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CHAPTER 1

The rise and fall of the economy

The State of Vietnam became an independent nation when conferees at Geneva in July 1954 partitioned the former French colony of Indochina. It began as a monarchical state, but that condition lasted only fifteen months, until its emperor, Bao Dai, was ousted in a plebiscite by Ngo Dinh Diem in October 1955. From this referendum, which was “a test of authority rather than an exercise in democracy” (Karnow 1984, p. 223), emerged the Republic of Vietnam. The republic survived as a nation for about twenty turbulent years, until April 30, 1975.¹ This chapter traces the rise and fall of an economy shaped by the most expensive foreign aid program in history and buffeted by the tides of a very long and destructive war.

The beginning economic assets of the new nation can be listed quite simply: an adaptive and industrious population of about 11 million, a number of highly productive foreign-owned and -operated rubber plantations, much potential in rice production, and not much else. At the onset of World War II, throughout Vietnam there was a prosperous rice economy able to export 1.2 million metric tons out of its production of 7.7 million tons, or 1,025 pounds of rice per person (Fall 1963, p. 292). By contrast, in 1956 the South portion reported rice production of 2.6 million tons, or 525 pounds per person, and exports of 162,000 tons. Successive disruptive events – the Japanese occupation, the return of the French at the end of World War II, and the First Indochina War – had practically wrecked Vietnamese agriculture as these struggles brought insecurity to the farmers and destruction to the infrastructure. Sixty percent of the road network and one-third of the railroad track had been destroyed, along with much of the river transport system and irrigation canals.

It was an economy “heavy at the top.” Aside from agriculture, which engaged about 80 percent of the population, most of the jobs available were due to French operations in the country: 120,000 Vietnamese served in the French army, and 40,000 civilians were employed in military-related activities. In 1954, French expenditures of \$500 million created many jobs in commerce and services. By one estimate, the contribution of commerce, services, and government to the GNP (52 percent) was twice as much as that of agriculture (Hoan 1958b, Table VIII). Furthermore, the indigenous Vietnamese did not figure significantly in commerce, because external trade was controlled by the French, and internal commerce and lending by the Chinese

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minority. Industrial production, which had been located in the North prior to partition, was so limited in the South that Bernard Fall (1963, p. 298) was able to catalogue virtually all industry as consisting of four cigarette factories, two plants producing oxygen and acetylene, two soft drink plants, two small shipyards, a naval arsenal, a distilling plant, a match factory, and two machine shops, altogether employing about 50,000 workers or 1.25 percent of the work force. Evidently, Fall overlooked Vietnam's major industry, rice milling, and the ice plants and sawmills that were prominent at the time. Even so, that was a meager starting point, and Vietnam would need to develop rapidly if it were to have any hope of overcoming even greater obstacles than it had encountered previously.

1.1 Period of resettlement and reconstruction²

The new government was confronted immediately with a number of imposing economic problems. The most urgent of these was how to resettle some 900,000 refugees from the North, who were allowed by the Geneva agreements to migrate freely. Next there were the critical financial and technical problems arising from the withdrawal of French forces, technicians, and aid. Agricultural production needed to be expanded quickly if the country was to feed itself, the infrastructure needed to be restored, land tenure arrangements needed attention, and the country had to develop industrial capacity.

A massive resettlement of refugees was accomplished between August 1954 and May 1955 using French and U.S. naval vessels and French aircraft.³ In that short period of time the population of South Vietnam increased almost 10 percent, with the influx of people characterized by Bernard Fall (1963, p. 336) as "doubly alien" – northern and predominantly Catholic. They were settled in temporary camps in the Saigon area according to previous occupation (e.g., farmers, fishermen, artisans). The plan was to permanently relocate the refugees in groups of 1,000–3,000 on reclaimed agricultural lands primarily in the delta region in the case of farmers and in proximity to fishing areas in the case of fishermen.

The resettlement plan permitted elected officials of the temporary villages to participate in the planning for the permanent settlements along with the General Commissariat for Refugees and the U.S. aid mission called USOM. Once the land had been selected, the refugees were supplied with minimal building materials, some tools, and buffalos. The largest resettlement project was at Caisan, 125 miles southwest of Saigon, where 77,000 hectares of rice land were cleared for up to 100,000 refugees. Most of the financing for resettlement was supplied by U.S. aid, \$93 million in the first two years, and much of the organizing and administrative work by Catholic relief organizations (Harnett 1959). By mid-1957, 319 resettlement villages had been

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built, accounting for about half the refugees who had migrated to the South. The remainder disappeared into the urban population, principally in Saigon. It is an interesting sidelight that the flow of refugees southward did not materialize into the economic debacle foreseen by the Viet Minh's great leader, Ho Chi Minh (Sulzberger 1974). Instead, the situation furnished the new government with a showcase problem that, if properly managed, would go a long way to dispel many of the doubts of its critics. Although some complaints were registered by various relief organizations in regard to resettlement financing and other actions, one is impressed with the apparent success and speed with which this difficult first problem was resolved.⁴

Replacing French financial assistance and technicians was perhaps the easiest task, with the United States committed as Vietnam's next benefactor. AID's *Terminal Report* states that the first function of the U.S. aid mission in Vietnam (USOM) was to "plug the financial gap" left by the departing French (AID 1976, pt. A, p. 1). There was indeed a large financial gap, mainly because of the need to maintain a large Vietnamese military force to replace the previously provided French security. Maintaining this force, numbering 250,000 during the first five years, would have been an impossible burden on the budget of the new government, and it became the prime responsibility of the United States. In the period 1955–60, gross U.S. economic aid to Vietnam was \$220 million per year on average, or roughly 22 percent of South Vietnam's GNP.⁵ Because U.S. military aid supplied arms and equipment, this amount of economic aid was grossly in excess of what was needed to support military operations, and it created a disincentive for the government to engage in any serious effort to raise domestic revenues to finance its own activities. This problem was to persist throughout the war. It was decided very early as a proposition of faith that the standard of living of the Vietnamese must not fall, and therefore much economic aid was used to supply imported consumer goods to support this goal. Probably no economic matter received so much criticism as the "lavishness" of the U.S. economic aid in the early years of the Republic of Vietnam.⁶

A draft of a five-year plan was submitted to the president in June 1957. This plan is interesting because it indicates the priorities of Vietnamese officials at the time. A five-year budget of 17.5 billion piasters (\$500 million at the official exchange rate, and half that at a realistic exchange rate) was proposed initially. Of this, 43 percent was earmarked for public works and power, 22 percent for agriculture, 12 percent for health, education, and housing, and 9 percent for industry. Cutting across all sectors, 80 percent of the budget was allocated to the public sector (Rosebery 1959, p. 195). Thus, the government claimed a major role in agricultural development, mainly in land clearing, and was to become a dominant partner in the production of cement, coal, textiles, and sugar. Smaller enterprises planned in paper and glass were

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left to the private sector. The growth targets of 27 percent in agriculture, 70 percent in fisheries, 20 percent in industry, and 18.5 percent overall were not unrealistic. However, as with most plans, there were controversial projects: The large power plant at Da Nhim in central South Vietnam was overambitious, and rebuilding South Vietnam's part of the old Trans-Indochina Railway seemed cost-ineffective given that its main line was parallel to the coastal shipping lanes. Because most of the financing was to come from U.S. aid, the plan paid little attention to private saving, taxation, and the unhealthy balance-of-payments problem, and this inattention to sources of permanent financing and trade at a time when the country already consumed more than it was able to produce is indicative of a point of view that was not to serve the country well in the coming years. Yet, despite many shortcomings and lack of systematic execution of the plan, many of the goals were met.

President Diem realized almost immediately that something had to be done about two problems that threatened the popularity of his rule. The first was the problem of land ownership. About 3 percent of all landowners and only $\frac{2}{3}$ of 1 percent of the million or so cultivators owned 45 percent of all the rice land in South Vietnam, and most of the big landlords were absentee owners, having fled to the cities when the Viet Minh took control of the countryside (Scigliano 1963, p. 121; Fall 1963, p. 308). The second problem was that rents were excessively high, in some places as high as 50 percent, despite a previously enacted cosmetic law that limited them to 15 percent (Wurfel 1957, p. 87). During their struggle with the French, the Viet Minh had initiated a "land to the tillers" reform, giving lands confiscated from large landowners to the tillers. When peace ensued in 1954, the legal basis of these reforms was questioned, and the ex-landlords sent their agents, usually government officials, to collect their rents. Quite understandably, this caused considerable resentment among the peasants.

Reforms in January and February 1955 addressed the issues of maximum rents, interest payments, lengths of contracts on lands under cultivation, and provision for contracts on land that had lain idle. The ordinances that implemented these new arrangements required formal written contracts, but without strict enforcement they proved to be ineffective. Ordinance 57 of October 1956 was addressed to the problem of land redistribution. By this ordinance, a landowner was limited to 100 hectares (plus 15 hectares as ancestral worship land). The government was to purchase all excess land at a price below market value and sell it to the tillers. This reform program required extensive land surveying and legal and other paperwork and proved cumbersome to implement, especially at a later phase when the Viet Cong gained control of the countryside. Thus, a program that grew from good intentions and had a chance of conferring a major political advantage on Ngo Dinh Diem could claim only partial success as a genuine land reform program.

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Despite the lack of significant progress in land reform, impressive gains were made in agricultural production with the closing of the First Indochina War and the return of relative security to the countryside. Rice production, reported to be as low as 2.2 million tons in 1954 and 2.8 million tons in 1955, increased to 5.1 million tons in 1960.⁷ Although the exactness of these figures is questionable, the remarkable recovery in rice production is not contested. Much of the increase, as would be expected, came from reclaiming land that had been abandoned during the war, about 700,000 hectares, or as much as 45 percent of the land in rice cultivation in 1954 (AID 1976, pt. A, p. 5). Figures on rice production and land in cultivation indicate that the yield per hectare increased from 1.3 tons in 1954 to 2.1 tons in 1960. The latter figure on yield is high in comparison with yields in Indonesia, Thailand, and the Philippines at the time, but low in comparison with figures for the more productive rice countries such as Japan, Korea, and Taiwan (Cole 1959, p. 183), and it is consistent with reported yields for Vietnam in the 1960s. The recovery in rice production permitted Vietnam to export 360,000 tons in 1960, a level probably not achieved during the previous two decades and not to be achieved again. Rubber production increased by about one-third over the period, and production of other crops improved by 40 percent from 1956 through 1960, with the most impressive gains in manioc, sweet potatoes, sugarcane, and copra.⁸ The rapid gains in agriculture seem to be unrelated to any major event other than the restoration of peace.

In industry there was no catching up to be achieved, but rather a complete building program to be accomplished. It appears that much of the first five years was spent in discussing and developing an industrial strategy, with the United States supplying technical assistance, feasibility studies, some capital goods, and half a billion dollars in raw materials under the Commercial Import Program (CIP). The section in AID's *Terminal Report* on industry (AID 1976, pt. B), as had many previous AID reports, placed stress on inputs rather than on the more difficult to measure outputs, as if there were a one-to-one correspondence. Most of the imported capital equipment supported infrastructure development rather than manufacturing. In fact, from the beginning there was a conflict between U.S. advisors' emphasis on development through private enterprise and the preference of the government of Vietnam (GVN) for government ownership.⁹ Despite the establishment of the Industrial Development Center (IDC) in 1957 to advise on investments and to help finance them¹⁰ and declarations by the president of Vietnam favorable to private domestic and foreign investment,¹¹ the investment climate was not favorable, and the slowness of industrial development has been attributed to "untimeliness and government inertia and disinterest" (Morrison 1959, p. 225). Relatively little was achieved during this period. A large cement plant was planned at Ha

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Tien, the Nong Song coal mine was improved, and new construction in the Saigon area included two textile plants, a tire plant, a glass factory, a paper plant, and a shoe factory employing 8,000 workers (Fall 1963, p. 299). To put these accomplishments in perspective we need only point out that one Vietnamese analyst thought that 400,000–500,000 jobs needed to be created each year just to avoid “urban pauperization” (Fall 1963, p. 301). From 1956 to 1960 the index of industrial production increased 16 percent, but most of that was due to increases in electric power and beverages.

Efforts to build the infrastructure were more successful. First, it was fairly well agreed what had to be done. Second, financing was less of a problem because the local content for some projects was relatively large and the United States was willing to supply the necessary imports in the form of equipment, construction machinery, and technical assistance for projects it approved for the government sector. As early as 1954, USOM developed a highway program whose major objective was to provide assistance for rehabilitation and modernization of the national highway system, consisting of about 6,000 kilometers, and much of that program was completed in the first five years (AID 1976, pt. D, p. 3). By 1959, most of the national railway system was operative, with a continuous line from Saigon to Dong Ha at the seventeenth parallel. The National Institute of Administration was established to train Vietnamese in public administration, and a large effort was expended to improve police operations.¹²

According to Vietnam’s rather primitive national income accounts, the GNP increased from 65.4 billion piasters in 1956 (1960 prices) at an annual rate of 4.5 percent to 81.8 billion piasters in 1960.¹³ Despite this creditable performance, it appeared to some analysts who were greatly concerned with Vietnam policymaking mistakes, its continuous dependence on U.S. aid, its inability to reduce the percentage of imports covered by exports, and the government’s lack of interest in development that Vietnam was on its way to becoming a “permanent mendicant” (Taylor 1961, p. 256). However, a closer look at the components of GNP reveals that the country was making progress in the direction of economic independence. Crude data (in comparison with import and export statistics) show that domestic saving was negative by 8.1 billion piasters in 1955, but by only 0.5 billion in 1960. Essentially, this means that gross investment in the country in 1960 was just about equal to the value of U.S. aid, whereas in 1955 it was considerably below U.S. aid.¹⁴ Alternatively stated, private and public consumption exceeded GNP by 13 percent in the first full year of peace, whereas in 1960 the country consumed its total potential output. Obviously this condition could not persist in the long run, but the record of performance was somewhat better in this period than it has sometimes been made out to be.¹⁵

1.2 Period of heightened insurgency

Failure of the Diem regime to hold a plebiscite in July 1956 and its further show of contempt for reunification by issuing a republican constitution in the following October led to the Second Indochina War. No notable battle ushered in this war, which Bernard Fall (1963, p. 316) dates to early 1957, and neither the government of South Vietnam nor that of the United States seems to have been much concerned by it up to 1959, despite low-level but continual Communist terrorist activity throughout the country. With its program to move masses of the rural population into “agrovilles” in 1959, the government tacitly recognized that the insurgents had gained the upper hand in the countryside. The year 1960 was marked by a major escalation in terrorist activity and, in December, by formation of the National Front for the Liberation of the South, shortened to National Liberation Front (NLF), and popularly referred to in subsequent years as the Viet Cong. The success of the Viet Cong in wresting control of the rural population away from the government was aided by the frustration, disappointment, and discontentment brought on by failure of the regime to work seriously toward any of its proclaimed social goals.¹⁶ Thus, the time when significant economic gains might have been made relatively easily passed, and the country slipped from bad to worse – from a condition of terror to one of “full-fledged insurrection” (Buttinger 1967, vol. 2, p. 983).¹⁷

A plan to move peasants away from certain areas of the country and into concentrated population centers called agrovilles was unveiled by President Diem on July 7, 1959. According to the president, these settlements were to be constructed for the purpose of improving the conditions of rural life, and they became the centerpiece for a new drive toward economic and social development (Zasloff 1962–3, p. 327). It is difficult to imagine how anyone could have contended that a plan forcing peasants to move to unfamiliar locations and requiring, in addition, that they pay for them both in money and in conscripted labor time would be bettering their condition. In any event, this program was abandoned in 1961 as unworkable after only about 40,000 peasants had been resettled.

In its place, the regime initiated a much more ambitious plan to move about 10 million peasants into strategic hamlets. The new plan at least had the redeeming feature that the hamlets were to be located in the vicinity of the rice lands already under cultivation. The strategic hamlets were to be fortified by barbed wire, hedges, moats, and fences of pointed bamboo stakes and defended at night by units of the Civil Defense Corps. Like the abandoned agrovilles, the strategic hamlets “were largely just another means of trying to wrest control over the population from the Viet Cong through police coer-

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cion, not through reforms that would have taken care of the people's needs'' (Buttinger 1967, vol. 2, p. 988). Although that effort touched the lives of millions of people and caused much discontentment, it proved ineffective as a pacification measure, and the strategic hamlet concept was abandoned several years later.

During this difficult period for the country there was a shift in emphasis in the use of foreign aid in the direction of pacification and away from development (AID 1976, pt. A, pp. 10–11). Increasingly, AID advisors were to serve in field operations, and funds were diverted from the CIP to pacification efforts. In addition, there was a substantial reduction in the amount of economic aid and an increase in military aid. The former dropped to \$159 million on average per year in 1961–4 from \$231 million for the previous six years, whereas military aid rose to \$191 million in 1964 from \$73 million in 1960. A large increase in military advisors accompanied the rise in military funding. There were 16,000 U.S. military personnel in Vietnam when Diem was assassinated in November 1963 in a coup d'état, in comparison with only 700 who had served as advisors in 1960. Vietnamese "regular equivalent" forces increased by 80 percent from 1960 to 1964,¹⁸ and the GVN budget deficit rose from 4.7 billion piasters in 1961 to 15.9 billion.

Despite the ominous signs reported earlier, the economy did not collapse, nor was there runaway inflation. To finance some of the deficit, which an AID report claims was at least double the value of American aid in 1964 (AID 1976, pt. A, p. 8),¹⁹ the National Bank of Vietnam, founded in 1955 as the country's central bank, printed 10.6 billion piasters in the years 1961–4, or about one-fifth of the government deficit, causing the money supply to rise by 70 percent. However, Saigon retail prices rose by only 20 percent over the same four-year period. It is evident that the Vietnamese people did not have high inflationary expectations at the time. Physical output increased in almost every sector, as the following gains indicate: rice 4.6 percent, total crop production (including rice) 5.5 percent, fish catch 59 percent, industrial production 54 percent, construction 64 percent. Overall, the economy grew 14.9 percent, or about 1.1 percent per capita per year.

These growth figures do not imply that the economy was developing satisfactorily. The growth in net domestic product was primarily a side effect of moving the economy to a wartime footing; of the total gain of 11.7 billion piasters in real product, 7.3 billion piasters were due to increases in public administration and defense. Thus, the economy was becoming even more top-heavy than it had been, and that condition could not have been sustained out of local resources. The domestic saving rate, which had improved up to 1960, sank to a negative 6 percent, and the export/import ratio to 15 percent, in 1964. The industrial development that occurred during this period was due mainly to the completion of factories planned or begun in the earlier period.

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By the end of 1964, less than two dozen new factories had been built in South Vietnam since independence (Buttinger 1967, vol. 2, p. 966). Only 12,000 additional jobs were expected to be created in the course of Vietnam's second five-year plan ending in 1966 (Fall 1963, p. 300).

The only economic reform of any note during this period was the devaluation of the piaster in December 1961 from 35 to 60 piasters per dollar. Normally, devaluations are expected to stimulate exports. However, this particular devaluation was ineffective in stimulating exports because the new rate did not apply to rubber, Vietnam's major dollar earner, presumably because the rubber plantations were under French (foreign) ownership. The land reform program was not and could not have been pursued vigorously under the existing condition in which the Viet Cong controlled most of the countryside.

1.3 Beginning of the big war

Americanization of the war in Vietnam brought economic complications to a country already strained with political problems. We date this period from the time U.S. Marines set foot on Vietnam soil in March 1965 to the collapse of the Communist Tet offensive in mid-1968. The difficulty on the economic front during this period is indicated roughly by the buildup in U.S. troop strength from 23,000 at the end of 1964 to 543,000 in April 1969, the doubling of South Vietnamese forces to about 1,000,000, and the growth in other forces (mainly South Koreans) to 60,000 in the same period.²⁰ There was, of course, the matter of how to finance the rapidly growing RVNAF (armed forces, Republic of Vietnam) without creating inflationary pressure while at the same time building a government with authority and the administrative capability to rule. Inflation, then, emerged as the number-one economic problem at the beginning of this turbulent period. The decline in agriculture, and especially rice production, was soon to join it at the top of the list of pressing problems.

That the country was already on the verge of political collapse could be seen through the "revolving door" to the premiership. After the assassination of Ngo Dinh Diem in November 1963, the government changed hands at least five times before General Nguyen Cao Ky took the premiership in June 1965. Under these circumstances it is understandable that national economic policy came to a dead stop. But war conditions had not yet disrupted the countryside in such a way as to have a major impact on agricultural production. Rice production and our index of crop output were about the same as they had been in the late 1950s.²¹

The average rate of inflation up to 1965 was about 4 percent per year. Within six months after the big war began, prices rose by 20 percent, and it appeared that there was unlimited scope for further acceleration. To stem this inflationary potential, the nature of U.S. economic aid to Vietnam changed

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drastically. With a change in the character of the war it was recognized that war financing requirements would have to be met almost entirely by U.S. aid. There was no other way. In 1965, Vietnamese domestic tax revenues were less than 7 percent of GNP, and most of those were due to a small tax on production, along with excise taxes on beer, soft drinks, cigarettes, and gasoline, with little potential for significant revenue enhancement. To meet the war deficit, U.S. aid rose from \$230 million in 1964 to almost \$800 million in 1966.

One must recognize that this massive aid inflow was intended to stabilize the country rather than to promote economic development, although that would have been a welcomed side effect. Importing was the mechanism for turning dollars into the piasters needed to finance the GVN and also to support a considerable American establishment in Vietnam. An economy already dependent on imports became more dependent. Of course, aid and imports did raise the standard of living of the Vietnamese, but they also created a disincentive system that was to work against economic development.

A major problem connected with the aid-finance system was how to fix the foreign exchange rate for a country that hardly exported anything. In 1965, Vietnam was able to export only \$36 million, mostly in rubber, while importing about ten times that value. It is obvious that under this condition the international value of the piaster was very low; yet Americans and Vietnamese exchanged their currencies at the official rate established arbitrarily in December 1961 at 72 piasters per dollar (with surcharges). This gross overvaluation of the piaster was a disincentive to local production; it permitted large windfall gains to be made by privileged importers and raised the price of war assistance to the Americans. No single economic problem consumed as much energy among various economics officials and analysts as setting the foreign exchange rate.

In July 1966, the piaster was devalued from 72 per dollar to 118, including a “perequation” tax. The most immediate effect of this move was to slow down the rate of inflation. Prices hardly rose for the next six months. Devaluation was not repeated again during the period of American domination of the war. Prices began rising again in 1967, and in mid-1968 consumer prices were three times higher than they had been at the end of 1964, or an annual average rise of about 40 percent. Aid had done the job assigned it, as even this relatively high rate of inflation did not create a major political problem.

As security in the countryside deteriorated in 1965 and in 1966, rice production began to fall. The response to this problem was to import rice from the United States and to establish a “resources control” program to deny this important foodstuff to the Viet Cong (who lived among the peasants at the time!). Both actions had the unwanted effect of reducing rice production