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in the belief that this would alleviate distress and strengthen the economy. But at the same time Indian traders and farmers have been increasing their holdings of grain in inferior storage facilities that are plagued by rats. This, in effect, is a wastage of aid, and in any case the net effect of the transfer has not benefited Indian consumption or increased real capital investment. It is, of course, pointed out by advocates of the present aid system that rupees paid by India to the U.S. Government for food or other imports can be, and often are, *re-loaned* for development projects. But such re-lending of funds can be highly inflationary, and in effect makes the situation worse, not better.

The critical point is that foreign aid has not augmented capital formation nearly as much as its volume indicates. As already noted, during the first three years of the second five-year plan, aid plus drafts on currency ran to $2.7 billion. But net capital formation from budgetary sources (and most aid flowed through the budget) amounted to only $1.5 billion. Even allowing for private capital formation, these figures reinforce the conclusion that funds have been diverted to non-development uses. This may come as a surprise to many people who point out that often foreign aid (for instance, loans from the World Bank) is "tied" to specific development projects—dams, steel mills, harbor development, etc. Hence, it is argued, aid in these cases *must* have forwarded development. But "tied" loans do not in fact ensure this result. Foreign aid and domestic savings get collected into the same reservoir of resources. If total resources are being wasted, it is pointless to argue that foreign aid has been somehow magically insulated from the wastage by leakproof accounting systems. No system of accounting can prevent inflation from diverting resources to non-productive uses. And this experience is not confined to India. Inflation in Turkey has led to the same result. As a World Bank survey of 1951 observed: "The ratio of real investment to the gross national product [of Turkey] did not increase appreciably in the postwar period as compared to 1936, even though substantial amounts of foreign assistance were received to finance investment."

The way out

It is essential for India, no less than for the U.S. and other donors of aid, to remedy the present situation. For it should be emphasized that many types of aid are not outright gifts. They involve for India a growing burden of amortization and interest payments, which today may be on the order of $250 million per year. The servicing of debt is a manageable problem if productive capacity is being increased. It becomes an intolerable burden on the people if the debt is incurred for wasteful uses. The current thinking of the Indian planners seems to be that debt service can be met by increased borrowing. This, of course, avoids rather than solves the problem. Nor is there any hope of bettering the situation by instituting more vigorous specific controls, of which India already has too many.

The real way to make foreign aid effective is to adopt a radical change in policy. There is overwhelming need for fiscal retrenchment on the part of the Indian Government. There is need for restriction of state enterprises and welfare measures to their rational limits. There is need for monetary and exchange-rate stabilization, for a cessation of monetary inflation, for the lifting of exchange controls, import restrictions, price controls, and for the restoration of the price system and the competitive market. Were these things done, the forces

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of private initiative would go to work; and limited foreign aid would fulfill its purpose, stimulating both domestic and foreign private investment. In the process both light industry and heavy industry would benefit; and it would be perfectly possible to ensure control of key industries by Indian nationals. Freed from useless regulations, and assured of sound money, all India could prosper. Normal and healthy growth would replace forced-draft improvisation.

There is no doubt that when foreign aid is made conditional on sensible internal economic policies on the part of the receiving country, it raises difficult issues of sovereignty. But we must not despair that these could be overcome. The International Monetary Fund, for instance, has found a way to be useful without abridging sovereign rights. When the United Kingdom drew on the fund for help in 1956, it guaranteed that "strict financial and credit policies would be pursued, that quantitative restrictions would not be reimposed, and that the value of the pound sterling would be maintained." Going further back, Marshall-plan aid was canalized through a special agency, the Organization for European Economic Cooperation, which took as one of its principal aims the monetary stabilization of European countries, and the relaxation and removal of their restrictionist policies on trade and payments. It well may be, following these precedents, that a special agency, representing both borrowers and lenders, is needed in the case of the underdeveloped countries. But such an agency will succeed only as it puts first things first, and as it insists that tested and proved economic principles replace the modern fad of central planning.

Back door to Communism

Above all, it is necessary to see the issues now facing India, as well as other underdeveloped countries, in large perspective. The generous aid so far given by the American people and others is not animated just by humanitarian motives—important and welcome as these may be. Aid to India in particular has been justified by the realization that India is the key to the prevention of the further spread of Communism throughout Asia. But the Communist threat is not just an external one. The fact is that if a nation carries statist measures too far, it can unintentionally slide into a Communist form of economic organization. In India today there is considerable danger of this happening, and choice between the free and the socialist economy cannot be indefinitely delayed. Present planning measures are clearly breaking down, yet India is now contemplating still a third five-year plan more grandiose than those that have preceded it. The obvious threat is that in trying to carry through this new effort India will adopt ever more stringent totalitarian controls with consequent loss of individual and political freedom.

Such a denouement would be a tragedy of the first order—the more so because it is wholly unnecessary. India, though poor today, *has* a magnificent potential and future ahead. That potential can be realized only as government confines itself to its proper sphere of activity and allows the forces of initiative and freedom scope on the farm and in the factory. It can be realized only as India takes its stand for the principles of liberty under the rule of law and builds an economy consonant with those principles. This in the first instance is the responsibility of the Indian people and their government, but the outcome may well be affected, also, by the policies of the rest of the free world. Nations extending help cannot divest themselves of their responsibility to ensure that aid, in fact, aids.

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