

**REFLECTIONS ON FOREIGN AID**

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## REFLECTIONS ON FOREIGN AID

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It is a major axiom of the current development literature that Foreign Aid, in the sense of inter-governmental grants, or subsidised loans in cash or kind, are indispensable for the material progress of poor countries. This argument or axiom is often coupled with the suggestion that foreign aid by the Western countries is a discharge of a moral obligation to help the poor.

Foreign aid in the sense of inter-governmental grants and subsidised loans is a system of doles. A contemporary discussion on aid is pervaded by the view that such a system of doles is necessary for the progress of poor countries. A convenient formulation of this view is presented by a passage in a letter by Prof. Wolfgang Friedman of Columbia University, who is not to be confused with Prof. Milton Friedman. The letter which appeared in "The New York Times" says: "It is the unanimous opinion of all foreign aid experts that the total amount of development aid is grossly inadequate for even the minimum needs of developing countries." Thus, according to Prof. Friedman, economists who dispute the necessity for foreign aid, cannot be experts in this field. Yet, there are many economists of widely different political views — some in prominent positions — who dispute this contention. For example, Prof. Milton Friedman, who is an economist of some prominence, and Prof. Joan Robinson, who may be known to some of you and whose views differ greatly from those of Prof. Milton Friedman in most subjects, are in agreement that foreign aid is certainly not necessary and is actually harmful for under-developed countries.

\* This text is based on a public lecture delivered under the auspices of the Forum of Free Enterprise in Bombay on February 3, 1970. The text is a transcript from taperecording, unedited by Prof. Bauer. A revised and enlarged version will appear in Prof. Bauer's forthcoming book, "Dissent on Development".

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

—Eugene Black

The idea that foreign aid is indispensable for the progress of under-developed countries seems to be derived from the idea that without aid these countries are so poor that they cannot save and invest enough for the capital formation necessary to raise their income. But foreign aid is obviously not a generally necessary nor a sufficient condition for economic advance. It is clearly not a generally necessary condition for economic development as is obvious from the very existence of developed countries. All developed countries began as under-developed countries and progressed without foreign aid. Moreover, many **under-developed** countries have advanced very rapidly over the last 70 or 80 years without foreign aid, which is the **particularly** relevant consideration in this context. There are many such **countries** in the Far East, South-East Asia, East and West Africa and Latin America. So aid is clearly not a necessary condition for economic development, nor is it a **sufficient** condition. Foreign aid, for example, cannot promote development if the population at large is not interested in material advance nor if it is strongly attached to values and customs incompatible with material progress. An instructive example is provided by the results of the large scale American domestic aids to their Navajo Indian population. The Navajo Indians are a large group with their own territorial government. Since about 1900, vast sums have been spent by the United States Government, in attempts to improve the material position of this group, with no perceptible result.

There are many examples from the **experience** of the last decade or two of the comparative ineffectiveness of foreign aid as an instrument for raising general living standards in poor countries. Fifteen years after the inception of Western aid and the Five-Year plans, India in **1966-67** experienced the most acute of its recurrent food and foreign exchange crisis. India has been dependent for large scale foreign aid and gifts of food for so long now, that this external dependence has come to be taken for granted. Indeed the economic history of India since about 1956 can be summarised as a progression from poverty to pauperism. Yet, it was an explicit objective of Indian planning to reduce or eliminate economic dependence. Now after well over a decade of foreign aid its

general **ineffectiveness** to promote living standards in poor countries is freely **recognised** in current discussions.

The advocates of aid, however, at the same time insist on more foreign aid. Supporters of foreign aid regard the absence of an appreciable improvement in the economic conditions of recipient countries as an argument for extending foreign aid, both in volume and in size. The case of foreign aid is treated as axiomatic. Once you treat a case as axiomatic, then empirical evidence becomes irrelevant. Because, take for example foreign aid - either progress or **lack** of progress can be used as an argument in support of its continuation or expansion. Progress is **evidence** of its success, and lack of progress is evidence for **the** need for more! Foreign aid is thus, indisputably, **neither** a necessary nor a **sufficient** condition for **advance** from poverty.

When foreign aid is likely to promote or retard development cannot be established so clearly. This is because the economic situation, and its rate of change at **any** given time or any given period are affected by so many different factors that it becomes very **difficult** to disentangle the **specific** effects of aid. Further, it is impossible to know what policies would have been pursued in the absence of aid. For these reasons, before saying that the foreign aid is likely to accelerate or retard economic **development**-it has accelerated or retarded development over the last 15 years - it is necessary to proceed by reference to certain general considerations supplemented by specific empirical evidence. However, the **difficulty** of ascertaining whether in a particular situation foreign aid has promoted or retarded the progress of a particular community may be difficult, but it can be said conclusively that it is neither a necessary nor a **sufficient** condition for material progress.

I believe that the flow of aid since the Second World War has probably more retarded than promoted the **overall** economic advance of recipient countries. This conclusion is paradoxical. It is paradoxical, because foreign aid certainly increases the resources of the recipient countries or, at any rate, of their Governments. But it does not follow from this that foreign aid increases the rate of development. This result depends on how aid affects the

determinants of economic progress, notably its repercussions on economic attitudes, policies and institutions and **also** on the allocation of resources in the recipient countries. The repercussions are often damaging in practice and **tend** to outweigh any favourable results of the **inflow** of resources. This is the reason why foreign aid, though it may improve current economic conditions in the recipient countries, has not served generally to promote their economic development.

The major determinants of material progress are people's economic faculties and motivations and the social and political institutions which reflect these faculties and motivations. Foreign aid is relatively ineffective as an instrument of development because, even at best, it cannot **affect** these underlying determinants of development favourably. If a country, or rather a people, cannot develop without external doles, it is unlikely to develop with them. **Advocates** of aid encourage the unfounded belief that the pre-requisites of development can be had for nothing and they ignore or obscure the fact that the populations of developed countries themselves have had to develop the faculties, attitudes and institutions favourable to material progress.

At this juncture of the discussion somebody **is** bound to raise the question of Marshal Aid because this is often **quoted** as an example of the effectiveness of foreign aid. But the analogy between Marshal Aid and the **aid**-programme for under-developed countries is false. The economies of Western Europe had to be restored, while those of the present recipients have **to** be developed. The peoples of Western Europe had the faculties, attitudes and institutions favourable for development for centuries before the Second World War. Hence a rapid return to prosperity in Western Europe and the termination of Marshal Aid after four years, in contrast with the economic plight of India **and** of many other recipients of aid after a much longer period.

Persons and groups react to material poverty and backwardness in different ways. They may not **even** notice the condition. Such an attitude **is** often a part of a wider attitude of an unquestioning acceptance of the nature of **things**, especially, if comparisons with other people are

not readily available. They may consciously accept poverty, either in the form of resignation or unwillingness to change modes of living, or they may improve their position by relying on charity or beggary. Finally they may attempt to improve their own economic performance. **Only** the last of these responses can lead to sustained material progress. And it is the one least likely **to** promote it by insistence on foreign aid as allegedly necessary for material advance. Moreover, the way the advocacy of foreign **aid** is presented **often** sets up unfavourable repercussions within the recipient countries.

It is often said or implied that the West owes **foreign** aid to the under-developed countries as evidenced by its riches. It is suggested that the riches of the Western countries **have** somehow been extracted from the under-developed countries, while in fact they have been generated in the West. And if you suggest that riches are extracted from other people, then you suggest before **very long** that within the underdeveloped countries the better-off people owe their prosperity somehow to the exploitation of the rest of the society. This then sets up attitudes and **results** which are harmful to material progress.

Certain differences between resources developed locally and resources supplied gratis, as external doles from abroad, are relevant to an assessment of **foreign** aid. When resources are both generated and used locally the personal faculties and attitudes, social institutions and economic opportunities are encouraged to develop simultaneously and to serve as they see for further material progress. This beneficial inter-relation is missing when resources are **supplied** gratis from abroad. Moreover, external doles tend to bias development in directions based on inappropriate external prototypes. And the adoption of external **proto**-types in development policy is often damaging, and it **may** retard rather than promote material progress, lead to frustration and political tension. Inappropriate, external prototypes come to be adopted in political life, legal system, the organisation of the Civil Service, the establishment of **Western** type Universities, as well as in technology and forms of industrial and commercial **organisations**.

The establishment of Universities based on Western models, when there are no employment opportunities for

their graduates, is a familiar example. And adverse **results** are all the more likely when the expenditure is undertaken by people who do not themselves bear the cost. The impact of foreign aid in biasing development policy and strategy in directions based on inappropriate external prototypes is an instance of the **wider** issue of the problem of **transferring** institutions between different cultures and societies.

Foreign aid augments the resources of Governments compared to those of the private sector in recipient countries. This effect promotes concentration of power within under-developed countries, increases the weight of the Government in the society and economy and thereby promotes a concentration of power. This effect is greatly reinforced in the current political scene by the preferential treatment in the allocation of aid to Governments engaged in Comprehensive Planning. This criterion in the allocation of aid is based on the belief that comprehensive planning is necessary for economic progress, so that its adoption by Governments is seen as evidence of the earnest of the Governments to promote it. Indeed in much of current discussion, planning is equated with development. This notion is opposite of the truth. Comprehensive planning is demonstrably not a necessary condition of economic development and is much more likely to retard than to promote it. However, Governments engaged in comprehensive planning are preferentially treated in the allocation of Western aid. Moreover, the flow of aid is often linked to the balance of payments deficits of the recipients. This is particularly so when these deficits are regarded, as they often are, inevitable concomitants of Governments' **efforts** to carry out development plans. Governments are thus encouraged to make their development plans as ambitious as possible, to pursue inflationary monetary and fiscal policies and to avoid the accumulation of foreign exchange reserves. The pursuit of **inflationary** policies, the recurrence of balance of payments crisis, the imposition of specific controls, notably exchange controls and high taxation, usually lead to a widespread feeling of insecurity. This insecurity and crisis-atmosphere, which is engendered, encourage the export of capital, and discourage domestic savings and investment expenditure so that the inflow of foreign aid is matched by a reduction in the rate of

domestic savings and investment, **and** by an outflow of private capital. Often private capital is much more productive than the capital represented by this external doles. But foreign aid may even reduce, rather than increase the investment expenditure within the recipient countries.

Foreign aid is also likely to discourage recipient Governments from seeking capital abroad on market terms. It is politically unwise, and may indeed be even suicidal, to pay market terms, if foreign aid, that is funds secured gratis, or on heavily subsidised terms, are available. And practically all recipients of foreign aid **impose** severe restrictions on the inflow and deployment of private capital, although they often pay lip service to its usefulness.

Preoccupation with foreign aid, central planning **and** investment expenditure has encouraged the facile belief that material advance is possible without cultural change. **This** belief has in turn inhibited the exploration of ways to promote institutional changes, especially change without coercion. In the sphere of institutional change, the **recipients** of large-scale foreign aid have, so far, largely confined their activities to the expropriation of politically **weak** and unpopular classes in the name of land reform, social justice or the removal of alleged exploitation. Such measures have generally retarded economic development.

A variant of the case for foreign aid to promote investment, links aid specifically to the financing of the infra-structure, sometimes called the social overhead, necessary for development in poor countries. Infra-structure in this context refers to such installations **as** ports, railways, roads, which do not produce commodities directly but promote economic activity generally. It is said that without these installations economic advance is impossible. Moreover, it is argued that the high cost puts them beyond the means of poor countries, particularly as economic return is either too long delayed, or too general, or too indiscriminate for private financing. These arguments are invalid. Much of the infra-structure, even in under-developed countries, has been financed and operated by private capital. Indian Railways and Calcutta Tramways are examples. Moreover, Governments of under-developed countries could themselves borrow from private resources, service loans from increased revenues, which is

indeed what has happened in many under-developed countries, in the comparatively recent **past**. Other instances can be cited to show that natural facilities such as good harbours, navigable rivers **and** the other facilities developed simultaneously with the expansion of economic activity and out of the revenue yielded by it.

Infra-structure of highly developed economies **represents** substantial capital which have absorbed much of total investments over decades or even centuries. The suggestion that a ready-made infra-structure is necessary for development ignores that **infra-structure** was usually developed in the course of economic advance. The suggestion represents another example of an unhistorical or unrealistic attitude to the process of development. Its literature **suggests** somehow that infra-structure is something like a railway and that the process of development is something like running a railway. You construct a permanent way, put a rail over it, then put an engine over it and it runs! But this is not how the process of **economic development** occurs. And also much of the literature **suggests** that the world was somehow created in two **parts**. One part was created by God with a **readymade** infra-structure of railways, roads, **ports**, pipelines and other public utilities, but somehow the Creator inadvertently forgot to provide the other **part** of the world with the infrastructure, which is why it has remained undeveloped or under-developed. But, of course, this is not the way it has happened. Now-a-days the problem of financing the infra-structure has been made much more **difficult** by various factors. They include the **poor** record of many under-developed countries in the treatment of foreign capital or the tendency of Governments to divert resources into **subsidised** manufactures, which reduces the funds available for the construction and maintenance of the social overhead. But these factors are rarely mentioned in the literature.

I **said** earlier that foreign aid is not a generally necessary nor sufficient condition for economic advance. The reason why I put in the word generally is because one can think of rare and occasional exceptions. Normally where the basic personal, social and political prerequisites of

material progress are present, capital will either be generated locally or it will be available from abroad on commercial terms, either to the Government or **to** the private sector. But in exceptional political conditions, outside the control of the Government, this may not be so. Taiwan in the early 1950's may have presented such an **exceptional** case. It was then widely believed that Taiwan would shortly be taken over by the People's Republic of China. This apprehension led to a crisis of **confidence**, which was reversed by the flow of American **aid**, when no other policy was available for this **purpose**. The inflow of aid was also accompanied by major changes in the **Government's** domestic economic policy, notably, the **removal** of some of the more restrictive economic controls and the withdrawal of Government from direct participation in certain economic activities. And it is said that in this particular instance, American **influence** was partly responsible for these changes. The material progress of Taiwan since the early **1950's**, has indeed been remarkable, though not more so than that of Hong Kong or Japan. It is probable that in the political conditions of Taiwan this progress would have been much slower without aid and might have even been prevented altogether. Aid to Taiwan **was** stopped three or four years ago.

It is also possible that foreign aid can promote the material progress of the recipients even where this is not an indispensable condition of material progress. Foreign aid increases the availability of investible funds and of know-how, where it takes the form of technical assistance. These effects may outweigh the unfavourable repercussions of its operation. But these results are likely only if the other pre-conditions of development are already substantially present. And even in these circumstances the question remains, why the capital should not be sold on commercial terms but presented in the form of external doles with economic and political disadvantages which usually accompany them. Commercial terms might be more expensive but both the capital and the technical know-how, both commercially, are **likely** to be much more productive than they are when supplied gratis or on **subsidised** terms. And except in such special circumstances as those of Taiwan, which I have just noted, there is no

reason why, either the **Government** or the Private Sector should not borrow abroad.

These arguments still leave open the question, how far the effectiveness of aid could be increased. You might say: "Well, there we are! We have the aid; we have to live with it; So, how can we make the best of it?" I think there is scope over there. There seems to be much scope for improvement in the operation of aid in several **directions**:

1. The criteria of allocation could be revised. **Aid** could be allocated much more selectively than at present and on different criteria. It could be allocated to favour Governments, which within their human, administrative and economic resources try to perform the essential and difficult tasks of Government while at the same time refraining from close control of the economy. **This** criterion would promote a relatively liberal economic system in the recipient countries, **minimise** coercion and favour material progress, especially the improvement in living standards. It would also reduce political tension in the recipient countries.

2. More thought could be given to prevent the inflow of aid from biasing the development of the recipient countries in directions based on inappropriate external prototypes. Preference could be given to Governments interested more in improving their ways and extending **external** contacts, rather than opening Western type Universities or erecting steel mills.

3. The flow of aid could be divorced more effectively, than it is at present, of the pressure of the commercial influence in the donor countries, for foreign aid often presents sheltered markets. You may know that **part** of foreign **aid** is in fact a subsidy, not from developed countries to under-developed countries, but from the tax-payer in developed countries to the exporter in developed countries, because exporters obtain sheltered markets and get higher prices for their products than they would under competitive conditions.

Even if aid was reformed on these lines, which I think is **highly** improbable, it is still unlikely to serve as an

effective instrument, let alone an indispensable instrument, for the material progress of poor countries.

The suggestion that foreign aid is necessary **for** the development of poor countries is the principal argument in favour of **aid** canvassed in the West. But there are a number of subsidiary arguments, which in **popular** discussion at any rate, figure **as** prominently — in some **cases** even more prominently — than the principal arguments. I shall run over some of these, rather briefly, because they are perhaps of some interest although not of major interest as the ones I have just mentioned.

One argument is that foreign aid represents the natural extension of progressive taxation from the domestic to the international sphere and that it is an **instrument** for the redistribution of wealth internationally. But foreign aid differs radically from domestic progressive **taxation**, whatever the merits of the latter. Foreign aid is **paid** by Governments to Governments. It is not a redistribution of income between persons and families. The flow of aid cannot be adjusted to the incomes and circumstances of persons and families. And foreign aid is necessarily partly regressive, because many tax-payers in the donor countries, who contribute to aid, are poorer than many people in the recipient countries. **This** is unavoidable. In practice, these partially regressive aspects of **aid** are made much more pronounced, because foreign **aid** benefits better-off people in recipient countries, like **politicians**, civil servants, academics and certain sections of the business community. **This** aspect of aid justifies the gibe that foreign aid is a system by which poor people in rich countries subsidise rich people in poor countries. Of course, in practice, the allocation of aid depends on the vagaries of political pressure and of public sentiments in the donor countries. It does not depend on any of the recognised canons of progressive taxation. In fact, the poorest communities in the under-developed world, the aborigines, the desert people and the tribal population in the interior of many under-developed countries, are **not** reached by aid at all.

In any case, the general case for redistributing taxation implies a basic uniformity in Living conditions and

requirements of income recipients. Physical and social conditions, and thus modes of living, differ enormously in the recipient countries. This difference is obvious for physical requirements but is applied also to social conditions. And the meaning and significance of income differences, and of riches and of poverty, depend greatly on social context and cannot be readily transformed between persons in widely different societies. For example, recipients of national assistance in Britain often have larger incomes than African Chiefs or smaller rulers in India, who are not normally considered poor.

Finally, the general case for redistributing taxation is far from self-evident, even on a national level, let alone on international level.

Another argument which you widely hear with reference to foreign aid is that of need. It is argued simply that the need of under-developed countries for aid is shown by their low income and is measured by it, and aid must, therefore, be given regardless of other conditions, and no questions should be asked. However, the adoption of need as an argument for aid, and as a criterion for allocation, leads to absurdities. If a country is poor or experiences payment difficulties and is in need, because the Government spends large sums on armaments or on political propaganda directed against the donors, should it be given aid? Or, if a country, or rather a Government, expels the most productive citizens, with incomes above average and thereby incomes get reduced in the country, should this serve as an argument for aid? And this is a very important practical consideration. Because, consider for example a mass expulsion of Asians from East Africa or the expulsion of Indians from Burma. In both these areas, the income of the Asians in East Africa and specifically of the Indians in Burma were above the national average, because they were the most productive groups. Therefore, the expulsion has reduced the average income. Therefore, it has increased the need. Should this be used as an argument for further aid, which would lead to further expulsion and therefore for further reduction? This shows the absurdity of adopting need as a criterion for the allocation of aid. This, of course, is quite apart from the question

that the poorer groups in the under-developed countries, like the aborigines, the desert people and the like are not touched by aid at all.

An appeal for help on grounds of need should appropriately take into account the conduct of the recipients. The activities of Governments in many underdeveloped countries obviously and manifestly retard material progress and increase the need for aid. Again, the attitudes and values of people of many under-developed countries are inconsistent with material progress. In these conditions, aid is bound to be ineffective and irrelevant, because it does not supply the base required for material progress.

The next argument is that foreign aid is a discharge of moral duty to help the poor. But its analogy with moral obligation fails completely. Foreign aid is taxpayers' money compulsorily collected. It is thus outside the area of volition and of choice. And it, therefore, has no moral element. Indeed, contributors not only have no choice, but quite often they do not even know they are contributing. A moral obligation to help the less fortunate cannot be discharged by entities such as Governments. It can be discharged only by persons who are prepared to impoverish themselves and weaken their position, relatively to others, in order to help their poorer fellowmen. Those wishing to help under-developed countries can easily write a cheque in favour of their Governments, or missions, or schools, or hospitals operating there. For example, I am opposed to foreign aid. I still have to pay it, whether I like it or not, everytime I drink a glass of wine in England. Wine is heavily taxed and part of it goes to foreign aid. And everytime I pay income-tax, I pay some foreign aid. If I do not pay the income-tax, I go to jail. Where is the moral element?

There are also other differences between foreign aid and voluntary charity. Voluntary actions can be readily directed to the specific needs of persons and groups. It sets up possibilities of adjustment to specific requirements and circumstances, which increases the effectiveness of charity. Foreign aid, on the other hand, is distributed to Governments, not to persons or voluntary organisations. The recognition of this difference between foreign aid and



voluntary charity is of much practical and of some **political** consequence. Of course, **most** people in under-developed countries do not know that **their** countries receive foreign aid. And those who know, usually cannot reason out the difference between **foreign** aid and voluntary charity. But those people who do know about foreign aid, generally and rightly, set some fundamental difference between voluntary charity and tax-payers' money compulsorily collected. And they accordingly suspect the statements that foreign **aid** is motivated by humanitarian sentiments.

Foreign aid **is** sometimes justified, specially in American discussions, on the grounds that **it** represents a valuable instrument of Western political strategy in keeping under-developed countries out of the Communist bloc. **The** argument is that somehow or other without aid these countries would become poorer and that would make the people turn to communism. This argument is in curious contrast to those based on moral and **humanitarian** grounds and its clear implication is exactly opposite. The argument is quite invalid. First, the argument assumes that foreign aid serves rapidly and appreciably to raise living standards, and it assumes further that an inclination to accept communism depends largely on the standard of living. Neither of these assumptions is valid. Secondly, with few exceptions, foreign aid promotes **centralised** and closely controlled economies. In operation, therefore, it strengthens Governments, which understandably lean towards Communist countries, whose policies they find more congenial. **Thirdly**, beneficiaries **in** these areas, as in others, are apt to resent the donors. And the transfer of taxpayer's money to foreign Governments, **without** control over its use, understandably arouses suspicion of sinister motives, especially of political domination. **In** a curious way, this suspicion **is** more aroused by Western aid than **by** Communist **aid**, because that aid is much more specific and much more selective and directed to certain countries which are politically and strategically important. Western aid is so indiscriminate, that it is completely baffling. Moreover, foreign aid is often regarded, in the recipient countries, as an instrument for forcing them to purchase goods, otherwise unsaleable from donor countries.

Finally, many people in recipient countries consider aid as an admission of guilt on the part of the donors as a partial restitution for past wrong. This view is held in under-developed countries, where it is widely put about that their material backwardness is a result of Western exploitation. Lastly, if foreign aid was to serve **as** an instrument of political strategy, you would have to align **much** more selectively than at present and its allocation would have to be divorced from the pressures by commercial interests in donor countries. Actually, a very striking evidence of the ineffectiveness of foreign aid, as an instrument of political strategy, **was** presented by the Tashkent **Conference** of 1966. Pakistan and India had then at least for ten years been substantial recipients of Western aid. And when they tried to have somebody to mediate for them, they did **not** turn to the President of America for mediation, but to the Soviet Premier.

What I have stated goes contrary to widely held views and is **politically** very unpopular. And, of course, it may well be that I am wrong. If it is shown that I am wrong, in the sense that the facts I presented do not correspond **with** **empirical** evidence, or that my logic is defective or internally inconsistent, I shall have to reconsider my **arguments**. But political popularity alone will not make me do so, because the validity of my arguments has nothing to do with their political popularity.

*[The views expressed in this booklet are not necessarily the views of the **Forum** of Free Enterprise]*

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

—A. D. Shroff

(1899-1965)

Founder-President.

Forum of Free Enterprise.

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Published by M. R. PAI for the Forum of **Free Enterprise**, 'Sohrab House', 235 Dr. Dadabhai **Naoroji** Road, Bombay-1, and printed by Michael **Andrades** at Bombay Chronicle **Press**, Syed **Abdullah Brelvi Road**, Fort, Bombay-1.

10/July/1970

245