

MEMORANDUM

NATIONAL SECURITY COUNCIL

CHRONSECRET/SENSITIVEINFORMATION

January 14, 1975

MEMORANDUM FOR:

SECRETARY KISSINGER

FROM:

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SUBJECT:

The South Vietnamese Economy and
U.S. AidON-FILE NSC RELEASE
INSTRUCTIONS APPLY

The attached intelligence memorandum addresses the relation of U.S. aid to the Vietnamese economy. It makes a strong case for the continuing requirement for economic aid over the rest of the decade, while noting differences among agencies as to the necessary level. The report is deficient in failing to point out the link between military aid and economic development.

The two main points of the memorandum are:

(1) The Vietnamese economy has adjusted to the withdrawal of U.S. troops and declining aid levels much better than anyone would have expected two years ago. On this basis, it is judged unlikely that economic factors alone will lead to political unrest in the near future.

(2) The requirement for substantial economic aid will continue for the rest of the decade. Estimates of the needed amount vary with assumptions concerning the resilience of the economy and security conditions. The lowest estimate is \$500 million annually.

The memo contains a further useful clarification concerning potential oil revenues. If the current finds turn out to be commercially feasible, it will be at least 1980 before important revenues start to flow. Oil will not reduce the aid requirement in the 1970's.

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The Economic Significance of Military Aid

Economic aid can be reduced to the extent that (1) GVN military expenditures are trimmed; (2) private consumption is diminished; or (3) domestic production increases. Increased domestic production is the safety valve which permits the GVN to alleviate the political and military costs that otherwise would be associated with declining aid. Over the past two years, this safety valve has worked well as increased agricultural production has brought South Vietnam to the threshold of food self-sufficiency after a decade of food imports. The opportunities for employment in the countryside have even begun a process of reverse migration from city to country. This movement is central to the development of the food production and export potential of the Mekong Delta, which is South Vietnam's best prospect for reducing its dependence on aid.

Until very recently, it could be said that everything was moving in the right direction. Private consumption had been squeezed without political consequence, agricultural production had increased enough to eliminate food imports, and the movement of labor back to the countryside had begun.

This situation rested upon a military stalemate which, while not permitting the reduction of military expenditures immediately, did suggest the possibility should the adversary ever tire of what would seem an increasingly hopeless game as the economic foundations of an independent South Vietnamese economy were laid. The recently increased level of violence removes the possibility of reducing GVN military expenditures; it also makes problematic the reverse migration of labor from city to country. If the increased violence tends to keep labor from moving to the countryside, while also forcing the GVN to support an increased defense burden with diminished external assistance, then the current hostilities will surely bring out what the North likes to call the "internal contradictions" of the Thieu government.

The contradictions could be circumvented by increased economic aid, as they have in the past; but aid of this sort is only disguised refugee support. It keeps people eating without providing employment. A better solution would be to recreate the status quo ante which permits economic aid to promote the development which alone holds out the

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promise of reduced aid. The hallmark of the earlier situation was the military stalemate. It needs to be recreated either by providing the GVN the arms and munitions to reestablish the balance or by persuading the North to desist, or more probably both.

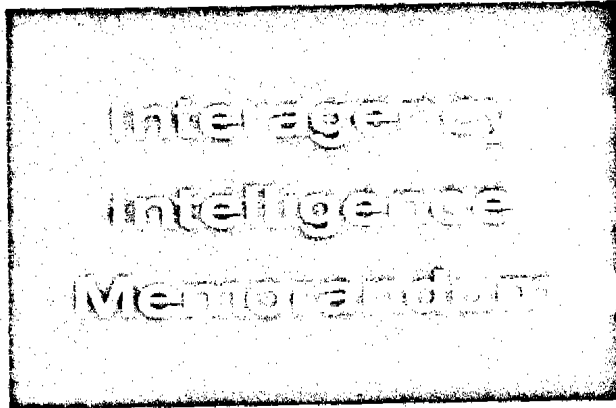
It is still early for a definitive prognosis, but the signs indicate that the continuation of the encouraging economic trend since the ceasefire depends on a level of military aid that will maintain the stalemate. A deteriorating military situation causes economic aid to provide progressively less development and more relief. We need now to recognize, as has not been in the attached memorandum, the economic importance of adequate military assistance.

The development of a more self-reliant South Vietnamese economy depends on two conditions: (1) adequate economic aid to support the level of military expenditures and to provide investment for the employment of idle urban labor in the countryside, and (2) security conditions that permit reverse migration. Economic aid addresses the former, while military aid conditions the latter. The South Vietnamese economy is equally dependent upon both.

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Nsc #146



**SUPPLEMENTAL RESPONSE TO
PART I OF NSSM 213:**

The South Vietnamese Economy and US Aid

Secret/Sensitive

DCI/NIO 025-75

7 January 1975

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January 7, 1975

INTERAGENCY INTELLIGENCE MEMORANDUM

SUBJECT: Supplemental Response to Part I of NSSM 213: The South Vietnamese Economy and US Aid

The Key Points

- South Vietnam has adjusted well to a variety of unsettling changes over the past decade and is likely to avoid substantial political unrest from economic factors alone in the near future. Nevertheless, real incomes of the military, public servants and most city-dwellers have been cut sharply and much of existing industry is severely depressed.
- A marked deterioration of security conditions would obviously create a situation requiring more US economic (as well as military) aid. Even assuming no significant decline in security through 1980, however, major US economic support will be necessary at least until then to assure the political survival of the Government of Vietnam (GVN).*
- A gradual phase-down of US economic aid to \$100 million or less by 1980 would place the survival of the GVN in serious jeopardy, though the government would not necessarily collapse quickly.
- Should US support drop sharply to an annual level of \$100 million or less much before 1980, it is doubtful that the GVN's present political and economic structure would survive.

* *US economic assistance in FY 1974 amounted to some \$650 million, including appropriations of some \$350 million in aid grants, a \$50 million development loan, and \$250 million in PL-480 shipments of agricultural products from the US. For FY 1975, non-PL-480 economic aid will be limited by Congress to \$450 million, and PL-480 shipments are unlikely to exceed \$100 million because of South Vietnam's advances in agricultural production. Here and throughout this memorandum all values are in 1974 US dollars.*

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- There are different views among observers on precisely what amounts of US aid are needed to permit at least a slow rate of economic progress. Since the South Vietnamese population grows at about 3 percent a year, a 3 to 4 percent rate of growth in GNP would be necessary to allow even a small (less than 1 percent) increase in per capita incomes.
 - The Central Intelligence Agency believes, assuming no further decline in security conditions, that this objective would require average US economic aid of some \$700 million annually.
 - The Department of the Treasury believes that per capita incomes could at least be maintained roughly at the 1974 level from now through 1980 with average annual US economic aid on the order of \$500 million.
 - The Department of State/INR and the Defense Intelligence Agency believe that security conditions will deteriorate further and preclude any early economic recovery or sustained growth, and that substantially more than \$700 million per annum in US economic aid will be required for the foreseeable future.
- All agencies of the intelligence community agree that the GVN over the next 5 to 6 years can best cope with reduced aid levels by giving priority to expanding agricultural output in order to replace food imports and develop exports.
- The Department of the Treasury sees 1974 as an important turning point in achieving rice and sugar self-sufficiency and believes this strong performance can be repeated without substantial additional growth in imports if security conditions are no worse than in 1974.
 - The Central Intelligence Agency and the Department of State/INR believe that the circumstances surrounding the 1974 crops were exceptional, and that higher imports of fertilizer and other producers' goods will be necessary to assure continuing agricultural expansion.
- Regardless of how much aid is pumped into South Vietnam from 1975 to 1980, security conditions, large-scale relocations of population, and a greater degree of integration into the world economy have permanently changed key features of Vietnamese society. Any program designed to return South Vietnam to the peasant economy of the early 1960s in the interest of reducing the country's dependence on US aid would have little prospect of success.

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Discussion

1. Economic aid from the US and other donors will be a major determinant of South Vietnam's political stability over the rest of this decade, although it is not possible to specify the amount of aid needed to insure survival of the Government of Vietnam (GVN). The weather, changes in security conditions, political trends not directly related to economic conditions, and the GVN's ability to implement sound economic policies all affect aid needs. Moreover, the demonstrated ability of the Vietnamese people to cope with adversity forces great caution in estimating their political "breaking point." Owing to these uncertainties, there are differences within the intelligence community on the question of appropriate US aid levels to South Vietnam. These views are presented in the following paragraphs.

I. THE SETTING

2. Since the mid-1960s the South Vietnam economy has been wrenched by many sharp changes that have affected output and living standards. These have included large-scale mobilization, major Communist military offensives, a rapid buildup and then somewhat slower drawdown of the US presence, and rapid inflation. Although US economic aid long provided the means largely to offset these shocks, that aid has been declining in real terms for several years.

3. Because of the cumulative impact of such changes, South Vietnam almost certainly will not return to the sort of economy that prevailed in the early 1960s before the major step-up in US military involvement. At a minimum, certain of the new features in the economy will persist at least through the rest of this decade.

- Security conditions will prevent full use of all arable land, although there will be continuing slow migration out of the cities and back to the land as long as there is no major Communist offensive.
- An unusually large share of the population will continue to live in Saigon and a few other major cities, and will provide a basis for continuing high urban unemployment rates.
- A standing army of some 1 million men will continue to strain the national budget and to draw off large

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numbers of technically qualified young men to national defense and away from the production of goods.

4. The rapidity of recent changes and a lack of firm data make it difficult to determine where the Vietnamese economy is now. During 1971-1972 major economic reforms were undertaken to give South Vietnam a greater chance of success in meeting its own development costs over the longer run, and these had a short-term deflationary impact. At the same time, the process of US military withdrawal, underway since mid-1969, was accelerated. Before either of these factors had worked their way through the economy, the 1972 Communist spring offensive uprooted large numbers of Vietnamese and further depressed consumer demand. The industrial recession deepened and unfavorable weather contributed to a decline in crop production in late 1972. Since then, soaring world market prices have spurred both domestic inflation and recession by pushing up import costs and leading to a reduction in import volume.

5. Currently the economy shows elements of all these strains and some signs of recovery. Many industrial firms and most of the services that were directly or indirectly supported by the US presence are working sharply below capacity or are out of business. Real incomes in urban areas are still falling, and there is widespread urban unemployment. Exports, which grew rapidly to reach \$60 million for 1973 and appeared on their way to \$100 million in 1974, slipped in recent months and will now only reach \$80 million in 1974.

6. On the other hand, agriculture, which is the mainstay of the economy, has had two good years in succession, and the current rice crop apparently will be a record 7 million tons. Foreign exchange reserves are about \$200 million, up from \$150 million at the start of the year, although much of the increase came from one-time signature bonus payments by oil companies and repatriation of funds held abroad by liquidity-tight businesses. Inflation, which reached a rate of 65 percent last year and in the first few months of 1974, now appears under better control. The outlook now is for something on the order of a 40 percent increase in consumer prices for the whole of 1974, but prices have risen very little in the last few months. Moreover, large-scale urban unemployment is encouraging a continued -- albeit small -- movement of people back to rural areas, where there is the best prospect of production increases that will both meet South Vietnam's food needs and allow substantial exports.

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7. Although there is general agreement throughout the intelligence community concerning the major features of South Vietnam's economic situation, there are differences on some specifics which have implications for assessing future aid needs. Some of the differences result at least in part from the decline in GVN statistical reporting and the total absence of hard information on such important questions as rice and chemical stocks.

8. For example, despite the anticipated excellent 1974-1975 rice harvest, estimates of future agricultural performance are greatly influenced by what is assumed about the levels and the use of existing chemical fertilizer stocks. CIA and State/INR believe that in spite of relatively low import levels for fertilizer in 1974, high application rates for fertilizer and other chemicals were sustained in the current crop year by drawing down in-country stocks. Considering that there are fairly immediate limits to such stock drawdowns, the position of CIA and State/INR is that larger imports of agricultural chemicals will be necessary to maintain yields in the future. Treasury believes that a substantial increase in imports of fertilizer would not be required because adequate agricultural progress also could be achieved through reclamation, double cropping and reversion to traditional methods including greater use of animal fertilizer for domestic strains of rice.

9. Estimates of Vietnamese import needs are also strongly influenced by how great a change in South Vietnam's industrial structure is considered both desirable and feasible. The Department of the Treasury believes that to the extent South Vietnam develops manufacturing industries, these should be better adapted to its needs and be less dependent on imported materials. Although CIA and State/INR agree that this is an appropriate development strategy, they note that existing and new Vietnamese industries will be heavily dependent for some time on foreign suppliers of machinery, fuels, metals, chemicals and fibers; consequently, CIA and State/INR believe that even modest industrial recovery in keeping with steady agricultural growth leads to larger imports.

10. Despite these differences, most observers agree that South Vietnam is at best at the beginning of an economic recovery. The focal point of future growth will be the agricultural and related sectors, which have shown great flexibility in adapting to disruptions and have the best prospects for providing in the short term the bulk of incremental output, employment, and exports. The unusually large service sector (including the armed forces)

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is on a plateau and movement of labor away from war-oriented activities into more traditional, viable pursuits will of necessity be a slow process. Industry, which accounts for roughly 10 percent of GNP, will be hard-pressed to adjust to the likely continuation of stringent financial conditions and tight foreign exchange supplies.

II. SUPPORT LEVELS

11. Continued large-scale US economic aid will be important to the survival of the GVN in the next five years and beyond. If, for example, US assistance were phased down gradually to about \$100 million annually by 1980, large further cuts in national output would be inevitable. In these circumstances:

- The South Vietnamese would not be able to expand their own exports sufficiently to substitute for a reduction of US aid of this magnitude.
- They could not obtain offsetting aid from third parties.
- Per-capita import levels, already low, would be further reduced.

Such developments would place the survival of the GVN in serious jeopardy, especially if security conditions do not improve, though the government would not necessarily collapse quickly. If, however, US economic aid were cut abruptly and soon to a \$100 million annual level, it is doubtful that the GVN's present economic and political structure would survive.

12. There are, however, different views on precisely what amounts of US aid are needed to permit at least a slow rate of economic progress. The Department of State/INR and the Defense Intelligence Agency believe that security conditions will deteriorate further and preclude any early economic recovery or sustained growth without substantial increases in US economic assistance beyond \$700 million per annum for the foreseeable future.* The relative degree

* NIE 53/14.3-2-74 of December 23, 1974, entitled "Short Term Prospects for Vietnam," states that "at a minimum the Communists will sharply increase the tempo of fighting" in the next six months. The estimate also expresses the judgment that "...the Communists will commit part of their strategic reserve to exploit major vulnerabilities in the South Vietnamese position or to maintain the momentum of their military effort." Furthermore, the estimate states that there is a possibility of an all-out NVA/VC offensive in 1975 or 1976.

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of stability resulting from stringent economic measures adopted by the GVN during 1974 will prove only temporary in the face of military developments that will probably produce large numbers of refugees and will largely inhibit expansion of the agricultural sector and ancillary activities, export growth, and the securing of lines of communication. In these circumstances, unfavorable security conditions and their effects on Vietnamese priorities and domestic and foreign business attitudes will leave the GVN at least as dependent on US economic assistance in the foreseeable future as in the past.

13. The Central Intelligence Agency believes that minimum annual imports of \$1 billion (1974 prices) would be required to permit modest (one percent or less) increases in per-capita incomes between now and 1980, assuming no sharp changes in security conditions. (Since the South Vietnamese population grows at about 3 percent a year, a 3 to 4 percent rate of growth in GNP would be necessary to allow even a slow increase in per capita incomes.) Estimating that exports, other foreign aid, and foreign private investment will probably average some \$300 million annually, CIA concludes that the US will be called on to provide the remaining \$700 million.* Such assistance would underwrite Vietnamese imports of at least \$1 billion for machinery, raw materials, and fuel for a recovery and growth strategy centered on agricultural expansion and export development. Food aid, until this year an important part of US support, would probably be unnecessary; and substantial increases in food and other primary exports would become possible. Domestic industry could recover somewhat to meet the demands of growing incomes in the farm sector and avert a rise in consumer imports. Both through its direct effects on production and its signal effect on potential foreign donors/investors, who increasingly believe the US has written South Vietnam off, this level of aid would enhance the prospect of other kinds of capital inflows that would ultimately permit substantial US aid reduction without adverse impact.

* If security and weather conditions remain favorable, the path of the aid use would be a rather modest decline from the \$700 million annual level toward the end of the period. CIA does not believe this decline would be large enough, considering what is needed to assure sustained agricultural growth, to affect significantly the \$700 million average.

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14. At the same time, CIA believes it is important to note that certain broader objectives could not be met with this level of aid. It would not allow the GVN to:

- raise substantially the already depressed military and civil service salaries;
- rebuild non-vital facilities such as some public buildings and remote bridges, roads and power lines, damaged during the war;
- relax what are now among the stiffest tariffs and controls in the world on consumer imports;
- initiate major make-work projects for the unemployed;
- expand public services in the areas of veteran benefits, education, public health, and provisions for the aged and infirm.

15. CIA and the Department of State/INR recognize the potential importance of oil discoveries but feel that there is still scant basis for projecting major revenues from this source during 1975-1980. Considering security problems, normal engineering lead times, and some of the administrative difficulties experienced so far, there is a strong possibility that crude oil will not be produced in appreciable quantities in this period. Under an optimistic scenario, substantial earnings from oil probably could not begin until 1978, and such earnings (including those from production and all fees) would probably not exceed \$125 million in 1980, with related private sector inflows adding perhaps \$75 million.

16. The Department of the Treasury believes that the CIA and State/INR positions do not adequately allow for the extent of economic readjustment back to the urban consumption patterns of the 1950s and early 1960s which has occurred since the US departure. Treasury notes the continuing prosperous conditions in the delta farm region, feels that rice and sugar self-sufficiency has essentially been achieved and that South Vietnam has a fairly early potential for exporting modest amounts of food and other farm products. It notes also a return of some workers back to the

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countryside and the beginnings of small-scale public works projects that will help alleviate employment problems. Combining this evidence with recent observed improvements in foreign exchange holdings, it concludes that the GVN's need for US economic aid over the next few years probably could be closer to \$500 million annually, given sound GVN economic policies. Aid of this magnitude, in Treasury's opinion, would not only maintain per capita incomes at about the 1974 level, but would also allow some income redistribution from the agricultural sector to soldiers, civil servants and urban dwellers.

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