

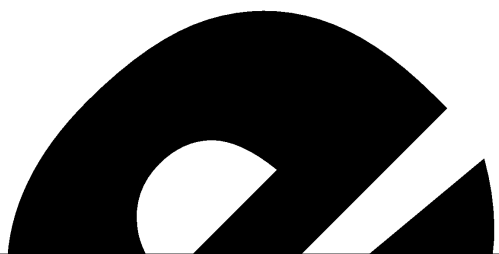


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**DIRECTORATE OF
INTELLIGENCE**

Intelligence Memorandum

The Economic Situation in South Vietnam

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January 1972

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
January 1972

INTELLIGENCE MEMORANDUM

THE ECONOMIC SITUATION IN SOUTH VIETNAM

Highlights

1. In the face of many potentially disruptive factors, South Vietnam's economic performance was notably brighter on several fronts in 1971. The rate of inflation was the lowest since 1964. Interest rate reform gave rise to a phenomenal increase in savings. Real output -- from both agriculture and industry -- increased at a very respectable pace. Moreover, the government showed greater flexibility and resolution in dealing decisively with economic problems.

2. One of the prime goals of government economic policy for 1972 -- increasing domestic tax collections -- received a setback recently when President Thieu signed a bill that provides large-scale exemptions from income taxes.

3. The Saigon retail price level rose about 1% during the first two weeks of 1972, but some specific commodity prices went higher as tighter security measures slowed the flow of goods into the city.

4. Black market dollar prices have been generally stable since the November 1971 devaluation. The price of gold, however, has risen steadily in recent weeks, reflecting the higher price of gold in the world market as well as the usual increase in demand prior to the Tet holidays.

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

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

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CONFIDENTIALDiscussionHighlights of 1971

6. South Vietnam's economy brightened notably on several fronts in 1971. One of the most obvious successes was the slowing of inflation to the lowest rate since 1964. Tied to this factor as well as to the impact of the interest reforms in 1970-71, there was a phenomenal rise in savings as real interest rates turned positive for the first time in many years. Even more significant for the longer term was the government's increasing flexibility in adapting policy to meet changing conditions in the economy. Not only were comprehensive reform packages enacted, (1) but periodic small adjustments in policy also were made throughout the year. The Vietnamese also made solid progress in terms of output levels in 1971. It was another record year for rice production, and preliminary indications are that industrial output increased at a very respectable rate. These achievements are the more remarkable considering such factors promoting uncertainty as two national elections, the accelerated withdrawal of US forces (with a consequent potential decline in local employment), and the US Senate rejection of the foreign aid bill.

Prices

7. The rate of increase in the cost of living fell to a seven-year low in South Vietnam during 1971. Saigon retail prices rose only 14% in 1971, compared with increases ranging from 30% to 55% during 1965-70 (see the table). More than 80% of the 1971 increases occurred during August-December, mainly reflecting some speculative activity prior to the presidential election in October and the major economic reforms of 15 November. The reforms - one of the most important elements of which was a devaluation - also resulted in price increases for particular commodities. Prices of imports rose 29% in 1971, with significant increases following the raising of import taxes in March and the devaluation in November.

8. The more interesting question, however, is why prices rose as little as they did. Although one significant reason was the relatively slow growth of money supply during the past three years (see the discussion, below, and the table), there were various psychological factors affecting price behavior. Thus the rate of inflation already had slowed markedly during

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CONFIDENTIAL**Prices and Money Supply**

<u>Year</u>	<u>Annual Percentage Increase</u>		
	<u>Saigon Retail Prices a/</u>	<u>Import Prices a/</u>	<u>Money Supply b/</u>
1965	50	N.A.	74
1966	55	N.A.	37
1967	33	N.A.	26
1968	30	11	51
1969	34	74	13
1970	30	31	16
1971	14	29	17 <u>c/</u>

a. Based on the USAID monthly average index (the December average of previous year equals 100).

b. Based on end-of-year data (the end of December of previous year equals 100).

c. Through November.

the last half of 1970, and consumer expectations about inflation (which tend to be self-fulfilling) probably were for more of the same. In addition, the only conspicuous commodity shortage was in rice,⁽²⁾ and the effects of this problem were limited to a few weeks near the end of the year. Indeed, even this problem was due to marketing difficulties rather than a shortfall in production. Reflecting the improved public confidence in the economy, the velocity of money (the rate at which money changes hands) was quite stable through July and then increased only about 10% during August-October, reflecting the flurry of pre-election and pre-reform speculation.

Money Supply

9. Higher interest rates and restrictions on credit were primarily responsible for holding the increase in money supply to 17% during

2. Prices of medium-quality rice increased more than 50% during the year, but other important items in the USAID index such as vegetables, pork, cloth, and kerosene were either unchanged or down slightly for the year.

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January-November in the face of a 30%-35% increase in government expenditures and almost no change in US aid last year. The major factors in expanding the amount of money in circulation were the growth of private sector credit and deficit financing by the government. Despite higher interest rates, loans to the private sector increased almost 40% during the first 11 months of 1971. They increased at almost double that rate during the first half of the year, but the lower guidelines for loan/deposit ratios for commercial banks set in June and August succeeded in actually reducing the amount of credit outstanding. Deficit financing, or government borrowing from the National Bank of Vietnam (which generally must resort to printing more piasters), rose about 25% during January-November. It would have increased much more, however, had not the government raised some import taxes in March and acted to increase sales of treasury bills. As a result of interest rate increases in March and again in August, holdings of treasury bills increased almost 15 billion piasters during January-November, an amount equivalent to about 40% of government borrowings from the National Bank during the period.

10. In addition to the credit restrictions and higher interest rates on treasury bills mentioned above, higher commercial and rural bank interest rates on savings and time deposits also succeeded in holding down the growth of money supply. The interest rate reform of September 1970 and another small increase in rates in August 1971 resulted in an almost 110% increase in savings and time deposits during the first 11 months of 1971. Savings and time deposits in proportion to the money supply thus rose from 15% to 26%. The large advance deposits required on imports beginning in October 1970 were a major contractionary factor during the first half of 1971, but their impact lessened as coverage and rates were reduced.⁽³⁾

Production

11. Although real output may not have risen so rapidly in 1971 as in 1970, preliminary and incomplete data indicate that both agriculture and industry made a respectable showing last year. Early estimates for the 1972 rice crop⁽⁴⁾ forecast an increase of 8% to 10%, compared with a 12% increase for the previous year. Partial data on forestry operations indicate a doubling of timber production. Even allowing for substantial underreporting in the past, the increase would be sizable. During the first half of 1971, industrial output increased at an annual rate of 12% compared with 14% in 1970. Existing firms planned significant additions to capacity as evidenced by a roughly 50% increase in the value of applications approved

3. Advance deposits on imports were eliminated as part of the 15 November 1971 reforms.

4. The crop year ends on 31 May of the stated year.

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for US-financed imports of industrial machinery and equipment. Foreign private investors, especially the Japanese, showed greater interest in establishing joint industrial ventures in South Vietnam, although there understandably has been no foreign investment boom. There was virtually no change in the total value of imports in 1971 compared with the previous year, but the supply of goods available in the economy -- both total and per capita -- increased as a result of the increase in domestic production.

Manpower

12. Additional resources became available to the civilian economy in 1971 in the form of about 20,000 workers released from the US sector. Recorded employment by US military and civilian agencies and their contractors has declined steadily since March 1970 from 153,000 to about 105,000 at the end of 1971. The decline actually has been much larger, however, if one considers the workers who are employed privately by US personnel and those whose jobs depend on the spending of the Vietnamese who work for Americans. Through 1971, most of these people found other jobs or, in the case of women, simply dropped out of the labor force. There are, however, localized unemployment problems in Military Regions 1 and 2, where the dependence on US sector employment has been greatest and where there are fewer job openings in the private sector.

Outlook

13. At the outset of 1972 it appears that the Vietnamese are facing more severe pressures on the economy than last year. There are some signs that enemy military activity may increase significantly over last year's level. As the US withdrawal continues, the release of labor from the US sector will become more difficult to absorb. Incomes will probably be reduced in many areas of the country, and unemployment may become a serious problem in Military Regions 1 and 2. Government expenditures are expected to rise another 25%, while most of the anticipated increase in revenues depends on the very difficult task of increasing domestic tax collections. Moreover, there probably will be at least a slight reduction in US aid to South Vietnam. Prospects of obtaining offsetting aid and/or investment from other countries are most uncertain. Coping with these and other problems will severely tax the capacity of the Thieu government. Its much improved performance in economic policy matters in the last 18 months, however, is encouraging. Much more than in the past, top officials seem willing to adapt policy to changing conditions. Although recent reforms are clearly designed to enhance growth prospects, there will undoubtedly be some lingering price pressures and difficulties in adjustment.⁽⁵⁾

5. See the discussion below on tax reform problems.

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Income Tax Reduction

14. Efforts to increase domestic tax revenues were set back on 14 January when President Thieu signed into law a Lower House income tax bill despite the opposition of his economic advisers. The new law exempts from income tax all wage earners with annual incomes below 360,000 piasters (\$878 at the financial market exchange rate of 410 piasters per dollar) for the duration of the war. It also exempts pensions and triples the standard deduction allowed for taxpayers and their dependents. All provisions are retroactive to 1 January 1971, thus requiring the government to refund roughly half of individual income tax receipts for 1971.

15. The principal objections to the new law do not so much concern the loss of revenue, which is small,⁽⁶⁾ but the scope of the exemptions granted during a period when the government is planning a major drive to increase domestic tax collections. President Thieu apparently felt he could not risk vetoing or amending such a popular bill. Early in 1971 he had proposed exempting government employees from income taxes, but the National Assembly then took over the issue and considerably broadened the exemptions. The new law will, in effect, exempt from income taxes almost all civil servants and military personnel as well as a great many private sector employees. Thieu's economic advisers hope to regain some ground later in the year by submitting to the National Assembly a completely new income tax code to take effect in 1973. They also plan to increase considerably the number of tax collectors.

Current Developments

Prices

16. During the first two weeks of the new year, retail prices in Saigon rose about 1%. From mid-November -- when the piaster was devalued -- through mid-January, the USAID index increased 4.5%. Except for rice, there was a general increase in food prices during the week ending 17 January, reportedly because tighter security measures slowed the flow of goods to market. Rice prices, however, have declined fairly steadily since mid-December, when the new crop began reaching the market.

Currency Black Market

17. Following an initial adjustment to the mid-November devaluation, the black market price of dollars in Saigon has been quite stable at or near 415 piasters per dollar. The price of gold leaf, on the other hand,

6. Individual income tax receipts generally have amounted to only 1%-2% of total revenues from both domestic and import taxes.

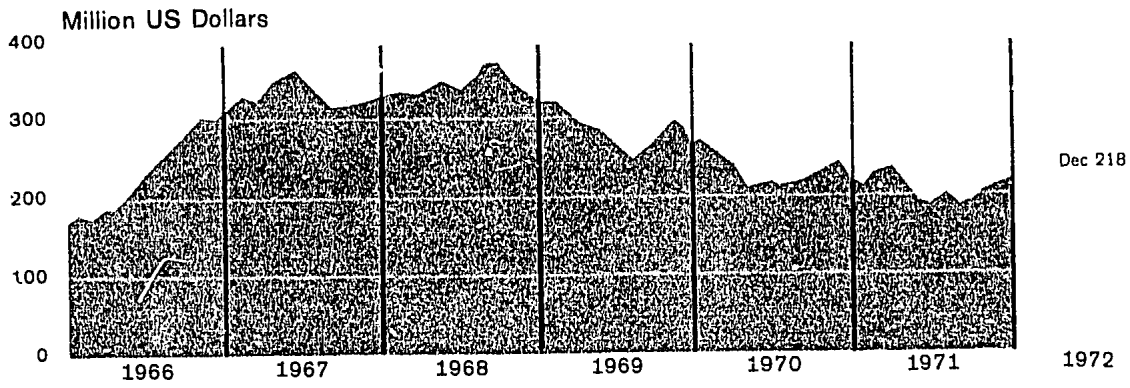
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rose steadily between 20 December and 17 January from 581 to 626 piasters per dollar. According to market sources, this increase reflects an adjustment to the realignment of world currencies as well as the usual increase in demand for gold prior to the Tet holidays (14-17 February). The rate for MPC has fluctuated throughout the period from 368 to 390 piasters per dollar, well below the legal rate of 410.

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Foreign Exchange Reserves*

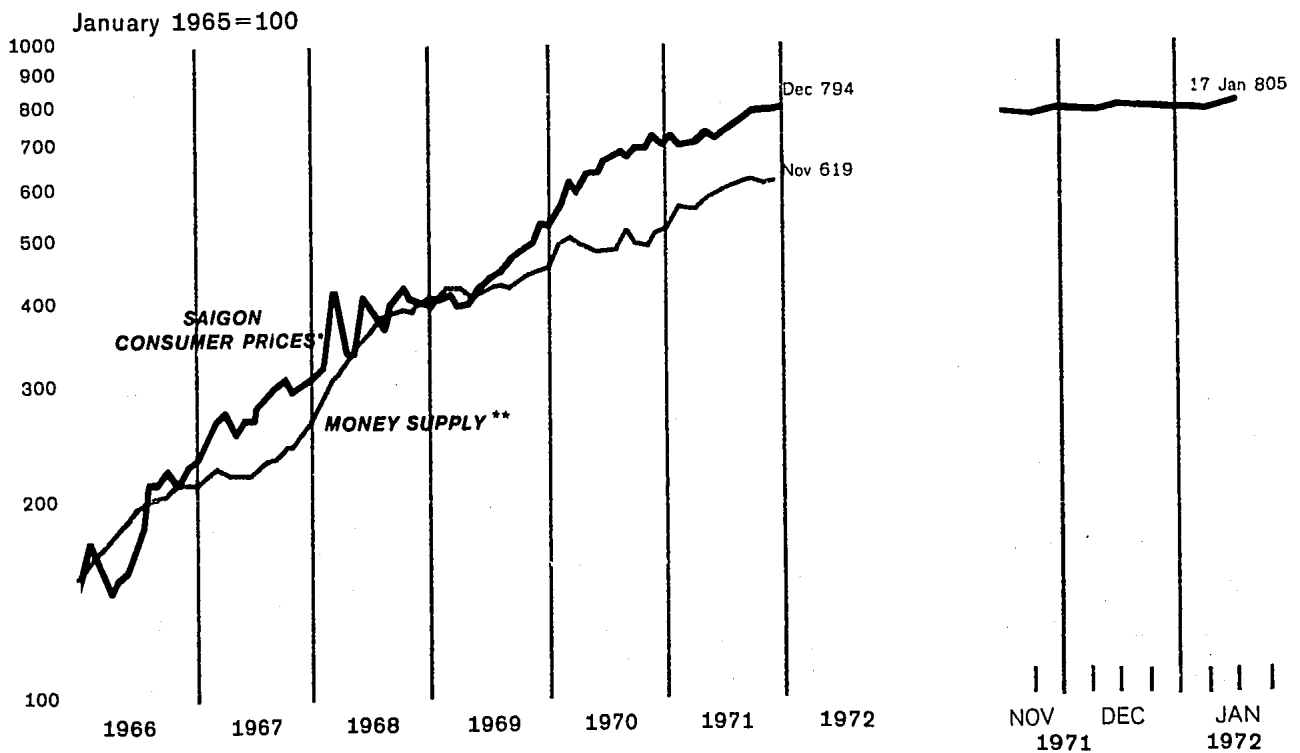


*Excluding holdings of commercial banks

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SOUTH VIETNAM

Indexes of Money Supply and Saigon Consumer Prices



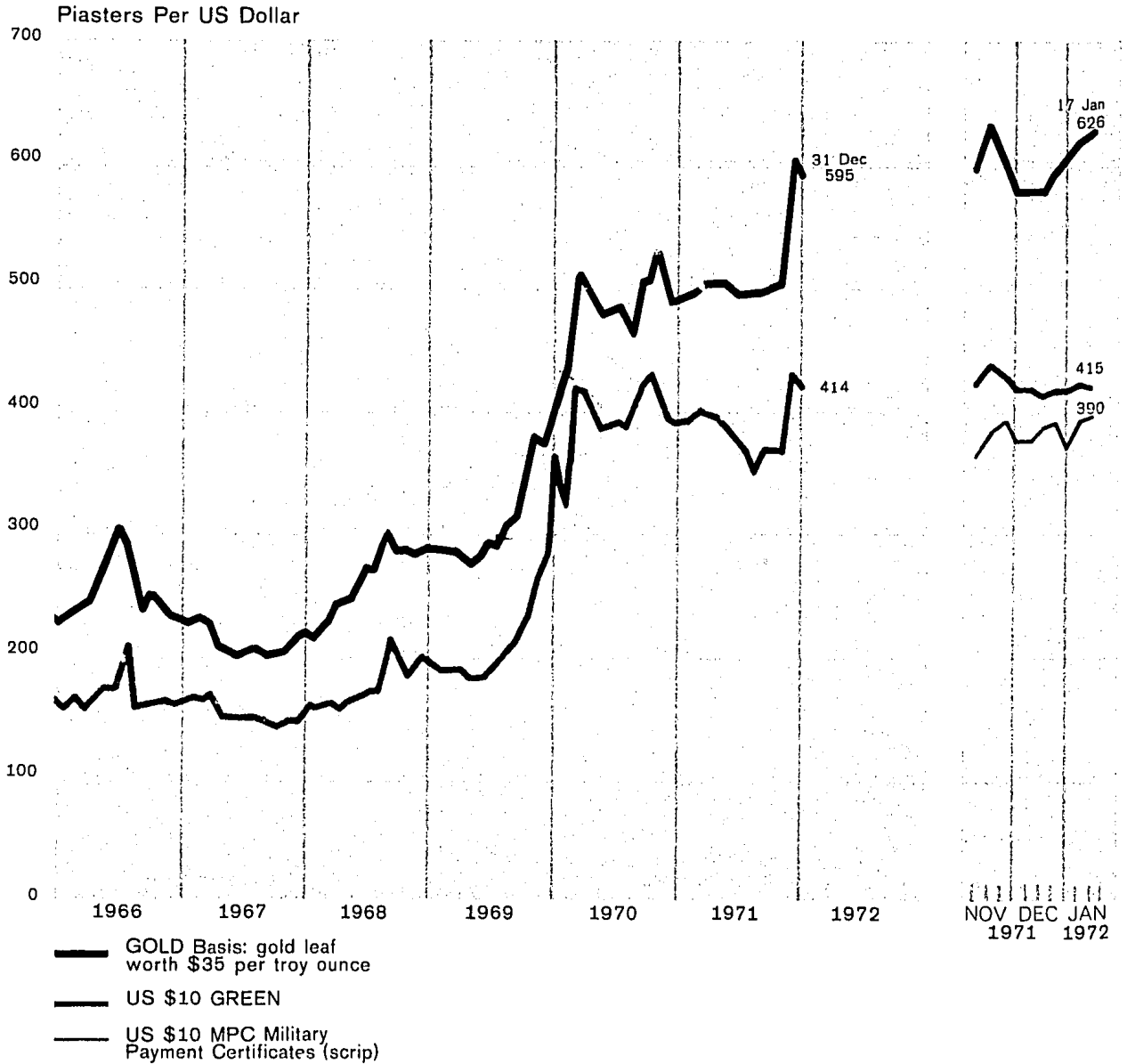
*USAID monthly average retail price index for Saigon

**Data are for end of month

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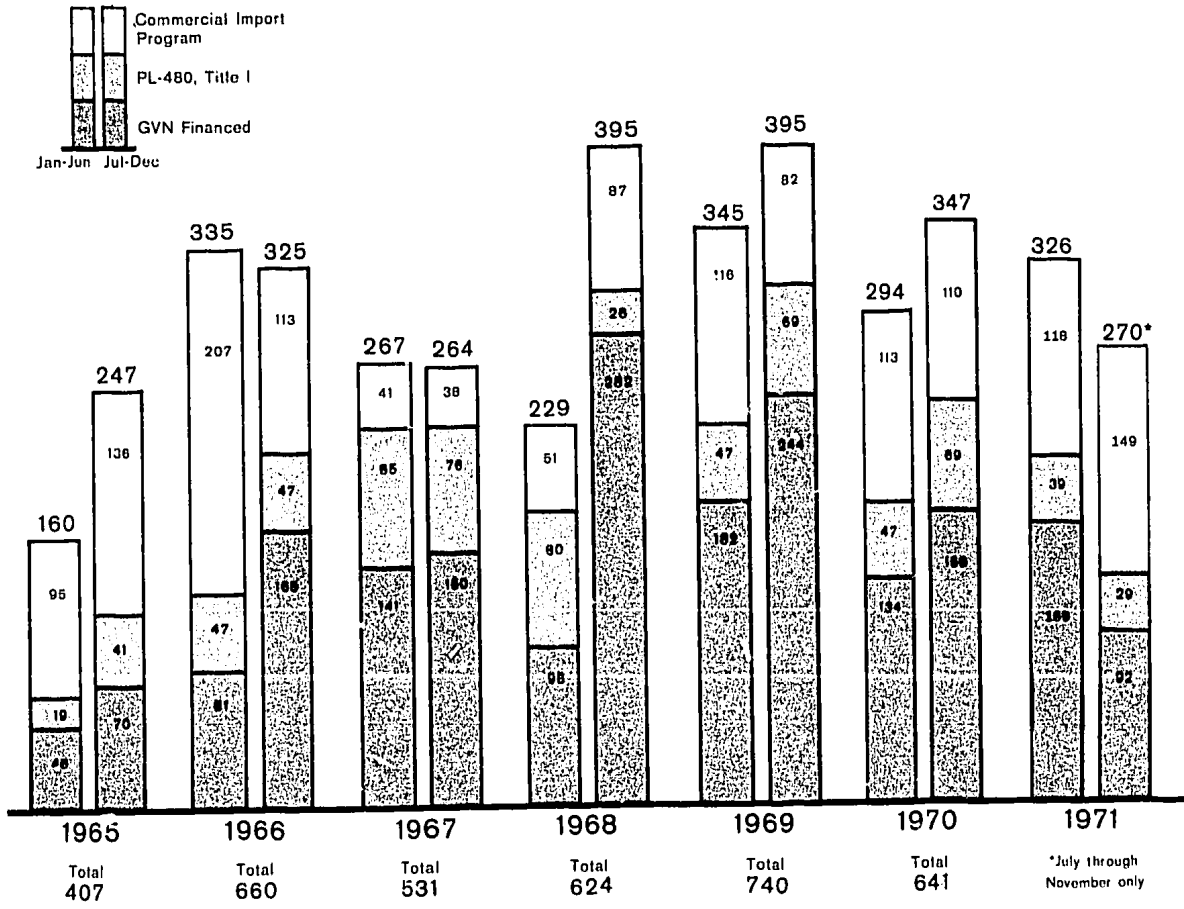
Free Market Gold and Currency Prices



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IMPORT LICENSING

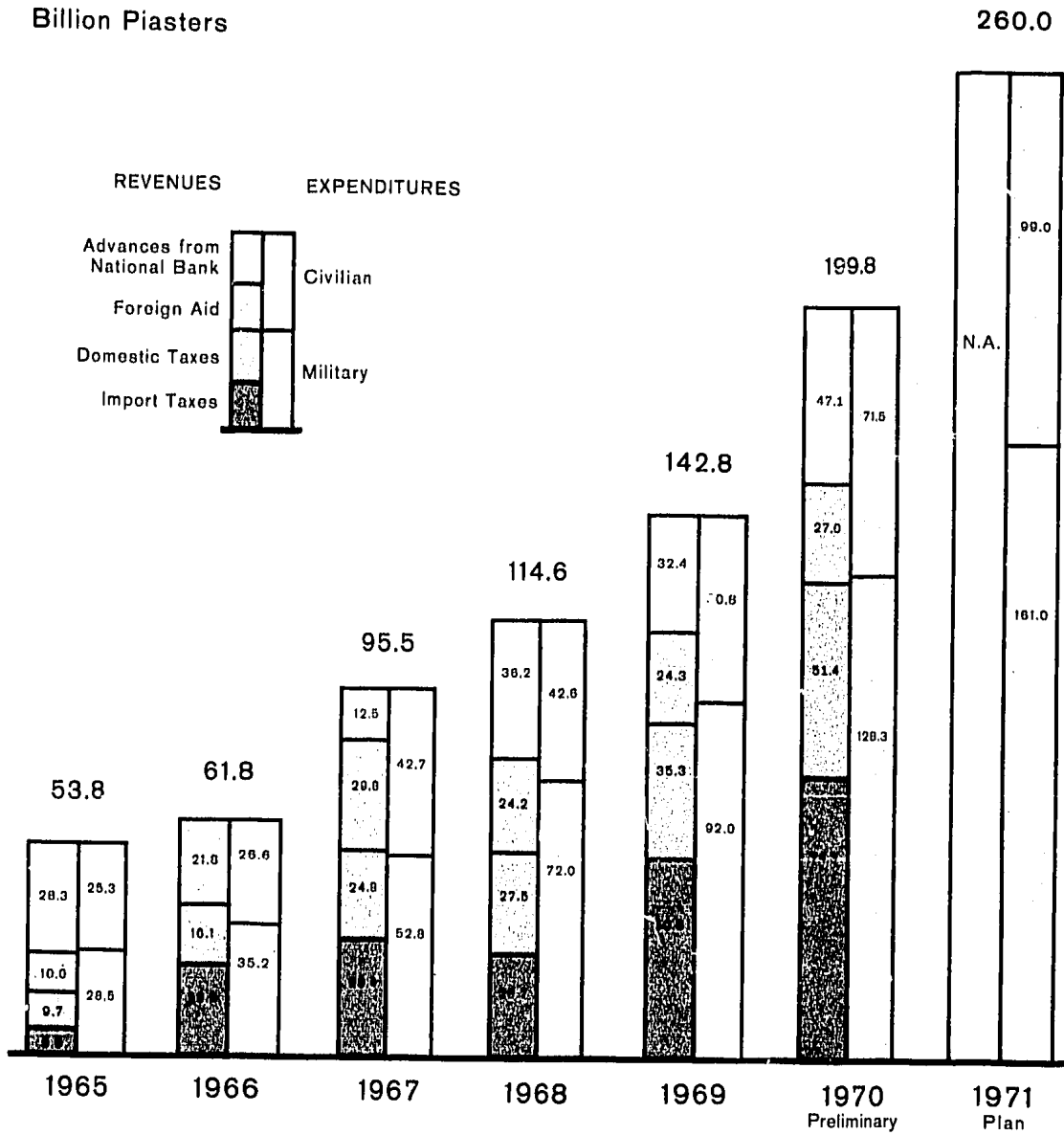
Million US Dollars



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GOVERNMENT BUDGET *

Billion Piasters



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*Data include extrabudgetary revenues and expenditures