

Draft

April 1, 1974

MEMORANDUM FOR THE DIRECTOR OF CENTRAL INTELLIGENCE*

SUBJECT : Implications of Different Economic Aid Levels
for South Vietnam in FY 1975

The Key Points

This memorandum projects three possible U.S. assistance levels for South Vietnam in FY 1975 and assesses the impact of each on the South Vietnamese economy.

- The Low Aid Option -- \$300 million in Commodity Import Program (CIP) aid and \$50 million in development aid -- would be a continuation, in dollar terms, of the present assistance level. Under this option --
 - South Vietnam's real imports in the first half of CY 1975 would be only about three-fourths as large as in the first half of 1974.
 - The present recession in South Vietnam would deepen.
 - Real incomes, especially among the urban population, would continue to decline, and inflation would remain a serious problem.
- The Medium Option -- \$600 million in CIP aid and \$50 million in development aid -- is the level of assistance which the Administration presently plans to request from the Congress for FY 1975. Under this option --
 - South Vietnam's real imports would remain essentially at the present level from now through the first half of CY 1975.

* This memorandum was drafted jointly by the Central Intelligence Agency and the Bureau of Intelligence and Research, Department of State. It was reviewed and endorsed by representatives of these agencies, and the Defense Intelligence Agency, and the

- The decline in South Vietnam's economic output could be halted, but there would not be much of an upturn.
- Real incomes, among both the urban and agricultural population, could be stabilized. Urban incomes, however, would remain appreciably below those of 1970-1971.
- The High Option -- \$850 million in CIP aid and \$50 million in development aid -- is the level of assistance requested by the US Mission in Saigon for FY 1975. Under this option --
 - South Vietnam's real imports would increase appreciably from now through mid-1975.
 - The total economic output of South Vietnam could grow, in real terms, as much as 5 percent in FY 1975, assuming investor confidence and consumer demand were restored.
 - Real incomes of all population groups would also increase, though the 1970-1971 level could not be reached until 1976.

If the US objective is to put South Vietnam on a growth track and move it well down the road to self-sufficiency, big "shots" of assistance limited to the next two years or so will not do the job. To meet this objective, South Vietnam will need large-scale U.S. aid until the 1980s.

There are two diametrically opposed schools of thought within the intelligence community on the political implications of the aid levels discussed above:

- One school holds that even the Low Option would provide enough aid to prevent unacceptable political risks from arising regarding the survivability and reasonable effectiveness of the GVN.
- The other school believes that under the Low Option the GVN would run an unacceptable risk of serious adverse political reactions in FY 1975, which could both create instability and weaken the control of the central government. This school further believes that under the Medium Option there would be some adverse political reaction, though the Thieu government would probably be able to keep the lid on the situation. The High Option, this school believes, would clearly strengthen the present government of South Vietnam.

Discussion

Background: The South Vietnamese Economy and Recent Aid Levels

1. The large scale mobilization ⁱⁿ ~~of the~~ South Vietnamese ~~economy~~ which began in 1965 was carried out without a significant reduction ⁱⁿ ~~of national~~ consumption levels ~~only~~ because ^{heavy} large in-flows of US economic assistance filled the gap. The US aid program from 1965 through 1970 was aimed primarily at containing the severe inflationary problems that were the by-product of huge government deficits necessary to finance military expenditures. After the 1968 communist "Tet" offensive, ~~had run its~~ ~~course~~, however, the pacification program of the Government of Vietnam (GVN) began to make steady progress and economic conditions ^{improved markedly.} ~~also began to improve.~~ By the end of the 1960s, the pre-occupation of the GVN -- and the US -- with stabilization lessened, and a greater effort was devoted to fostering growth in the South Vietnamese economy. With imports ^{still} ~~financed~~ largely by US aid ^{and} continuing at the high levels of the mid-1960s, the South Vietnamese were able to channel more resources toward increased output rather than current consumption. During 1969-1970 GNP increased at an annual rate of some 4 percent in real terms, ^{and} ~~with~~ agricultural output ^{ed} ~~increasing~~ by about 10 percent per year.

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2. In late 1970, the GVN (closely advised by the US) began to undertake a series of reforms designed to stimulate the private sector and ultimately to end dependence on US economic assistance. The measures taken included interest rate reforms (establishing interest rates higher than the rate of inflation), domestic banking reforms to increase private saving, adoption of a flexible and realistic exchange rate policy to stimulate exports, and, by late 1971, a liberalization of import procedures to ^{give} ~~allow~~ the market system ^{greater influence over the} ~~to determine~~ volume and type of goods to be imported. The response to the reform measures was favorable; by the end of 1971 the South Vietnamese economy appeared on the verge of a new departure in recovery and development. With continued foreign aid and the establishment of greater political and military stability, It was generally believed that Vietnam's largely untapped resource base could provide the basis of steady and relatively rapid growth.

3. The 1972 Communist military offensive dashed these optimistic predictions. ~~About the GVN economy~~ A ~~deep~~ recession occurred as consumer demand dropped and investment came to a virtual halt. Moreover, military disruption and poor weather combined to produce a shortfall in the 1972-1973 rice harvests.

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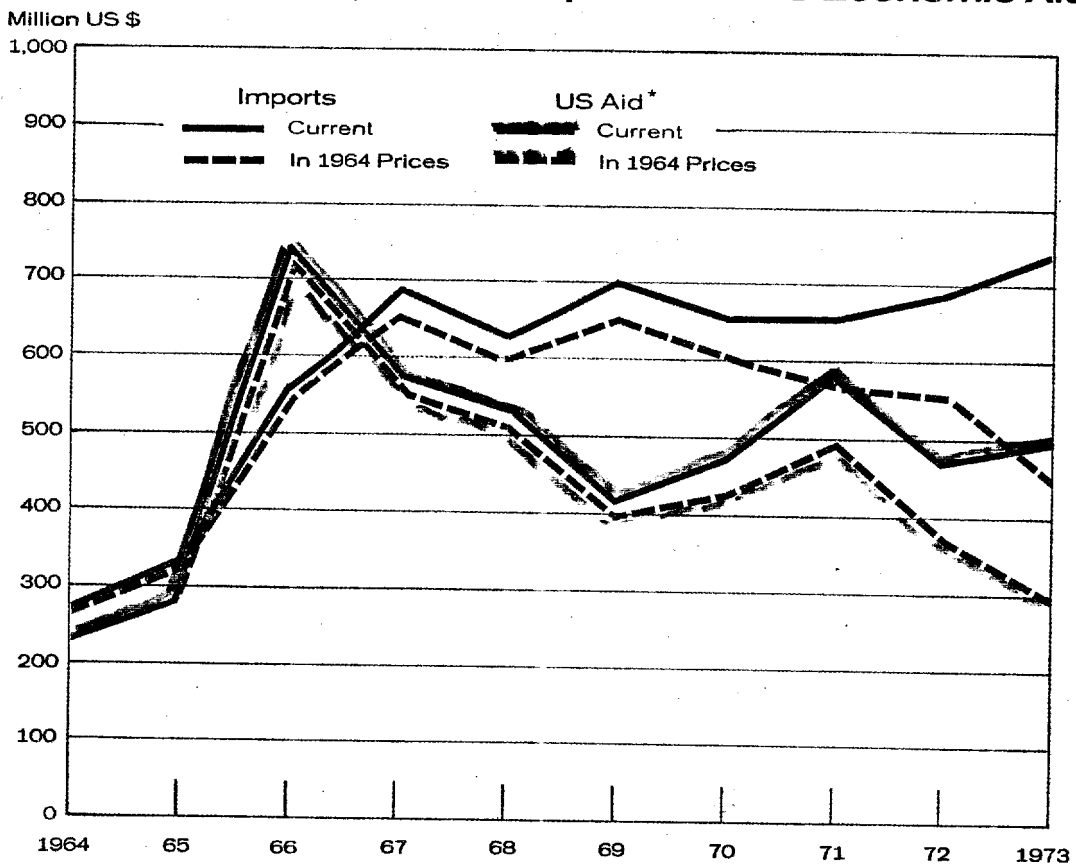
The Vietnam settlement agreement of January 1973 did little to remedy the situation. Consumer confidence was not restored, foreign investors continued to show reluctance to make commitments, and key commodity shortages created upward pressure on prices.

4. Coupled with these problems ^{was} ~~has been~~ a steady, significant decline since 1971 in real aid levels and a commensurate reduction in real imports. (See Figure 1.) Indeed, in constant prices the volume of US aid fell by about one-third from ~~1970~~ ¹⁹⁷¹ to 1973, and South Vietnamese imports -- again in constant prices -- diminished by 25 percent in the same period. These declines are the result of the depreciation of the dollar (to which the piaster has remained tied) combined with sharp increases in world prices. In 1973, for example, import prices were on average some 35 percent higher than in 1972, while the actual volume of imports dropped by some 20 percent. Although the government has made every effort to reduce imports of nonessential consumer goods and to channel available funds toward investment, attempts to initiate reconstruction and steady growth have been completely frustrated. Rising shares of the country's import bill have necessarily been diverted to meet essential commodity shortages; the lack of funds for invest-

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Figure 1

South Vietnam: Estimated Imports and US Economic Aid



*Excludes piaster purchases.

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ment has also wiped out most of the earlier progress in strengthening the private sector of the economy and in reducing the reliance on foreign capital.

5. Thus, South Vietnam's economy has been in a severe slump for two years. There has been very little investment, consumer demand has diminished, and average real incomes have declined.

The Present Situation

6. The impact of the slump has not been felt equally by all economic sectors. The resulting economic difficulties are concentrated in urban areas and among those with fixed incomes. The stagnation of industrial production, rapid inflation, and the sharp reduction in US military spending have hit these groups the hardest.

7. Wages are failing to keep up with the rising cost of living and ~~the problems~~^{is} of unemployment ~~are~~ increasing. Government employees, both civilian and military, who account for more than one-fifth of the labor force, received a 25 percent pay increase in 1973. Because of inflation, however, the real wages of civil servants and military personnel ^{now} are only about two-thirds what they were in early 1973. The wages of lower-

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level officials, enlisted men and junior officers ~~will~~ now barely cover a family's expenditures for food. For most wage earners, rice purchases alone probably take more than half of their income. Moonlighting and the employment of other family members help, but jobs are scarce. There have been some layoffs by Vietnamese manufacturers, and the US government -- which in 1969 directly employed some 150,000 Vietnamese and probably indirectly provided work for an equal number -- continues to reduce the size of its establishment in South Vietnam. Although no firm data are available, as many as one million people, some 15 percent of the labor force, may now be unemployed in the country.

8. Agriculture remains relatively strong, recovering from a disappointing year in 1972. Real incomes in farming have probably increased somewhat over the past few years, and there are preliminary indications that a record harvest is now coming in. This growth is unlikely to continue, however, unless the supply of fertilizers and fuels is increased and the prices of these commodities are brought down. Recent increases in rice production have been due almost entirely to the greater use of high-yield varieties, more intensive application of chemical

fertilizers, and increased mechanization. The retail price of fertilizer has more than doubled over the past year, and the price of gasoline has tripled. Faced with these prices, some farmers are reportedly reverting to subsistence agriculture and to the use of the traditional, lower-yielding varieties of rice. These varieties are hardier and less dependent on the vagaries of weather, require less fertilizer, and are easier to cultivate without gasoline-burning machinery.

9. If such a shift became widespread, farmers would probably still be able to meet their own needs as well as insulate themselves somewhat from external market forces. But private merchants or government representatives would find it increasingly difficult to purchase delta rice for shipment to Saigon and other rice-deficit areas of the country. Further increases in paddy prices would eventually bring forth the needed production response from farmers, but these prices had already nearly doubled in 1973. More price increases would either further burden low-income urban families or, if the government attempted to subsidize rice sales, put added strains on a government budget already showing a large deficit.

10. In the area of foreign trade, South Vietnam's outlook is also cloudy. Despite a rapid growth of exports from a very

small base, total earnings from this source are unlikely to reach \$100 million in calendar year 1974. Aid from countries other than the US (primarily Japan and France) will probably show some increase, but in 1974 the total amount will still make only a small dent in Vietnam's import requirements. South Vietnam's imports in 1973 totaled some \$765 million. Unless imports are to decline catastrophically, the bulk of them must continue to be financed by US aid. Moreover, since prices for major import items (fertilizer, rice, wheat, petroleum products) are markedly higher now than they were a year ago, the same volume of goods imported last year would cost about \$1 billion in 1974.

Aid Alternatives and Economic Prospects Through Mid-1975

11. In the material that follows we have projected three possible Commodity Import Program (CIP) ^(aid development) aid scenarios for FY 1975 and have attempted to assess the prospects for economic growth in South Vietnam under each. The three scenarios are:

-- a low case, reflecting continuing appropriations

on approximately the same level as FY 1974: some ~~\$350~~ ^{\$300} million in CIP aid ^{(aid \$50 million in development aid)*}

* The FY 1974 aid appropriation includes a basic \$300 million for CIP funding plus a \$50 million development loan and a requested supplemental appropriation of about \$50 million. An additional development loan of \$60 million has also been requested for FY 1974. Even if the latter is authorized, however, it will almost surely not be available during the few months remaining in this fiscal year. It is assumed, therefore, that this request will, under each option, eventuate in a \$50 million development loan, \$25 million used in the first half of FY 1975 and \$25 million in the last half of FY 1975.

- a medium case, reflecting the Administration's request to Congress for FY 1975: some \$600 million in CIP aid *(and \$50 million in development aid.)*
- a high case, reflecting the request of the US Mission in Saigon for FY 1975: some \$850 million in CIP aid *(and \$50 million in development aid.)*

12. It should be borne in mind that external aid is only one factor influencing the economic situation of South Vietnam. A lack of business confidence has kept private sector demand below what it would be in a peaceful, stable Vietnam. Since the communist offensive of 1972 and the succession of austerity measures necessary to cope with global and domestic inflation, the private sector (particularly in industry and commerce) has been reluctant to invest or plan business expansion. This problem will not be solved by increased aid levels alone, although higher aid -- and the US commitment it would signify -- would clearly affect the climate in which Vietnamese and foreign businessmen made their decisions.

13. It should also be borne in mind that the impact of FY 1975 aid levels will be affected by events in the last three months of FY 1974 (April-June). If the present high rate of CIP licensing continues unabated, FY 1974 funds may be depleted by some time in May. If an emergency supplemental appropriation cannot be obtained, no further CIP funds could be used until

next fiscal year's appropriation became available, probably some-
time in July. The instability and uncertainty generated by even
a short CIP closure could in turn have a measurable effect in
depressing South Vietnamese economic conditions in the early
months of FY 1975. Speculation would almost certainly mount, as
many importers assumed that licensing through US aid funds would
not again be available at levels comparable to the past. Although
imported goods would continue to flow into South Vietnam for
a while under previous orders, business confidence ~~would clearly~~
~~be adversely affected~~ *would clearly*
~~affected quite seriously.~~

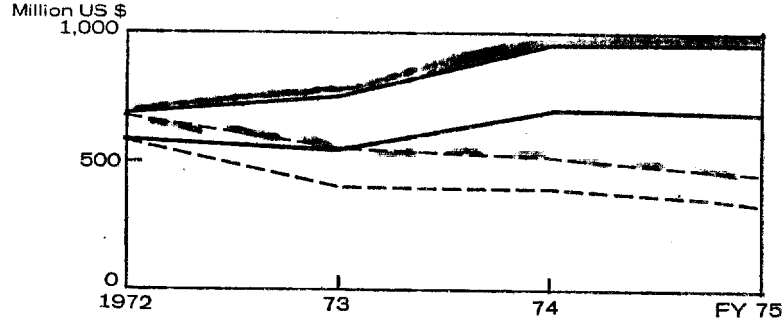
14. The GVN's flexibility in dealing with a shortfall of
US import financing in May and June of this year is limited by
its relatively weak foreign reserve position and by a virtual
halt in recent US piaster purchases. Declining US piaster needs,
combined with a rapid buildup in piaster holdings generated from
last year's PL-480 program, may allow the US to meet its total
local currency requirements for the rest of CY 1974 without
further purchases. Although GVN dollar earnings from US piaster
purchases have declined in recent years, they still amounted
to some \$130 million in CY 1973.

15. The impact of an immediate funding crisis arising
from the above factors is discussed under the Low Option case
below; although it could occur under any of the three scenarios,

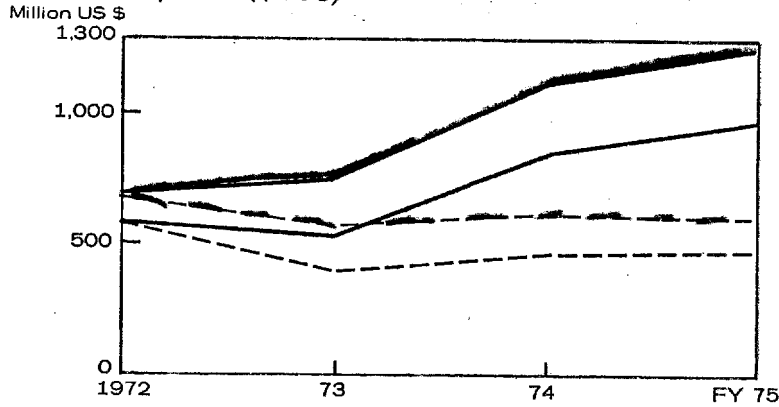
Figure 2

South Vietnam: Imports and US Aid* Under Three Funding Alternatives for FY 1975

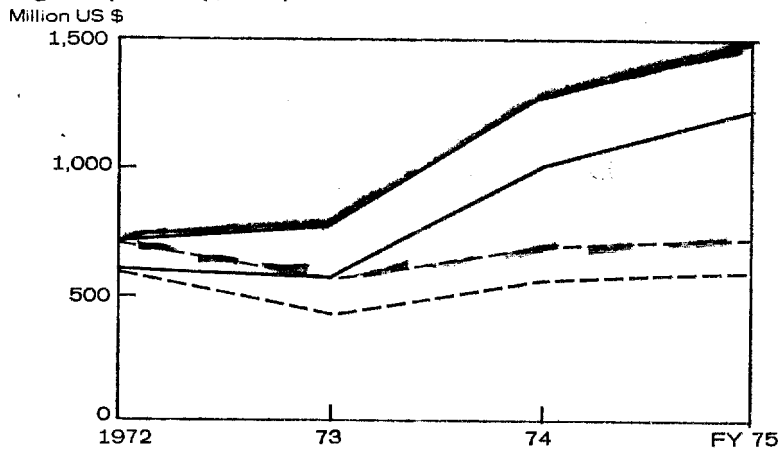
Low Option (Continuing Resolution)



Medium Option (\$600)



High Option (\$850)



*Including US plasters purchases

Imports ——— Nominal - - - - 1972 Prices
 US Aid ——— - - - -

it would have a significant impact on FY 1975 only under the Low Aid option.

16. The three aid options and the projected import levels they would support are summarized graphically in Figure 2.*

Low Aid Option

17. Under this scenario, world price increases would mean a modest reduction in South Vietnam's real imports in CY 1974, and a further reduction in the first half of CY 1975 (see Table I). The Commodity Import Program ^{(plus} ~~including~~ development loans) would provide about \$350 million to South Vietnam for FY 1975. PL-480 funded imports would increase considerably because of higher world rice prices and reliance on the program for stabilization purposes. Piaster purchases by the US, however, would drop significantly -- as they would under all three options -- through CY 1974 and the first half of CY 1975. South Vietnamese exports would probably decrease gradually from a high point in the first half of ^{CY} ~~FY~~ 1974 toward a stable level near \$4-5 million per month in the first half of CY 1975, ~~at the end of FY 1975,~~ as production suffers from rising costs and the unavailability of capital for replacement and expansion. Invisible earnings (other than piaster purchases) ^{would} ~~are~~ ^{be} likely to decline through FY 1975 as the poor state of the economy fails

* See Annex I for a statement of the assumptions which underlie all of the projections in this memorandum.

TABLE I

FY 1975 Low Option Funding (CRA)

Millions of US Dollars

	<u>1973</u>	<u>1st Half 1974</u>	<u>2nd Half 1974</u>	<u>Total 1974</u>	<u>1st Half 1975</u>	<u>FY 1975</u>
Total Imports (1973 Prices)	766 (766)	492.5 (394)	477.5 (329)	970 (723)	492.5 (300)	970 (629)
Financing:						
A. US	<u>530</u>	<u>362.5</u>	<u>337.5</u>	<u>700</u>	<u>337.5</u>	<u>675</u>
1. CIP (including DLF)	<u>258</u>	<u>225</u>	<u>175</u>	<u>400</u>	<u>175</u>	<u>350</u>
a. POL	(74)	(76.5)	(76.5)	(153)		
b. Fertilizer	(50)	(37.5)	(37.5)	(75)		
c. Other	(134)	(111)	(61)	(172)		
2. PL-480	<u>144</u>	<u>137.5</u>	<u>137.5</u>	<u>275</u>	<u>137.5</u>	<u>275</u>
a. Rice	(76)	(80)	(80)	(160)		
b. Other	(68)	(57.5)	(57.5)	(115)		
3. Piaster Purchases	<u>128</u>	<u>0</u>	<u>25</u>	<u>25</u>	<u>25</u>	<u>50</u>
B. Non-US Aid (including non-commercial import financing)	<u>50</u>	<u>40</u>	<u>60</u>	<u>100</u>	<u>100</u>	<u>160</u>
C. Commodity Exports	<u>60</u>	<u>45</u>	<u>35</u>	<u>80</u>	<u>25</u>	<u>60</u>
D. Net Invisibles	<u>48</u>	<u>20</u>	<u>20</u>	<u>40</u>	<u>15</u>	<u>35</u>
E. Decline in Foreign Reserves	<u>78</u>	<u>25</u>	<u>25</u>	<u>50</u>	<u>15</u>	<u>40</u>
(Gold and Foreign Exchange, End-Period)	(154)	(129)	(104)	(104)	(89)	(89)

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to attract foreign businessmen and tourists. Although limited in its capacity to do so, the GVN would probably be forced to draw its foreign exchange reserves down to the equivalent of one month of imports at the end of FY 1975.

18. South Vietnam's projected imports for FY 1975 under the Low Option would be less than two-thirds the annual volume of imports in 1970-1971. Consequently, as FY 1975 progresses South Vietnam would be forced to shift increasingly to imports for current consumption -- largely food and fuels -- and forego many of the foreign inputs required for economic development. The few capital goods imported would probably be for support of the agricultural sector, since the continuing business slump would preclude many industrial imports.

19. The real import levels resulting from the Low Option would not provide the South Vietnamese economy a basis for ~~even~~ ^{any} ~~moderate~~ ^{at all} growth. Investment would remain depressed and a further real decrease in GNP would be likely, particularly if fuel, fertilizer and transportation problems in the agricultural sector continue. Inflation would remain a serious problem, and there would be continued declines in real income.

20. Under the Low Option, the South Vietnamese government would be able to carry out a modest nominal increase in salaries for government workers and military personnel, but not one which

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would keep step with inflation. Moreover, the reduction of aid arrivals would be sharper in the first half of CY 1975 than in the last half of CY 1974, and this would deepen real income declines. The result would be a further perceptible deterioration in living standards, particularly in urban areas. The real incomes of most urban families would probably fall to a level that would cover little more than a modest diet, limited clothing expenditures, and shelter. Unemployment would also probably increase above present levels, as imported industrial inputs became scarcer and more expensive.

21. The cost of imported goods under the Low Option would almost inevitably continue upward, not only because of increasing global prices but also because of government efforts to limit imports. The GVN would almost certainly impose more and higher import taxes, for example, under the low funding scenario, and these taxes would affect the prices and availability both of industrial imports and of those few non-food consumer imports now allowed.

22. If the Low Option for FY 1975 were accompanied by a serious funding shortfall in the remaining months of FY 1974, the above problems would be magnified, ~~and would arise more quickly~~. Moreover, even a short-term import crisis could have ²serious

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impact on the living standards of particular groups. The natural concentration on commodity imports under limited funding availabilities would be spurred by import speculation and a run on licensing. Importers would attempt to take advantage of the uncertainties by increasing both inventories and prices of imported goods. Windfall profits, common in the late 1960s but largely eliminated by the exchange and import tariff reforms of 1970-1972, would probably become a problem again, causing further income transfers to a small group of Saigon speculators.

23. A basic problem facing the South Vietnamese government under the Low Option is that the government ^{would have} ~~has~~ few administrative and financial tools left to cope with its economic problems, particularly in the short run. This was demonstrated in 1973 when a series of emergency measures had little impact except for forcibly drawing rice reserve stocks out of the delta. Import controls -- including increased taxes, outright bans, and rationing of specific commodities -- as well as more direct government intervention in rice marketing ~~[cabinet reshuffles]~~ and subsidies of various kinds ~~and~~ for various groups, were all tried with little success. By early 1975, the GVN would be faced with heavy pressures for further government controls -- more stringent than those applied in CY 1973 and early CY 1974, but probably no more effective.

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Medium Aid Option

24. The Medium Option would provide CIP and development loan aid of \$650 million to South Vietnam in FY 1975. Under this option, capital inflows and GVN exchange earnings through FY 1975 should show a marked improvement in comparison with the Low Option (see Table II). In particular, a CIP of \$600 million (plus development loan financing of \$50 million) should allow imports in the first half of FY 1975 to increase somewhat more than they would under the Low Aid option, and prevent them from declining in the second half of FY 1975. Adequate imports of raw material and capital goods, in turn, and a reasonably healthy business climate would support expanded export growth. Similarly, invisible receipts could be expected to improve. The competition for imports between the agricultural and industrial sectors might be greater under the Medium than under the Low Option, and this might slow the growth of agricultural output if imports of fertilizers and pesticides, for example, diminished. The PL-480 program would probably have to be maintained at a high level because of continued high world rice prices, slow growth in the South Vietnamese agricultural sector, and stabilization requirements. Under this option, South Vietnam would also have to draw on its foreign exchange reserves during the first half of FY 1975, but by the end of the fiscal year, total capital inflows would be such that some improvement in reserves should occur.

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TABLE II

FY 1975 Medium Option Funding (600)

Millions of US Dollars

	<u>1973</u>	<u>1st Half 1974</u>	<u>2nd Half 1974</u>	<u>Total 1974</u>	<u>1st Half 1975</u>	<u>FY 1975</u>
Total Imports (1973 Prices)	<u>766</u> (766)	<u>492.5</u> (394)	<u>642.5</u> (443)	<u>1,135</u> (837)	<u>627.5</u> (383)	<u>1,270</u> (826)
Financing:						
A. US	<u>530</u>	<u>362.5</u>	<u>487.5</u>	<u>850</u>	<u>487.5</u>	<u>975</u>
1. CIP (including DLF)	<u>258</u>	<u>225</u>	<u>325</u>	<u>550</u>	<u>325</u>	<u>650</u>
a. POL	(74)	(76.5)				
b. Fertilizer	(50)	(37.5)				
c. Other	(134)	(111)				
2. PL-480	<u>144</u>	<u>137.5</u>	<u>137.5</u>	<u>275</u>	<u>137.5</u>	<u>275</u>
a. Rice	(76)	(80)				
b. Other	(68)	(57.5)				
3. Piaster Purchases	<u>128</u>	<u>0</u>	<u>25</u>	<u>25</u>	<u>25</u>	<u>50</u>
B. Non-US Aid (including non-commercial import financing)	<u>50</u>	<u>40</u>	<u>60</u>	<u>100</u>	<u>100</u>	<u>160</u>
C. Commodity Exports	<u>60</u>	<u>45</u>	<u>50</u>	<u>95</u>	<u>60</u>	<u>110</u>
D. Net Invisibles	<u>48</u>	<u>20</u>	<u>25</u>	<u>45</u>	<u>30</u>	<u>55</u>
E. Change in Foreign Reserves	<u>78</u>	<u>25</u>	<u>20</u>	<u>45</u>	<u>-50</u>	<u>-30</u>
(Gold and Foreign Exchange, End-Period)	(154)	(129)	(109)	(109)	(159)	(159)

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25. The level of imports allowed under the Medium Option would still be such that food, fuel, and other basic consumer items would account for most of the total. There would be little funding available for many types of consumer imports normally found in countries at this stage of development. More important, little increase would be possible -- in real terms -- in raw material and capital imports. Investment would continue at a low rate and little reconstruction would take place. Some real growth in the private sector probably would occur, but it would come less from new investment than from increased use of existing capacity as the economy recovered from the stagnation of 1972-1973.

26. The positive impact on living standards under this option would be limited in CY 1974, but the declines registered in 1972-1973 should nevertheless be halted by the end of the year. Moreover, assuming that this level of funding were accompanied by a commensurate recovery in domestic economic activity, real incomes would probably register some gains by mid-1975. In particular, salary increases for government workers and military personnel could just about match domestic rates of inflation since early 1973, even though real incomes for ^{these groups} ~~this group~~ would still remain below those of 1970-1971. Under the Medium Option,

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employment in the private sector should also increase modestly, but industrial recovery ^{would} ~~will~~ be slowed by the higher cost and scarcity of petroleum inputs, the effects of which are likely to remain serious through FY 1975. Moreover, farm incomes, which increased in 1971-1973, would probably level off under this option because of the sharp jumps in fuel and fertilizer costs in late 1973. The government would probably attempt to introduce regulatory measures to reduce the cost of these imported agricultural inputs. This would lessen the impact of rising import prices, but agricultural growth would nevertheless be slow.

27. In sum, under this level of funding, the GVN would be able to allow somewhat more private sector initiative in economic activity than in 1973. Through FY 1975, however, there would be little scope for policy innovation or increased government investment. Inflation would ~~also~~ continue to be a serious problem with few options open to the government for stemming it. Even though real income declines could be halted and perhaps reversed, the government would face continuing though manageable pressures ^(elements of the population who) ~~from factions~~ that have seen no significant improvements [/] in living standards for 3-4 years.

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High Aid Option

28. The High Option would provide CIP and development loan aid of \$900 million to South Vietnam in ^{FY}1975 (see Table III). Likely to offset this increase somewhat would be a decline in PL-480 aid because of increased agricultural production within South Vietnam. On the other hand, exports would grow rapidly under the High Option because needed raw material and capital inputs would be available. Invisible receipts would also benefit from the improved business climate and the future growth potential of the economy. All these factors would combine to slow the rate of foreign exchange depletion during the first half of FY 1975 and result in ^{a substantial} expansion of reserves in the last half of the fiscal year.

29. In real terms, the volume of imports under the High Option would still be slightly below the 1970-1971 average, but it would be sufficient to support moderate economic growth. Financing would be available for an adequate level of industrial and agricultural imports, in addition to basic consumer imports. The level of "luxury" imports ~~probably~~ ^{almost certainly} would not increase because ^{continuing} of government restrictions.

30. The full amount of the High Option aid (and the imports of ^{almost} \$1.5 billion) probably could not be absorbed by the GVN economy during FY 1975. Importers would be hard-pressed in

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TABLE III

FY 1975 High Option Funding (850)

	Millions of US Dollars					
	1973	1st Half 1974	2nd Half 1974	Total 1974	1st Half 1975	FY 1975
Total Imports (1973 Prices)	<u>766</u> (766)	<u>492.5</u> (394)	<u>772.5</u> (533)	<u>1,265</u> (927)	<u>725</u> (442)	<u>1,497.5</u> (975)
Financing:						
A. US	<u>530</u>	<u>362.5</u>	<u>612.5</u>	<u>975</u>	<u>575</u>	<u>1,187.5</u>
1. CIP (including DLF)	<u>258</u>	<u>225</u>	<u>450</u>	<u>675</u>	<u>450</u>	<u>900</u>
a. POL	(74)	(76.5)				
b. Fertilizer	(50)	(37.5)				
c. Other	(134)	(111)				
2. PL-480	<u>144</u>	<u>137.5</u>	<u>137.5</u>	<u>275</u>	<u>100</u>	<u>237.5</u>
a. Rice	(76)	(80)	(80)	(160)		
b. Other	(68)	(57.5)	(57.5)	(115)		
3. Piaster Purchases	<u>128</u>	<u>0</u>	<u>25</u>	<u>25</u>	<u>25</u>	<u>50</u>
B. Non-US Aid (including non-commercial import financing)	<u>50</u>	<u>40</u>	<u>60</u>	<u>100</u>	<u>100</u>	<u>160</u>
C. Commodity Exports	<u>60</u>	<u>45</u>	<u>60</u>	<u>105</u>	<u>75</u>	<u>135</u>
D. Net Invisibles	<u>48</u>	<u>20</u>	<u>30</u>	<u>50</u>	<u>50</u>	<u>80</u>
E. Change in Foreign Reserves	<u>78</u>	<u>25</u>	<u>10</u>	<u>35</u>	<u>-75</u>	<u>-65</u>
(Gold and Foreign Exchange, End-Period)	(154)	(129)	(119)	(119)	(194)	(194)

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our judgment to find demand for nonluxury imports at a higher level than would result from a CIP of about ~~750~~ ^{(and development aid) \$750} million.

Nevertheless, rapid short-term recovery and growth could take place if private sector confidence and import demand were restored by US government approval of the High Option. The key problem is that of encouraging the private sector to buy the goods. Foreign assistance can pay for the dollar cost of imported commodities, but ultimate sale must be financed by piaster expenditures. For an agricultural economy like that of Vietnam, the problem is made more difficult because this sector does not respond quickly to monetary stimulation. Thus, if investor and consumer demand were restored, real growth in excess of 5 percent would be possible with high aid funding. Although there might be a temptation to encourage a much more aggressive role on the part of government in productive investment, this sort of development strategy, in addition to working against the US preference for greater private initiatives, would require many more well-conceived and carefully-planned projects than could be generated in this period. Even with major reconstruction expenditures, the full amount of ~~an \$800~~ ^{\$900} CIP ^(and development aid program) probably would not be spent by the end of FY 1975.

31. Assuming some ~~\$700~~ [#] 750 million were spent, however, there would still be substantial improvement in private sector employment and wage conditions, particularly in the last half of

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FY 1975. Moreover, government receipts under this option should allow not only real wage increases for government employees and military personnel but possibly also some expansion of government employment in reconstruction/development activities. If a significant portion of this aid ~~is~~ ^{were} channeled into projects, a further increase in private sector employment could also result. Even this level of aid, however, would not entirely insulate the average Vietnamese from the effects of global inflation, because increased costs of consumer imports ~~will be further~~ ^{would} magnified by the competition of industry for a greater share of total imports. Under the best of circumstances, with continued large-scale foreign capital inflows accompanied by domestic economic recovery, the average living standards of 1970-1971 ~~would likely~~ ^{probably} not be reached again until 1976 or beyond.

32. The High Option should also allow the government to retreat from its recent efforts to control economic activity directly. A relaxation of import controls would, for example, allow a more rational and responsive distribution of available financing. To a greater degree than in the Medium Option, this option would also permit ~~an effort to maintain~~ ^{retention of} the 1971-1972 interest rate reforms which have encouraged the private sector, ~~and~~ ^{allow} the price adjustments necessary to keep the Vietnamese economy in tune with changing global economic conditions. Even the High Option, however, probably would not solve Vietnam's problem of

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domestic inflation during the period under review, as increasing import costs rather than excess demand will remain the major factor. Nevertheless, this option does provide the basis for more optimistic predictions for real growth and stabilization beyond FY 1975, assuming that continued foreign capital inflows are forthcoming. Moreover, the increase of real resources available to the economy would allow the government to attempt income redistribution measures with less likelihood of absolute income declines among particular population or economic groups.

Implications for Future Growth and Aid Requirements

33. Overall aid requirements for moderate growth -- or the US share of them -- will not decline significantly during the next five years. That is, given the low base from which South Vietnam begins, the attainment of steady economic growth will not ^{result} ~~arise~~ from ~~one or two~~ big "shots" of capital ^(limited to the next two years or so.) No country ^(Asia) in circumstances similar to those of South Vietnam today has ever come close both to sustaining growth and to covering its trade deficit through exports and "normal" capital inflows in less than 15 years.

34. Unless South Vietnam continues to receive -- for the rest of this decade at least -- annual foreign capital inflows similar to those at present (in constant prices), it will not have moved

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significantly beyond the living standards and real income levels that obtained when the US began its massive military and economic aid in the mid-1960s. So much has taken place in the global and domestic economies since mobilization shifted large numbers of the best workers into the armed forces, that prospects for accelerating the pace of recovery or shortening the period of "client" status for South Vietnam are not good. If the US objective ^{is} ~~is~~ to put South Vietnam on a growth track, and move it well down the road to self-sufficiency, it ~~is unlikely that~~ ^{will be impossible for} South Vietnam ^{to} ~~will~~ move out of a leading position among US aid recipients until the 1980s. The only development which conceivably could shorten this ~~time~~ period appreciably would be major oil discoveries in areas under South Vietnamese control, *and the immediate exploitation of such discoveries.*

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The Political Factor

35. In Vietnam as in the rest of the world, it is impossible to define precisely the relationship between economics and politics. Nor is it possible to identify that point at which a nation with growing economic problems starts to experience serious political instability. In the case of South Vietnam, there are two diametrically opposed schools of thought within the intelligence community on the political implications of the economic aid levels discussed in this memorandum. The arguments of these two schools are presented below.

SCHOOL A: This school holds that even the Low Option would provide enough aid to give reasonable assurance of political stability in South Vietnam, and to prevent the Communists from gaining an advantage in the continuing political struggle with the GVN.

36. Analysts who support the School A case argue as follows:

A. South Vietnam is in many ways relatively well ~~well~~ equipped to face substantial economic dislocation without political breakdown. South Vietnam has withstood intense military, political and economic pressures in the past. There is no sign that Thieu's tight control and political strength is weakening and no particular reason to question his ability to handle any political repercussions with his usual skillful blend of political finesse and, where necessary, tough

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security measures. It seems unlikely that even the economic conditions projected under the low case option-- the continuance of the present level of US assistance-- would pose unacceptable political risks regarding survivability and reasonable effectiveness of the GVN.

B. The increased assistance assumed by the medium and high case options would of course further reduce the possibility of serious political unrest and would further improve the relative position of the GVN vis-a-vis the North Vietnamese Communists.

C. South Vietnam's current economic problems are not new. The country has been in a recession since shortly after the start of the Communist Easter Offensive in March 1972. During this economic slump, the government has steadily increased its involvement in regulating the economy to help check the worsening situation. It has regularly informed the public that the economic road ahead will become rougher. President Thieu also has stated repeatedly that Saigon must work at solving its growing domestic economic problems with lesser amounts of US assistance.

D. There has been almost no indication that such bleak forecasts and repeated calls for belt tightening have triggered serious popular dissatisfaction with the government, and there has been nothing approaching panic by the people over the prospect of even darker days ahead. While all sectors of society have expressed various degrees of concern about the economic situation,
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the prevailing attitude has been one of acceptance, if only for want of a feasible alternative. The South Vietnamese population generally recognizes that conditions and prospects in Communist-controlled areas are even more bleak and unacceptable.

E. Any economically-derived political tensions would likely originate from one or a combination of three major groups: the military, Buddhists, and labor. The military is the most capable of challenging Thieu's authority. It is highly unlikely, however, that it would do so for fear of losing all forms of US assistance and support. Military officers would be quite hesitant to move against Thieu unless they were certain that the US wanted a changeover and would support it. In any event, there are now no signs of unease within the military over economic problems and Thieu is using promotions to ensure the loyalty of his senior officers.

F. A more realistic concern is the likely effect of worsening economic conditions on ARVN effectiveness. As belts are further tightened within ARVN the familiar problems of corruption and moonlighting are bound to intensify, as they are in other government services. This will probably take some toll in morale and it may contribute to a perceptible decline in combat effectiveness, but it is unlikely to result in a

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substantially adverse shift in the existing military balance in the South. As long as US military assistance is not diminished, as long as South Vietnam faces an immediate military threat from the north and as long as the GVN is controlled by President Thieu and the military, ARVN is almost certain to remain a relatively privileged organization. ARVN rank and file have little incentive to desert or to transfer their loyalties to the other side because of their comparatively advantaged position.

G. The Buddhists have traditionally dealt with political rather than economic issues. They have some potential for fomenting local unrest but factionalism and other problems probably would prevent them from rallying any widespread antigovernment support. The Buddhists, in fact, might serve as a stabilizing rather than a disruptive force. They are strongly anti-Communist and thus might view any political exploitation of economic hardships as ultimately serving Communist ends.

H. Organized labor is potentially the most volatile of the three groups. The workers are already bearing the brunt of South Vietnam's high unemployment and inflation. Historically, however, labor has tended to support the central government. Such support is likely

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to continue and may even be reinforced by the same considerations that militate against political agitation by the military and by the Buddhists--the need to maintain US support and the lack of an acceptable alternative. While labor leaders can be expected to encourage local protests to publicize shortages on perceived regional discrimination, they have the capability to keep such demonstrations under control. Consequently, the Thieu government is not likely to face a nationwide challenge from organized labor.

I. Hanoi's perception of the GVN's economic situation could be more significant than the actual domestic reaction to worsening conditions. The North Vietnamese are clearly alert to Saigon's economic problems. COSVN has in fact warned its cadre to be ready for "sudden developments" arising out of the economic situation that may present an opportunity to "destroy the enemy." Just as clearly, however, the economic situation is only one factor--and not the most important one--that Hanoi must consider in determining its strategy in the southern struggle.

J. Through the end of FY 1975 the South Vietnamese economic situation seems unlikely by itself to present

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Hanoi with many easily exploitable opportunities. The Communists currently lack the assets either to exacerbate any economic troubles or to turn them to their direct political advantage. Basically they must wait until economic difficulties have sapped the strength of the Saigon regime and made the South Vietnamese populace more receptive to Communist pressures and blandishments. At this point (other considerations being favorable) they might move, through some combination of military and political action, to take advantage of Saigon's economic troubles. But economic deterioration of the sort that might provide such openings is not likely to occur in the next year or so.

SCHOOL B: This school holds that under the Low Option the GVN would run an unacceptable risk of serious adverse political reactions in FY 1975. These reactions could cause instability, weaken the control of the central government, and encourage Hanoi to advance its timetable for another large-scale military offensive in the south. Even under the Medium Option there would be some risk of such developments.

37. Analysts who support the School B case argue as follows:

A. The present government in South Vietnam has enjoyed a high degree of political stability since the late 1960's. It has also

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established a relatively effective administration from Saigon down to the village and hamlet and has been successful at eroding Communist political control in the countryside. ^{Part of the GVN's political} ~~achievements~~ ^{however,} ~~perhaps a rather large part~~ ^{-- and perhaps a large part --} must be attributed to the economic stability of the period and the economic opportunities enjoyed by a rather large segment of the population. This in turn was made possible by regular large doses of US assistance over the years. South Vietnamese society has undergone a significant transformation in the last decade. The dramatic shift in population from rural to urban areas has created a new situation in which it is very difficult to judge the impact of economic privation. Belt tightening, the traditional Vietnamese reaction to hardship, may have new limits under these circumstances.

B. In the past two years the economic situation has begun to deteriorate, and South Vietnamese society has experienced a rather severe decline in living standards. Those hardest hit have been urban residents and those living on fixed salaries, mainly the military and civil service. Thus far there has been little overt political reaction, and President Thieu's

control of the political scene remains intact. However, virtually all Vietnamese government officials, starting with President Thieu, appear to be greatly concerned about the economic situation and the potential political dangers. The Communists also appear to be counting strongly on the possibility that economic problems will weaken the GVN.

C. Short Term Implications of the Low Option: Under the Low Aid Option, it is likely that in FY 1975 the GVN would start to face serious political reactions. The reactions might take several forms, each of which would have the effect of weakening central government control and creating political instability:

- With continuing inflation and rising unemployment, unrest in the hard hit urban areas, especially in the cities in Central Vietnam, is likely to increase. There is a significant possibility of strikes by organized labor and of demonstrations led by veteran groups and religious and political organizations in Central Vietnam and Saigon.
- The morale and combat efficiency of ARVN will decline. All military commanders admit that this problem is significant, although it has yet to have a debilitating impact. It is impossible to predict if there is a critical point at which a breakdown in combat effectiveness will occur, and it is likely that ARVN will continue to fight if its back is to the wall. RVNAF's capability to protect rural areas and to conduct offensive and counter-offensive operations, however, could be seriously reduced.

- Corruption is likely to become a serious political problem for the GVN. Saigon will almost certainly institute more government controls which will result in a growing black market and widespread illegal payoffs. The GVN will not be able to increase civilian and military salaries adequately to keep pace with inflation; the resulting decline in real wages will result in more corruption. There have recently been an increasing number of reports of troops selling their equipment and in some instances even selling ammunition to the other side. There are also increasing incidents, especially in MR I, of armed robbery by ARVN troops. Continued corruption could begin to impact seriously upon the morale and combat efficiency of ARVN.
- Declining military and civil service morale and growing corruption will adversely affect the implementation of GVN programs at all levels.
- There is likely to be increasing criticism of GVN economic policies and further cabinet changes in the economic ministries, producing a loss of confidence and uncertain policy direction.
- The Communists could make some psychologically important political gains by taking advantage of GVN vulnerabilities. Recruitment of Communist sympathisers in the cities and rebuilding of the rural infrastructure might be easier, and increasing numbers of South Vietnamese might opt for a neutral stance.

D. Hanoi's Reaction: The North Vietnamese are counting on Saigon having major economic problems this year. They are certain to exploit the situation in some form. Communist cadre will step up ~~subversive~~ ^{subversive} activities if there is rural economic dislocation and urban disorder. Indications that the GVN was seriously weakened by economic and political problems could encourage Hanoi to advance its timetable for military ~~attacks~~ ^{attacks} in the south.

E. Long Term Implications: While the Thieu government will probably survive the political consequences of the adverse economic ~~consequences of the adverse economic~~ situation in FY¹⁹75, a low level of aid could set in motion a process which ultimately might threaten the existence of the government. Such a process may be difficult to reverse even with increased US assistance in FY 76.

F. The South Vietnamese police and rank-and-file military men, who will be called upon to control demonstrations, strikes, and rioting, are some of the people who have been hit hardest by economic problems. The situation would become critical for the GVN if elements of the police and army were to participate in demonstrations and strikes or to engage in their own organized protest measures. Incidents of police and military involvement in civil disorder occurred in the mid 1960's in South Vietnam, most notably in MR I in 1966. There would be little the Thieu government could do to lessen the economic plight of these groups.

G. Any real domestic challenge to Thieu's position would probably come from his major political base -- the military. While there are no signs of unrest in the military at this time, the political ~~in the military at this time, the political~~ developments outlined above, could during FY ¹⁹⁷⁵ ~~75~~ create dissension within the officer corps. Middle grade officers, caught between the declining morale and discipline of their men and the unabated corruption and ineffective performance of senior ARVN officers and politicians, could pose a serious threat to the present government. A "Colonels' coup," designed to establish an austere, disciplined, nationalistic South Vietnam prepared to continue the struggle against the Communists, seems unlikely now, but after a period of severe economic dislocation it could become a serious possibility.

H. The Medium and High Assistance Options: Under the High Aid Option, it is unlikely that there would be any major political ~~be any major political~~ consequences. There might be a period of several months before the impact of the high level would be felt. During this initial period there could be minor political problems, but the GVN would certainly be able to arrest these before they became serious.

I. Under the Medium Aid Option, the consequences would be more difficult to assess. There would be continued economic stagnation ~~There would be continued economic stagnation~~ at this level which would be a major problem for GVN policy makers. While there would probably be political reaction, the Thieu government would probably be able to keep the lid on the situation during FY ¹⁹⁷⁵ ~~75~~.

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ANNEX *Z*

The following assumptions underlie all of the economic projections which are made in this memorandum.

- The security situation will remain the same (no marked improvement over conditions prevailing since the cease-fire agreement in January 1973).
- No demobilization of the GVN armed forces will occur.
- The 1974-1975 harvest will be at least as good as 1973-1974, and therefore PL-480 requirements will not increase significantly in real terms.
- There will be no change in the distribution of population (no significant outflow from urban to rural areas).
- Import prices will rise by 35 percent *in dollar terms* during CY 1974 and by 10 percent during the first half of 1975.
- Inflows from third-country aid will not exceed an annual rate of \$100 million in CY 1974 and \$200 million in CY 1975, slightly less than half of which will be available for general imports -- i.e., not earmarked for specific projects.

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- (except under the High Option,)*
- The private sector will actually use ^(all) the available aid; i.e., South Vietnamese businessmen will overcome their own uncertainties and will use available capital. Otherwise the economic situation under any of the postulated scenarios would be bleaker than described herein.
 - The aid pipeline (the unutilized portion of past funding) will not change significantly during the period.
 - The timing of aid for import financing will coincide directly with the period for which the aid is authorized.

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