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DIRECTORATE OF INTELLIGENCE

Intelligence Memorandum

The Economic Situation In South Vietnam

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
April 1972

INTELLIGENCE MEMORANDUM

THE ECONOMIC SITUATION IN SOUTH VIETNAM

Summary

1. Saigon's commodity and currency markets remained reasonably calm during the first three weeks of the enemy's military offensive. Except in those provinces hardest hit by the fighting – which are not major contributors to the nation's food supply – there is little evidence of economic activity being disrupted.

2. First quarter exports, led by shrimp and timber, were double last year's level. Barring major and widespread military setbacks for ARVN, this pace is likely to be maintained, thereby giving South Vietnam its first increase in exports since 1963.

3. Despite concentration on military affairs, the government continued to respond promptly to changes in leading economic indicators. To curb the rapid growth of the money supply and hold down import demand, interest rates on deposits and loans were raised two percentage points effective 7 April.

4. The exchange rate system was considerably simplified on 1 April when South Vietnam devalued the rate for government transfers (mainly US piaster purchases) to the more realistic level in effect for most other foreign transactions. The resulting large loss of dollar earnings from US purchases of piasters will be offset by several measures, including a drawdown in foreign exchange reserves.

5. A recent cabinet decision that the armed forces should not participate in business activities spells an end to military ownership of one of Vietnam's largest banks and several other firms as well. Acquisition of

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

these firms was financed through a forced soldiers' savings fund which the government ordered dissolved.

6. Charts on foreign exchange reserves, money supply and prices, import licensing, gold and currency prices, and the government budget (Figures 1-5) follow the text.

Discussion

Current Developments

7. The enemy's military offensive has caused apprehension in Saigon, especially as fighting intensified in adjacent Military Region (MR) 3, but business activity apparently has gone on much as usual. Commodity and currency prices have remained comparatively stable. The commodity price level in Saigon rose only 2% during the three weeks ending 17 April. This index is now up 8% since the start of the year and 21% during the past 12 months.(1) There has been similar relative stability in black market currency and gold prices, which have even fallen slightly below the pre-offensive level.

8. The offensive has, however, stimulated limited hoarding of goods and caused minor interruptions of marketing in some areas. Hoarding has been reported for such staples as rice, kerosene, and canned goods, and supplies of charcoal and beef have declined because of fighting in the major producing areas near the Cambodian border. For the most part, however, the hardest hit provinces are not major contributors to the nation's supply of goods. Moreover, the flow of imports – an important source of goods – has not been affected at all by the fighting. Rice supplies probably are adequate in most areas because the major harvest has been completed, but the traditionally deficit areas of MRs 1 and 2 may run short if the offensive continues. In locations where there are large numbers of refugees, the government reportedly has sufficient food and medical supplies available, but distribution problems have arisen.

9. Production of goods has been relatively little affected by the military offensive so far. Industrial output has been largely untouched because most productive facilities are in the Saigon area and depend on imports for a significant share of raw materials. The following tabulation shows the share of nationwide output of selected agricultural products provided by five provinces (Quang Tri and Thua Thien in MR 1, Kontum

1. No information is available on price developments outside the Saigon area.

Product	Percentage Share
Rice	4
Vegetables	5
Sugar cane	2
Tobacco	5
Rubber	61
Cattle	9
Pigs	7
Chickens	5

in MR 2, and Binh Long and Tay Ninh in MR 3) where fighting has been most intense. Except for rubber, nationwide output of agricultural products has not been seriously affected. Rubber production from the plantations in Binh Long and Tay Ninh (which have been the scene of many battles over the years) undoubtedly will suffer, as will rubber exports. The longer term effect on production in these provinces will depend, of course, on how long the offensive continues and when the large numbers of refugees will be able to return to their homes. Since the offensive began on 30 March, more than 150,000 persons in the five provinces, or about 10% of their population, have become refugees.

Exports on the Rise

10. First quarter data indicate that this year South Vietnam's exports will increase handsomely for the first time since 1963.[2] Exports declined steadily from $83 million in 1963 to only $12 million in 1968 and remained at that level through 1971. During the first quarter of the year, however, exports amounted to about $5 million and are expected to total $24 million for the year as a whole.

11. This striking upturn is essentially the result of improved security and a more realistic exchange rate. Most of the increase has occurred in exports of timber and shrimp, which have found ready markets in Japan, Singapore, Hong Kong, France, and the United States. Access to the forests of MRs 2 and 3 requires good security, and security has – until just recently – been improving throughout much of the country for the past two years. The impetus to exploit the forests and fishing grounds, however, came with the major devaluation last November. Exports of shrimp, for example, amounted to $830,000 during the first two months of this year,

2. Assuming, of course, that the current enemy offensive does not create major economic dislocations.

which is almost double the value of shrimp exports for all of 1971. Data are not available for timber exports, but they are likely to slack off somewhat as a result of the current offensive.

12. Fishery and forestry products are likely to be the leaders in export growth during the next several years. For this period, at least, they will tend to take over the traditional role of rubber and rice, output of which declined because of the war. Rubber exports are still significant, but have dropped to about one-third of the 1963 level, and rice has been imported each year since 1964. Neither is expected to again drive export growth, largely because foreign markets for these products have shrunk.

13. As a further stimulus, the government is considering granting a subsidy to all exporters. US officials expect announcement shortly of a 100 piaster subsidy, which will boost the current exchange rate from 410 to 510 piasters per dollar. The subsidy should be of particular help to shrimp exporters, whose product already is in great demand but who must invest in trawlers and refrigeration equipment to increase their catch.

Interest Rates Up

14. Despite concentration on military activity and concern over its effect on the economy, momentum on economic policy changes has not been lost. Responding to the rapid increase (10%) in the money supply during the first two months of this year, interest rates were raised two percentage points. In viewing average rate changes, it should be remembered that the banking system has been – and presumably will continue to be – encouraged to make exceptions for certain categories of loans. For example, the lending rate was lowered for such activities as export financing and financing of commercial rice shipments to MRs 1 and 2. The new interest rates, effective 7 April, are as follows:

	Percent	
	16 Aug 71 - 6 Apr 72	7 Apr 72
Deposit rates		
Savings deposits	12	14
Time deposits		
6 month	16	18
12 month	21	23
Treasury bonds		
6 month	17	19
12 month	20	22
Lending rates		
Guaranteed loans	24	26
Unguaranteed loans	30	32
Preferential loans	14	10

15. Higher interest rates should encourage more saving and at the same time curb the expansion of credit, which increased 21% during January-February, or about half the increase projected for the entire year. Since a large share of commercial credit goes to finance imports, the higher interest rates should also dampen the demand for imports. Advance deposits on imports were reinstituted last month, but further action was believed necessary to keep import demand within the limits of foreign exchange availability this year.

Exchange Rate Reform

16. In a long-planned move, South Vietnam on 1 April raised the exchange rate at which the US Government buys piasters to the more realistic rate that now prevails for most other foreign transactions. The rate, which has been unchanged since October 1967, was raised from 118 to 410 piasters per dollar. As a result, the United States (and other governments) will spend fewer dollars for the piasters it needs to cover expenditures in Vietnam. The new rate also means, of course, that South Vietnam's earnings of dollars, most of which come from US piaster purchases, will decline sharply. In 1971, US piaster purchases were worth about $400 million to South Vietnam, but this year the amount will drop to about $175 million. The decline is almost entirely due to the change in the exchange rate, since US piaster expenditures are expected to change very little.

17. Several factors will offset the loss of these earnings, which South Vietnam must have if import requirements are to be met. These include: (1) a drawdown of South Vietnamese foreign exchange reserves; (2) an acceleration in the use of US Commercial Import Program funds; and (3) some increase in Food for Peace (PL 480) imports.

18. With this recent change in rates, South Vietnam has simplified the exchange rate system considerably. There are now only two rates that apply to almost all foreign transactions: 285 piasters per dollar for US-financed imports and 410 piasters for all other transactions.(3) Although this rate structure undoubtedly will move up somewhat by yearend, US economic advisors are urging the government to change it more frequently – both up and down – in order to prevent speculators from taking advantage of what they must now think is a steady process of devaluation.

3. The remaining exceptions are that transactions for overseas students and official business of the South Vietnamese government continue at the 118 rate.

Military Involvement in Business Ends

19. The growing role of South Vietnam's armed forces in business activities was curbed recently by a cabinet decision to take over enterprises owned by the armed forces and to abolish the Soldiers' Mutual Assistance and Savings Fund (SMASF) which financed them. The SMASF was started in January 1968 ostensibly to encourage saving among the armed forces and provide funds for them and/or their families when they were discharged or killed. Since that time, 100 piasters per month (about $0.25 at the rate of 410 piasters per dollar) had been collected through mandatory payroll deductions from all military personnel except the Popular Forces. These deductions ceased as of 1 April, and the government has said it will refund all contributions with interest. There seems to be some sentiment among the armed forces, however, that the fund should not be dissolved but merely reorganized and put on a voluntary basis.

20. Through the SMASF, the armed forces had by the end of 1971 become heavily involved in commercial activities. The military establishment had set up five firms engaged in banking, road construction, transportation, insurance, and food processing and had acquired part ownership of two other companies.[4] All of these assets, according to the government's 23 March decision, are to be bought out by the Commercial Credit Bank, the commercial arm of the National Bank of Vietnam, and eventually sold to private interests.

21. The fund's first and largest business venture – the Bank of Industry and Commerce – was established in June 1970, and four other firms were set up between March and September 1971. The bank, which has a new headquarters skyscraper under construction in Saigon, is currently the fifth largest bank in the country in terms of deposits. By virtue of its high level of deposits, fed by the monthly payroll deductions, and the services of experienced banking personnel detailed from active military duty, the bank has had a considerable advantage over most of its competitors. Moreover, one must presume that the SMASF's other business ventures have had little difficulty getting lucrative military contracts.

22. Although the dissolution of the SMASF was triggered by allegations of mismanagement by Ministry of Defense officials, the fund has been criticized since its inception because of its collection method. Concern, especially among US officials, increased as the assets of the fund grew and it began to involve itself in activities more appropriately handled by the private sector. By the end of last year, the assets of the fund totaled

4. One of these is a government paper mill (COGIVINA). The SMASF acquired the 19% share previously owned by the US firm of Parsons and Whittemore, Inc.

3.2 billion piasters ($7.8 million), an amount equivalent to 6% of total commercial bank savings and time deposits.

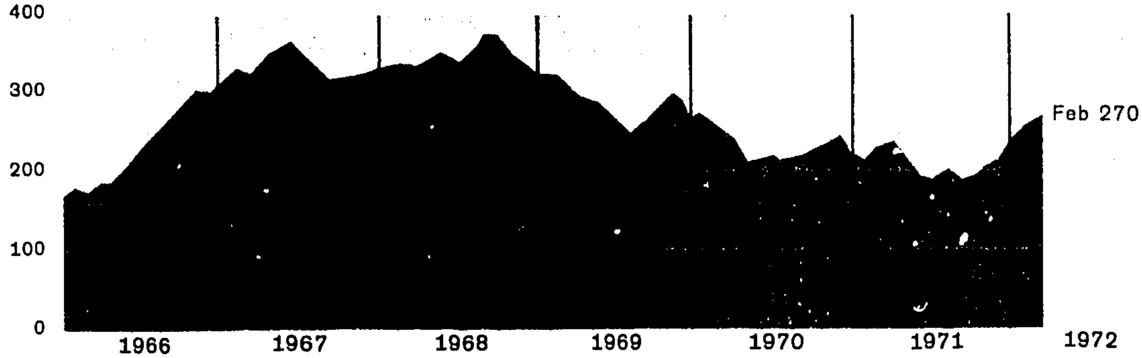
23. The government resale of the SMASF's business interests is likely to take a long time, and thus the costs of operating them will continue to be a drain on the budget. With the exception of the bank, the military firms are relatively new and probably not all that profitable. Most of the government-owned firms in South Vietnam, which are involved in the manufacture of such products as cement, sugar, paper, and textiles, operate at a loss. For several years the government has announced its intention to sell its enterprises to private interests, but until recently no action had been taken. Last month, shares in COGIVINA, the paper mill of which the SMASF is part owner, were offered to the general public at 4,000 piasters (about $10) per share, with a guaranteed annual return of 16% for three years. Response to the offering apparently has been good (about 30% of the 100,000 shares were sold by early April), but the market probably is not yet large enough, or confident enough, to buy out more than a few government-owned firms.

SOUTH VIETNAM

Figure 1

Foreign Exchange Reserves*

Million US Dollars



*Excluding holdings of commercial banks

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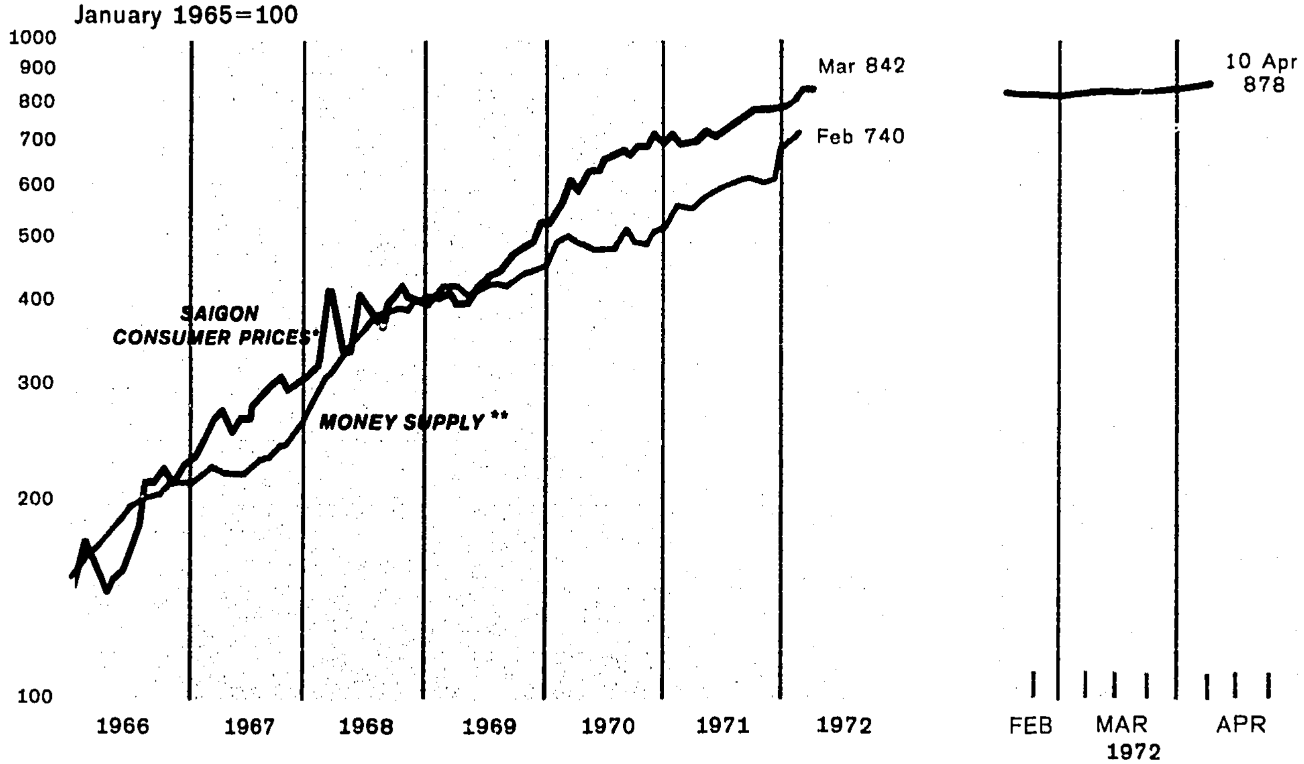
Figure 2

Indexes of Money Supply and Saigon Consumer Prices

January 1965=100



*USAID monthly average retail price index for Saigon

**Data are for end of month

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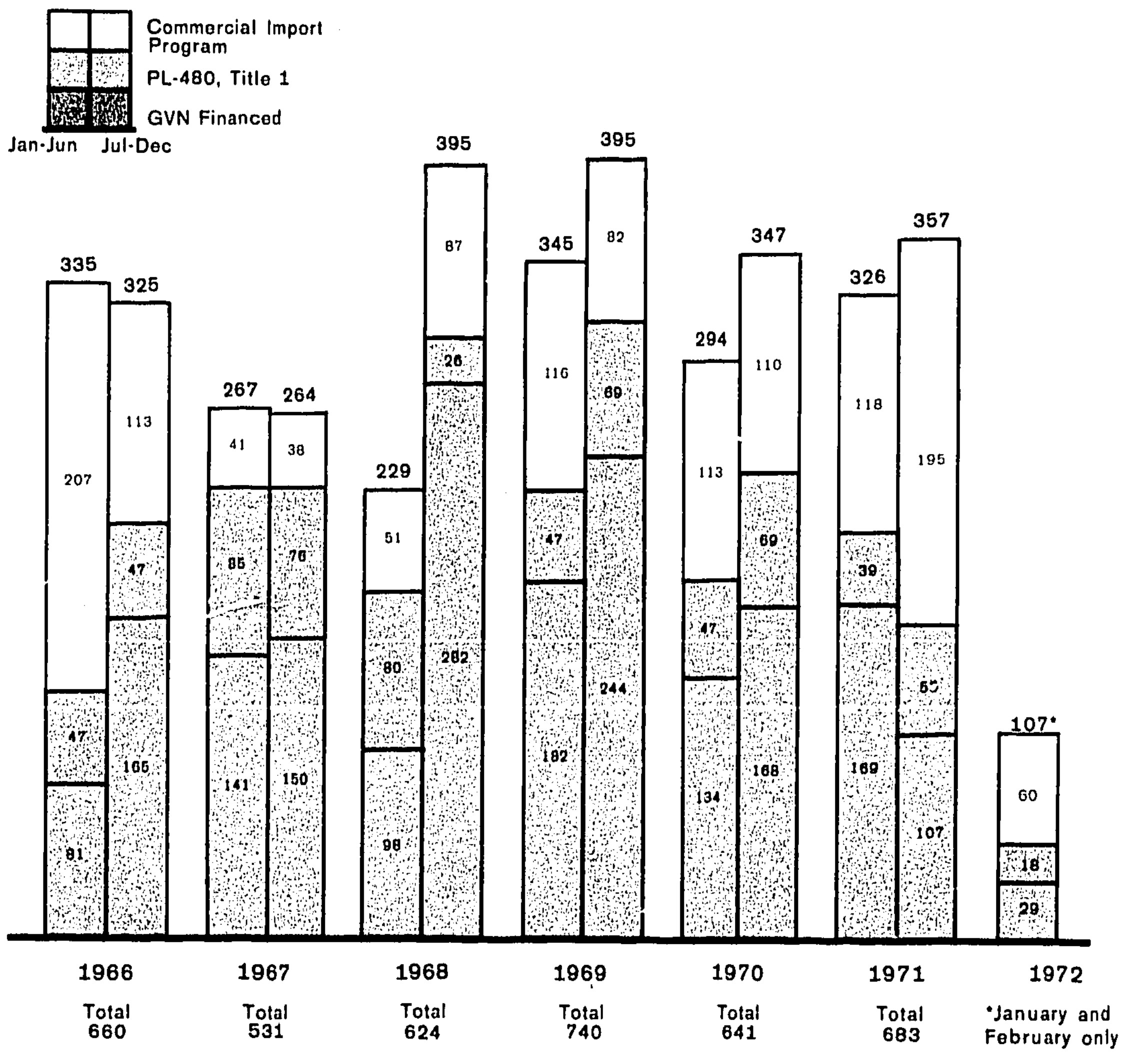
SOUTH VIETNAM

Figure 3

Import Licensing

Million US Dollars



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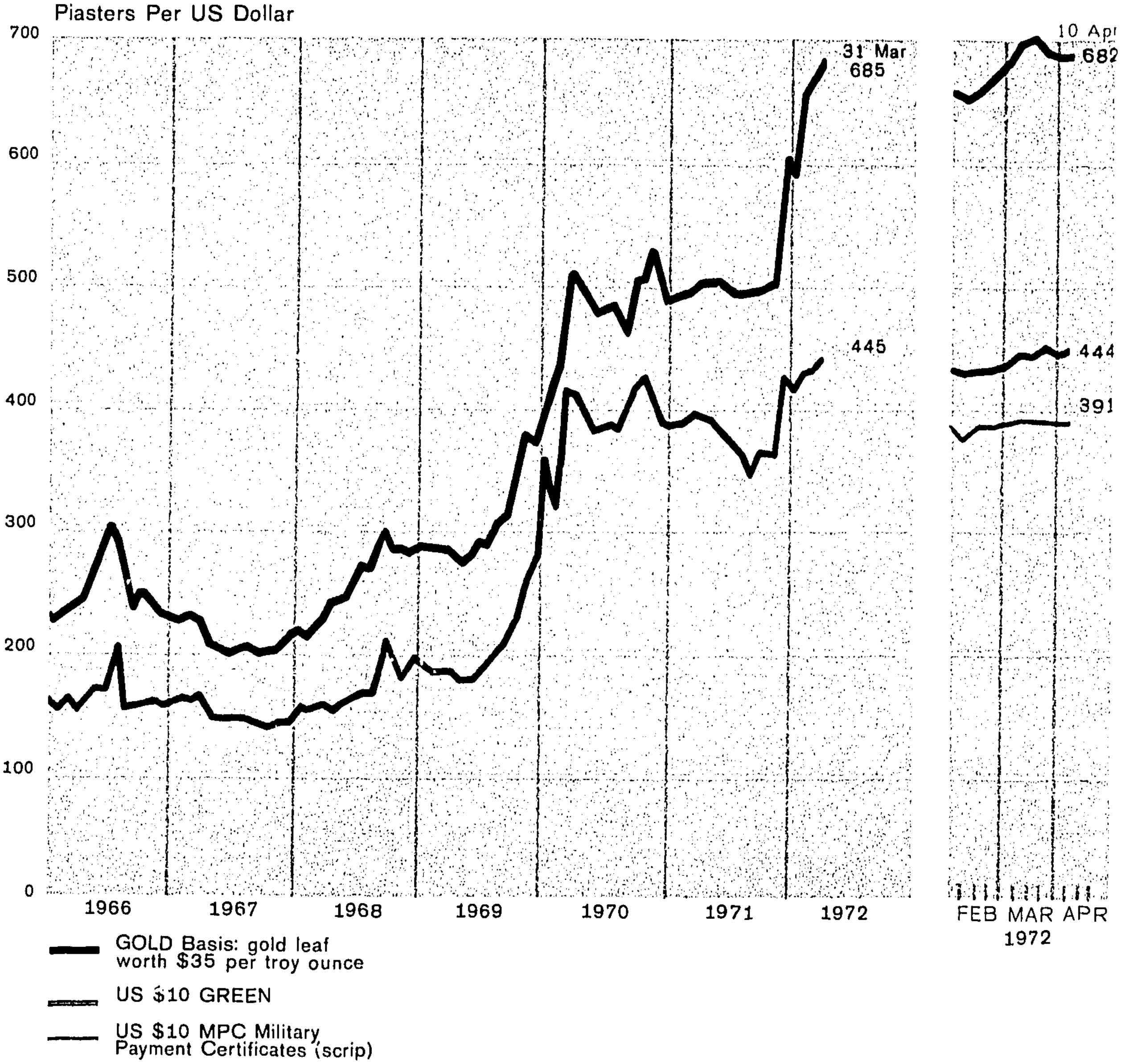
SAIGON

Figure 4

Free Market Gold and Currency Prices



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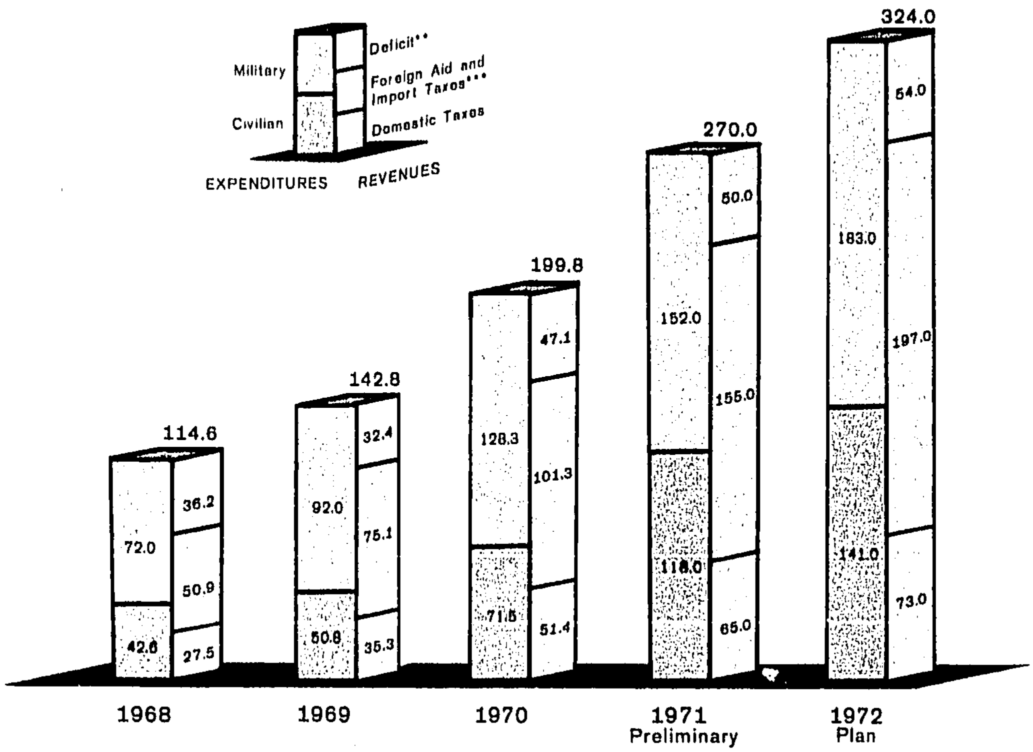
SOUTH VIETNAM

Figure 5

Government Budget*

Billion Piasters



*Data include extrabudgetary revenues and expenditures.

**Residual. Financed primarily by borrowing from the National Bank.

***Includes customs duties and other import taxes, counterpart funds generated by US-financed import programs, and profits from foreign exchange transactions. A major result of the November 1971 reforms was to make explicit a greater share of US aid to the budget that earlier took the form of high customs duties on aid-financed imports.

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