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**DIRECTORATE OF
INTELLIGENCE**

Intelligence Memorandum

The Economic Situation In South Vietnam

Secret

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November 1971

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**CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
November 1971**

INTELLIGENCE MEMORANDUM

THE ECONOMIC SITUATION IN SOUTH VIETNAM

Highlights

1. Despite official apprehension, initial reaction to the sweeping economic reforms enacted on 15 November has been calm. Officials predict the reforms will boost prices 5% to 15% in the short run, but as of 22 November Saigon retail prices had risen only 2%.
2. Unlike past reform efforts, which were aimed mainly at achieving price stability, the current measures are focused principally on paving the way for more rapid economic growth. They include a major devaluation of the piaster, adoption of a flexible exchange rate system, restructuring of import and domestic taxes, and removal of restrictions on trade.
3. Although emergency rice imports arrived early in November, continuing concern over the low level of government stocks has prompted US officials to divert another PL 480 rice shipment to South Vietnam.
4. Charts on foreign exchange reserves, money supply and prices, import licensing, gold and currency prices, and the government budget follow the text.

Major Economic Reforms

Initial Reaction

5. The initial response of both consumers and businessmen to the sweeping reform program announced by President Thieu on 15 November

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

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has been a wait-and-see attitude. A check on 22 November showed prices up only 2% since the reforms were announced. At the time the reforms were agreed upon, Embassy spokesmen expected them to boost prices 5%-10% in the short run, whereas Vietnamese officials forecast a 10%-15% increase.

6. A variety of other pressures will continue to influence prices over the next few weeks, however, and could lead to increases greater than these estimates. Commodity and currency speculation,⁽¹⁾ initially triggered by low rice stocks and concern over reduced US foreign aid will be a persistent threat in the period of uncertainty that accompanies initial application of the reform measures. In addition, the effect of substantial increases in rice prices in early November has been to cause producers to continue to withhold rice in anticipation of further gains.

Content of Reforms

7. The two major targets of the reforms are increased efficiency in the use of available resources and creation of an improved investment climate. The first of these is to be achieved through exchange and customs reforms that bring South Vietnamese prices more closely in line with world market prices. The second target will be served by less government interference in the private sector and by public capital assistance for private-sector development. The principal measures enacted were: (a) devaluation of the piaster to a rate near its recent black market level and provision that the new rate be flexible; (b) removal of administrative controls on foreign trade; (c) simplification and reduction of import taxes; and (d) restructure of domestic taxes. President Thieu called for speedy passage of a new investment law already pending in the National Assembly that would provide greater incentives for private foreign investment. He also established a 10 billion piaster (\$24 million) development fund to be used for medium-term loans for private-sector development projects. Along with the reform measures, Thieu announced a wage increase for all government employees plus special incentive payments for combat troops,

1. The speed with which price changes from these forces can take place was shown just prior to the reform announcements. After an increase of only 7% from the end of 1970 through the end of October 1971, retail prices in Saigon jumped 3% during the first two weeks in November, and rice prices rose about 12%. Prices of imported goods jumped 5% during the second week alone. The tendency of the Vietnamese to hoard rice in times of uncertainty has created even further concern, since the current low level of government rice stocks is not sufficient to withstand a major wave of speculation and hoarding. Corresponding increases occurred in the currency black market as the price of gold reached an all-time high on 15 November and the rate for dollars also rose sharply.

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police, and tax collectors. All of the new measures were enacted by decree, but the government will ask the legislature to change the official exchange rate and seek its *ex post facto* endorsement of the changes in import taxes.

Exchange Rates

8. The new exchange rate system (see the table) will maintain the existing multiple rate structure. There will be less differentiation of rates within the main categories of transactions, but special subsidized rates will be established for certain basic commodities such as fertilizer, wheat flour, and sugar in order to prevent their prices from rising too sharply. A special rate (275 rather than 400 piasters per dollar) was given to US-financed imports to overcome the disadvantages of higher cost and longer delivery time for goods purchased in the United States.

9. The major departure from past practices is that exchange rates are to be flexible. Small adjustments at frequent intervals will be determined by a group composed of the Ministers of Economy and Finance and the Governor of the National Bank. They already have indicated that they expect about a 20% devaluation over the coming year. The rate likely to be most flexible is the so-called financial rate, which has initially been set at 410 piasters per dollar. The financial rate will be announced daily, and the other rates probably weekly. It is hoped that such a flexible rate for personal transactions will eventually eliminate most of the currency black market. The extent to which this hope is fulfilled, however, depends on the rate selected and the restrictions adopted to prevent capital flight.

10. As shown in the table, the rate of exchange for official transactions of governments - 118 to 1 - has not changed. It is the "official" exchange rate and cannot be changed without legislative approval, which the government hopes to get by yearend.⁽²⁾ The rate at which the US Government buys piasters for official use is crucial for the Vietnamese, for most of their earnings of foreign exchange come from these purchases. For the past several years the Vietnamese have earned more than \$300 million annually from this source. Although US purchases will decrease in any case as our military involvement winds down more rapidly, a change in this rate to, say, 400 piasters per dollar would of itself reduce Vietnam's dollar earnings from this source by 70%. With likely reductions in US economic aid in the offing, the legislature, as well as the government, may be extremely reluctant to devalue the official rate to any great extent.

2. Changes in the other rates are being made by administrative decree under authority granted by the National Assembly at the time of the October 1970 devaluation.

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Exchange Rates

	Piasters per US \$	
	<u>Old</u>	<u>New</u>
Merchandise imports		
GVN financed		
About half	118	400
About half	400	
A few items including pharmaceuticals and machinery	275	
US financed <u>a/</u>	118	275
Merchandise exports		
Rubber	275	410
Most other goods	350	
Invisible transactions		
US and other governments' piaster purchases for official use	118	118
Piaster purchases for personal use (accommodation rate)	275	410
Most others, including profit remittances of foreign firms and foreign investment <u>b/</u>	275	410

a. Although by US law, PL 480 imports must enter the country at the highest existing exchange rate, the actual rates paid by private-sector importers are those shown. Internal adjustments, not yet fully worked out, will cover the difference.

b. Invisible transactions directly related to imports, such as freight and insurance, will be carried on at the appropriate merchandise import rates.

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11. A very important, but much less publicized, feature of the reforms is the elimination of the licensing system for all exports and for GVN-financed imports, which make up about half of total imports.⁽³⁾ Henceforth, importers will simply buy their foreign exchange from commercial banks and order the goods they desire. Market forces -- rather than administrative rules -- generally will be allowed greater play in determining the type and volume of goods to be imported. This will mean an end to a system that was not only cumbersome but also rationed imports, frequently on the basis of graft. It is hoped that opportunities for corruption will be reduced. Furthermore, most of the many imported items currently barred from the country will be taken off the prohibition list by mid-1972. Some imports, however, such as automobiles and motorbikes will continue to be prohibited.

Import Taxes

12. The major achievement of the new import tax structure is to boil down the existing maze of customs, austerity, and perequation taxes and their hundreds of different rates into a single tariff schedule with only four rates ranging from 0% to 200%.⁽⁴⁾ Although the new schedule will reduce tax rates on most imports, the average cost of all imported goods will still be higher because of the higher exchange rates.

13. In addition to reducing tax evasion, a single tariff schedule with lower rates is an important first step toward aligning domestic and foreign prices and encouraging a more rational allocation of resources. Imports that now compete with domestically produced items will be taxed at the 25% rate. Some of these imports will cost less than they did before, and, as a result, inefficient local producers may be driven out of business. In some instances, however, as competing imports now banned (live baby chicks, for example) are allowed into the country, the government may give local producers the benefit of an additional tax on the competing good.

Domestic Taxes

14. The major aims of the proposed domestic tax reforms will be to increase government revenues and to spread the tax burden more equitably. The specific proposals are not yet available, but it is known that

3. The first step toward elimination of licensing was taken last June, when licensing requirements for most exports were abolished and the so-called general licensing system was introduced for about half of GVN-financed goods.

4. Only automobiles, if permitted, will be taxed at the 200% rate.

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the government has prepared a revised income tax code for submission to the National Assembly. Any tax program probably will face rough sledding in the legislature. Irrespective of the constructive uses to which the government might put new revenues, the initial and most obvious effect on the nation is to hit consumers with higher income and property taxes and/or higher taxes on locally produced goods.

Government Wage Increase

15. A 50% decline in real wages of government employees since 1964 has led to a decline in morale and an increase in corruption. Moreover, it almost certainly has contributed to the high desertion rate among the armed forces. An increase of some 20% in the total government wage bill announced by President Thieu obviously will not eliminate these problems, but it is a useful first step. All employees were granted an increase of 1,200 piasters (about \$3) per month retroactive to 1 November, but for the first time there will be incentive pay for combat troops (4,500 piasters per month), police, and tax collectors.

Evaluation

16. The 15 November measures were the sixth and by far the most wide-ranging series of reforms enacted during the past year. They mark a turning point in the direction of economic policy in the sense that they are focused more on future economic growth than on price stabilization. Decisions such as those to adopt a more realistic and flexible exchange rate, to free restrictions on trade, and to rationalize both domestic and import taxes had to be made if significant growth is to occur. The government still must do a real sales job on the legislature to ensure that many of these decisions are carried out. Nevertheless, the program is a courageous one to adopt in the face of continuing warfare and probable cuts in US aid.

Rice Problems Continue

17. Despite the arrival in early November of emergency rice imports, concern has not yet abated over the low level of government stocks. Officials had earlier thought that the imports would tide government stocks over until mid to late December, when domestic rice from the new crop would be marketed in quantity. Because of the rapid rise in rice prices during the first two weeks in November, however, merchants apparently are unwilling to commit themselves to a fixed-price government contract for deliveries in December. Therefore, diversion of another PL 480 rice shipment is planned, with arrival scheduled for early December.

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18. As part of a longer term solution to the recurring rice marketing problems,⁽⁵⁾ the government announced on 15 November a substantial increase in the retail prices of rice sold from government stocks in order to bring them more in line with free market prices. This move is designed to help reduce dependence on government stocks in the northern rice-deficit provinces by encouraging commercial marketing of domestic rice in this region. Heretofore, private merchants have had no incentive to market Delta rice in the north, because a large part of the population has had access to government rice at considerably below commercial market prices.



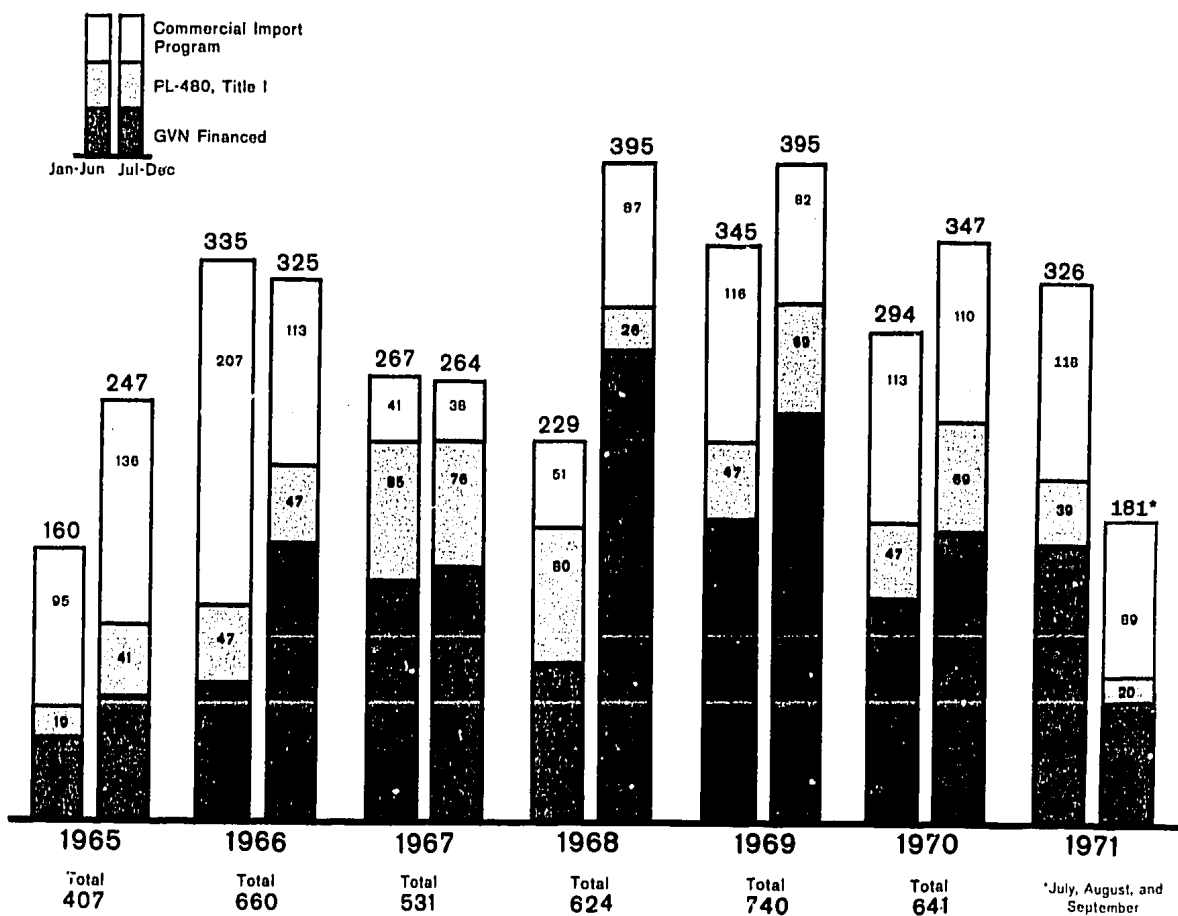
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IMPORT LICENSING

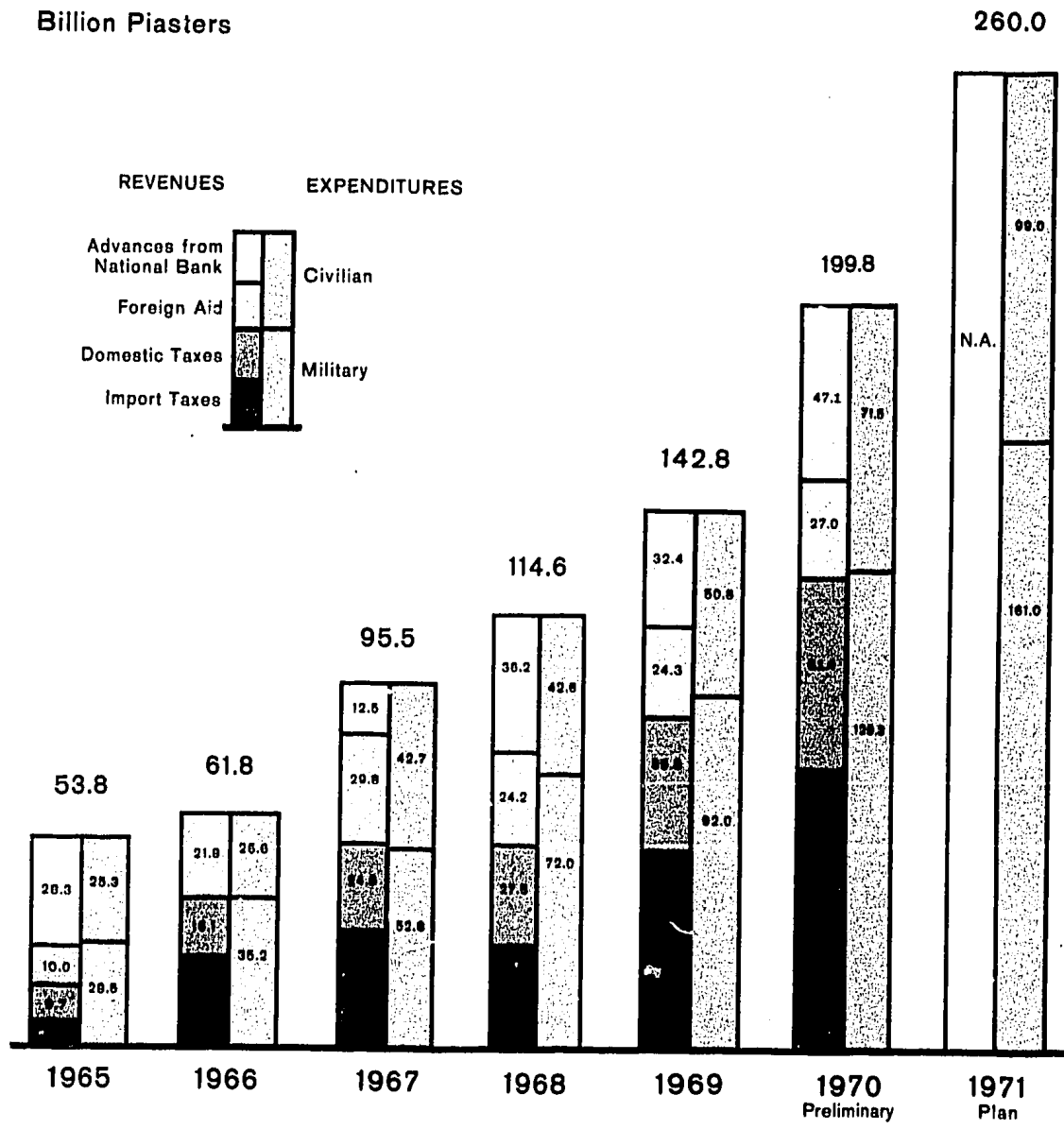
Million US Dollars



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GOVERNMENT BUDGET *

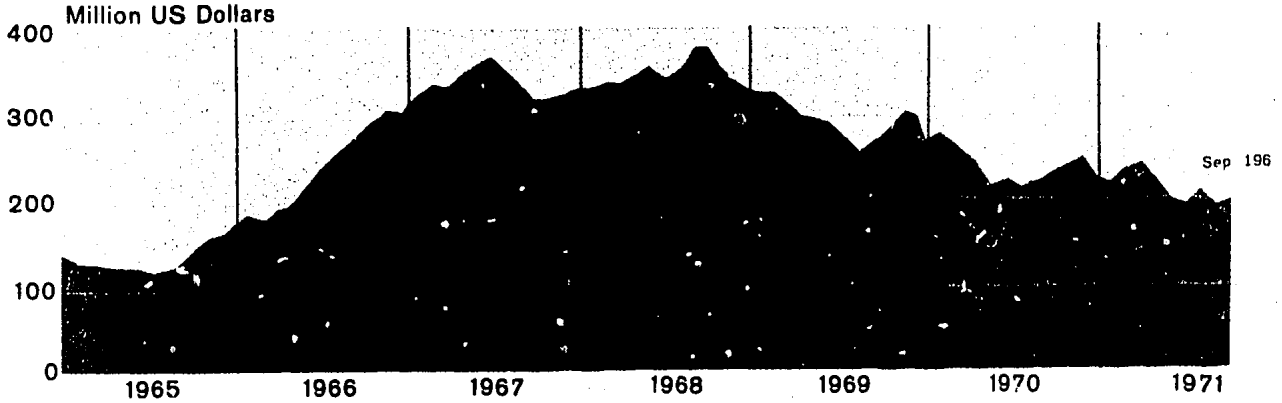
Billion Piasters



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*Data include extrabudgetary revenues and expenditures

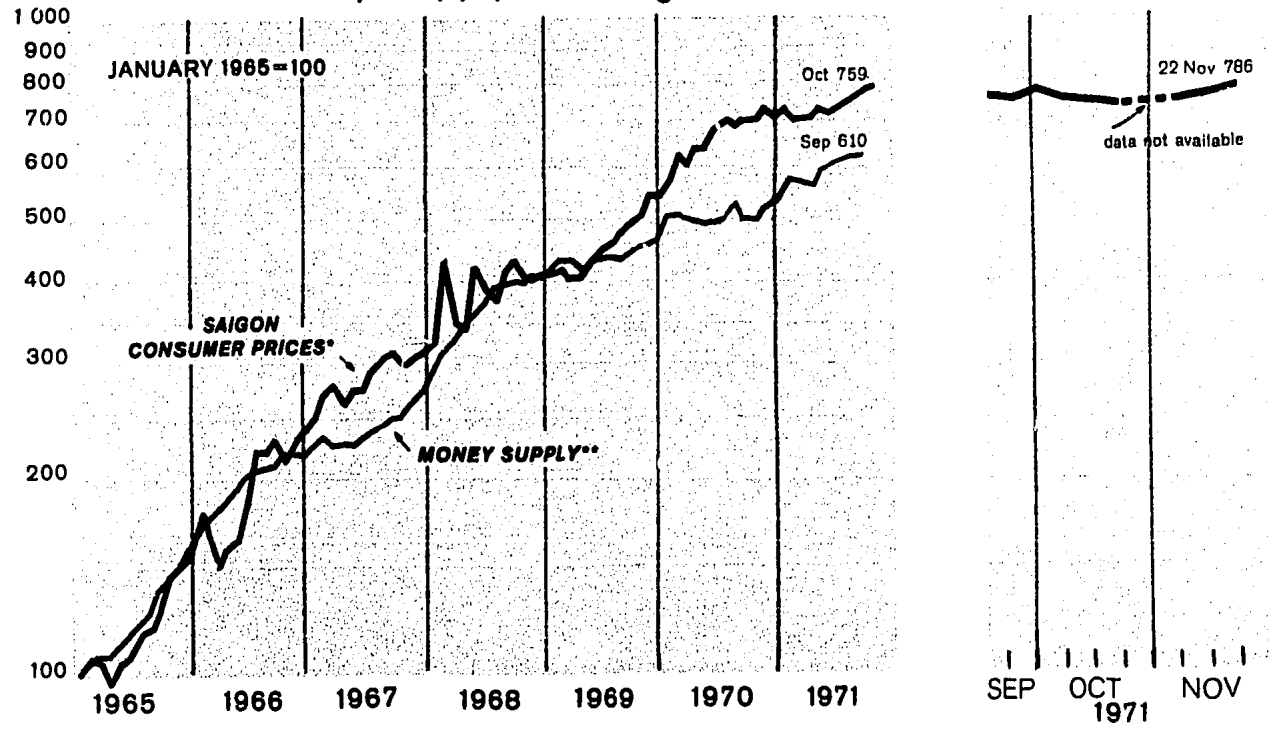
SOUTH VIETNAM Foreign Exchange Reserves*



*Excluding holdings of commercial banks

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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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SAIGON Free Market Gold and Currency Prices Piasters Per US Dollar

