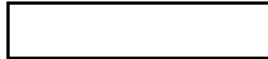


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DIRECTORATE OF
INTELLIGENCE

Intelligence Report

The Economic Situation in South Vietnam (Biweekly)

State Dept. review completed

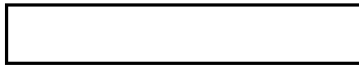
USAID review completed

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence

The Economic Situation in South Vietnam

Summary

By limiting the issuance of licenses for imports the Vietnamese Government has succeeded in halting the decline in foreign exchange reserves, but in so doing has added to inflationary pressures. Prospects for enactment of effective economic stabilization measures are not bright in view of the current unsettled political situation.

Retail prices in Saigon declined slightly in August. During the first eight months of this year the USAID monthly average index increased about 42 percent. Black market currency and gold prices continued to increase, approaching the all-time high levels of last April.

ANNEX: Weekly and Monthly Currency and Gold Prices
(Graph)
Cost of living, money supply, and foreign exchange reserves (Chart)

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Imports and Stabilization

1. Following the rash of orders for imports subsequent to the enactment of higher austerity taxes last October, the Vietnamese Government restricted the issuance of import licenses in order to halt the decline in its foreign exchange reserves. As a result of this restriction the value of orders for imports during the first half of 1970 was 45 percent below that of the last half of 1969 and the decline in reserves was halted, at least temporarily. Imports financed by the US through the Commercial Import Program (CIP) and the Food for Peace Program (PL-480) are not affected by Vietnamese restrictions on licensing--the amounts being largely determined by US Congressional appropriations in the case of the CIP and by the need for surplus US agricultural commodities, mainly rice, in the case of PL-480 imports.

2. Although one might have expected the increase in austerity taxes to reduce orders for imports, orders increased dramatically, as shown in the following tabulation, with the result that foreign exchange reserves dropped sharply several months later when the dollar payments were made by the National Bank (see chart).

Import Licenses
(million dollars)

| | <u>2nd Half 1969</u> | | | <u>1st Half 1970</u> | | |
|-------------------------------|----------------------|---------------------|--------------|----------------------|---------------------|--------------|
| | <u>Jul- Sep</u> | <u>Oct- Dec</u> | <u>Total</u> | <u>Jan- Mar</u> | <u>Apr- Jun</u> | <u>Total</u> |
| CIP | - | - | 82.0 | - | - | 113.1 |
| PL-480 | - | - | 69.5 | - | - | 46.9 |
| Vietnam- ese-Fi- nanced | 70.1 | 173.7 | 243.8 | 80.8 | 53.3 | 134.1 |
| | | | <u>395.3</u> | | | <u>294.1</u> |

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Importers speculated on continuing inflation and on the possibility of a large devaluation, which would greatly increase their costs. Despite the higher austerity taxes importers still can make enormous windfall profits on many goods because they sell them at the inflated domestic price level while paying for them at the artificially low official exchange rate. Some US officials have estimated that importers' excess profits amount to \$100-150 million per year. Moreover, speculative buying by importers is easy because they are able to obtain what amounts to free credit to finance their inventories. Commercial bank interest rates to importers currently are 12 percent per year, whereas commodity prices rose about 42 percent during the past 12 months.

3. Although the licensing data show that the importers' spending spree had almost run its course by January 1970, the government, concerned about the decline in foreign exchange reserves that had already started, decided to limit licensing to a maximum of \$20 million per month from a restricted list of goods. Had the government been able to outwait the importers, much of the speculation in imports probably would have died out. The licensing restrictions reportedly were removed in August, but by reducing the flow of imports for six months the government has added to inflationary pressures. The slowdown in arrivals of imports will cut back the major source of government revenue--taxes on imports--and force the government to resort to increased deficit financing in order to cover its expenditures. Although the money supply has not yet increased significantly--only eight percent during the first seven months of this year--the rate of increase will pick up as expenditures on new programs, such as veterans' benefits and land reform, get under way. Moreover, a wage increase for government employees cannot be long delayed and it will add significantly to government spending.

4. The prospects for early enactment of effective stabilization measures, such as tax increases or devaluation and interest rate reform, are not bright. The government already has delayed such measures several months awaiting Senate approval to enact reforms by decree, and most

observers agree that favorable Senate action is unlikely. President Thieu has indicated that if he does not get legislative agreement he will then decree stabilization measures on his own authority. The enactment of reforms in this manner, however--even measures much less stringent than those called for by economic considerations alone--would cause a considerable political uproar, such as occurred last October when austerity taxes were raised without National Assembly approval. Some changes in tax and exchange rates probably will be made with or without legislative approval during the next several weeks, but major reforms apparently will be postponed until some unspecified future date when the political situation is less unstable. In the meantime, the Vietnamese will rely in large part on increased US aid to keep inflation from getting out of hand.

Prices

5. Although retail prices in Saigon increased slightly during the last week in August, the average price level for the month declined slightly from the July level. Prices increased about 42 percent during the 12 months ending in August, and about 25 percent during the first eight months of 1970. Data on prices of imported commodities during August are not available, but the USAID index for imports rose 21 percent during January-July 1970.

Currency and Gold

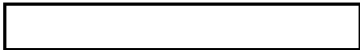
6. Saigon black market currency and gold prices continued to increase during the two weeks ending 31 August. The rate for MPC (scrip) reached a new high of 240 piasters per dollar, while the prices of dollars and gold approached the all-time high levels of last April. On 31 August the price of dollars was 415 piasters per dollar compared with the official rate of 118 piasters, and the price of a dollar's worth of gold leaf was 505 piasters. In addition to the general uncertainty about government economic measures, one factor that apparently influenced black market rates was the widespread press reporting that the National Bank is planning to issue

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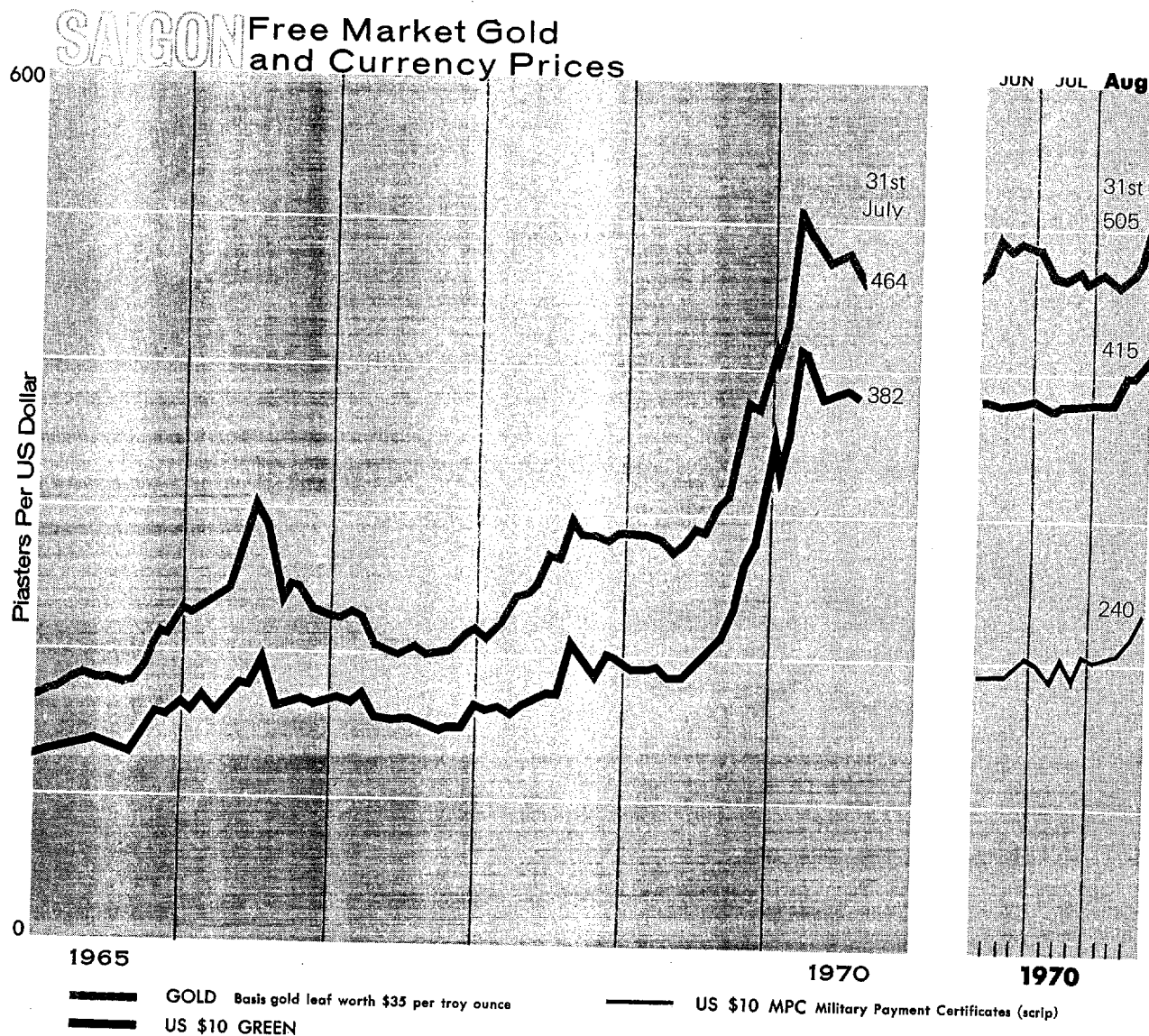


the 1,000-piaster notes that have been in its vaults for several years. The largest banknote now in circulation is the 500-piaster note, and the bank has denied any plans to issue the larger denomination, which the press views as inflationary. (A graph on monthly and weekly currency and gold prices is included in the Annex. Also included are charts on the cost of living, money supply, and foreign exchange reserves.)

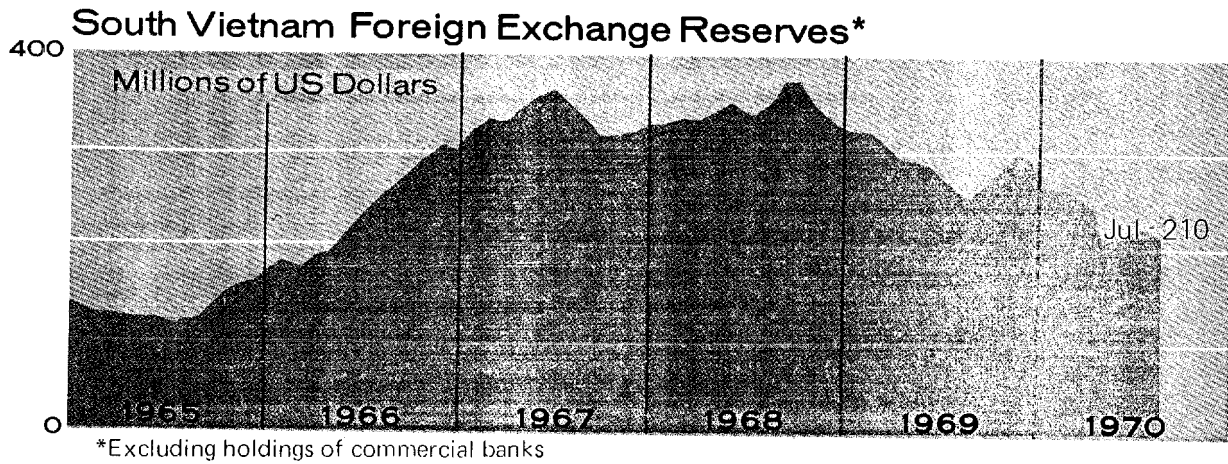
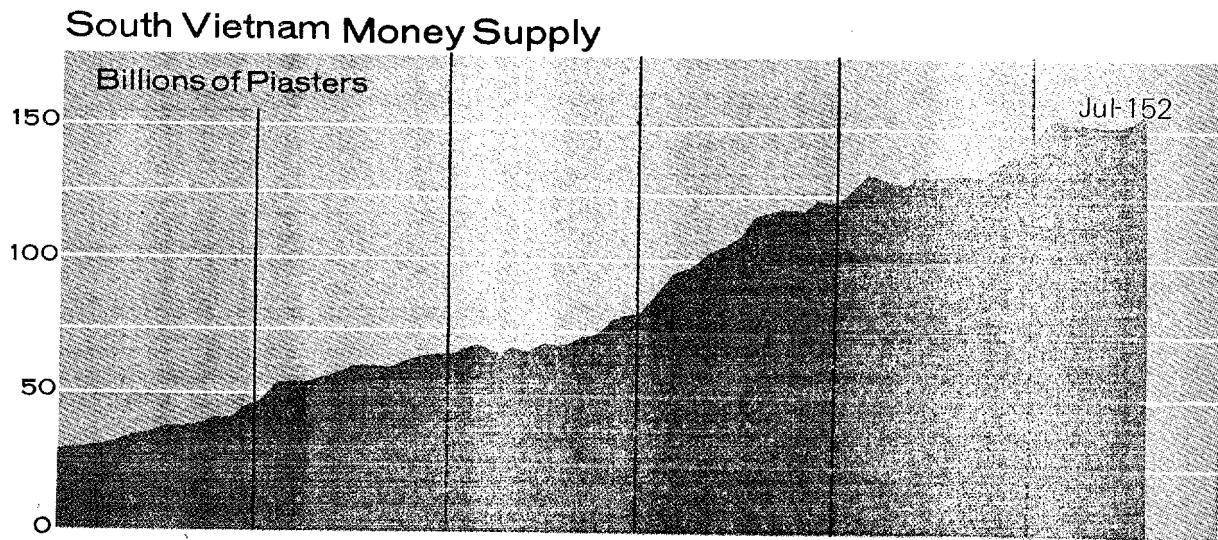
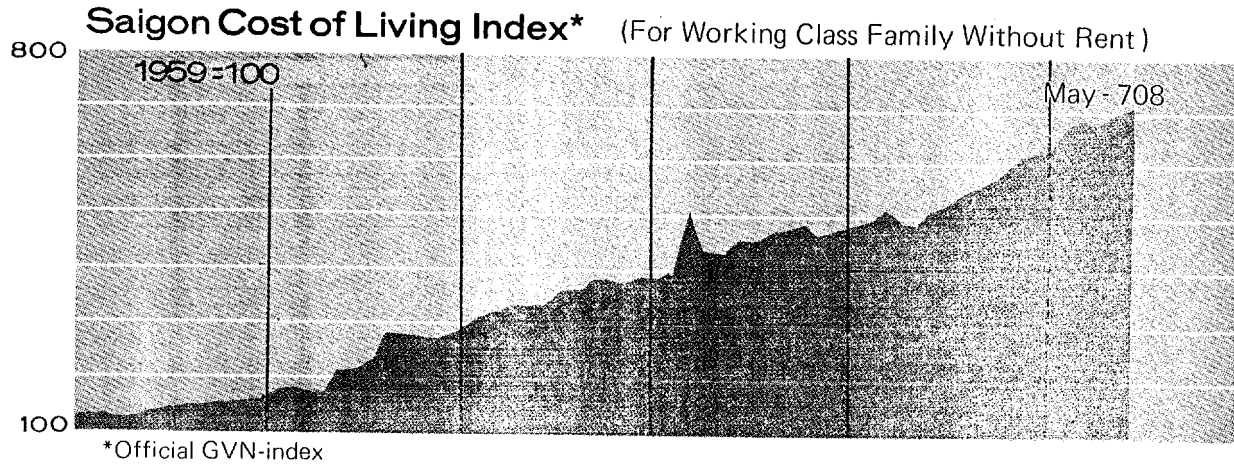


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