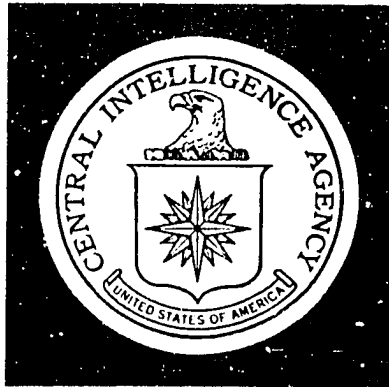


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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

*Economic Problems and Prospects
in the Fledgling Peoples Republic
of Southern Yemen*

Secret

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
April 1968

INTELLIGENCE MEMORANDUM

Economic Problems and Prospects
in the Fledgling Peoples Republic
of Southern YemenSummary

The newly independent Peoples Republic of Southern Yemen* faces economic and political problems of immense proportions. Both personal and governmental incomes have fallen rapidly since mid-1967, severely hampering the government's ability to maintain order and to plan for the future. The present economic decline, triggered by the British withdrawal, follows a period of rapid economic expansion created almost entirely by the major British military presence in Aden, which began in 1959. Between 1959 and 1965, Aden's population grew from about 150,000 to about 250,000 and its national income increased about 75 percent. By the end of 1968, Aden probably will have lost slightly more income than it gained during 1959-65. If 100,000 residents leave by the end of 1968, as expected, average per capita real income will fall well below the 1959 level, perhaps by 35 percent (this estimate includes a price rise of approximately 30 percent).

* South Yemen comprises the former British Crown Colony of Aden and 20 principalities formerly grouped into the Aden Protectorate. It is the successor to the South Arabian Federation, which never became fully operative, but it encompasses the four Protectorate states that had refused to join the Federation (see the map, Figure 1).

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research and coordinated with the Office of National Estimates and the Office of Current Intelligence.

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The economic life of the new state is concentrated in Aden. Aden's main economic activities -- (1) petroleum refining and bunkering and (2) tourism and trade fostered by free port status -- slowed down sharply during months of turmoil preceding independence. Closure of the Suez Canal and withdrawal of British troops destroyed most of Aden's remaining port-related business. With the loss of the \$40 million annually contributed by the British base, Aden can expect its gross national product (GNP) in 1968 to reach less than 55 percent of the level attained in 1966. The impact of economic contraction on individual incomes will be cushioned somewhat by emigration. The departure of British citizens and of Indian, Somali, and Pakistani shopkeepers and minor functionaries, however, has deprived Aden of most of its relatively well-educated and skilled inhabitants.

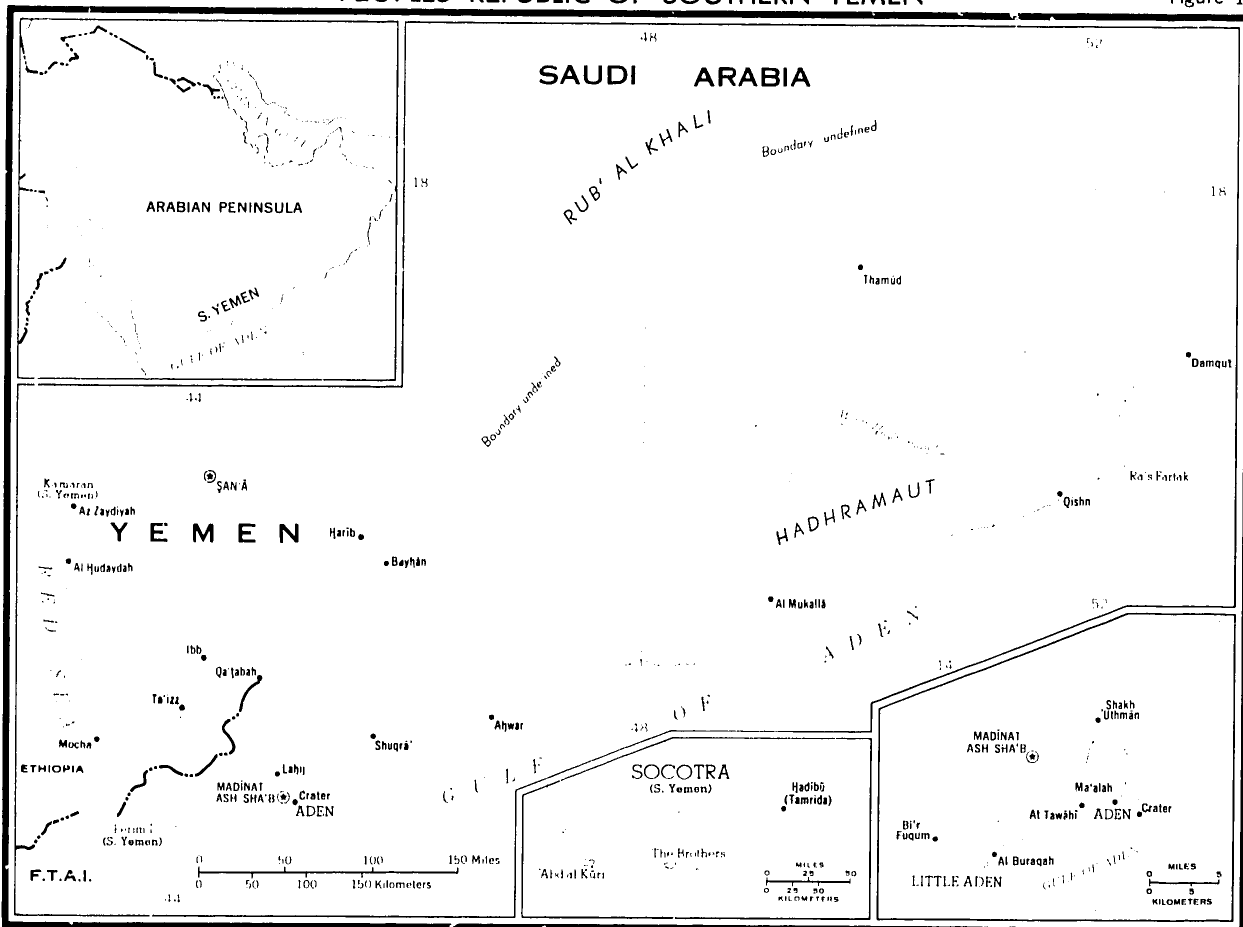
The flow of population out of Aden to its hinterland has contributed to problems in the outlying areas, which have relied mainly on British subsidies, emigrant remittances, subsistence agriculture, smuggling, and a few handicrafts for a near subsistence income. The South Yemenis remaining in Aden now have less income to spare for their families at home; those who have returned home increase the population that inadequate resources must support.

Prospects for a reversal of fortune in the immediate future are poor. The reopening of the Suez Canal would bring some improvement in port- and bunkering-related activities. Political unrest and terrorism, however, remain major deterrents to recovery. Subsidies from the United Kingdom have been the major source of governmental revenue in the past, and no British aid has been promised for the period following May 1968. Without substantial foreign assistance, the ruling National Liberation Front will be unable to meet current expenses, much less embark on development schemes. With the economy shrinking, revenues from local taxes and fees are falling. The regime has visions of ambitious but nebulous development programs aimed at building a stable economic and political atmosphere and fostering welfare and growth. It has appealed for aid from any nation that will offer help, but response to date has been meager. The immediate need is for budget support funds, a category of aid becoming increasingly rare throughout the world. The longer term need is for substantial public and private investment.

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PEOPLES REPUBLIC OF SOUTHERN YEMEN

Figure 1



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Contrast Between Aden and the Outlying Areas

1. South Yemen is divided, economically and politically, even more sharply than most underdeveloped countries. When the area was under British control or protection, Aden was ruled as a colony while the remainder of the area experienced only a minimal British advisory presence. The administrative and advisory mechanisms operated separately, and two greatly different economic and social structures existed. Goods exchanged between Aden and the outlying areas were regarded and recorded as foreign trade.

2. When the British began trying in the late 1950's to merge the disparate areas into a nation-state that could be granted independence, Aden was relatively modern and prosperous. The surrounding area was made up of monarchical, feudal, tribal states that had little contact with the outside world. The Adeni power groups tended to be nationalistic, anti-British, and progressive; the country sheiks and their supporters were beneficiaries and advocates of the status quo. The initial British formula for unification favored the traditional tribal rulers. Elements in Aden, however, resisted this formula with increasing violence as the time for power transfer approached. In mid-1967 the British abandoned the attempt to impose domination by the sheiks and agreed to negotiate procedures for independence with any group that could demonstrate effective control in South Arabia. Aden then erupted into warfare among various nationalist groups. Within weeks, the National Liberation Front had established control in Aden and in most of the principalities, and the majority of the hereditary rulers had fled the country.

3. Political unity is precarious, however, and economic unity has not even begun to appear. Aden depends on the hinterland for some foods and in turn supplies some consumer goods and machinery, but their separate economic and financial institutions differ greatly. The economy of the hinterland is based on subsistence agriculture and some foreign aid and is largely nonmonetary. That of Aden, on the other hand, is relatively modern, industrialized, and monetary.

SECRETThe Economy of Aden*

4. Even before the British transferred their major Middle East headquarters to Aden in 1959, Aden was a prosperous city. Aden's location relative to major international waterways and its excellent harbor attracted a large clientele for bunkering, commerce, and tourist services. Both the location and a history of political stability encouraged the British Petroleum Company to build an oil refinery that supplied bunkers and provided exports. British, Indian, and Pakistani expatriates, attracted by the city's bustling atmosphere, controlled most of the commercial and industrial sectors of Aden's economy, holding nearly all of the management and proprietary functions and contributing a sizable portion to the city's GNP. Conversion of the British military establishment from a small garrison to a major headquarters added \$35 million directly to Aden's GNP by 1966, and the resulting economic boom inspired other activities that generated a similar amount of new income.

5. The decision of the United Kingdom to withdraw its forces from Aden and to grant independence to the area in November 1967 brought an immediate end to economic growth. Even if the transition had been peaceful, Aden would have lost about \$40 million annually -- \$35 million in expenditures by the British military and military dependents and \$5 million in subsidies. Such a decline would have removed almost a quarter of Aden's GNP directly, and adverse repercussions would have been felt throughout the economy. The blow dealt by the British withdrawal was compounded by a struggle for post-independence power between rival groups whose mutual terrorism disrupted economic activity. Problems are intensified by the closure of the Suez Canal, which altered world shipping routes and left Aden isolated from most maritime traffic. Aden's economy thus has been crippled so seriously that recovery will be painfully slow.



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6. No sector of Aden's economic life was left untouched by the chaos of the last half of 1967. GNP, which had been estimated to total some \$175 million in 1966, fell to roughly \$120 million in 1967 (see Table 1), the greatest decline occurring in the last half of the year. Prospects for recovery in 1968, which depend on continuation of a precarious peace, are slim. Some renewal of domestic and foreign trade is possible, but it will not compensate for the loss incurred when the British base was closed. GNP probably will decline to about \$95 million in 1968 unless substantial new foreign aid is forthcoming (see the chart, Figure 2).

Table 1

Aden: Gross National Product
1966-68

	Million Current US \$		
	1966 a/ (Estimated)	1967 (Estimated)	1968 (Projected)
Military installations	35	20	
Refining	10	8	8
Port and shipping	12	6	7
Retail and tourism	36	19	17
Bunkering and petroleum distribution	5	2	2
Construction and transportation	10	8	9
Other industry	8	6	7
Government b/	40	35	30
Emigrant remittances	4	3	3
Other	15	13	12
<i>Total</i>	<i>175</i>	<i>120</i>	<i>95</i>

b. This item includes expenditures of foreign aid revenues estimated at \$20 million for 1966, \$16 million in 1967, and \$14 million in 1968.

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SECRETBritish Military Expenditures

7. When the United Kingdom decided to end its rule in Aden, expenditures by British military authorities and personnel accounted for more than 20 percent of Aden's GNP and provided direct employment for more than 8,000 persons. As many as 25,000 local contractors, grocers, merchants, and servants depended indirectly on the presence of British troops for their livelihood. As British civilians and dependents were evacuated in the summer of 1967 and strict security measures were imposed on British troops, economic activity declined sharply. The part of the GNP that was derived from the British military presence in 1967 probably declined by \$15 million -- to about \$20 million (see Table 2) -- and this income ceased altogether in November 1967 when the British withdrawal was completed.

Table 2

Aden: Contribution of British Military Installations
to the Gross National Product
1966-67

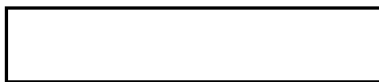
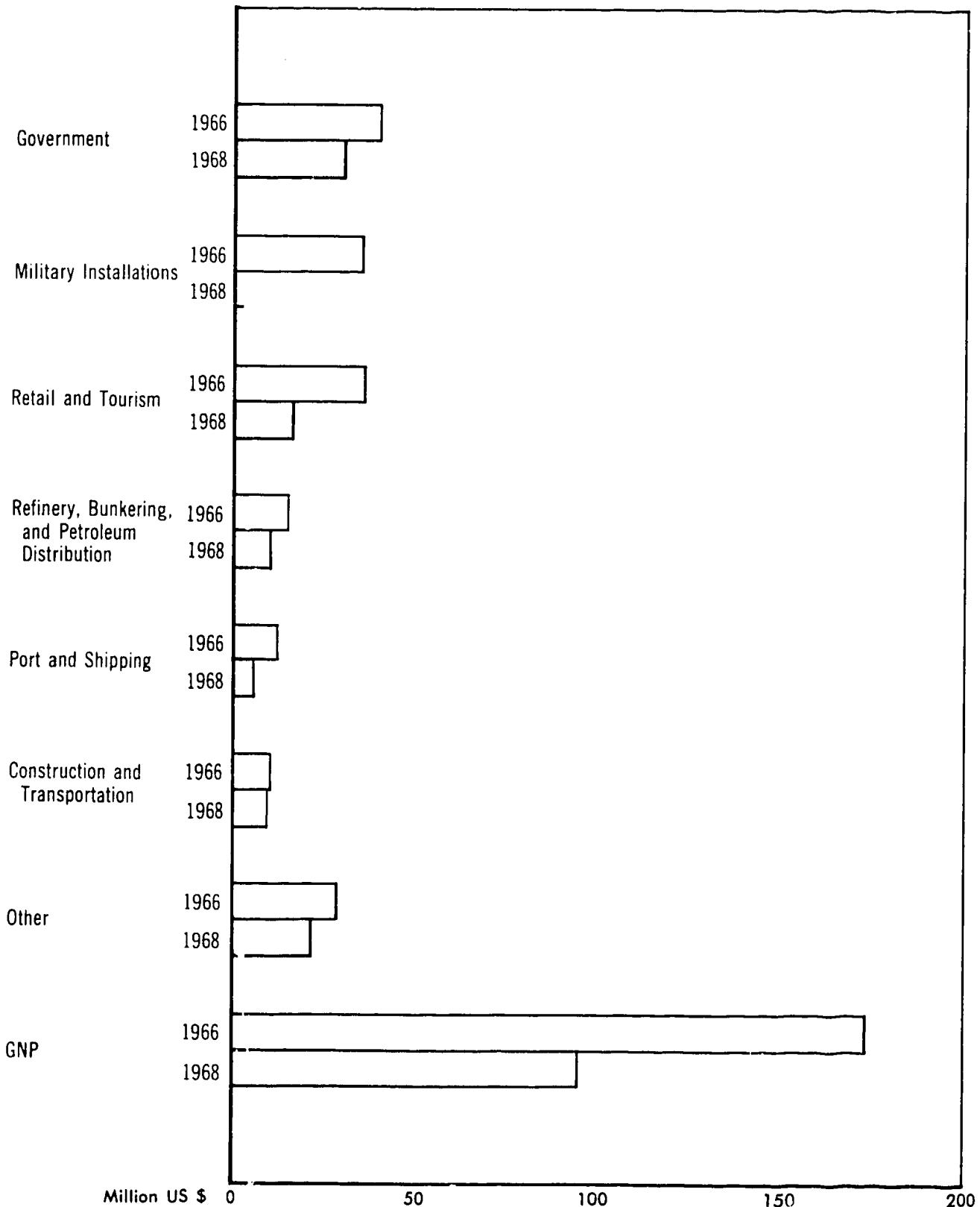
	Million Current US \$			
	1966		1967	
	Total Expenditures	Contribution to GNP	Total Expenditures	Contribution to GNP
Spent by service men and families				
For services	12	12	6	6
For local goods	2	2	1	1
For imported goods	10	2	5	1
Spent by base authorities				
Salaries to the local personnel	8	8	6	6
Fuel, utilities, and goods	9	7	7	5
Capital investment	4	4	1	1
<i>Total</i>	45	35	26	20

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Aden: Gross National Product 1966 and 1968

Figure 2



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8. When the British withdrew, about 25,000 people -- about one-third of Aden's labor force -- were left jobless. They include workers at the base, a large number of domestic servants formerly employed by the British, and workers in restaurants, laundries, barber shops, and similar local service industries. Many of these unemployed left Aden to return to their former homes in other countries or to the outlying districts of South Yemen, but many remain in Aden and constitute a serious problem for the new government.

Port, Shipping, Retail, and Tourist Revenues in Aden

9. Port, shipping, retail, and tourist revenues, which together contributed \$48 million to the GNP in 1966, accounted for only about \$25 million in 1967 (see Table 3). Although emigration aggravated the situation, a sharp decrease in shipping activity was the largest single factor in the decline.

10. Violent strikes in the spring of 1967, followed by the closure of the Suez Canal, combined to reduce ship calls at Aden. Only about 3,000 major vessels visited Aden in 1967, compared with more than 6,000 in 1966

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11. The decline in ship traffic and fear of terrorist activities also depressed income from tourist services and retail trade. Arrivals of transit passengers in 1967 dwindled to 28 percent of the 1966 level, and tourist arrivals were only 10 percent of normal levels in late 1967 and early 1968 in the face of continuing unrest, and are unlikely to revive as long as this continues. Hotels and restaurants suffered from the loss of tourists as well as from declining expenditures of British

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military personnel and their dependents. Aden's free port status was maintained, but earnings from lavish expenditures by tourists and ship crews on duty-free items, such as watches, cameras, and household items, also dropped. General strikes and the flight of expatriate Indian, Pakistani, and European shopkeepers and businessmen have depressed retail trade further. Many of Aden's retail outlets are closed, and their departing owners have taken away a significant part of the market for Aden's more expensive goods -- luxury food items and manufactured goods.

12. If some semblance of peace is maintained, Aden's retained income from shipping and visitor-related services during 1968 probably will rise slightly, but recovery to the level of 1967 is highly unlikely. The exodus of European and Asiatic consumers presumably is permanent in most cases, and thus retail trade will remain slow. The prospects for a significant increase in shipping activity also are dim. A slightly larger share of any profits from tourism and retailing will remain in Aden because the businesses that continue to function will be operated increasingly by Adenis and other Arabs. As remittances of profits abroad decline, money retained in Aden will provide some basis for renewed activity.

Table 3

Aden: Contribution of Port, Shipping, Retail,
and Tourist Revenues
to the Gross National Product
1966-68

	Million Current US \$		
	1966 (Estimated)	1967 (Estimated)	1968 (Projected)
Total income earned from:			
Port and shipping	61	32	29
Retail and tourism	15	7	8
Less: repatriated earnings of foreigners	46	25	21
<i>Contribution to net income</i>	13	7	5
	48	25	24

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Refining and Bunkering in Aden

13. In 1967, refining and bunkering activity contributed only about \$10 million to Aden's GNP, compared with some \$15 million in 1966. The British Petroleum Company refinery at Little Aden, with throughput capacity recently expanded to 8.3 million tons per year, is the largest single non-government source of earnings in the area, but its operations have been severely hampered by recent events. Rising political unrest, violent strikes, and the change in basic shipping routes due to the closure of the Suez Canal in June 1967 have made Aden an inopportune bunkering port. Sales of bunker fuel fell from 3.9 million tons in 1966 to less than 2 million tons in 1967. Loss of the bunkering trade was a major factor in the decline of refinery output. The refinery operated at about 70 percent of capacity in 1967, with an output of 6.0 million tons, compared with 7.1 million tons in 1966. Production increased nearly to capacity in November and December 1967, when Aden began refining Egyptian crude at the rate of 50,000 barrels per day (bpd). Egyptian business is a temporary phenomenon, however, brought about by the closure of the Suez refineries. Processing of Egyptian crude was reduced to 20,000 bpd in January 1968. The refinery will continue to operate nearly at capacity until the Suez refineries begin operations in the summer of 1968.

14. Both British Petroleum and the government of South Yemen are anxious to keep the refinery operating. Refinery activity accounts for about \$1.5 million in tax revenues to the government and an additional \$1.6 million in salaries to the more than 3,000 Arab workers employed there. Profits remitted to the United Kingdom amounted to \$15 million in 1966. Output, however, is not likely to be maintained at capacity unless the substantial bunkering trade is regained. Unless the Suez Canal reopens soon, 1968 output can be expected to remain at the 1967 level, and contribute some \$8 million to GNP.



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Other Aspects of Aden's Economy

15. Aden's small industries, construction, and transportation have suffered from the general depression. Small industries, which began a gradual decline in the early 1960's, lost more of their consumer market as the wealthy expatriate groups left Aden.



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Construc-
tion at the port has stopped, and other new building has dwindled. Only the local fishing industry, which is an important supplier of domestic consumption, seems to be operating normally.

16. Rising prices and incipient shortages of food are beginning to cause some concern to the government. Food prices, rents, and doctors' fees have been pegged at their pre-independence level. Fresh fruits, vegetables, and fish, which form an important part of Aden's diet, are available locally on a day-to-day basis as long as the Central Market and retailing outlets remain open. The government is working to avoid the potentially explosive position reached in February 1967, when the marketing system broke down, leaving the large, poor segment of Aden's population without fresh food for several days. Most other staple products -- rice, sugar, tea, flour, ghee -- are imported. With shippers reluctant to visit Aden, food imports have declined. Thus far, the population exodus has averted a serious food shortage in Aden, and an emergency committee was appointed in December 1967 to insure a food supply adequate for at least three months.

17. Economic recovery is hampered by a serious shortage of skilled personnel. Before independence, foreigners in Aden accounted for nearly all of the bankers, accountants, white-collar workers, businessmen and managers, harbor pilots, and skilled labor in the utilities industries. The majority of these people left Aden in the fall of 1967, and the gradual departure of the remainder probably will inhibit the economy further. Recovery will depend

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either on the return of skilled foreigners or on an extensive government program to train Adenis in white-collar and management skills.

Outlying Areas

18. Economic life in the vast areas of South Yemen outside Aden, already at a near subsistence level, also has been depressed somewhat by the events of 1967. Formerly, the hinterland derived almost one-half of its income from a combination of British subsidies and emigrant remittances. Earned income came from some agriculture, fishing, smuggling, and handicrafts. The standard of living probably deteriorated in 1967, as unemployed workers returned home from Aden. An expected decline in British aid probably will lead to a further decline in 1968. The estimates in Table 4 of GNP for the outlying areas are indicative of the trend; the absolute values are largely only gross approximations.

Table 4

Outlying Areas: Estimated Gross National Product a/
1966-68

	Million Current US \$		
	<u>1966</u>	<u>1967</u>	<u>1968</u>
Local government	30	30	20
Agriculture and fishing	20	20	20
Smuggling and "services"	15	15	15
Emigrant receipts	10	8	5
Petroleum and industry	5	2	4
Other	5	4	4
<i>Total</i>	85	79	68

a. Since the area is primitive and lacks financial institutions, much of its economic activity is non-monetary.

19. The flow of population from Aden to the countryside has a dual impact. The people of the

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Hadhramaut* region traditionally have supported their families at home by working abroad. Rising nationalism in Indonesia, East Africa, and other areas began to impel the Hadhramis to return by about 1965. By the end of 1968, perhaps 25,000 South Yemenis will have left Aden for their outlying villages, where they will be jobless. Consequently, emigrant receipts probably will amount to only about \$5 million in 1968 -- half the 1966 level. The influx of people will place an additional strain on the subsistence-level food supply of the area. Unless new sources of food or financing can be found, widespread malnutrition may become a serious problem.

20. Faint hope for slightly increased income is offered by the possible resumption of oil exploration. In 1966, \$5 million was added to the income of outlying areas by the expenditures of unsuccessful oil prospectors. In 1967, Pan American abandoned its explorations, but preliminary discussions have been held between the government and Atlantic Richfield concerning new explorations.

21. The short-term future of the rural area of South Yemen hinges on government expenditure and hence on foreign monetary aid. Expenditures by the feudal governments formerly provided more than a third of the total income of the hinterland. The rulers, in turn, derived more than two-thirds of their income from British subsidies. The United Kingdom maintained its aid payments at the 1966 level of nearly \$50 million per year through 1967, but the British aid commitment expires in May 1968. Most of the sheiks and sultans of the area have fled, and government expenditure henceforth will be channeled through the South Yemeni mechanism in Aden. Given the poor prospects of South Yemen for revenue and the obvious need for large expenditures

* *Hadhramaut is a general term referring to the region that was formerly the East Aden Protectorate. It constitutes about 80 percent of the land area of South Yemen. The major economic feature is the Wadi Hadramawt, a fertile 400-mile-long valley.*

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to maintain security in Aden, the outlying areas probably will receive no more than \$20 million in government expenditure in 1968.

22. If rural earnings from farming, herding, gunrunning, handicrafts, and other activities are maintained at the 1966 level, the expected changes in government expenditure, emigrant remittances, and population probably will leave per capita income in 1968 at about \$100 -- some 25 percent below the 1966 level. The outlook is even more bleak if food shortages, unemployment, and political disputation lead to unrest that interferes with normal economic activities.

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Government Finance

23. British aid will bolster South Yemen's revenues until May 1968, but the new nation may face a serious shortage of government funds and foreign exchange by the end of 1968. Both foreign and domestic revenue are falling, and the government faces a \$60 million deficit in a putative budget of \$86 million. At birth, South Yemen possessed foreign exchange reserves of only about \$8.4 million. Because these reserves were held almost entirely in pounds sterling, more than \$1 million was lost when the British pound was devalued. During the fiscal year ending in March 1967, aid from the United Kingdom amounted to more than 65 percent of the \$86 million spent by the various governments in the area. Aid inflow in fiscal year 1968 was slightly larger, and about \$10 million is pledged to South Yemen for April and May 1968.

24. Estimated domestic revenues also are falling. Customs duties normally make up the bulk of tax income; with foreign trade declining, collections are down. Receipts from other sources -- for example, the electric company, the airline, the refinery, and some small industries and shops -- similarly have been depressed by slackening economic activity. Thus domestic revenues of the government may well decline from the estimated 1966 level of \$30 million to some \$20 million in 1968 (see Table 5).

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Table 5

Peoples Republic of Southern Yemen:
Government Domestic Revenues
1966-68

	Million Current: US \$		
	<u>1966</u>	<u>1967</u>	<u>1968</u>
Income taxes	10	9	7
Customs and excise duties	12	9	7
Agricultural taxes	1	1	1
Other	7	6	5
<i>Total</i>	<i>30</i>	<i>25</i>	<i>20</i>

25. Early in December 1967, President Qahtan al Shabi of South Yemen outlined ambitious plans for defense and development. In addition to internal security and defense, he proposed port expansion to help boost income and the establishment of a banking and financial system to help establish the country's role as a commercial nation. He also outlined agricultural, industrial, medical, cultural, and educational projects.

26. With UK aid almost certainly ended, development plans will be nearly impossible to carry out. The government of South Yemen was forced to cut salaries of civil servants and military personnel by between 6 and 60 percent in February 1968, but defense and security expenditures, which accounted for nearly half of total government expenditure in the recent past, probably will grow as internal rivals and the former sheiks and sultans continue to threaten the present government. Education and welfare projects will require foreign teachers, technicians, and foreign financing. Many of the teachers and medical personnel in the country, as well as agricultural and other technical experts, were British citizens who have been evacuated.

27. The British have not offered future assistance, and significant aid from other sources has not been forthcoming. In the fall of 1967, South Yemen asked the United Kingdom for more than \$180 million during a three-year period. The British,

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however, promised only about \$29 million in aid, to be provided from December 1967 through May 1968. West Germany has responded to South Yemeni requests for aid by offering to send technical assistance for irrigation and other agricultural projects, but West Germany has not yet offered money. Arab countries have been asked for aid also, but response has been meager. Egypt has promised to send doctors, teachers, and agricultural experts. Scholarships for twenty-five South Yemeni students are being discussed with Algeria. Aid from South Yemen's largest and richest neighbor, Saudi Arabia, presently is out of the question, since the Saudi Arabian government considers the government of South Yemen hostile [redacted]

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28. South Yemen has turned increasingly to Communist countries for aid, but little has been forthcoming. The Chinese have sent some technicians [redacted]

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[redacted] A few Rumanian and Bulgarian doctors now help staff hospitals in South Yemen. [redacted]

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[redacted] A Soviet military training mission is expected to arrive in Aden in 1968.

29. Facing a desperate need for hard currency, South Yemen has appealed for foreign investment as well as aid. The government specifically has stressed the desire for foreign investment in railroads and air transport facilities. Because of the unstable political situation, the general mistreatment and mistrust of foreigners, and the government's announcement that it will pursue a socialist, "anti-imperialist" policy, substantial new foreign investment in the near future is not likely.

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