

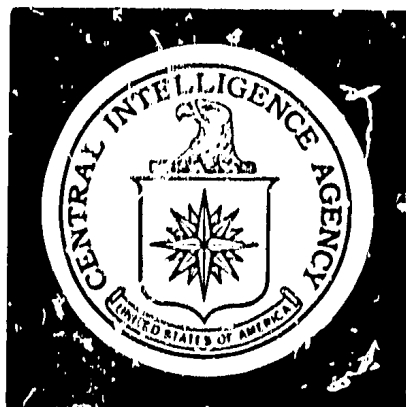
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Sanitized Copy Approved for
Release 2012/02/14 :
CIA-RDP85T00875R00170001
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Release 2012/02/14 :
CIA-RDP85T00875R00170001

10/1/71
CIA/OCER/IM 71-113

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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

The Economic Situation In South Vietnam

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ER IM 71-113
June 1971

Copy No. 200

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
June 1971

INTELLIGENCE MEMORANDUM

The Economic Situation In South VietnamHighlights

1. During the past 18 months, a number of foreign businessmen -- mostly Japanese -- have submitted proposals for industrial projects in South Vietnam. The projects approved by the Government of South Vietnam (GVN) have been criticized, however, because they focus on import substitution -- particularly in luxury goods -- and often provide a related monopoly position in importing.
2. Several economic stabilization measures involving commercial credit and import procedures are to be enacted prior to the elections this fall. The question of another wage increase for GVN employees, however, has not been resolved.
3. USAID officials have discovered that official data have substantially understated rice deliveries from the Delta to Saigon during recent months. This discovery does not reduce the uncertainty surrounding GVN ability to meet regional rice deficits from domestic sources.
4. Saigon retail prices increased slightly during May, but by 7 June were still only 3% above the level of December 1970.
5. Black market dollar prices fell during May to the lowest level of the past 12 months both as a result of the international monetary crisis and the crackdown on smuggling at Tan Son Nhut airport.

Note: This memorandum was prepared by the Office of Economic Research.

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6. Charts on foreign exchange reserves, money supply and prices, import licensing, gold and currency prices, and the government budget follow the text.

Discussion

Private Foreign Investment

7. During the past year and a half, security and economic conditions in South Vietnam have stabilized enough to have attracted inquiries from a number of private foreign investors. Although there is understandably no rush to invest in Vietnam, projects capitalized at perhaps 3 billion piasters ^{1/} (or roughly 5% of total domestic investment) have been authorized over this period. Since the beginning of 1970 the GVN has approved about a dozen proposals from foreign businessmen -- mostly Japanese -- to invest with Vietnamese partners in local assembly plants for farm machinery, trucks, radio and television sets, and sewing machines (see the table). Two large American firms -- Ford Motor Co. and R.J. Reynolds (tobacco) -- submitted project proposals this spring, but the Ford proposal may run into difficulty because it provides for no Vietnamese participation.

8. The composition of the private foreign investment has been criticized on two counts. First, it is argued that it is too much directed toward import substitution. Many feel that the government should be encouraging foreign investment in industries, such as fishing, with an eye to the export market. Second, there is concern that the proposals include facilities for the production of luxury goods. Critics maintain that such import substitution as takes place should be centered on essential rather than luxury goods. In the short run, however, the government may believe that the best way to interest foreign businessmen is to allow

1. Investment data are incomplete, but the GVN requires a minimum investment of 200 million piasters (\$730,000 at the parallel market exchange rate of 275 piasters per dollar) in plant and equipment for each project.

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Private Foreign Investment in South Vietnam a/
1970-71

Product	Name of Firm	Foreign Partner <u>b/</u>	Status
Agricultural and fishing equipment	VIKYNO	Kubota	Operational
	VINAPRO	Yanmar and Nichimen	Under construction
	FARMASSIN	Mitsubishi	Proposal approved
	NOTICO	Shibaura	Proposal approved
Radio and television sets	Saigon Ky Nghe Dien	Sony	Proposal approved
	Sanyo Industries, Vietnam	Sanyo	Proposal approved
	Vietnam National Co.	Matsushita	Proposal approved
Light trucks	CARIC	100% French including Citroen	Operational
	VAP	Toyota	Proposal approved
Commercial and passenger vehicles	Ford Motor Co., Vietnam	100% American	Proposal submitted
Cigarettes	R.J. Reynolds Tobacco	R.J. Reynolds	Proposal submitted
Textiles	Toya Menka/ Kanegafuchi Spinning Co.	100% Japanese	Proposal submitted

a. Four sewing machine assembly plants also have been approved, but detailed information is not available. Other projects may have been approved but not yet reported.
b. Less than 50% ownership unless otherwise indicated.

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them to participate in setting up assembly plants for their own products, including luxury products for which demand is high.

9. Some of the issue of the direction of foreign investment could be solved by appropriate law. A new, liberalized investment law was submitted to the National Assembly in January, but it is not clear what incentives it will provide for investment in particular industries. Even within the framework of a new law, however, there is likely to be scope for considerable administrative discretion in project approvals. The granting of investment privileges and incentives is especially vulnerable to the sorts of corruption common to South Vietnam. For example, a sewing machine plant was constructed and equipped several years ago, but was never opened. When the owners decided to start production following the suspension of imports of sewing machines, they were told they must submit a completely new project proposal.

10. Several of the new industrial projects are designed to take advantage of import restrictions -- such as those on sewing machines -- to secure a monopoly position in the market. GVN regulations for establishing new plants in fact encourage such a development. Thus, during the 18 months allotted for construction and installation of plant and equipment, the firms are granted exclusive rights to import the product approved for assembly.

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There apparently is widespread opinion among Saigon businessmen that some foreign investors are interested only in securing the import monopoly and that the proposed assembly plants will never become operational.

11. Because most of the new industrial projects will be assembling imported components, there also is concern that the GVN is committing itself in advance to a large expenditure of scarce foreign exchange. The government requires that initially 20% of the value of the completed product must be

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manufactured locally and that over a five-year period the share of domestic components be increased to 80%. Even if the 80% goal is reached, the government will be committed to these industries for a considerable period of time, and its options for spending foreign exchange will be correspondingly limited.

Economic Reform Efforts Continue

12. Vietnamese and US officials have agreed on several key economic measures to be enacted prior to the elections this fall. The pressing question of another wage increase for government employees, however, apparently has not been resolved. Most US officials considered a wage increase unlikely before early next year, but the GVN may have other ideas. President Thieu's final decision on this issue will probably depend on how he weighs (1) his prospects for reelection and (2) the risks of renewed inflation.

13. The aim of the new measures -- which are directed toward commercial credit and imports -- is to reduce the supply of money and thereby lessen the risk of renewed inflation over the longer run. Commercial banks will no longer be able to loan out all of the new time deposits collected since last September's interest rate reform, but will be subjected to the existing 70% loan/deposit ratio for "old" time deposits. Customs officials, who apparently have been allowing importers up to 60 days to pay duties, must now operate strictly on a cash basis.

14. The key change in importing is the introduction of a new licensing regime designed to simplify procedures and reduce opportunities for graft. A so-called general licensing procedure was decreed on 7 June for all imports coming in at the parallel market exchange rate. Under general licensing, licenses will no longer be purchased for specific goods but can be used for any item and are transferable to other authorized importers. Moreover, importers may now bypass the bureaucracy of the Ministry of Economy and obtain their licenses directly from commercial banks. Importers will buy licenses at the flat

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rate of 400 piasters per dollar (the parallel market rate of 275 plus a perequation tax of 125 piasters), and customs and austerity taxes will be collected as usual on each commodity when it arrives. Under this system, some goods will come in at higher and some at lower effective exchange rates than now prevail. In general, however, the system is expected to increase absorption of funds through imports.

15. For goods eligible for import at the official exchange rate of 118 piasters per dollar (other than those under US aid programs), importers will have the option of either buying a license at the 400-to-1 rate or taking their chances on obtaining it at the lower rate through normal procedures. Normal procedures, however, can be time consuming, and importers may not be able to get the licenses they want because, although nominally unrestricted, licenses still are rationed to some extent. The relative simplicity of the new procedure and the prospect of speedier processing, therefore, may make it worthwhile for importers to buy a general license despite the apparently higher effective rate.

Rice Windfall

16. An investigation by USAID officials has revealed considerable understatement, especially during recent months, in the official data on rice deliveries from the Delta to Saigon. According to official data, deliveries during the first four months of this year averaged 37,000 metric tons per month, whereas the USAID-revised series shows average shipments of 47,000 tons. Data on deliveries for 1970 have been similarly increased through revision from 399,000 tons to 469,000 tons (or 18%).

17. The understatement was revealed by the discovery of consistent differences in records at a number of government checkpoints. Rice shipments usually have been counted at one checkpoint on Route 4 and at two harbor police checkpoints near the Cholon rice warehouse complex. In questioning harbor police at the three checkpoints

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near the entrance of the Saigon-Cholon waterway system, however, USAID representatives discovered that substantially more rice is entering the waterway than is being unloaded at the Cholon warehouses. It still is not clear whether the discrepancy is primarily the result of careless recording, poor choice of location for the checkpoints, or losses to theft; but an investigation reportedly is under way.

18. This statistical windfall is not large enough to allay concern for whether enough rice will come out of the Delta this year to meet fully the rice requirements in the deficit areas. Deliveries still will have to be about 10,000 tons a month larger if the domestic rice market is to satisfy the needs of the entire country. Shipments from the Delta were expected to reach the desired level of about 60,000 tons in May, but may decline in June because the Ministry of Economy was late negotiating what are supposed to be monthly purchase contracts with the rice merchants. US officials estimate that present stock levels provide a margin of safety through September, but are unwilling to predict beyond that point because of market uncertainties.

Prices

19. Saigon retail prices rose slightly during May primarily because (1) heavy rains reduced supplies of vegetables and (2) short-lived strikes at both Esso and Shell pushed up the price of kerosene. By 7 June, however, the USAID index still had increased only 3% since the end of last year and only 8% since June 1970. ^{2/} The price index for imported commodities, on the other hand, declined slightly during early May to reach a point at mid-month about 7% above the level of December 1970. Through April the money supply remained essentially unchanged from the January level.

Currency and Gold

20. The black market price of dollars dropped sharply in mid-May both as a result of the international monetary crisis and the more stringent

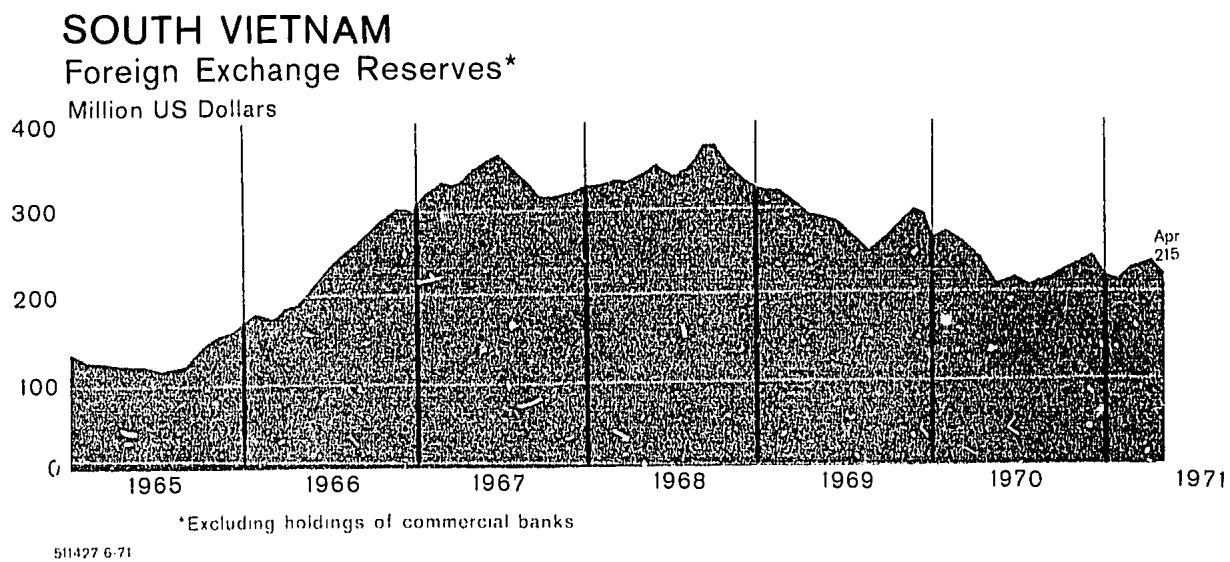
2. The comparable price increase for the year ending in June 1970 was 50%.

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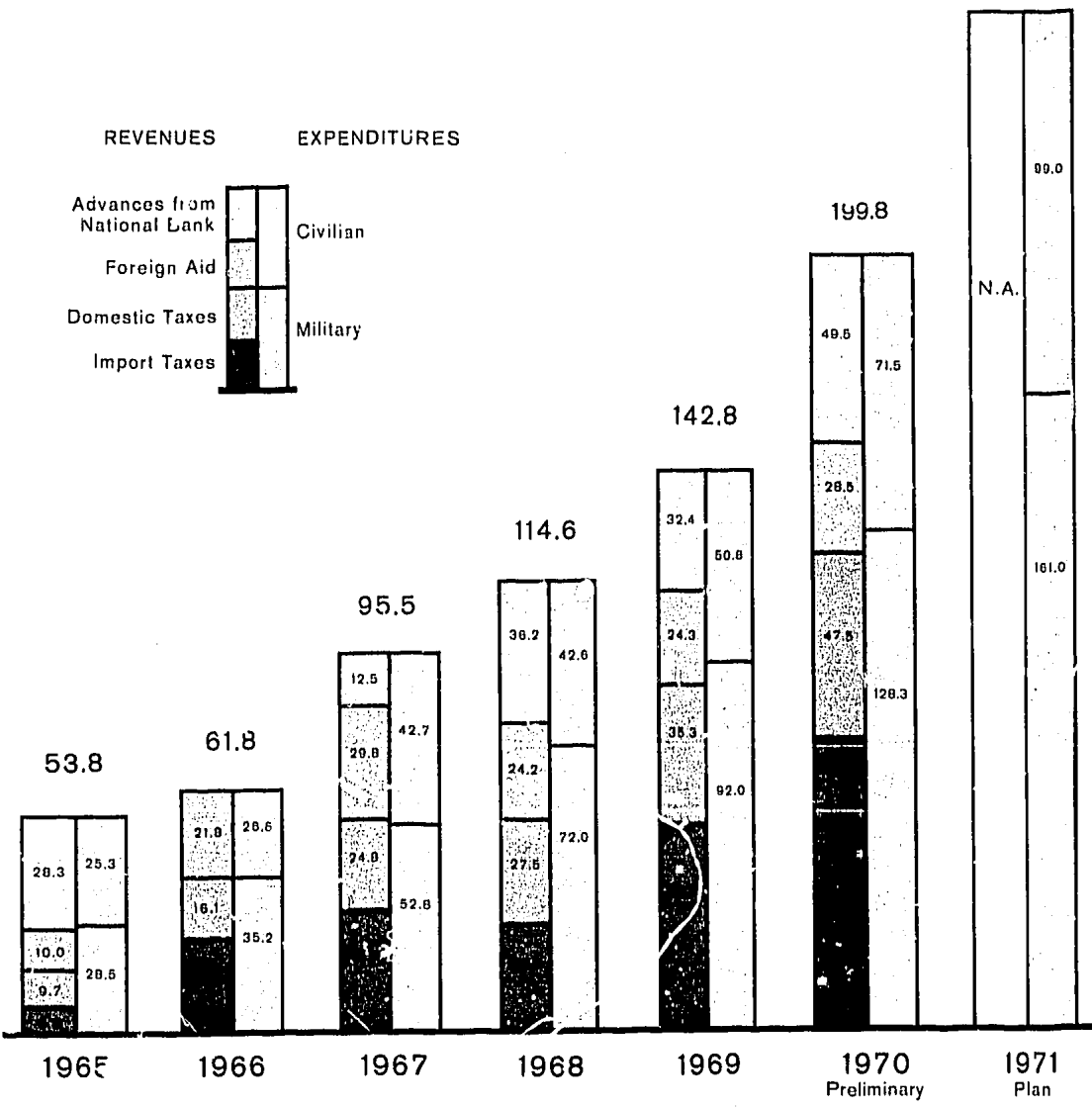
enforcement of customs regulations at Tan Son Nhut airport. While the rate for dollars declined, the rate for gold increased as the tighter customs controls -- aimed primarily at drug smuggling -- made it more difficult to get dollars out of the country and gold into it. By 7 June the price of dollars had risen somewhat (to 376 piasters per dollar), but it still was lower than at any time during the past year. The price of a dollar's worth of gold leaf rose to 514 piasters in mid-May, but had declined to 508 piasters by 7 June. The rate for military payment certificates (scrip) -- which generally followed that for dollars -- was down to 261 piasters per dollar on 7 June (or 14 piasters below the legal rate).

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GOVERNMENT BUDGET*

Billion Piasters

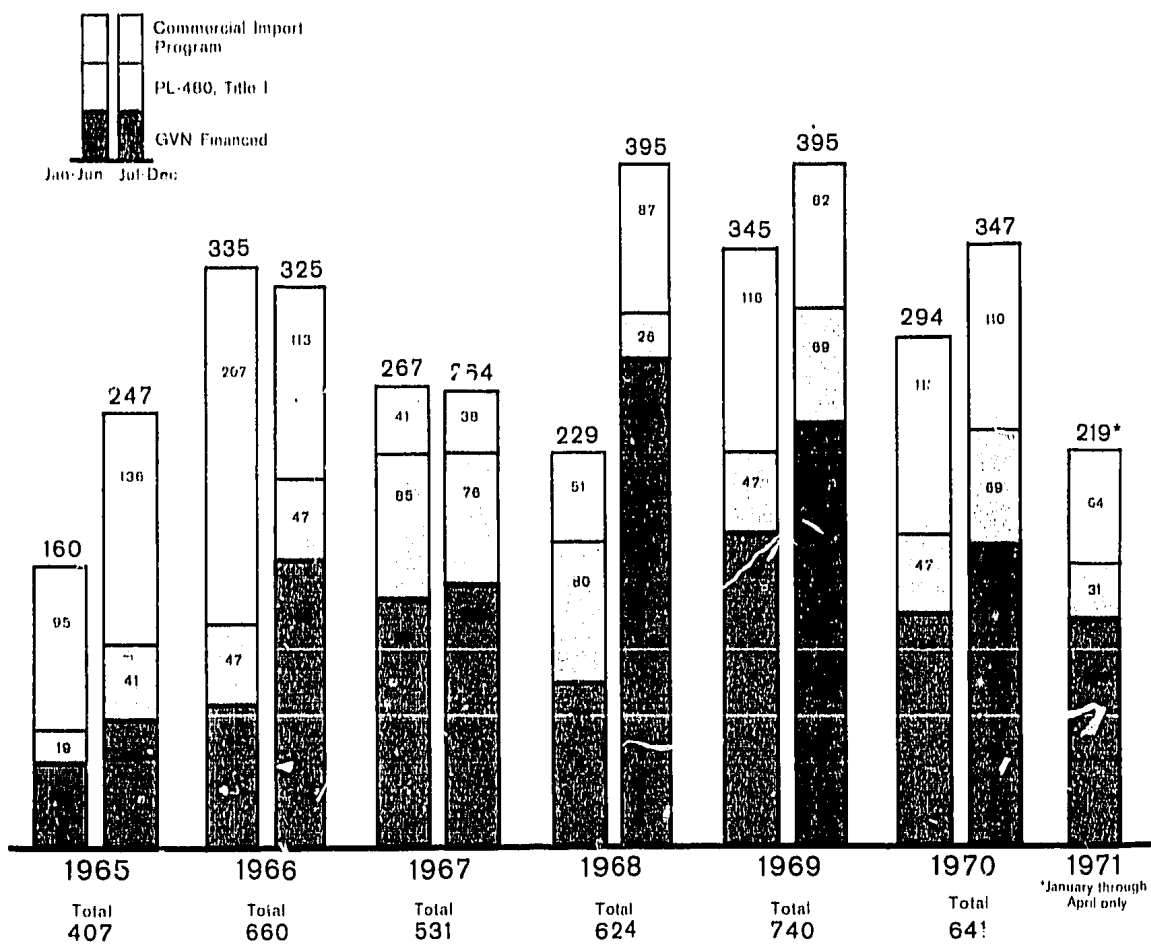


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*Data include extrabudgetary revenues and expenditures

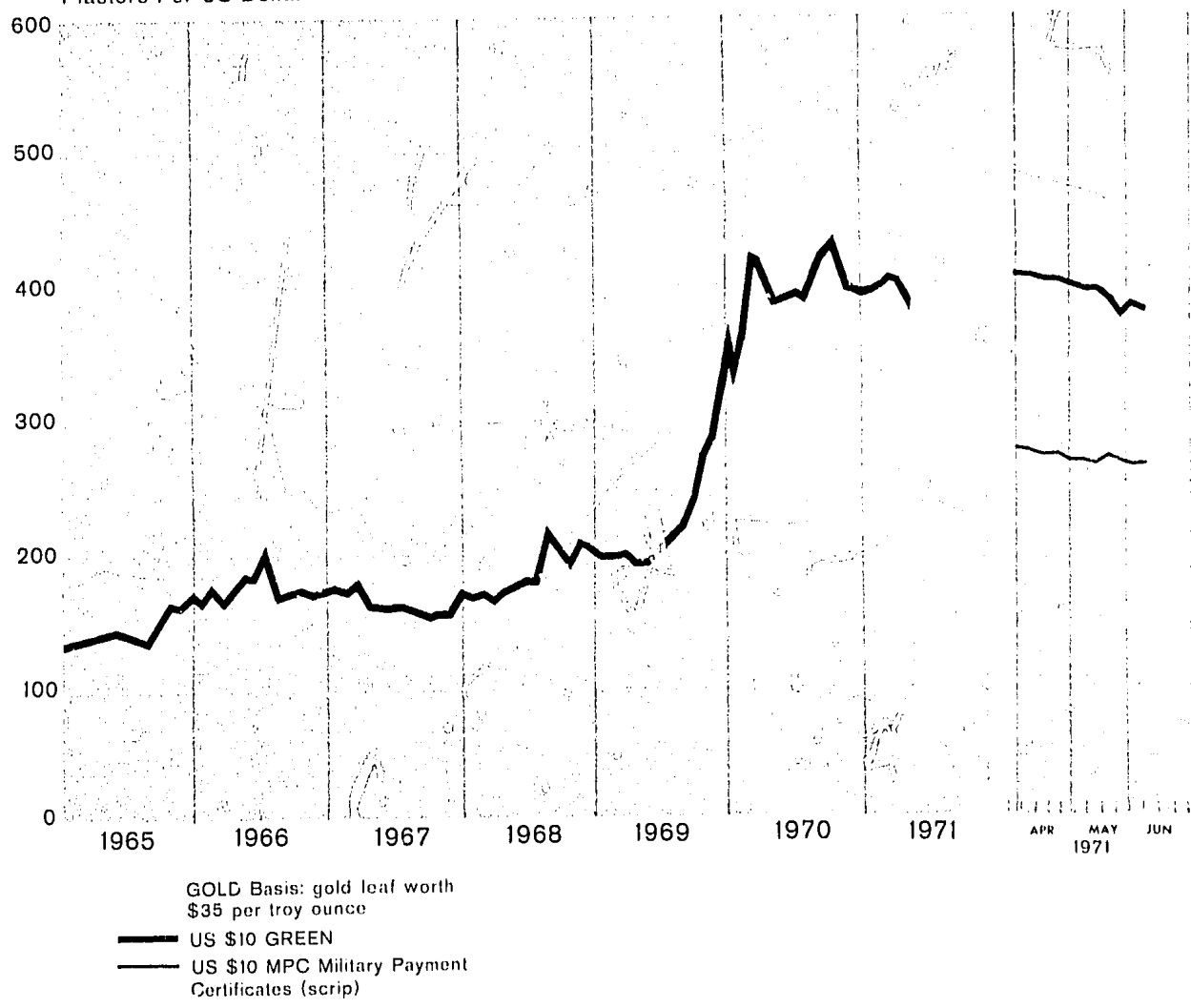
IMPORT LICENSING

Million US Dollars



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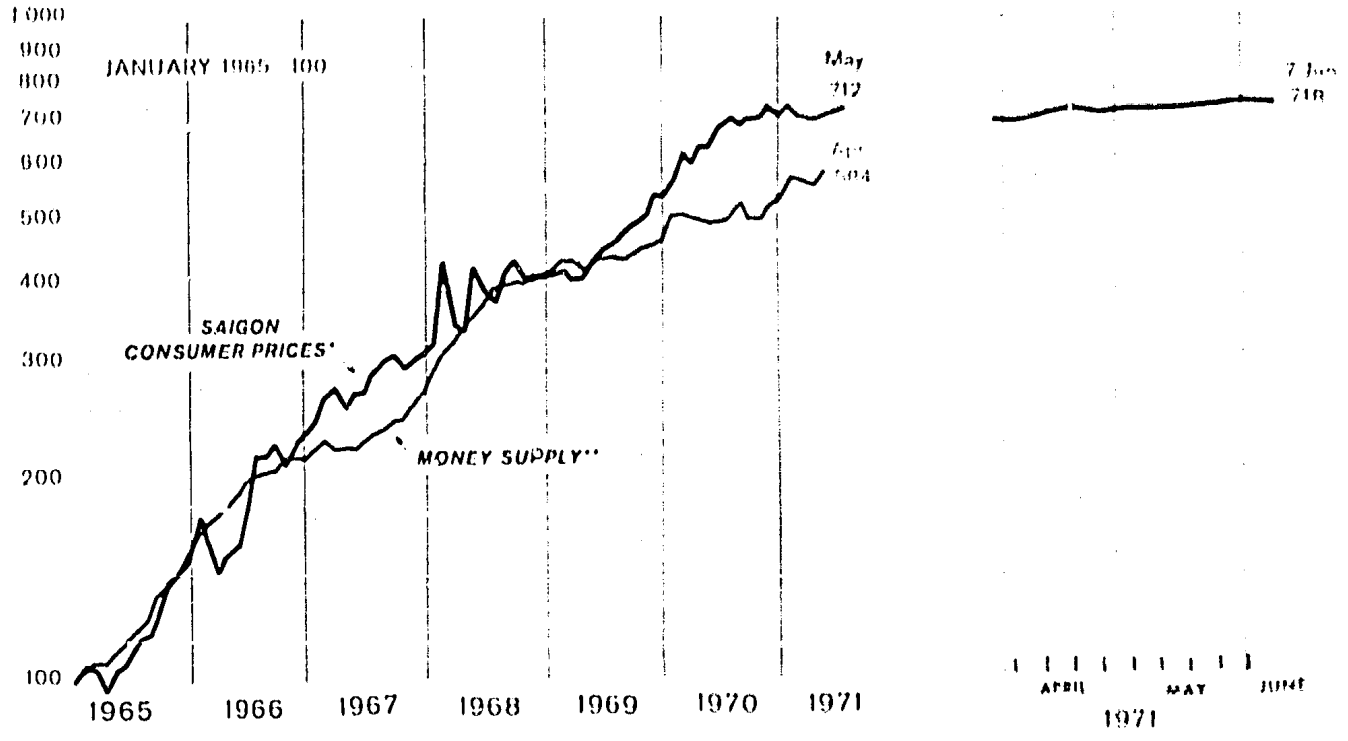
SAIGON Free Market Gold and Currency Prices Piasters Per US Dollar



GOLD Basis: gold leaf worth
\$35 per troy ounce
— US \$10 GREEN
— US \$10 MPC Military Payment
Certificates (scrip)

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SOUTH VIETNAM Indexes of Money Supply and Saigon Consumer Prices



*USAID monthly average retail price index for Saigon
 **Data are for end of month

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