

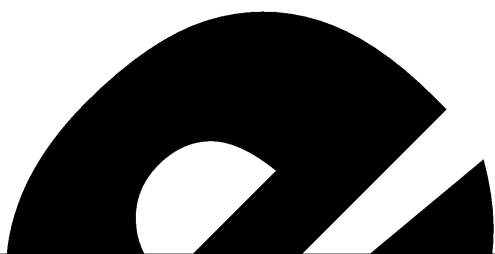


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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

The Declining Gold Trade in Laos

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September 1968

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
September 1968

INTELLIGENCE MEMORANDUM

The Declining Gold Trade in LaosSummary

A sharp decline in tax receipts from gold imports in the first half of 1968 has complicated the Lao government's fiscal problems and probably will require an increase in foreign, particularly US, budgetary assistance. Laos, one of the two major legal importers of gold in the Far East, is the source of most

taxes on gold imports account for an important part of Lao government revenues. Government revenues, however, cover only about 45 percent of expenditures, the difference being made up through foreign aid.

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Gold imports into Laos in the first half of 1968 were some 50 percent smaller than in the first half of 1967. Initially the drop was a result of the disruption of distribution channels to and in South Vietnam caused by the Tet offensive. Since the establishment in March of a two-tiered world gold market, speculative demand for gold has fallen sharply, and the continued decline in Lao gold imports probably reflects this development. The instability of world free gold markets and the resultant fluctuations in gold prices in Vientiane and Saigon also may have contributed to reduced imports of gold through their unsettling effects on gold traders.

The drop in gold imports has deprived the Lao government of about \$1.8 million in anticipated tax

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revenues from gold, which had been expected to contribute about 45 percent of total domestic revenues in fiscal year (FY) 1968.* Although increases in other government revenues -- mainly customs receipts -- nearly made up for the decline in gold revenues, government expenditures were higher than expected and the Lao budget deficit exceeded the level on which planned foreign economic aid was based.

Laos' benefactors are now using the gold problem as an opportunity to increase pressure on Vientiane to improve its fiscal structure and performance. Increases in taxes on activities other than the gold trade, improvements in tax collection, a crackdown on corruption, and tighter controls on government spending are being recommended. Action along these lines is likely to be meager, however, and an increase in foreign budgetary support probably will be necessary to avoid a devaluation of the kip. Increases in budgetary support probably will be at the cost of some reduction in development aid to Laos.

* *The Lao fiscal year begins on 1 July of the year stated.*

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Background

1. On 10 October 1958, Laos suspended all licensing requirements and controls on financial transfers and gold movements as part of a monetary reform directed at the establishment of unrestricted convertibility of the Lao kip. This action allowed gold to be imported and exported, subject only to payment of an *ad valorem* duty and to a declaration for statistical purposes. In 1959 the duty on gold imports was reduced from 20 to 3 percent and gold was exempted from the 16 percent business turnover tax. Laos, one of the world's most underdeveloped nations, soon became a major legal importer of gold in the Far East,* although the growth of its gold market was interrupted in 1960 and again in 1962-64 by political instability. Gold imports into Laos during 1958-67 are shown below:

| <u>Year</u> | <u>Metric Tons</u> | <u>Year</u> | <u>Metric Tons</u> |
|-------------|------------------------|-------------|------------------------|
| 1958 | 0 | 1963 | 7.0 |
| 1959 | 12.4 | 1964 | 11.3 |
| 1960 | 16.7 | 1965 | 36.3 |
| 1961 | 26.3 | 1966 | 53.0 |
| 1962 | 20.1 | 1967 | 72.2 |

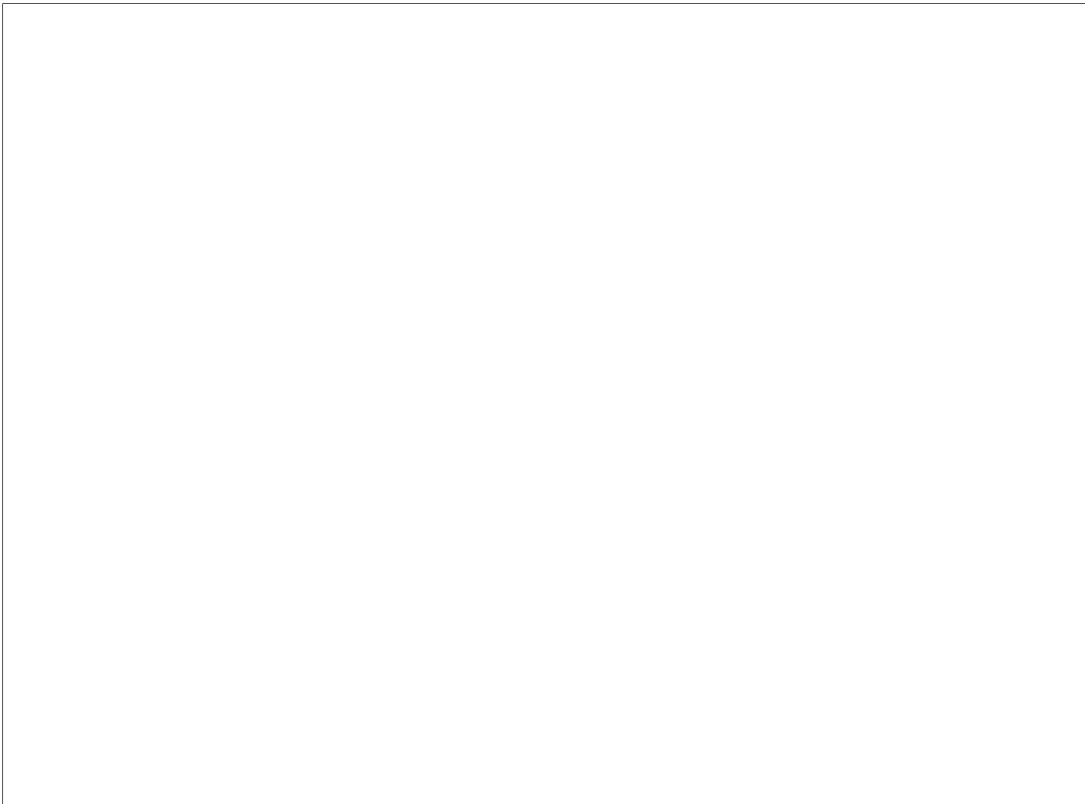
2. The increase in gold imports in 1964-67 resulted in large part from the increased demand for gold in South Vietnam as US dollars became more available there and Saigon's political future became more questionable. In early 1968, Lao gold dealers estimated that about two-thirds of their gold finds its way into South Vietnam. The remainder, except for small amounts purchased by Lao citizens, moves to Thailand, and then perhaps to Malaysia, Singapore, or India.

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* Macao, through its close ties with Hong Kong, is Laos' only important Asian rival as an entrepôt for gold trade.

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5. Approximately two-thirds of the gold entering Laos is imported by the Banque de l'Indochine (BIC), with most of the remainder handled by two local Chinese entrepreneurs who rely on the BIC for banking services. The gold is purchased in London and delivered to Vientiane by commercial airlines via Bangkok. Some 20 local dealers in Vientiane act as middlemen for a host of smugglers, who are often Vietnamese nationals.

6. Trade in gold has become the largest source of domestic revenue for the Royal Lao Government (RLG), and taxes on gold imports accounted for more than 40 percent of internal RLG receipts in FY 1967. (For RLG revenue sources in FY 1965-68, see Figure 1.) A growing demand for gold led the RLG, encouraged by the United States and other financial backers, to boost the customs tax on gold imports from 3 to 5 percent in May 1964. The duty subsequently was raised in frequent steps to its present level of 8½ percent by April 1967, without any apparent effect on gold imports. US officials estimate that there is very little smuggling into Laos to avoid the payment of the customs tax.

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Gold in 1968

7. Gold imports into Laos declined sharply in the first half of 1968 as shown below:

| | <u>Metric Tons</u> |
|----------|--------------------|
| January | 6.7 |
| February | 3.2 |
| March | 3.5 |
| April | 3.0 |
| May | 1.8 |
| June | 1.7 |

Totals

| | |
|---------------------------|----------------|
| <i>January-June 1968</i> | <i>19.9 a/</i> |
| <i>January-June 1967</i> | <i>40.1</i> |
| <i>July-December 1967</i> | <i>32.1</i> |

a. Imports decreased to 0.9 tons in July, but rebounded to 1.3 tons in August.

8. The sharp decline in February imports probably reflects the disruptive effects of the Tet offensive. The restriction of air flights into Saigon sharply reduced the possibilities for smuggling gold. Within South Vietnam the personal security of gold distributors, like other South Vietnamese, was endangered, particularly in Cholon, the Chinese section of Saigon, where a large part of the Saigon gold market is located and where the fighting was most intense and prolonged.

9. The continued decline in gold imports since March is probably explained by other factors. The Washington agreement of 18 March separated the free market for gold from the official market and since then the free market price has fluctuated with supply and demand. The establishment of this two-tiered market sharply reduced the speculative demand for gold. Since March there has been a decline in gold imports in Hong Kong, where speculative demand is clearly of considerable importance. The decline in imports of gold in Vientiane probably reflects the same factors. Moreover, the increased instability of world free gold markets since March has produced greater fluctuations in the profit margin of

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Lao gold traders and a greater financial risk. The spread between the large dealers' price of gold in Vientiane and the price of gold in Saigon in recent months has been as low as \$2.00 per troy ounce and as high as \$8.00 or more between mid-March and June.



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10. The Vientiane dealers' selling price for gold, which stayed in the neighborhood of \$1,255 per kilogram (\$39.04 per troy ounce) between April 1967 and 14 March 1968, reached \$1,500 on 15 March when the London gold market closed. The BIC also stopped its sales on 15 March, while other Vientiane dealers sold from their stocks. By 18 March, after a free market was established, dealers' prices were fluctuating between \$1,450 and \$1,500 per kilogram. The instability continued, with prices ranging from a low of about \$1,340 (possibly even less) in April to a high of about \$1,485 in June. The amplitudes of the price variations appeared to closely follow those on the London and Zurich exchanges, as shown in Figure 2.

Implications for the Lao Economy

11. The drop in gold imports into Laos in the first half of calendar year 1968 resulted in a decrease of about \$1.6 million (800 million kip) in gold customs receipts, compared with revenues in the first half of 1967. The decline in gold duties during all of FY 1968 compared with FY 1967 amounted to only about \$0.7 million, but an increase of about \$1.1 million had been planned in the Lao budget.

12. Although other revenues -- principally customs taxes other than those on gold -- were some \$1.6 million higher than anticipated for FY 1968, RLG expenditures also increased faster than planned, largely because of intensified Communist military activity. Total expenditures probably were on the order of \$31.7 million, which resulted in a budget deficit of some \$17.3 million. Such a deficit approximates the deficit originally projected by the RLG but is larger than the \$16.8 million limit agreed to by the RLG as a basis for budget support assistance from the United States and other aid donors in 1968. Moreover, the



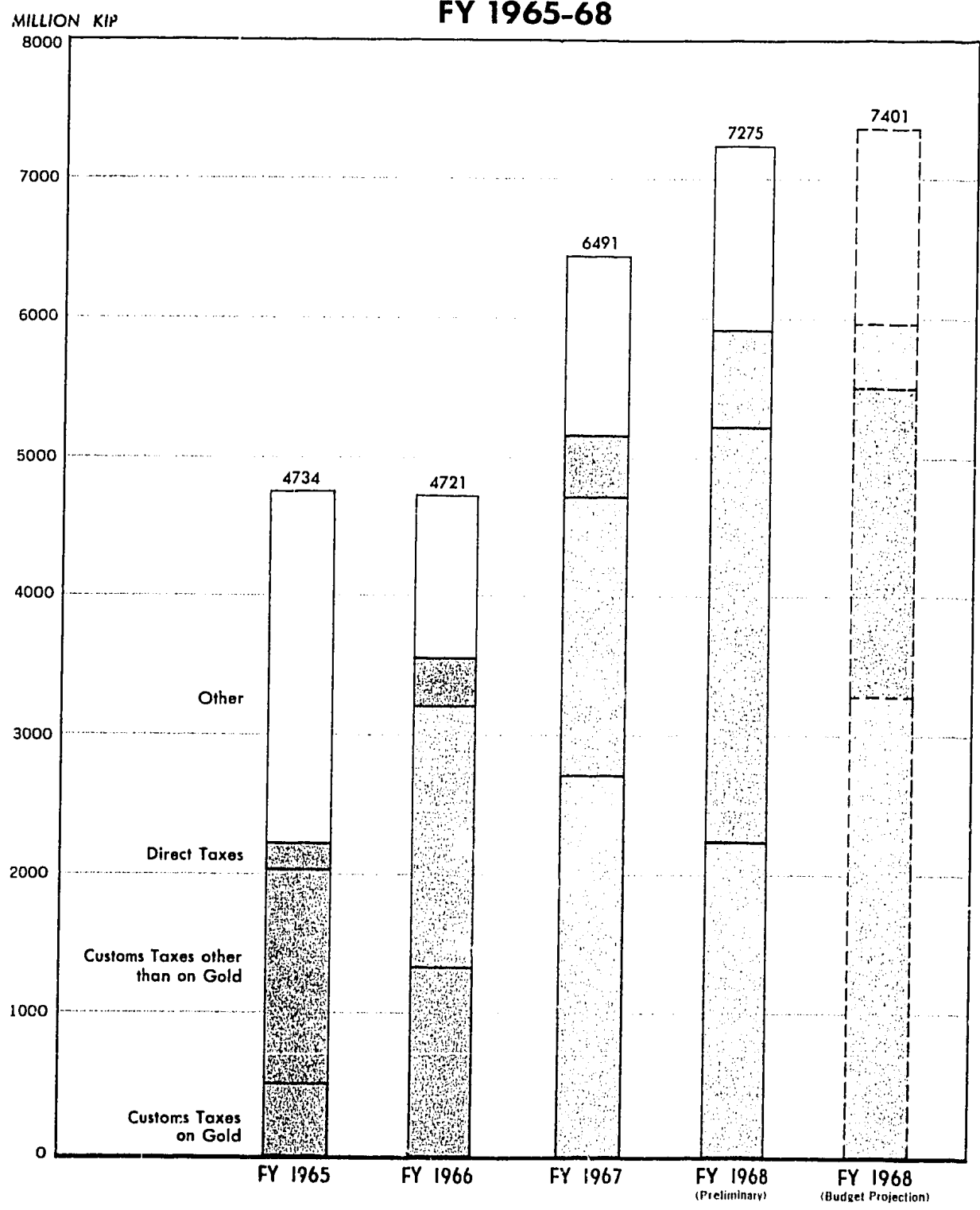
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Figure 1

REVENUE SOURCES OF THE ROYAL LAO GOVERNMENT FY 1965-68



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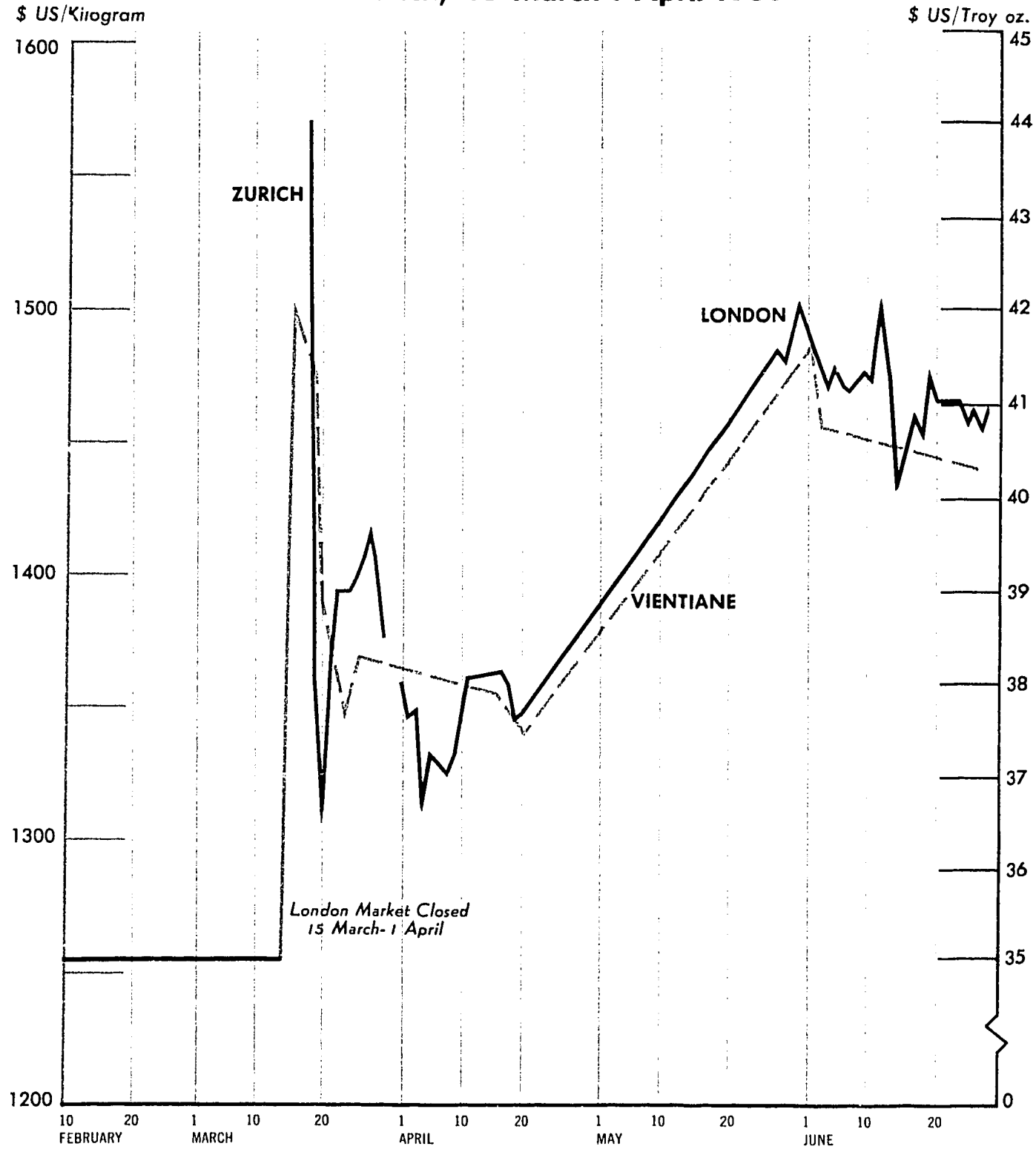


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Figure 2

GOLD PRICES: Vientiane and London, March-June 1968 and Zurich,* 18 March-1 April 1968



*Prices on the Zurich gold market closely paralleled those in London after the London gold market reopened on 1 April

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FY 1969 budget proposed by the RLG to its national assembly in July 1968 -- which is less sanguine in its projections of gold imports -- projects a deficit of \$16.8 million compared with the \$15.8 million deficit limit agreed to earlier by the RLG and the foreign aid contributors.

13. The budget deficit is closely linked to Laos' requirements for foreign exchange because Lao government expenditures are the country's predominant source of money income. Since most of the economy is geared to subsistence production, a very large share of money income is spent on imports, the bulk of which are financed by foreign aid. According to official Lao statistics, which are notoriously inadequate, in 1966 imports were \$23.9 million and exports only \$1.5 million. Taxes on the gold trade covered another \$3.8 million worth of imports. A large and growing share of foreign aid to Laos (about 25 percent of the total in 1967) has been provided in the form of budget support assistance through the Foreign Exchange Operations Fund (FEOF).*

14. The increase in Lao government expenditures in 1968 is tending to increase commercial activity and the demand for imports beyond expected levels at a time when foreign exchange earnings from taxes on gold are declining. In consequence, FEOF will have to provide more foreign exchange unless the kip is devalued or something is done to reduce the budget deficit. Imports could be reduced through devaluation or by cutting the budget deficit. Devaluation, however, might well trigger a rapid inflation and undermine morale in a country where most wage earners are government employees who already have been complaining about inadequate salaries for years, and on whom the government depends heavily for political support.**

* FEOF, which receives contributions from the United States, the United Kingdom, Australia, France, and Japan, was established in 1964. Within agreed limits it makes foreign exchange available on the open market in Laos without restrictions as to the individual amount or to the purposes for which it may be used. The United States has been the primary donor to FEOF, accounting for more than 60 percent of the total contributions of almost \$60 million to FEOF in calendar years 1964-67. Total US economic aid to Laos since 1946 has amounted to almost \$600 million. Total US military aid is approaching \$500 million.

** The cost of living in Vientiane, which approximately quadrupled [footnote continued on p. 8]

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15. In preference to devaluation, FEOF has prescribed the prompt implementation of measures to improve Laos' fiscal structure and performance. Foremost among these measures is a crackdown on the corruption prevalent at the highest official levels, including the general staff of the Royal Lao Army. Military corruption includes illegal traffic in opium (and infrequently gold), the smuggling of liquor and cigarettes, the utilization of military aircraft for smuggling, and budgeted expenditures covering 7,000 soldiers who could not be specifically identified. Additional steps needed to bring the Lao economy into line include the following: a tightening of tax collection procedures; increases in existing taxes, particularly on imports other than gold and on real estate; a reduction of spending on construction and nonessential military outlays; and a halt to the rapid growth of the government's civil payroll.

Outlook

16. It is unlikely that gold trade in Laos will soon regain its former high level. In recent weeks the two-tiered world market has seemed more durable and the prospects for an increase in the official price of gold more remote. Consequently, the speculative demand for gold probably will remain depressed, barring a new dollar or sterling crisis. Moreover, Vietnamese Communist military activities in South Vietnam threaten to continue disrupting the market for gold there. The RLG, as noted, has taken account of these conditions and has reduced its reliance on gold in its FY 1969 budget. Revenues anticipated from the gold tax in FY 1969 are based on average monthly gold imports of 3.2 tons compared with the 6 tons a month projected in the FY 1968 budget and the 4.3 tons per month actually received. The RLG currently is negotiating with a Lao-Thai group which would guarantee Laos gold imports of at least 3 tons per month in return for a monopoly on gold imports into Laos.

17. Laos probably will be able to struggle through its current economic crisis without being forced to devalue its currency, primarily because foreign aid

in the period 1962-64, when the external value of the kip also decreased precipitously, increased by the relatively moderate amount of 30 percent in 1965-67, when FEOF was keeping the exchange rate stable.

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is still on tap to underwrite Lao deficits and thereby underwrite Lao political stability. On the other hand, long-term prospects for economic growth are bleak. The allocation of foreign funds for budget stabilization through FEOF may be at the cost of funds originally planned for development projects. Although some progress can be expected in Laos' own efforts to improve fiscal performance and reduce corruption, these efforts will be hindered, as ever, by bureaucratic inertia and by the reluctance of many Lao officials to put aside their own vested interests in favor of the nation's needs. Thus, although the RLG is currently sponsoring outspoken indictments of corruption and tax evasion in the Vientiane press, a proposed capitation tax has been rejected by the RLG assembly and higher taxes on gasoline have been postponed until October, after the rice crop is in, when people will have more cash available and the political reaction will be more subdued.

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