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THE VIETNAMESE ECONOMY IN OCTOBER 1974
An Assessment with Policy Recommendations

John E. Koehler and Albert P. Williams, Jr.

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PREFACE

The purpose of this Working Note is to provide a summary assessment of the South Vietnamese economic situation as of the fall of 1974. The authors' perspective is that of outsiders, although their past involvements with economic issues in Vietnam and other less developed countries gave them a general familiarity with the structure of Vietnamese economic problems.

With very few exceptions, the assessment is based on information gained during a brief visit to Vietnam in October 1974. The events of March and April 1975 have not been taken into account. The information was obtained from published data sources and discussions with U.S. Embassy and AID officials, and with South Vietnamese businessmen and government officials. In some instances information from different sources was contradictory, and simple ambiguities were common. In such circumstances, we have sometimes ventured our own interpretations of the situation but have tried to reflect their uncertain nature in the text.

The work on which this note is based was financed by a contract with the U.S. Agency for International Development (AID). The scope of the work was broad, directing us to make an "inquiry" into a large number of economic areas. Given this broad scope, we would be very surprised if U.S. government officials in Washington and Vietnam, officials of international agencies, and South Vietnamese policymakers did not take issue with at least some of the interpretations and recommendations contained herein. This note has been reviewed neither for technique nor for consistency with U.S. policy. The views expressed are those of the authors and are not necessarily those of The Rand Corporation.

ACKNOWLEDGMENTS

Our understanding of the Vietnamese economic situation owes much to the knowledgeable Vietnamese and Americans in Saigon and other cities who generously gave of their time, patiently responded to our questions, and shared their data with us. Incumbents and former officials in Vietnamese government policy positions were accessible and spoke with candor.

We are grateful to John Robinson, AID Mission Director in Saigon and John Bennett, Deputy Director, for insuring that our support needs were met, for responding to our many questions, and for giving us their criticisms on earlier drafts of this paper. Willard Sharpe and Arthur Smithies helped us make the most efficient use of our time by suggesting where to go, what to look for, who to see, and what to ask, and by engaging in constructive debate when our interpretations differed from theirs. C. Stewart Callison, David S. C. Chu, Charles A. Cooper, Harry Ditchett, Dennis Ellerman, Richard Moorsteen, and Robert Ralston provided valuable criticism on earlier drafts of this paper. Of course, we bear full responsibility for errors of fact and interpretation and for the unsoundness of any policy recommendations.

I. INTRODUCTION

This report is designed to provide an assessment of the economic policy problems of South Vietnam. The perspective is that of two economists who have no continuing analytical involvement with, much less operational responsibility for, economic policy in Vietnam. Although the assessment benefits from our previous research on the economies of Vietnam and other less developed countries, it is not a report of what we consider economic research. It is a policy analysis, constrained by the availability of time and information during a brief trip to Vietnam in October 1974.

Our trip to Vietnam came at a time when there was substantial divergence among the GVN policy makers, U.S. officials, and the IMF advisor regarding the appropriate courses of action to take on a range of issues. We have attempted to understand the positions of various contenders in the policy debate, their arguments, and the degree to which their recommendations, if followed, would lead to different outcomes in Vietnam. Our understanding is necessarily limited by the shortness of the time we spent in Vietnam, and by the scarcity of data that plagues any analysis of the Vietnamese economy. While accepting these limitations, we have nonetheless attempted to address most of the policy questions that are currently part of the policy debate in South Vietnam.

This paper addresses a number of items on both agendas. The material is organized into four sections: an assessment of the current situation as of early October 1974, a set of recommendations on the direction of economic policy in a number of areas, a discussion of the problems inherent in deciding future AID requirements in Vietnam under alternative assumptions, and a summation.

The most important attribute of South Vietnamese economic problems is uncertainty. Although uncertainty presents problems for all economic analysis, particularly that involving less developed countries, the importance of uncertainty in the Vietnamese situation is much greater than that normally encountered. The data describing the present state of the economy are so sketchy as to make any evaluation of the current

situation uncertain. The behavioral patterns that link policy variables and other factors to economic outcomes are even more uncertain. What the future will bring is a matter of uncertainty in any country, but for Vietnam the range of uncertainty is much greater than elsewhere.[1] Taken together, the uncertainty about the present state of Vietnamese economy, the behavioral patterns that relate policy variables to economic outcome, and the difficulty in predicting future events, render any economic predictions or planning beyond the medium term so speculative as to be fruitless.

However, decisions on economic policy cannot be avoided just because they are risky. Inaction reflects an implicit decision to continue policies as they are; to continue an AID project for another year implies that the money required for that project cannot be used to greater advantage elsewhere. Vietnamese, Americans, and other third parties involved in Vietnamese economic affairs seem no less reluctant to act on important matters than their counterparts in other countries. However, regular events--IMF visits appropriations requests, budgets, and price changes--do force a number of items onto the economic policy maker's agenda.

The list of items on this agenda includes a number of more or less conventional economic decisions. The GVN has to prepare an annual budget that requires assumptions about tax receipts, operating expenditures, and subsidies that must be addressed at least once a year. During the past two years, an exchange rate policy has evolved in Vietnam using a series of small adjustments in the rate to maintain something close to an external balance at existing AID levels. After many years of passive interest rate policy, even in the face of severe inflation, GVN monetary authorities have accepted the value of interest rate changes in achieving their policy objectives and have made periodic changes accordingly. Government involvement in the rice trade and frequent price changes on the international market have forced the GVN to reconsider rice pricing policy at frequent intervals.

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[1] In March 1975, a new element of uncertainty was added by the North Vietnamese offensive and the South Vietnamese loss of all the northern and central provinces of the country. In the face of these cutbacks, the uncertainty pertains not so much to the economy but to the near term survival of South Vietnam as a nation.

In addition to issues that appear regularly on the economic policy agenda, there are a number of other issues that deserve attention but are too infrequently discussed in terms of their effects on the economy. One category of neglected but important issues concerns impediments to trade. A seemingly endless set of regulations relate to data collection, the control of inter-provencial commerce, and inspections aimed at interfering with enemy logistics. The aggregate effect of all these regulations is to make some internal trade in Vietnam unprofitable and to raise the real economic cost of most other forms. Military manpower policy, another question rarely discussed in terms of its impact on the economy, substantially influences the availability of the requisite skilled manpower to private and public productive enterprises.

The economic policy agenda items listed up to now, both those on the regular agenda as well as those that deserve more consideration, are the responsibility of GVN authorities; there is an additional list of economic policy decisions that appropriately belong on the agenda of American officials. Most directly relevant to Vietnam's economic performance are those pertaining to the foreign aid program: questions of how much aid and what kind. Given decisions on amount and composition, there remains the question of how to use the aid to influence Vietnamese economic decisions. To make intelligent decisions about appropriate use of influence, U.S. AID officials need to develop positions on most, if not all, of the items on the GVN agenda.

II. ASSESSMENT OF THE CURRENT ECONOMIC SITUATION

Economic data in Vietnam are not rich enough to permit a precise, confident assessment of the state of the economy. The most reliable data are collected in Saigon and a few large cities. This information provides a rather sketchy picture of what is going on in the urban economy and nothing more than indicators of the state of the rural economy. However, it is possible to supplement the analysis of formal statistical data with a great deal of casual empiricism.

While the standard statistical series are well known to most people who deal with Vietnamese economic questions, our particular casual data sources need some explanation. The major source of casual information was conversation with Vietnamese. These conversations included both present and past GVN officials responsible for economic policy decisions in the Ministries of France and of Trade and Commerce, and in the National Bank of Vietnam. We also talked with Vietnamese bankers, rice millers, merchants, and shopkeepers. The conversations covered general questions such as their views on the economic situation as well as specific questions on prices of particular items, and on the interest rates charged for particular classes of loans.

The assessment that follows uses a combination of casual and formal data. In most cases, the conclusions supported by the different types of data are not contradictory. Where they appear to be (as in the case of rice) we have so indicated.

General State of the Economy

A number of indicators lead us to infer that the economy is now in a recession of uncertain depth. The large change in U.S. sector employment which has taken place since 1969, together with the natural growth of the labor force, should have created a reservoir of job seekers, how many can only be guessed because labor force participation rates are variable. The labor market shows direct evidence of slack. The public works employment project undertaken both in the Danang area and in Saigon have attracted many more potential workers than required, at wages of

VN$400 - VN$500 per day. These wages are significantly below the apparent going rate for agricultural labor.

Evidence that the economy is operating at less than full capacity is also offered by the numerous stories we are told of industries--textiles, shrimp fishing, soft drinks, fish meal, plywood, logging, construction--operating far below capacity. These stories are more credible because of their pervasiveness and because they come not only from the managers of the troubled industries but from their creditors.

Finally, the behavior of the price index (see below) suggests that the country no longer faces a situation of excess demand. In the first half of the year, prices rose at a rate which seems to be consistent with the cost-push pressures arising from world commodity price increases. Recently, the price index appears to have been stable. Based on the seasonal movements of prices in years prior to 1965 or 1966, when war-caused instability disturbs the picture, we would have expected some seasonal price rises at this time of the year, before the main harvest. So the currently observed stability is even more striking.

Imports

The most striking aspect of the Vietnamese balance of payments situation is the effect of world market price increases on the import bill. The most significant price increases occurred during the 18 months prior to March, 1974. During this time, for example, the price of urea rose 131%, the price of diesel fuel 253%, and the price of rice 108%. While the current dollar value of import licenses rose from $345 million in the last half of 1974 to $445 million in the first half of 1974, the real value of these imports fell about 32%. In a somewhat longer perspective, the same $445 million of imports that Vietnam bought during the first half of 1974 could have been bought for about $210 million in 1971.[1]

Although the economic recession caused by withdrawal of U.S. troops helped to stem imports, the GVN took a number of actions specifically aimed at restricing import demand and at making speculation in imports

[1]The data for these calculations were obtained from the U.S. AID mission in Saigon.

unprofitable. These actions include large advance deposits on import orders, high interest rates, making importers pay for imports at the exchange rate in effect at the time of delivery in Vietnam. In addition, the GVN has absolutely prohibited a large group of import commodities. The remaining eligible imports are largely small capital goods (pumps, tractors), producer goods (fertilizer, POL), and PL-480 commodities (rice, tobacco, cotton, wheat).

Prices have shifted in favor of local goods relative to imports, and there has been some direct import substitution--charcoal for kerosene; local sugar for imports. However, most of the ready opportunities for import substitution have by now been exploited. The demand for the remaining eligible imports is most probably very price inelastic within the range of moderate exchange rate changes--say 30-50%. The effect of further devaluation of the import rate would fall heavily on the industrial and farm sectors. Devaluation-caused increases in the price of intermediate goods would likely be passed on by producers to consumers.

Exports

In the last three years the exports of Vietnamese goods to the world market have risen sharply, from $15 million in 1971 to $62 million in 1973. However, the export of Vietnamese services to the foreign sector of the economy has declined sharply with the withdrawal of U.S. troops, from $400 million in 1971 to $128 million in 1973. The net effect of the two has been a reduction in foreign exchange earnings, but this has been partly offset by oil company payments for exploratory drilling rights that will total $30 million in 1974. Earnings from the export of goods reached about $75 million in 1974, but the growth ceased in the latter half of the year due to economic recession in Japan and other markets. Export growth has also been hampered by insecurity as well as GVN administrative controls on commerce, including the Vietnamese Navy's interference with fishing.

In the beginning of 1973, exports received a subsidy in the form of a preferential exchange rate that was equivalent to 22% of their piaster value, but by the end of the year that subsidy had declined in value to 5%. The preferential exchange rate for exports was abolished in January 1974.

It was replaced by a new subsidy outside the exchange system that paid 7 to 15% of the piaster value of most exports.[1] Hence, world market conditions, rising costs of imported inputs such as diesel oil, and the effective decline in GNV export promotion incentives have had an adverse economic effect on the country's small export sector.

Prices

Although prices increased sharply (by 68%) during 1973, much of the increase can be attributed to the cost push effects of rising import prices, a poor rice crop, disruption of trade by both GVN attempts at regulation and VC harassment, by higher interest rates, and by new taxes. The economy was moving into a recession, but the fact was disguised. Producers and merchants tried to pass higher costs on to consumers in the form of higher prices, but demand also shrank, and inventories grew. Prices continued to rise during the first quarter of 1974. In the second quarter, the rate of price increase began to drop, and prices remained essentially stable for the last four months of 1974. (The U.S. AID index rose only 3% from September through December).[2]

At this time, there is no evidence of aggregate demand-pull inflation. Prices of some goods may rise in the short term, but those price increases will reflect supply situations peculiar to specific goods, not to excess demand in the economy as a whole. Large inventories of domestically produced goods as well as consumer imports are on hand to absorb any short term surge in demand.

Credit Policy and Money Supply

There has been relatively little monetary expansion in the Vietnamese economy during the last two years. Money supply increased by about 34% during a period when prices increased by 136%. Prices led money supply throughout the year. This suggests that monetary policy was ineffective

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[1]The precise characteristics of the present export subsidy system were difficult for the authors to determine during their visit. Information on the present range was provided to the authors in a February 6, 1975 letter from John T. Bennett, Deputy Director, U.S. Aid Mission.

[2]Bennett letter, *op. cit.*

in controlling price inflation, and indeed that was true in 1973. However, the situation has clearly changed in recent months as the country has moved deeply into recession.

But even the modest monetary growth has stopped in recent months, private credit has become tight, and as the economy slowed down, bank savings and government savings have appeared as an increasingly attractive, low risk alternative to business investments. Under present circumstances, with high Treasury bond rates, ceilings on private interest rates, and tax exemptions on interest, it is more attractive financially for a profitable bank to lend to the government than to private individuals. Although real interest rates for savings appear negative when viewed against prices of a year ago, the rates are attractively positive over the shorter term of the last three months. The total effect of present policies is a strong monetary drag on an economy that is moving into depression.

The Rice Situation

The rice situation in Vietnam is, as usual, confusing, and the policy confused. In mid-October rice was moving more slowly than usual from the Delta to Saigon, but one cannot safely draw inferences about production from this fact. Late heavy rains were delaying rice shipments from farmers, tight credit deters rice merchants from holding stocks, and narrow margins on GVN rice sales make the business unattractive to private merchants. Our assessment from the limited information at hand--production estimates from the GVN and AID and statements by rice millers--is that the current crop is a good one, that present stocks are sufficient to prevent shortages from occurring in the next year, and the country is at or very near self-sufficiency. Rice millers in Can Tho say that farmers are beginning to sell rice held from last year's crop at a discount.

Business is poor for the rice merchants in Central Vietnam who have, in the past, been able to buy rice from the GVN in Saigon and sell it with good margins in the supply-short cities of the North. This "problem" appears to be the result of more private merchants in competition, somewhat more regular supplies in Saigon, and more production in the coastal region of Central Vietnam.

The present problems with the rice trade that require solutions center around the GVN. The GVN subsidizes marketing of its rice in such a manner that the spread between its purchase price for milled rice and paddy is too narrow to cover costs of business. The private trade cannot compete with the GVN at such a price, so their involvement in the trade is determined by the degree to which the GVN fails to meet its own objectives in controlling the retail price. The problems associated with GVN marketing operations are exacerbated by restrictions on the amount of inter-provincial shipments of rice.

The present domestic price of rice is attractive by recent world price standards, but not by current world prices. The current paddy price of 100-110 piasters per kilo is the best the Vietnamese farmer has ever seen in real terms. While the cost of his imported inputs has risen sharply, on the order of 150-200 percent since mid-1973, they still account for roughly 20 percent of the farm gate price of his output--slightly more for the dry season crop, slightly less for the wet season crop. The rapid growth in cultivation of improved varieties suggests that farmers are not substantially inhibited from using imported inputs such as fertilizer, pesticides, and diesel fuel (for plowing and irrigation).

III. POLICY RECOMMENDATIONS

It is nearly impossible to reach a consensus on an economic policy issue in Vietnam. There are many participants in the process of policy formulation, their perspectives and their objectives differ, and they often arrive at economic assessments using dissimilar information. Economic policy debate occurs not periodically but continually, and opponents in the debate generally prescribe policies that will have significantly different outcomes.

Notwithstanding that, positions in the October 1974 economic policy debate seemed too sharply drawn. There appeared to be no problems which demanded *drastic* action by the GVN, nor were the major contending positions so far apart as to be utterly irreconcilable. Although the short term did not demand drastic action and the long term is so uncertain as to preclude confident calculation, the benefits of effective action in the medium term are high. Attention and discretionary economic resources available both to the U.S. and to the GVN should be marshalled to ameliorate a set of medium-term problems that can now be identified and attacked.

The appropriate objectives for GVN economic policy at this time are thus straightforward: to expand employment and production as much as possible subject to the constraints of reasonable price stability and external equilibrium. These are quite ordinary objectives for a macroeconomic policy of incremental adjustments rather than sharp structural shifts. They are thus quite unlike the objectives that had to be pursued in the 1960s, objectives which required much greater shocks to the economy.

In viewing the measures required, it is appropriate to keep in mind that despite its cost the war has yielded certain advantages:

(1) The nation's capital stock is generally newer than it was before 1965.

(2) The labor force is better trained and there is a corps of potential middle and lower level managers in the armed forces and among veterans.

(3) A larger fraction of the population has become involved with the monetized modern economy.

(4) Although the society has been disrupted, it has been rendered correspondingly more mobile.

Thus we can expect that the Vietnamese economy is capable of responding to appropriate policies aimed at the problems outlined in the preceding section. We will suggest such policies in several areas: restructuring of interest rates, expansion of public works employment, export promotion, controlling import demand, rice pricing, and removing impediments to production and trade.

Interest Rate Policy

The aim of interest rate policy at the present time should be to provide additional credit to the private sector for production and investment and, if possible, to lower its cost. One way to provide such additional credit would be to cut the rate of interest paid on tax exempt Treasury Bills and thereby reduce their attractiveness to investors and banks. Treasury Bills yield a return of 13 to 19 percent, depending on maturity; the present portfolio in the hands of banks and corporations is estimated to have a term structure that yields an average of about 17 percent.[1] Since it is tax free, a 17 percent return is equivalent to a 31 percent taxable return for those banks which are generating profits from their other operations. The return to a bank on ordinary loans is something on the order of 31 percent or less, varying from bank to bank, after adjustment for the Value Added Tax and other costs. Since the Treasury Bill is almost riskless, while other loans certainly are not, it is easy to understand why holdings of such bonds by banks have risen sharply in the last year. Holdings by the public have also grown substantially. Since there is a large stock of pre-existing debt that can be sold to the banks and the public, current sales of Treasury bills need bear no relation to the size of the *current* government deficit. The contractionary effect of such sales, therefore, will not necessarily be offset by any expansionary effect from corresponding public expenditure.

Reducing the attractiveness of the Treasury Bills will increase the supply of credit potentially available to the private sector, but by how much is difficult to predict. It has been argued that the recession and

[1] Bennett letter, *op. cit.*

the overextended position of many firms may substantially raise the return banks require on private sector loans; that is, banks may not be willing to expand loans to the private sector unless there is a *large* difference between the return on Treasury Bills and the return on business loans. In the present circumstances, there is no reason to fail to establish such a large differential. In addition to these increases in potential supply, measures should be taken to make the interest rate on loans to the private sector more flexible downward. The government, operating through *Credit Commercial*, can strongly promote such flexibility.

While working to reduce interest rates in loans, it seems appropriate to consider reducing as well the current rates paid on savings deposits, particularly highly liquid non-term accounts, and cutting the rate of interest on savings free from the rate of inflation. There is no reason why the current goal of guaranteeing a rate of interest in excess of the rate of inflation should be continued; a shortage of savings is not the current central economic problem. Furthermore, the experience of other countries (including the U.S.) argues that an adequate supply of savings can be forthcoming even at a negative real rate of interest.

At the same time the risks faced by both lenders and borrowers might be addressed by undertaking to begin programs of deposit insurance and organizing to provide loan guarantees. One of the constraints upon Central Bank policy has been the need to prevent failures by keeping the banks prosperous. The principal threat to the banking system, of course, is flight of savings from the banks and the principal worry should be to protect the depositors, not the bankers. Even if the current rate of bank failures increased substantially, deposit insurance would likely be a low cost policy. It should be kept in mind, as well, that if deposit rates can be made flexible downward, the worries of bank failures could be substantially reduced. With respect to guarantees, bankers contend that they are reluctant to go into new lines of business in the private sector--particularly the agricultural sector--because of the risks involved. There seems to be no reason at all why the Central Bank could not play an entrepreneurial role in organizing guarantees on such loans, on an insurance basis and for a fee.

The overall objective of these measures is to make it relatively more attractive to lend to the private sector than to the public sector. It is appropriate to do this in such a period of recession.[1]

Public Works Employment

The ADDA and ADSA programs (Agency for the Development of the Danang Area and the Saigon Area, respectively) have already begun to provide significant amounts of public sector employment. The two programs, although similar, should be distinguished. The ADDA program began with projects aimed at cleaning up several northern towns but has now focused on restoration and rehabilitation of rural irrigation works. This work should raise future output fairly directly. ADSA, which is now working just in Saigon, rehabilitting the canal and undertaking similar work, improves the welfare of those who work, but probably has less effect on future output.

ADDA appears to generate additional income, employment and capital formation while creating relatively little demand for imports. We would expect that the demand generated by those employed is directed principally into food, clothing, and other domestic ally-produced goods. Doubtless, there is some spillover into import demand from secondary expenditures, but it would be surprising if that were large. In short, ADDA seems promising and easy to justify on economic grounds as well as for considerations of welfare.

ADSA, by contrast, must currently be justified more completely on welfare grounds. Rehabilitation of urban public facilities promises a lower return than work on rural irrigation. Furthermore, the present policy of paying more for ADSA work in Saigon than for ADDA work around Danang is questionable; the government wishes to provide incentives to move people away from rather than into Saigon and out of rather than into other urban areas.[2]

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[1]Since this was written, we have been informed by John T. Bennett that the tax exemption on Treasury Bonds has been eliminated and that loan rates have been cut a few points. The government has also announced its intention to establish deposit insurance and a system of guarantees for priority but risky loans.

[2]Policy toward urbaniztion and population distribution is now hard to contemplate, considering the flows of refugees caused by the GVN withdrawals of March 1975. The ADDA rate was raised after this report was drafted. Subsequently, Danang fell to the North Vietnamese Army, making the issue of wage rates moot.

Export Promotion

Import, export, and foreign exchange policy should in most circumstances be considered as a package; the net foreign balance of an economy can be adjusted by manipulating any of the three. In Vietnam, however, this recommendtion does not apply: Since exports are such a small fraction of imports and since the principal source of foreign resources--U.S. aid--is determined largely without regard for Vietnamese economic policy, tariffs and controls, export incentives, and the exchange rate are but loosely connected, and can profitably be viewed as separate policy problems. For example, it appears that the effect of a significant devaluation would now be a rise in the domestic price level unaccompanied by any major decline in import demand. So there is no reason to change the import rate. On the other hand, exports seem to be responsive to price incentives, and can be argued to be so important to the long run future of the economy--as aid declines--that the export rate should be raised to provide such price incentives. In such circumstances, introducing a split exchange rate--at least *de facto*--seems like wise policy.

A number of policy tools are available to the government to subsidize exports while maintaining a nominally unified exchange rate. The government currently grants "interest rebates" to exporters, equivalent to 7 to 15 percent of the foreign exchange value of the goods, except for exports of rubber and scrap. In addition to this subsidy one might add rebates of taxes. The tax rebates are especially attractive in that they give incentives for proper reporting of income. Further, the Central Bank could also offer favorable rediscount rates to banks extending credit to the export sector. The problem with any particular subsidy measure is that if it is relied upon exclusively and results in a wide spread between import and export exchange rates, it is more prone to abuse. Therefore, one may wish to rely upon a package of policies, no one of which offers a strong temptation but which together add up to a substantial incentive.

In addition to expanding current exports, the country should probably make preparations for rice exports. At a minimum the government should worry about altering the behavior of the large rice mill in Saigon owned by the French-controlled distillery. This is apparently the most appropriate

mill for production of export quality rice and has substantial capacity. It would be useful to shift it from the current policy of trading milling services for the brokens produced in milling to ordinary purchase and milling of rice. In addition, if exports become possible, the government should develop policy for issuing licenses; a particularly attractive option would be to hold an auction for such licenses.

Policy Toward Imports

Controlling import demand does not seem to demand sharp action at this time, and the exchange rate is probably a relatively ineffective tool, given the low elasticity of demand for the imports presently permitted. Nevertheless, the government may want to continue its policy of small but frequent upward adjustments in the exchange rate to retain its policy flexibility. That is obviously more a political than economic measure and is one on which we are not fully competent to comment. If reserves begin to slip, it would seem appropriate to consider tightening the present advance deposit requirements on imports rather than moving the exchange rate. In addition, it should be possible for the Central Bank to discriminate on rates offered for rediscounting commercial paper from importers.

Rice Policy

Rice is viewed as being so important to Vietnamese that to have shortages and high prices is regarded as inviting political crisis. It is hard to establish the political importance of rice empirically. On a number of occasions during the past eight years, prices have skyrocketed due to temporary shortages without causing a political crisis. On each occasion the problem has been viewed as serious, but the economy has adjusted--usually to higher prices--and policymakers have vowed not to let the rice situation get out of control again.

The most recent "rice crisis" occurred about a year ago and the usual happened.

It would be irrelevant to take issue with the GVN objective of maintaining control over the rice situation. The problem lies in the complexity of the system of controls. The mechanism of control is sales from

government rice stocks which are currently maintained with PL-480 assistance. The problem stems from the fact that the GVN attempts to set not just a single rice price for its wholesale sales from stocks in Saigon but wholesale, retail, and paddy prices throughout the country.

The policy prescription is simple: the GVN should decide only the price at which it is willing to sell freely from imported (or domestically-purchased) stocks. The price can be fixed at any point in time and at any single place as long as the GVN is willing to make unlimited quantitites available at the price. Alternatively, the price could be a target that the GVN seeks to reach by auctioning fixed amounts of rice from stocks to wholesalers. The objective of the GVN should be to stay out of the rice trade to the extent possible and when intervention is necessary, to do so effectively. This is an attainable objective if it limits its intervention to wholesale operations and removes controls over other prices and trade.

If this mechanism for control is accepted, there remains the question of an appropriate price level. This is a matter for Vietnamese to decide. Our view is that present high world prices are not likely to persist over the long run and probably not to the time when Vietnam again becomes a rice exporter. Present prices seem adequate to induce Vietnamese farmers to shift in large numbers to modern methods of cultivation and to use imported inputs, even at today's inflated prices. If higher paddy prices are justified, it should not be on the grounds that farmers are suffering relative to the rest of the economy.

Eliminating Impediments to Production and Trade

Over the years controls have accumulated aimed at limiting the flow of supplies and foodstuffs to the communists: controls on movements of fishing boats and prohibition of two-way radios on trawlers, checkpoints and curfews on highways, prohibitions on movement of livestock and rice. The utility of these measures in isolating the communists seems doubtful; as the conflict has become more of a war between main force units and less a small-unit guerrilla conflict, it has probably declined sharply. It seems reasonable for the government now to reduce such obstacles. These

controls cause delay, raise costs significantly, increase the uncertainty faced by businessmen, and unnecessarily expose them to arbitrary treatment by officials. Their elimination could generate significant economic benefits.

IV. AID POLICY ISSUES

So far we have focused upon issues on the policy agenda of the Government of Vietnam. The questions on the agenda of AID include: (1) How much aid should we provide? (2) How should the aid be divided among program, project, and other types? (3) Where should AID and the rest of the U.S. Mission attempt to use the influence gained by the provision of aid to encourage particular GVN economic policies. Decisions must be made on these issues for the short and medium term in the face of uncertainties and lack of appropriate information. We will consider these questions in turn.

How Much Aid Should We Provide?

Unfortunately, economics does not provide a way to set the "requirements" for aid with any certainty. Setting "requirements," of course, implies a clear decision that a particular set of economic goals "should" be achieved; that is, deciding that a level of aid is required presupposes a set of value judgments about alternative economic outcomes. Economics says little about such judgments. Even with clear goals, aid requirements remain unclear. We can distinguish between the effects of grossly different programs: Clearly, a program that provided a billion dollars a year to Vietnam would be very different in its effects from a program that provided ten million dollars a year, and an economist can comment on what those differences would be. It is very much more difficult, however, to speak about the differences between a program of 400 million and a program of 425 million per year.

Furthermore, there are many ways to accomplish the same goals with different economic programs. We cannot talk about the economic outcomes of a particular aid program without talking simultaneously of political and other non-economic considerations: How much strain are we willing to put on the political system? How ambitious will the choice of targets be? For example, it may be possible to accomplish much the same development objectives with 50 million dollars less aid, offset by a more intensive--and more politically stressful--program of tax collection. In Vietnam military operations absorb substantial resources; choosing not to divert resources from military to economic goals implies decisions on military

policy. Thus, the relations between economic objectives and aid levels are even harder to specify in this country than elsewhere.

Finally, we must confront the fact that aid levels cannot be set without some specification of the risks that we are willing to accept. For example, if we decide that it is important to avoid pressure on the balance of payments, we must also decide how certain we want to be that we may need to provide substantially more foreign exchange than our "best estimate" of the amount required. Similarly, we can buy insurance that a particular growth target will be achieved by deciding to provide more than the estimated minimum required resources. If a particular target is not crucial, we can safely provide fewer resources.

Thus, economics does not provide clear answers to the questions which AID policymakers must confront. The situation is even worse, however. Even if the risks which we will accept are specified, even if the political considerations are carefully worked out and thoroughly understood, much remains to be understood. We must know the structure of the economy, the parameters of the various relations within the economy, and the values of the various exogenous variables which will impact on economic outcomes. What we should know is shown schematically in Figure 1. (Here we follow the classification of variables by Jan Tinbergen.) Given a model of the economy, policy instruments--including aid levels--should be set to values such that, given the values of the non-controllable variables, the desired values of the target variables will be achieved. The outcome may be taken to be related by some function to community welfare.

In this framework, the policymaker with n targets needs exactly n instruments to assure the attainment of the desired outcome. Otherwise, there can be no guarantee that the equation representing the "model" of the relation between exogenous and endogeneous variables will have such a solution. Given such proper algebraic properties, however, the "problem" of policymaking is not only manageable but nearly trivial.

In Vietnam, the knowledge of the structure of the economy--the general form of the equations in the model--is highly uncertain. Beyond that, the values of the various parameters are also uncertain. Finally, because of the military situation, the political situation, uncertainties that

Figure 1

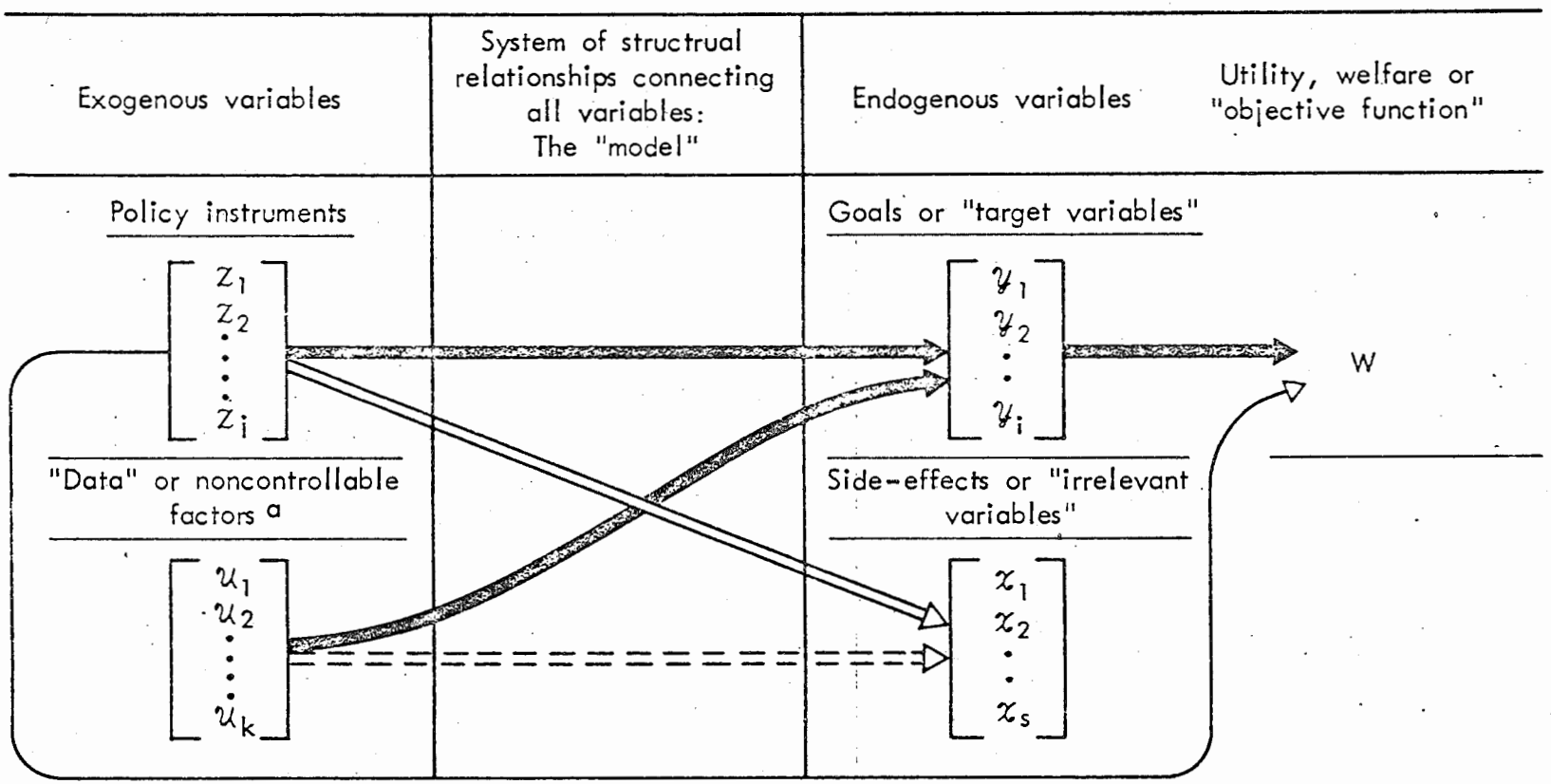

Fig. 1—The structure of economic policymaking [b]

[a] Not subject to control by the policy-maker or level of government that sets the goals and uses the policy instruments in question.

[b] Adapted from K.A. Fox and E. Thorbecke, "Specification and Data Requirements in Policy Models", in B.G. Hickman, ed., Quantitative Planning of Economic Policy, (Washington: Brookings Institution, 1965) P. 44.

face all agrarian economies, as well as uncertainties added by the state of world markets for commodities on which Vietnam depends, estimates of the exogenous or non-controllable variables are also uncertain. Since so much is unknown and uncertain we must question conclusions drawn from manipulation of a formal model of the economy. The best that one can hope for in such circumstances is an exemplary model that can be used simply to verify the internal consistency of assumptions concerning economic structure, parameter values, exogenous variables, and outcomes. We must realize that such a model will not "prove" anything beyond the internal consistency of the assumptions upon which it is based. We lack the data upon which appropriate parameter estimates would have to be based and, in any event, it seems highly likely that the sharp shifts which the Vietnamese economy has experienced would negate econometric estimations even with much better data than we now have.

The model which has been used by the Mission to estimate aid requirements is such an exemplary model. It is simply a linking together of a set of targets and assumptions with proposed aid levels. It is not based on empirical analysis of the economy, for the required analysis is impossible. Taken for what it is, it is useful. However, we should not rely heavily on the magnitude of its estimates. Basically, it provides only a check on the *consistency* of various sets of assumptions.

The model is essentially a very simple structure: It makes the simplest possible set of assumptions about the relation between resources devoted to investment and subsequent increases in output: a known incremental capital output ratio (ICOR) assumed to operate with a one year gestation lag. Given this method of generating investment requirements, given target levels of GNP year by year, given assumptions about what will happen to public and private consumption, given assumptions about imports, exports, and other elements of the foreign balance, deriving the "requirements" for U.S. aid which will render the target GNP attainable is a simple matter. The model is outlined in Figure 2.

It should be realized that the values of the parameters in this model are all highly uncertain. One can easily imagine circumstances in which, for example, the incremental capital output ratio could be 50 percent higher

or 50 percent lower, or in which consumption grew significantly faster than is assumed. Furthermore, there are substantial uncertainties about the rate of growth of imports, exports and other foreign balance elements. The amounts of aid shown as "required" by the model are quite sensitive to different assumptions about any of these phenomena. Some of this sensitivity is shown in Figure 3.

Thus the model can not provide convincing proof that a particular level of aid is *the* required level and that a particular pattern of aid levels over the next few years is *the* pattern needed. Fortunately, the decisions really on the AID agenda are not the long term choices which the model is aimed at illuminating. AID appropriations do not extend to the end of the decade and nothing prevents a choice made this year from being reversed next year. The real decisions which AID must confront are short and medium term. For these, incremental decisionmaking coupled with close monitoring of the current economic situation in Vietnam must substitute for knowledge of the structure and parameters of the economy.

Our interpretation of the current situation of the Vietnamese economy suggests that the current aid level is close to that level below which sharp changes in the GVN policy would be required. Our reasoning for that assertion is as follows. As outlined in the analysis of the current situation, the real level of imports has declined sharply in the last two years. Most of the imports now being allowed are producer goods, and their further restriction would have important direct and indirect effects throughout the economy. The economy has *already* adapted to sharp changes in the availability of foreign resources. Trying to reduce the level of imports still further would probably require a sharp devaluation or stringent controls, because the price elasticity of demand for those goods still imported is probably low. Thus, strong policy measures with high political costs would be required were AID-supplied foreign resources to fall much below the current level.

This observation requires one qualification: if international prices for fertilizer and petroleum and other goods which are important in South Vietnam's import bill decline, then the dollar level of U.S. aid could

Figure 2

An Exemplary Model of the Vietnamese Economy

RELATIONS

1) $I_{t-1} = s_{t-1} \cdot g_t \cdot G_{t-1}$

2) $A_{t-1} = C_{t-1} + I_{t-1} - G_{t-1} - F_{t-1} - P_{t-1}$

VARIABLES

I Required investment
s Incremental capital-output ratio
g GNP growth rate
G GNP
A Required U.S. aid level
C Public and private consumption
F Non-U.S. foreign resources
P PL-480

Base-Case Values
all except s & g in 1974 dollars

YEAR	s	g	G	C	I	F	P
1974	.33	---	3753	4429	62	63	275
1975	1.50	.05	3941	4429	355	195	100
1976	2.50	.06	4177	4506	731	300	85
1977	2.50	.07	4469	4585	894	330	60
1978	2.50	.08	4827	4599	1086	420	50
1979	3.00	.09	5261	4623	1420	490	50
1980	3.00	.09	5735	4769	1548	505	50

Figure 3

Sensitivity Analysis

BASE CASE

Year	Growth Rate	ICOR	GNP	Consumption	Investment Required	Aid Required
1974	.00	.33	3753	4429	62	400
1975	.05	1.50	3941	4429	355	548
1976	.06	2.50	4177	4506	731	675
1977	.07	2.50	4469	4585	894	620
1978	.08	2.50	4827	4599	1086	388
1979	.09	3.00	5261	4623	1420	242
1980	.09	3.00	5735	4769	1548	27

Total Aid Required: 2900 Million 1974 Dollars

ICOR LOWER

Year	Growth Rate	ICOR	GNP	Consumption	Investment Required	Aid Required
1974	.00	.33	3753	4429	62	400
1975	.05	1.50	3941	4429	355	548
1976	.06	2.00	4177	4506	585	529
1977	.07	2.00	4469	4585	715	441
1978	.08	2.00	4827	4599	869	171
1979	.09	2.00	5261	4623	947	-231
1980	.09	2.00	5735	4769	1032	-489

Total Aid Required: 1369 Million 1974 Dollars

CONSUMPTION GROWS AT 3 PERCENT PER YEAR*

1974	.00	.33	3753	4429	62	400
1975	.05	1.50	3941	4562	355	681
1976	.06	2.50	4177	4699	731	868
1977	.07	2.50	4469	4840	894	874
1978	.08	2.50	4827	4985	1086	774
1979	.09	3.00	5261	5134	1420	754
1980	.09	3.00	5735	5288	1548	547

Total Aid Required: 4897 Million 1974 Dollars

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*Base Case assumes an average rate of growth of consumption of 1.24%.

(Figure 3, Continued)

NON-U.S. FOREIGN RESOURCES 33% LESS

Year	Growth Rate	ICOR	GNP	Consumption	Investment Required	Aid Required
1974	.00	.33	3753	4429	62	421
1975	.05	1.50	3941	4429	355	612
1976	.06	2.50	4177	4506	731	774
1977	.07	2.50	4469	4585	894	729
1978	.08	2.50	4827	4599	1086	527
1979	.09	3.00	5261	4623	1420	404
1980	.09	3.00	5735	4769	1548	194

Total Aid Required: 3660 Million 1974 Dollars

decline accordingly without requiring the sharp policy changes we have considered. Thus the problem of setting aid levels should be viewed in terms of the required level of real imports.

The Composition of AID

The current aid program is primarily aimed at providing the level of general imports required by the economy at a given level of economic activity. Relatively little is devoted to the construction of large capital projects. We believe this is appropriate. As we argued in the first sections of this report, we believe the central problem of Vietnam is to get through the medium-term period. The appropriate focus for policy is to manage as well as possible until the uncertainties about the military situation and the uncertainties about the prospects for oil will be diminished. The more resources are devoted to the resolution of current problems during this time, the more confident we can be that Vietnam will successfully negotiate the period. Given that focus, it is hard to justify the diversion of resources from short and medium term objectives into projects which will have relatively long gestation periods. If the aid budget is regarded as relatively fixed--and that seems to be a politically realistic assumption--then the tradeoff between short-term and long-term payoffs is quite direct. It also seems hard to justify the expenditure of resources on large, vulnerable physical projects with long lead times until the security situation is improved.

AID Influence on Economic Policy

In our view, the most important change in the Vietnamese policy-making style would be the adoption of a short-term and incrementalist attitude toward the manipulation of economic policy instruments. Promoting this objective should be the aim of the U.S. Mission. If the policy problems faced by the Vietnamese government are now those of maintaining reasonably full utilization of resources subject to constraints on the balance of payments and price changes, then it is appropriate to regard the interest rate, the exchange rate, the government deficit, and other instruments as tools to be manipulated frequently and incrementally. It is not appropriate to debate at great length in an atmosphere of confrontation about what level of a particular policy variable will be "correct" in the long run.

For example, the upward adjustment of the interest rates undertaken this year was the result of such a debate. At the time it was proposed it was probably appropriate; by the time it was finally adopted, it was probably inappropriate. Certainly the terms of the debate were not incremental. Fortunately, however, the exchange rate has come to be managed in precisely the incrementalist way which we believe appropriate. The extension of this spirit to their realms of economic policy should be an important objective of the U.S. Mission.

V. SUMATION

Our view is that the economic problems Vietnam needs to deal with now are principally medium term problems, extending to the time when the uncertainties surrounding the prospects for oil and the security situation are somewhat clarified. In the very short run, no drastic changes seem to be called for. Foreign reserves seem not to be threatened, prices appear to be relatively stable, and rather than restraint, the economy seems to require some moves to expand aggregate demand.

Although there is no immediate need for major policy changes, we do believe that it is now possible to adopt measures that will make the medium term more prosperous economically as well as more stable politically. Moving to ease credit, providing more public works employment, further expanding exports, and maintaining the present restricted import list are low risk policies with potentially high payoffs. Further, they are policies that can be pursued in a tentative, exploratory, incremental way. Thus, the government need not become greatly committed to any of the components of this package before it has been tried and its effects are better understood.

The measures proposed in this package are all consistent with long-run growth. They will not further distort price ratios and they should increase the country's stock of real capital. They will not be difficult to undo when the economic situation changes so as to render them inappropriate.

What we have proposed is a package of measures that is internally consistent; all work in the direction of expanding output and employment subject to the constraints of reasonable price stability and maintaining external equilibrium. Although it is a coherent package, all of the components need not be adopted, nor do the measures need to be taken simultaneously. It is important to note, however, that doing the reverse of any of the proposed measures will undo to some extent the benefits of the other measures.

As a provider of aid, the U.S. should, of course, encourage the GVN to make policy decisions incrementally and to be willing to make changes when results do not meet expectations or when a previously sound policy

ceases to be relevant. This style of policymaking is consistent with the real uncertainty that the economy of Vietnam faces, and with the sharp exogenous changes in the world economy to which Vietnam has had to adjust in the past and will have to adjust in the future.

The uncertainties of the world economy together with the uncertainties of the war, politics, and oil exploration in Vietnam make long term forecasts of aid requirements an exercise that is so speculative as to be futile. To be sure, the U.S. budget process requires advanced planning, but projecting Vietnam's needs a year at a time will stretch the capacity of sensible forecasting. Longer term forecasts may be either too pessimistic or too optimistic. If any turn out to be close to correct, it will reflect luck, not analytic skill.