

THE ECONOMIC IMPLICATIONS OF
THE UNION BUDGET, 1973-74

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FORUM OF FREE ENTERPRISE

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

—Eugene Black

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By

PROFESSOR RUSSI JAL TARAPOREVALA*

The economic implications of the Union Budget for the year 1973-74 should be analysed in the context of various developments which occurred in the country during the previous year.

DROUGHT CONDITIONS

The Indian economy continued to be under stress and strain during 1972-73. The main cause of the abnormal conditions which prevailed in Indian economy during the year was the failure of the monsoon in many parts of the country during the kharif season in 1972, which caused unprecedented drought and a steep fall in the agricultural output. It is indicative of the strength and the basic soundness of the Indian economy that despite these natural calamities, the economy continued to make some progress.

NATIONAL INCOME

The growth of national income was severely affected by the shortfall in agriculture. National income at constant prices rose by 7.3% in 1969-70, by 4.6% in 1970-71, by

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an estimated $1\frac{1}{2}\%$ to 2% in 1971-72 and by an estimated $1\frac{1}{2}\%$ to 2% in 1972-73. The Economy Survey of the Government of India for the year 1972-73 frankly noted that "there is no doubt that the overall rate of economic growth in 1971-72 and 1972-73 has been unsatisfactory. However, in a country like India, in which agriculture accounts for nearly one-half of national income, fluctuations in national income resulting from the operation of such uncontrollable factors as weather conditions are not an unusual phenomenon." Thus the Indian economy continues to remain largely a gamble on the monsoon and it should be the task of future planning to do all such things which will lessen the country's dependence upon weather conditions and monsoons.

AGRICULTURAL PRODUCTION

The statistics of output on the agricultural front clearly indicate the havoc caused by the failure of the monsoon. The annual rate of growth of agricultural production, which was running to around 7% in the years 1969-70 and 1970-71, slumped to a negative figure of minus 1.7% in 1971-72 and is expected to decline further for the period 1972-73. Similarly, the food grain production which had increased by 5.8% in 1969-70 and 9% in 1970-71, slumped to a negative figure of minus 3.5% in 1971-72 and is likely to fall further in the year 1972-73. The production of food grains increased from 99.50 million tons in 1969-70 to 108.42 million tons in 1970-71, but fell to 104 million tons in 1971-72. Unless the rabi crop is better than present expectations, the production of food grains for the year 1972-73 is likely to register a substantial decline. It is esti-

mated that the monsoon in 1972 caused such havoc to the kharif crop that the loss of the output of food grains amounted to 8 million tons. It is not yet possible to gauge to what extent a better rabi crop will offset this sizeable loss. The Economic Survey of the Government of India for 1972-73 highlights that the "green revolution has so far made a limited impact on agricultural production. This is largely because the green revolution has so far been essentially a wheat revolution." The breakthrough on the technical side has been largely in the context of wheat production. The production of wheat in the coming years is likely to show further improvement. But the production of rice increased only at an average annual rate of 1.1% during the period of 1964-65 to 1971-72 as compared to the growth rate of 3% during the years 1949-50 to 1964-65. This indicates that there has not been a substantial breakthrough in respect of development of high-yielding seeds, etc. in the context of rice production. Similarly, the production of coarse grain continues to fluctuate. The production of pulses has been stagnant for more than ten years. The production of oil seeds actually slumped by 10.6% in 1971-72 and is estimated to have further declined in the kharif season of 1972-73 causing a substantial shortfall in the output. The production of raw cotton has improved and shows progress. But sugarcane output continues to fluctuate violently and fell by 9.6% in 1971-72 and is likely to have fallen further in 1972-73. There are similar erratic fluctuations in the production of jute and mesta. Thus the picture on the agricultural front is one of substantial gaps which will have to be tackled by technological improvement as well as by organisational efforts.

INDUSTRIAL PRODUCTION

Despite the adverse conditions operating in the Indian economy, industrial production registered a reasonable healthy growth. Thus the index of industrial production which has risen around 7% in each of the years 1968 and 1969 but had slumped to around 3% for each of the years 1970 and 1971, is estimated to have risen for the period January to June 1972 by 7.3%. Certain industries recorded a substantial increase in production. These industries were chemicals, where output jumped by 21.4%, rubber products where output rose by 12.8%, textiles where output rose by 9.3% and electricity where output rose by 11.2%. Government attempted during the year to liberalise the industrial licencing policy by allowing automatic increase up to 100% in licenced capacity of 65 industries. But the large industrial groups and foreign companies were excluded from the liberalisation and had to apply to a specially set up task force for expansion. This undoubtedly retarded industrial growth. Government has claimed that the working of the Monopolies and Restrictive Trade Practices Act "does not seem to have stood in the way of expansion" of industries. Thus it is pointed out that of the applications submitted under Monopolies and Restrictive Trade Practices Act, only 5 applications involving a proposed investment of Rs. 15 crores were rejected, whereas 77 applications involving Rs. 315 crores were approved. But there can be little doubt that the Monopolies and Restrictive Trade Practices Act delays the clearance of industrial projects by long periods.

There hangs considerable "uncertainty" about the progress of industrial production in 1973-74. As a result of power cuts announced all over the country after the failure of monsoon in 1972, industry is likely to be adversely affected in terms of its ability to run economically at full capacity. It is in this context that the Economic Survey of India states that "with proper management of demand, adequate availability of critical inputs and the right psychological atmosphere in which entrepreneurs can plan future industrial activity with a reasonable degree of confidence, the economy is capable of attaining a growth rate of 7 to 8 per cent in industrial production in 1973-74". However these factors are not operating as hoped for by this claim!

GALLOPING INFLATION

The most disturbing feature of the Indian economy in the past year is the substantial degree of inflation, which has occurred in the country. Prices have risen dramatically, reflecting shortages in the agricultural output. Thus the wholesale price index number of commodities rose by 2.1% in 1969, by 6.2% in 1970, by 3.9% in 1971 and is estimated to have jumped by 7.8% in 1972. Moreover, a comparison of the prices prevailing in December 1972 over those prevailing in 1971, show a jump in the index of 13.7%. This abnormal increase in the price level appears to be primarily caused by a steep rise in the prices of agricultural products. Thus a comparison of prices prevailing in December 1972 as compared with December 1971 show that the wholesale price index of food articles jumped by 19.5%, of foodgrains by 17.2%, of cereals by 14.7%, of

edible oils by 26.3%, of sugar by 38.5%, liquor and tobacco by 20.5%, of industrial raw materials by 18.1%, whereas the wholesale price index of machinery and transportation equipment rose by 4.9%, of manufactures by 5.9%, of intermediate products by 10.9% and of finished products by 4.4%. It is clear that on price front the agricultural sector has been primarily responsible for the dramatic upward thrust.

The shortfall on the supply side has been the main cause of severe inflation in 1972-73. Government attempts at controlling prices through price control, distribution controls, credit controls, etc., have failed to arrest the price spiral.

MONETARY PRESSURES

Inflationary pressures in the Indian economy were also aggravated by an increase in money supply which was not matched by an increase in real output. Thus money supply increased by 10.8% in 1969-70, by 11.1% in 1970-71, by 12.9% in 1971-72 and is estimated to have risen by 12.3% in 1972-73. On the other hand, the annual growth rate of real national output has witnessed a decline from 7.3% in 1969-70 to 4.6% in 1970-71 and it is estimated to have declined still further to less than 2% in 1971-72, and around the same figure in 1972-73. A further perturbing feature of the monetary statistics indicates a diversion of the banking sectors' financial resources from the private or commercial sector to the Government sector. Thus the net bank credit to the private or commercial sector during the period 31st March 1971 to January 14, 1972 fell by Rs. 180 crores and declined for the same period in 1972-73

by Rs. 487 crores. On the other hand, net bank credit to the Government rose in the same period by Rs. 747 crores in 1971-72 and Rs. 980 crores in 1972-73. It may be wondered whether these statistics do not indicate a substantial squeeze on the private sector by the banking system, which is now owned by the Government—a development which must lead to serious distortions in the coming years.

UNEMPLOYMENT INCREASING

One of the most depressing features of the Indian economy is the dramatic rise of unemployment. The Economic Survey for 1972-73 of the Government of India states that “the sluggishness of industrial production since mid-sixties has aggravated the problems of unemployment.” This highlights the need for more rapid industrial expansion in the coming years if the problem of unemployment is to be tackled even partially. The seriousness of the unemployment problem is indicated by the number of persons seeking jobs at the Employment Exchanges which rose from 44.95 lakhs in June 1971 to 56.88 lakhs a year later. The number of educated unemployed applicants rose in the same period from 20.53 lakhs to 26.12 lakhs.

Employment in the private sector has remained relatively stagnant at around 67 lakhs during the three years 1970, 1971 and 1972. In the public sector total employment has risen from 103.74 lakhs in 1970 to 107.31 lakhs in 1971 and to 111.89 lakhs in 1972. This rise is at best marginal. During the last three years, employment opportunities have barely risen whereas the unemployment problem has assumed draconian proportions.

On the foreign exchange front, India's reserves remained at a reasonably comfortable level despite a rise in imports and a relatively disappointing performance on the export front. This is the general scenario in the context of which the Union Finance Minister has framed the budget.

BUDGET GOALS

The Finance Minister claimed that the aim of the budget was to accelerate economic growth in a framework of greater social justice and self-reliance. In his budget speech he further stated that "the immediate tasks for the economy may be summarised as follows: Firstly, inflationary pressures have to be contained through a judicious combination of demand management, increased production of basic wage goods, and the strengthening of the public distribution system. Secondly, in order to improve growth prospects, vigorous efforts have to be made to increase the rate of savings and investment. The third most important task is to achieve greater viability on the external front, which can only be achieved through higher exports and restraint on imports. Fourthly, there must be a rapid increase in employment opportunities, both in rural and urban areas to make an adequate dent on the problem of unemployment. Determined efforts are necessary to reduce disparities in income and consumption. Finally, to secure greater social justice, programmes designed to provide minimum basic amenities to all citizens must be expanded in scope and coverage. These are the principal tasks which I have kept in mind in framing the budget proposals for 1973-74."

BUDGETARY POSITION

The budgetary position of the Government of India now may be outlined. The Finance Minister was fortunate that despite the many adverse factors operating in the Indian economy during the past year, the tax revenues were extraordinarily buoyant and rose from the budget estimate of Rs. 4400 crores to a revised estimate figure of Rs. 4538 crores. Corporation tax, which was estimated in the budget to yield Rs. 493.50 crores has, as per the revised estimates, yielded Rs. 558 crores in 1972-73. Proceeds from income tax, which were estimated in the last budget at Rs. 583 crores have been shown in the revised estimates at Rs. 602 crores. Customs duties which were budgeted to yield Rs. 720.40 crores are now, as per the revised estimates, expected to yield Rs. 810 crores. This indicates that the tax revenues were relatively under-estimated in the budget for 1972-73. The total deficit for the year 1972-73, which was budgeted at Rs. 251 crores is now shown to have jumped to Rs. 550 crores. Even this figure does not take into account Rs. 421 crores of loans to the States to clear up their overdrafts. Thus the revised deficit financing for the year 1972-73, taking into account the latter figure, is little less than Rs. 1000 crores. The increased deficit for 1972-73 estimated at Rs. 550 crores was caused by increased expenditure of Rs. 192 crores on defence, increase in drought relief of Rs. 145 crores and increased assistance for irrigation at Rs. 55 crores, etc.

LARGE DEFICIT

At current levels of taxation, the budget for the year 1973-74 would have yielded a surplus on revenue account

of Rs. 79 crores. The capital budget would have had a deficit of Rs. 414 crores. Thus the net deficit would have been Rs. 335 crores for 1973-74.

The Finance Minister has proposed new taxes, which are estimated to yield Rs. 292 crores in the coming year of which the States' share will be Rs. 42 crores giving the Centre net additional revenue of Rs. 250 crores. This will reduce the overall deficit from Rs. 335 crores to Rs. 85 crores. However, this figure is deceptively small. The Finance Minister has admitted that it does not take into account the implications of the report of the Third Pay Commission which is expected to be published and probably implemented in the coming year. This coupled with further increases in expenditure which is likely to take place over the budgeted figures, indicates that the overall deficit for the year 1973-74 may be somewhere in the region of Rs. 300 to Rs. 500 crores—and not Rs. 85 crores as shown in the present budget.

NEW TAXES

In the budget for 1973-74, the Finance Minister has proposed additional taxation spread thus: Increases in customs duties are estimated to yield Rs. 156 crores, increases in excise duties are estimated to yield Rs. 117.57 crores, increase in the corporation tax is estimated to yield Rs. 11 crores and increase in income tax is estimated to yield Rs. 7.60 crores. Thus, most of the tax effort is attempted through indirect taxation. This indicates that the limits for direct taxation, even in our socialistic economy, appears to have been reached and that Finance Ministers in the com-

ing years, will have to increasingly depend upon indirect taxation for financing their budgets.

CUSTOMS DUTIES

Some of the main budget proposals for additional taxation in the year 1973-74 may now be analysed.

The Finance Minister has proposed to levy auxiliary import duties on all imports except on foodgrains, books, family planning appliances and few selected items, which have been exempted from these duties. The auxiliary duties are to be levied at three differential rates of 20 per cent, 10 per cent and 5 per cent of the value of imported goods. These duties are expected to yield Rs. 36.50 crores. They are likely to push up the prices of almost all imported goods to the extent of the new tax burden.

The import duty on raw cotton is sizeably increased to yield Rs. 40 crores. This measure is either likely to push up the prices of fine cotton fabrics or sharply eat into the profits of fine count textile mills.

The import duty on all items of machinery is to be raised from 30% to 40%. The Finance Minister has claimed that this new levy is to "give a further impetus to import substitution and encourage more extensive manufacture of machinery in our country." However, in the short run, it will dramatically push up the project costs of those industries which are dependent upon imported items of plant and machinery. Under the present policy of the Government of India only items of plant and machinery which are not manufactured in India are permitted to be imported from abroad. Hence, the new levy will hit items of machinery

imports which are indispensable and this will result in a substantial escalation of new plant costs in industry. An increase in total project costs in industries is also likely in the long run to have a creeping inflationary impact on the prices of industry's finished products.

Import duties have been increased on various types of stainless steel items, copper and a whole host of miscellaneous items—these imports will push up prices of these items further.

EXCISE DUTIES

In the field of excise duties, the Finance Minister has proposed the levy of additional excise duties on cigarettes and tobacco, which is expected to yield Rs. 32 crores in a full year. This is a very modest increase and shows that the Finance Minister has not made a bold attempt to fully exploit the indirect taxation potential in respect of cigarettes and tobacco. These items could have yielded far greater revenues by bearing a much higher level of indirect taxation. An increase in the excise duty on motor spirit is to yield Rs. 20.80 crores and an increase on Rayon and synthetic fibre and yarn is to yield Rs. 9 crores. An increase in the excise duty on iron and steel products is to yield Rs. 29.85 crores. These levies are likely to be passed on to consumers and will have inflationary repercussions in the coming years.

The budget proposals for increases in customs duties and excise duties extend to an enormous range of goods, so that their inflationary impact is spread over vast sectors of the economy. Nevertheless, most of the excise duties and cus-

toms duties are likely to be passed on to the customer and are unlikely to be absorbed by industry. Therefore the result of the proposed budget will be a step-up in the price level of various items at least to the extent of the increase in customs duties and excise duties.

DIRECT TAXATION

In the field of direct taxation, the Finance Minister has proposed a number of changes aimed at raising a modest increase in the tax revenues. Most of the changes proposed are prospective, that is, are applicable for the financial year 1st April 1973 to 31st March 1974.

INDIVIDUAL TAXATION

The Finance Minister has made a beginning towards taxing agricultural incomes. He has proposed a partial integration of agricultural income with non-agricultural income for income tax purposes. The budget provides for the aggregation of the agricultural and the non-agricultural components of a taxpayer's income for determining the rates of income tax that will apply to the non-agricultural portion of his income. For the purpose of determining the rate of income tax applicable to the non-agricultural portion of a taxpayer's income, the first Rs. 5,000 of his non-agricultural income is to be appropriated to his lowest slab, which is exempt from tax. The agricultural income is put in the middle slabs and the non-agricultural income is appropriated to the uppermost slabs of the aggregate income. The budget proposals do not provide for taxing agricultural income. They will result in taxing the non-agricultural income in the higher or the uppermost slabs applicable to

such income and as such will push up sharply the burden of taxation on the non-agricultural income of those having large agricultural income. This is a step in the right direction.

HINDU UNDIVIDED FAMILIES TAXATION

The budget has also proposed an increase in the income tax and wealth tax payable by Hindu Undivided Families. It is recognised that the Hindu Undivided Family has so far been a loophole for avoidance of direct taxation and in keeping with the recommendation of the Wanchoo Committee, this loophole is to be partially plugged. It has been provided that the first Rs. 5,000 of income of Hindu Undivided Families will be exempt from tax and thereafter income tax will be applicable at the rates which are equivalent to the rates of the next highest slab of income tax applicable to individuals. Similarly, the rates of wealth tax applicable to the Hindu Undivided Family are raised and the highest rate will apply to the wealth over Rs. 10 lakhs. These steps will result in an increase in the direct taxation on the Hindu Undivided Family.

CAPITAL GAINS

The budget provides for a drastic change in the taxation of capital gains. Hitherto, capital gains in respect of assets held for more than 24 months were subject to tax at a concessional rate applicable to long term capital gains. The Finance Minister has proposed that effective from 1st April 1973, the definition of long term capital gains will be gains in respect of assets which have been held by an assessee for a period of more than 60 months (5 years). This change

is likely to have vast repercussions on the attitudes of assesseees towards investment in and sale of assets. It means that at least those assesseees who are in the higher slabs of income tax and who will therefore try to avail of the concessional tax treatment applicable to long term capital gains will have to make fresh investments in assets with the clear expectation that they will be locked into them for the long period of five years. Thus, the risk attaching to fresh investments in shares, real estate, etc., will be substantially increased.

The budget proposal will also have the effect of adversely affecting the liquidity of Indian stock markets after 1st April 1973, in so far as investors in higher income tax brackets will not sell shares acquired by them during the past five years and will have to in future hold shares for a minimum period of five years in order to get the concessional tax treatment applicable on long term capital gains. This will result in a substantial drop in the supply of shares available in the stock markets and if the demand for shares remains constant, this development will result in sharply pushing up share prices. The shrinkage in volume of trading and of liquidity in the stock market will accentuate upward and downward movements in prices of shares. Similar effects will also be noticed in price fluctuations of other assets in which assesseees may have invested their monies. The budget proposal for the extension of the period for which assets have to be held for long-term capital gains treatment is a step in the wrong direction and will lead to violent fluctuations in the prices of various assets and reduce dramatically the liquidity of assesseees in respect of their investments.

INSURANCE SAVINGS

The Finance Minister has stated that in order to encourage long term savings through life insurance and provident fund contributions the first Rs. 2,000 of such savings will be allowed as deduction from income instead of the existing first slab of Rs. 1,000. This is a minor change which may result in increased savings in this area.

MINOR CHANGES

Sports institutions are made eligible for tax relief in respect of donations given to them on the same footing as charitable institutions.

It will therefore be seen that in the field of direct taxation, the Finance Minister has only made a small beginning in respect of increasing the taxation of those having agricultural incomes and has raised the direct taxes on Hindu Undivided Families. The taxation of capital gains is made more complicated and onerous by increasing the length of period during which the capital assets must be held. The other changes are only minor and insignificant.

CORPORATE TAXATION

In the field of corporate and business taxation, the Finance Minister has proposed that the concessional income tax rate of 45% applicable to public companies having income of less than Rs. 50,000 will be extended to public companies having an income of less than Rs. one lakh in a year. This will only benefit a few companies. There are not many companies which are publicly held and have income of less than Rs. one lakh.

The basic rate of income tax payable by closely-held companies on the first Rs. 10 lakhs of industrial profits was 55%. The Finance Minister has proposed that this concessional rate of income tax will be applicable to a first slab of industrial profits of only Rs. 2 lakhs instead of the present slab of Rs. 10 lakhs. This means that the tax burden on the next Rs. 8 lakhs of industrial profits beyond the Rs. 2 lakhs will be enhanced in the coming year. It has been claimed in the budget speech that "this measure will encourage conversion of these companies into widely-held companies and thereby broaden the base of the ownership of industry." But this claim of the Finance Minister is not justified and unlikely to be fulfilled.

There are a few minor changes in corporate taxation. These are: Management compensation in respect of business undertakings or other property the management of which is taken over by the Government is made liable for income tax. Cooperative Societies are made liable in respect of deduction of income tax at source on payments made to contractors. The tax holiday concession for hotels is to be extended to hotels of all types irrespective of types of guest rooms and amenities, etc.

INITIAL DEPRECIATION

Besides the changes proposed in the Finance Bill, 1973, the Finance Minister has announced his intention to introduce major changes in taxation in the coming year. In place of development rebate, it is proposed to give a special initial depreciation allowance of 20% of the cost of plant and machinery installed after 31st May 1974 for a list of

industries which is to be announced. The list of industries eligible for such initial depreciation allowances should be announced at the earliest possible opportunity.

BACKWARD AREAS

It is proposed to introduce substantial tax concessions to promote investment in the backward areas. The Finance Minister has proposed that industries set up in backward areas after 31st March 1973, will be allowed a deduction of 20% of the profits made by them in such areas in computing their taxable income for a period of 10 years after the establishment of such industries. Moreover, the Central Government will give a subsidy of 15% in respect of such industrial investments subject to a ceiling of assets of Rs. 1 crore. These proposals are to be heartily welcomed and it is hoped that here again, the Finance Minister will follow up his announcement with the final law on these proposals, so that entrepreneurs may begin to plan substantial investments in the backward areas.

It will be seen therefore that in the field of corporate taxes, the budget contains only a few readjustments and that nothing major has been attempted in the Finance Bill. The proposals for granting initial depreciation and tax relief in the backward areas have been announced but their implementation will have to await finalisation by the Finance Minister.

BUDGETARY GOALS LARGELY UNFULFILLED

It is quite clear that the goal of curbing inflationary pressures will not be achieved by the budget. On the contrary,

the new vast array of excise and customs duties will push up the prices of many goods. The budget is unlikely to give any dramatic stimulus for an increase in the savings and investments. There is no dramatic decrease in direct taxation contained in the budget nor are there any measures which can lead to substantial savings and investments. The total plan outlays proposed in the budget is Rs. 4,356 crores for 1973-74 as compared with the outlay of Rs. 4,011 crores for the year 1972-73. If one takes into account the increase in the price levels occurring during this period, it is clear that the new allocation for plan outlays in real terms will be approximately the same level as that of the previous year presenting a picture of stagnation in this respect.

The budget does contain a few measures which may inhibit imports like the levy of customs duties especially on plant and machinery. But there are almost no measures which will dramatically spur the exports. The budget provides for a special allocation of Rs. 100 crores for providing employment for educated people. It is estimated that this will result in some relief to around 50,00,000 educated unemployed people. This is a step in the right direction but it will barely attack the problem of educated unemployed in so far as total figure estimated is 26.12 lakhs. Thus, the budget will only have a minor impact in respect of providing greater employment opportunities. Finally, the budget contains only minor changes in direct taxation which is a recognition of the fact that the limits of direct taxation have already been reached.

LONG-TERM POLICY NEEDED

It will be therefore seen that whereas the Finance Minister has set ambitious goals for achievement in this budget, they are not likely to be achieved. On the contrary, the fear is that a further dose of direct taxation may come. It is based on the announcement of the Finance Minister that he proposes to introduce a further taxation bill to implement some of the recommendations of the Wanchoo Committee in the field of direct taxation. This will cause considerable uncertainty and apprehension in the minds of people and act as damper on growth and investment and expansion in the coming years. It is to be hoped that the Finance Minister will recognise in the coming year the need for introducing a measure of stability in the structure of taxation. Uncertainty about taxation is one of the most disturbing factors in the Indian economy. Tax policy must be put up on a long term—perhaps a five year—basis if the country is to develop rapidly without uncertainty inhibiting its growth.

*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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