources like oil and diamonds, and so appear to be globalised. In fact their natural resources are controlled by elites, who seize the mineral wealth of their country for their personal benefit. The elites are globalised: they put their savings in global banks and enjoy holidays on the Rivera. But their people remain untouched by globalisation. There is capital flight out of such countries as elites put their ill-gotten gains in Swiss banks. But there is very limited capital inflow because of the predatory nature of regimes, and what little flows in goes mainly to the mineral enclaves controlled by the elites.

This is as true of ex-communist countries as darkest Africa. Russia, once a superpower, is now mainly an exporter of minerals, though also of defence equipment. Some of the worst run countries have a high export/GDP ratio. The answer is not to stop exporting (which will make them even poorer) but to have better policies, institutions, infrastructure and education, which enable a much larger proportion of each country's population to link up with the global economy. So, the main problem is not poverty caused by globalisation, but poverty caused by the lack of it. The new anti-globalisation rhetoric is a throwback to the rhetoric of leaders of independence movements in colonies in the last century. That rhetoric was fatally flawed, and developing countries paid a heavy price for it.

In the aftermath of colonialism : When developing countries emerged from colonial rule, most believed that globalisation was a recipe for enslavement by imperial powers, and hence continuing poverty. Most of them attempted to reduce their dependence on foreign trade and investment, and sought to industrialise behind high tariff and non-tariff barriers. Most opted for socialism, supposedly to reduce poverty. Most also opted for one-party dictatorships on the ground that this would help forge strong nations untrammeled by ethnic and religious separatism. We now know that this strategy empowered and enriched central leaders but not citizens. Its effects were dubious everywhere but worst in Africa, where it led to murderous dictatorships, civil wars, and economic collapse.

In India, self-sufficiency and centralised paternalism introduced by Jawaharlal Nehru did indeed yield some positive results. Princely oppression disappeared, the power of the landed gentry (zamindars) was curbed by land reform. GDP growth improved to 3.5 percent per year, thrice as fast as during the British Raj. This was initially hailed as a great success. Only much later did the miracle economies of East Asia show that 3.5 percent was slow, not fast.

In much of Africa, living standards improved only briefly after independence before falling again. African countries received enormous sums of aid per capita compared with Asia or Latin America. But this fattened only the central leadership, while the countries decayed. Many have lower standards of living today than at independence.

In the 90s : Self-sufficiency and state paternalism were supposed to produce strong, prosperous countries. Instead they produced more than 100 weak countries, pathetically dependent on foreign aid and suffering form various forms of mis-governance and oppression. By 1990, more than 100 countries had queued up at the gates of the IMF to seek financial rescue. The collapse of the Soviet Union showed that mere socialism could not provide a solution. And so the whole world began to move towards economic liberalism and globalisation.

Why did the charismatic men who led independence movements adopt such bad economic policies? Mainly because they mistakenly equated globalisation with 19th century colonialism, with domination by western powers. They failed to see that, in the late 20th century, globalisation was no longer political conquest but economic partnership, creating unprecedented opportunities for the poor to rise. This faulty interpretation led to faulty policies aimed at de-globalisation.

Indian socialists like Nehru cheered as India's share of world trade fell from 2.5 percent at independence to 0.4 percent by 1985. They thought such self-sufficiency was a passport to prosperity, and derided outward-looking countries like Singapore and Taiwan as neo-colonial puppets. Alas, the supposed puppets rapidly became rich while India remained poor.

All colonial masters extracted large sums from their colonies. The net transfer of capital from India to Britain in the 19th century was estimated at 1.5 percent of GDP. The drain from Indonesia to Holland was much larger, around 10 percent of GNP. In order to make these payments, the colonies had to chalk up large trade surpluses, and so exported to the hilt. India's export-import ratio ranged from 172.5 percent in 1840-69 to 133.4 percent in 1913-38. Socialists, like Nehru, interpreted this to mean that export-orientation was a tool of colonial exploitation, and free trade a ploy to help Britain dump its manufactures on a de-industrialised India. He and other Third World leaders knew that globalisation in the 19th century had produced alien rule, transfer of wealth to colonial powers, and rising inequalities. They assumed that globalisation in the late 20th century would produce similar results. In fact the differences have been enormous.

20th century : For starters, 19th century globalisation represented colonisation. 20th century globalisation has been the era of decolonisation. This is a huge difference. Remember that 19th century globalisation yielded GDP growth rates of no more than three percent per year in the fastest-growing countries like the USA and UK. At the time this appeared to be rapid growth. But 20th century globalisation has yielded GDP growth rates of up to 10 percent annually in several countries, creating far greater opportunities for the poor. In India many critics complain that the GDP growth of 5.5 to 6 percent is highly unsatisfactory and below target. Yet this is almost twice as fast as the growth of the biggest colonial powers in the 19th century.

Furthermore, the rich imperial powers grew fastest in 19th century globalisation. But after World War II, the fastest-growing countries have all been in the Third World, mostly in Asia but also in Africa (Botswana, Seychelles, Mauritius). Income per head is now higher in Singapore and Hong Kong than in their erstwhile colonial master, Britain. In the late 20th century, low-income countries (as defined by the World Bank) have averaged faster GDP growth than rich ones. Low-income countries averaged 4.4 percent growth in 1980-90 and 3.9 percent in 1990-97. High-income countries registered 3.2 percent and 2.2 percent respectively, lower in both cases (World Development Indicators). This is the very opposite of the trend in the 19th century.

Globalisation in recent decades has shifted manufacturing jobs from high income to low-income countries. This is in stark contrast with the 19th century, when British manufacturers decimated traditional industry in the colonies, and shifted manufacturing jobs (especially in textiles) from India and China to the West.

In the 19th century (and indeed for most of history), poverty was a major disadvantage. But in the 20th century factories shifted from richer to poorer countries wherever the latter had decent policies, institutions and infrastructure. The poorer the country, the greater was its wage advantage. For the first time in history, globalisation made poverty an advantage. The advantage was not automatic: a country had to build the institutions and infrastructure. In the 19th century, inequalities rose most between imperial and developing countries. In the 20th century, inequalities have risen fastest between developing countries that seized the opportunities created by globalisation and those that did not. The East Asians soared, the Africans stagnated.

In the 19th century, most Western foreign investment in and trade with developing countries was in minerals and agricultural commodities. So Nehru, Nkrumah and others thought globalisation was a trap to keep poor countries as commodity producers. But in recent decades foreign investment in developing countries has been overwhelmingly in manufacturing. According to one estimate (WDI 1998), manufactures now constitute 77 percent of the exports of low income countries. In 1997, developing countries actually chalked up a trade surplus in manufactures with the USA of $ 57.2 billion (World Development Indicators 1999. p. 331-332).

So, while the world was in many ways as globalised in the 19th century as today, it is now globalised in ways much more favourable to developing countries, and much more favourable to reducing poverty. All opportunities also carry risks. The Asian financial crisis of 1997-99 was a good illustration of this. Nevertheless, warts and all, globalisation has lifted huge numbers out of poverty, 250 million in China alone. Few forces in history have empowered the poor so much.

The views expressed in this booklet are not necessarily those of the Forum of Free Enterprise

" People must come to accept private enterprise not as a necessary evil, but as an affirmative good".

- Eugene Black

638

FORUM OF FREE ENTERPRISE

The Forum of Free Enterprise is a non-political and non-partisan organisation started in 1956, to educate public opinion in India on free enterprise and its close relationship with the democratic way of life. The Forum seeks to stimulate public thinking on vital economic problems of the day through booklets and leaflets, meetings, essay competitions and other means as befit a democratic society.

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