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CIA/OPR/IM 72-156 ECON SITUATION IN S. VIETNAM
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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

The Economic Situation in South Vietnam

USAID review completed

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
October 1972

INTELLIGENCE MEMORANDUM

THE ECONOMIC SITUATION IN SOUTH VIETNAM

Summary

1. Enemy interdiction of some supply routes led to a 6% increase in Saigon prices during the first three weeks of October. Consumers reacted calmly, however, with little hoarding reported.
2. Business activity continues to stagnate as consumer demand remains depressed because of the offensive. In general, only firms with government contracts to fill are operating anywhere close to capacity, while others have either reduced production sharply or closed. War damage has cut rubber output in half, and government security restrictions have greatly hampered forestry operations in some parts of the country.
3. Heavy fighting in recent weeks has sharply increased the already enormous number of refugees. Government relief centers now house 758,000 people - a new high for the offensive.
4. Despite the offensive, South Vietnam's exports are expected to reach about \$20 million this year, compared with only \$12 million in 1971. More realistic exchange rates are largely responsible for the upsurge, and the government recently authorized additional subsidies for exporters.
5. The proposed 1973 budget calls for a 19% increase in expenditures, but inflation and expenses related to the offensive almost certainly will boost spending beyond that level. Proposed revenues (including US aid) cover only 64% of projected expenditures, with the large deficit to be financed by borrowing from the banking system.
6. Charts on foreign exchange reserves, money supply and prices, gold and currency prices, and the government budget (Figures 1-5) follow the text.

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

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Discussion

Current Developments

Prices and Exchange Rates

7. Price problems dominated the economic news from South Vietnam in October. Enemy interdiction of some supply routes into Saigon led to a 6% rise in prices during the first three weeks of the month. Temporary shortages of perishable foodstuffs contributed significantly to the price rises, with fruits and vegetables in particular rising almost 30%. Sharp increases also were recorded for fish and meat. Surprisingly, prices of items usually hoarded by consumers - such as rice and canned milk - were either unchanged or down. The government pay increase announced in mid-September and a similar one on 1 October for Vietnamese employed in the US sector apparently have not yet impacted on Saigon prices, although several areas outside the capital city reported related price increases. Saigon retail prices, which had been relatively stable since mid-August with the continuing business recession, are now up 17% since the start of the offensive and 24% for the year.

8. The continuing stability of the currency black market suggests that the developments on the commodity markets are a function of real shortages and not speculative fever. The price of dollars on the Saigon black market has been rising slowly since the end of September but - at 436 piasters - is only one piaster above the official exchange rate. The gold market has remained even more stable since early September. On 23 October, gold leaf was selling at 26,500 piasters per troy ounce, or \$61 converted at the official rate of 435:1.

Business Recession

9. Business activity in Saigon, which turned down in August after a limited recovery earlier in the summer, continues to stagnate. All sectors of manufacturing are operating below 1971 levels, and many smaller, less competitive firms have closed. With consumer demand depressed because of the offensive, apparently only firms with government contracts to fulfill are operating anywhere close to capacity.

10. Construction and related industries seem to be the hardest hit by the recession. Construction, accounting for roughly one-fourth of industrial output, is said to be operating about 50% below the level of recent years. Firms producing construction materials such as reinforcing rod, galvanized iron sheets, cement, and bricks report output down 30%-50%

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from last year. Smaller firms have had to close, but many of the larger ones continue to carry their employees for maintenance and repair work at reduced hours or wage rates.

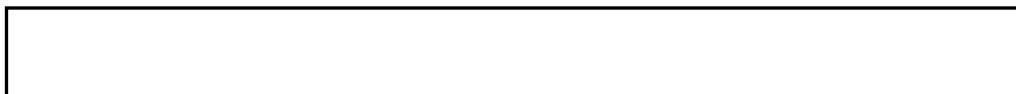
11. Other industries seriously affected by the recession include beverages, bottles, dairy products, shoes, and Vietnam's only automobile assembly plant. Sales of soft drinks and beer -- and thus bottles -- have fallen off sharply in areas directly affected by the fighting. The continuing reduction in US troop strength also has reduced demand for these products significantly. The largest bottling firm in Vietnam, which is French-owned, has shelved -- but not yet abandoned -- plans to erect plants in Can Tho and Da Nang.

12. Industries and individual firms that have escaped the impact of the recent falloff in consumer demand are for the most part those with government contracts -- textiles, canneries, and miscellaneous items such as batteries and aluminum utensils. Textile firms producing military uniforms have returned to full shift operation. Some others are operating at two shifts, reflecting some increase in civilian sales of cotton fabrics as people replace necessary items of clothing. Nevertheless, inventories of most finished textiles are still large, and the industry probably will not recover completely until there is a general revival of consumer demand.

13. The slowdown in production due to the offensive extends beyond Saigon's business community to agriculture and forestry. There has been no change in the gloomy outlook for rice production this year.⁽¹⁾ Rubber planters expect production to be down at least 50% from the 1971 level. The cost of rebuilding plantations and processing facilities is estimated to be at least \$8 million -- almost equal to the value of rubber exports in 1971. In addition to the loss of employment on rubber plantations, a sizable segment of the population of Military Region (MR) 3 was thrown out of work by a government ban on forestry operations in six provinces beginning in June. This ban was lifted at the end of September for three of the provinces (Bien Hoa, Long Khanh, and Phuoc Tuy), when the government realized that deteriorating economic conditions were more harmful to its interests than the security threat posed by enemy use of loggers and their trucks for resupply. The ban remains in effect, however, in the border provinces of Tay Ninh, Binh Long, and Phuoc Long.

More Refugees

14. Vietnam's already enormous refugee problem has increased significantly in recent weeks as the total number of refugees generated since



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the start of the offensive reached 1.2 million and the number of people in government relief centers climbed to a new high of 758,000.⁽²⁾ The in-camp refugee population had dropped from a high of 725,000 in mid-June to a low of 601,000 in early September, but recent heavy fighting in Quang Ngai Province in MR 1 and Long Khanh in MR 3 has sent the number soaring once again. More than 70% of all in-camp refugees are located in MR 1, primarily in Quang Ngai City and Da Nang. In Da Nang the number of people in relief centers has not fallen below 230,000 since shortly after the offensive began.

15. Considering the scale and nature of the problem, the government - with the aid of US funds and commodities - is doing a very creditable job in meeting refugee needs. As might be expected, however, the record has been marred by some instances of corruption. A recent investigation in Da Nang revealed that refugees were being given poor quality rice while officials were pocketing the funds earmarked to buy good rice. To prevent a recurrence of this scheme, rice for refugees must henceforth be purchased through the Ministry of Economy.

16. Because of the continued heavy fighting in MR 1, resettlement of refugees has been limited. Nevertheless, plans are under way for the return of refugees to southern Quang Tri, with perhaps 60,000 people scheduled to go back to their villages within the next six months. Resettlement benefits for housing were recently increased 9,000 piasters so that a family returning home or resettling elsewhere will be paid up to 25,000 piasters (\$57) or the equivalent in commodities. They continue to receive a maximum food allowance of either six months' supply of rice or 7,200 piasters per person.

Exports Still on the Rise

17. Despite the offensive, South Vietnam's exports have continued to increase this year largely because of more realistic exchange rates. Through September, exports totaled about \$16 million, compared with about \$9 million for the same period in 1971. For the year as a whole, exports are expected to reach about \$20 million, compared with \$12 million last year. Although down somewhat from pre-offensive estimates, the increase this year will be the first since 1963.

18. Rubber apparently is the only major export to decline as a result of the offensive. Because of the destruction of many rubber plantations

2. Refugees not living in government camps either are staying with relatives and friends or have returned to their homes.

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and processing facilities, exports are expected to drop more than 50% from the 1971 level. Exports of pine logs from MR 2, which have assumed considerable importance this year, reportedly have not been much affected by enemy operations. Even the government's six-week ban on transportation of logs through MR 3 to prevent enemy use of trucks in that region apparently had no lasting impact on the flow of logs out of MR 2. Exports of shrimp have grown apace and may well replace rubber as the leading commodity this year.

19. As an added boost, the government recently authorized additional subsidies for exporters. Exporters have had a preferential exchange rate of 500 piasters per dollar since mid-1972 (the official rate is 435), but since mid-September have received 550 piasters for each dollar of foreign exchange earned.⁽³⁾ Exporters of goods never before sold abroad are also entitled to an incremental subsidy of 25 piasters for a period of one year.⁽⁴⁾ Finally, exporters may now retain 10% of their earnings in hard currency, compared with 3% earlier. The new subsidies - combined with unlimited credit privileges at favorable interest rates - seemingly provide adequate financial incentives for exporters. Much remains to be accomplished on the institutional side, however, such as improving the performance of the Export Development Center and increasing commercial representation at Vietnamese embassies abroad. One step now being considered is converting part of the huge US base at Long Binh near Saigon into an export processing zone.

1973 Budget

20. President Thieu has sent to the National Assembly a proposed 1973 budget that calls for a 19% increase over projected 1972 expenditures. Expenditures in 1973, however, will almost certainly exceed the planned figure of 436 billion piasters (see Figure 5) - about \$1 billion converted at the official rate of 435 piasters to \$1 - because of inflation and expenses related to the offensive. In the past few years the government has submitted supplemental budgets later in the year with the result that, during 1970-72, spending increased at the rate of 30%-40% per year. The proposed 9% increase in military expenditures for 1973 seems particularly low, and some effort probably will be made to increase military funding by pruning civilian expenditures or transferring their financing to local governments.

3. Only exports of excess US military property do not qualify for the 50 piaster subsidy.

4. According to government sources, 50 different products were exported in 1971, and 20 new products, including some manufactured items, have been added this year.

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21. Proposed revenues (including US aid) cover only 64% of expenditures, compared with 92% estimated for 1972.⁽⁵⁾ The deficit, the largest since 1965, will be covered by borrowing from the banking sector (primarily the National Bank of Vietnam). Domestic taxes - such as those on income and business activity - are to provide 43% of revenues, but this share may be increased if proposed new income and property taxes are enacted. As in the past the most important source of revenues is the US foreign aid program. These revenues come from the sale of foreign exchange provided through US-financed import programs, as well as from customs duties on goods imported with this foreign exchange.

5. The government's financial situation greatly improved in 1972 because of the sizable devaluation of the piaster. The profits from revaluing the government's foreign exchange holdings from 80 piasters per dollar to 435 piasters per dollar were applied to reducing its debt to the National Bank of Vietnam.

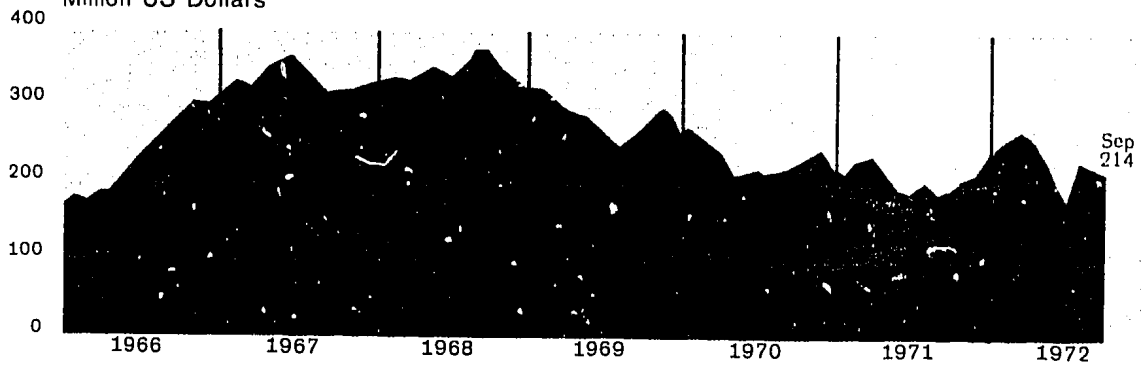
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Figure 1

Foreign Exchange Reserves*

Million US Dollars



*Excluding holdings of commercial banks

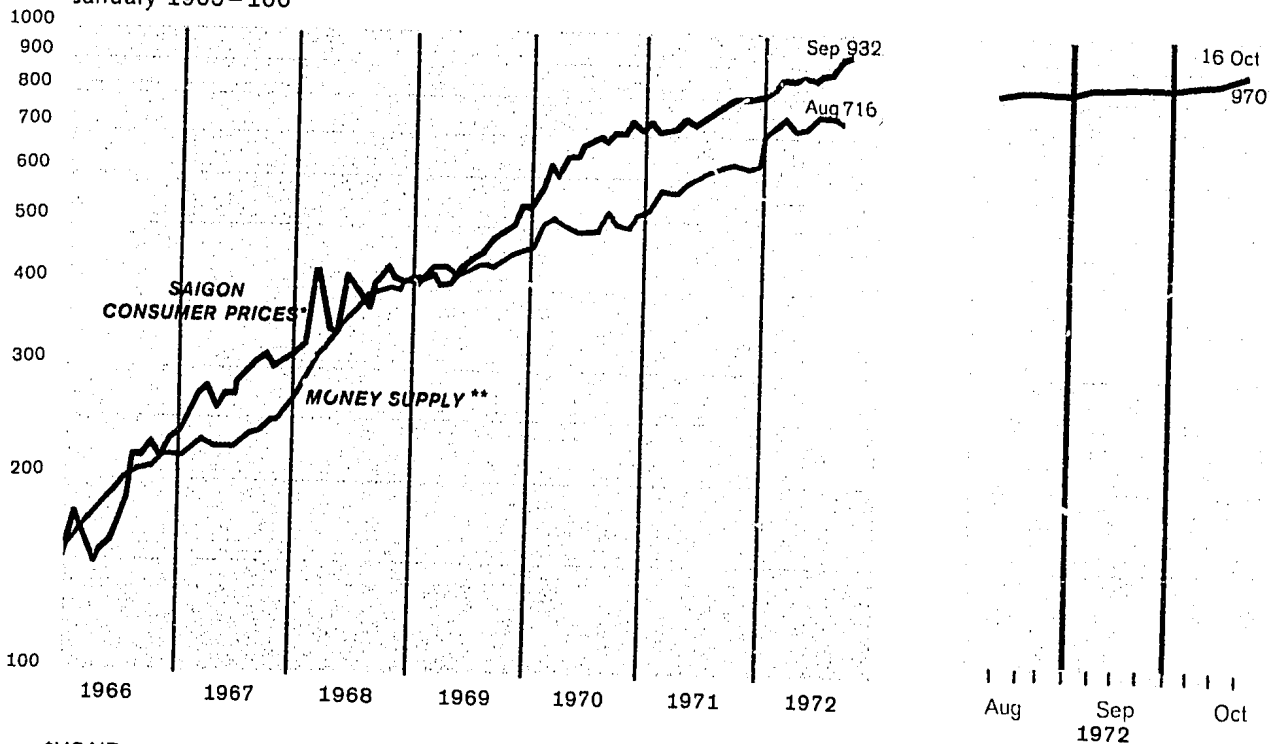
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Figure 2

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

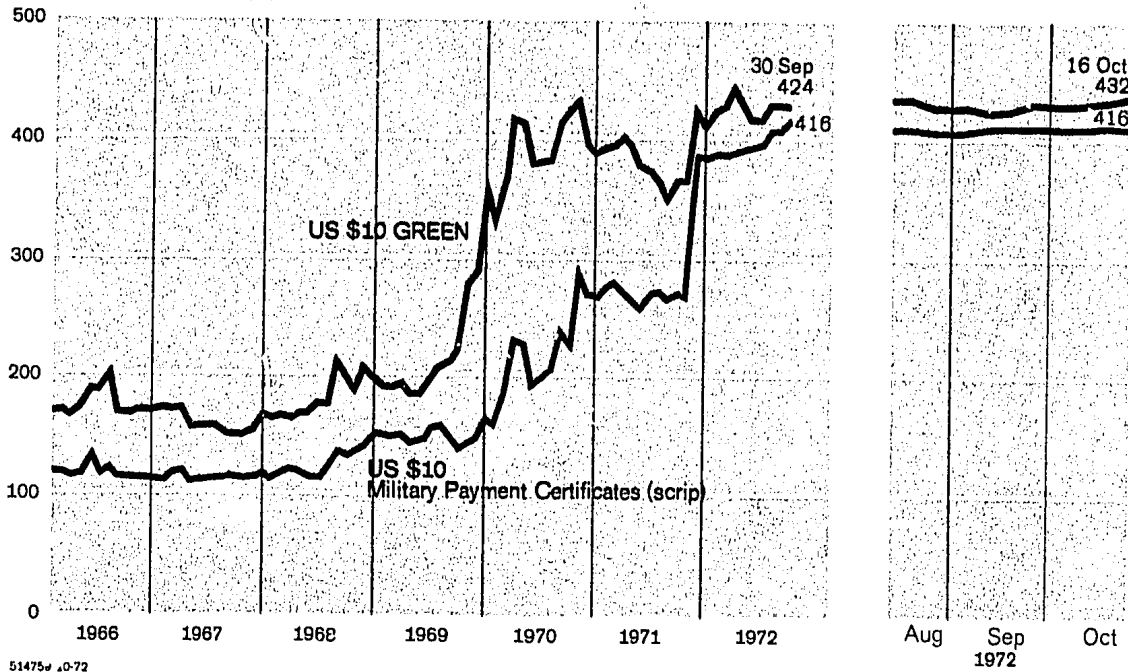
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Figure 3

Free Market Currency Prices

Piasters Per US Dollar



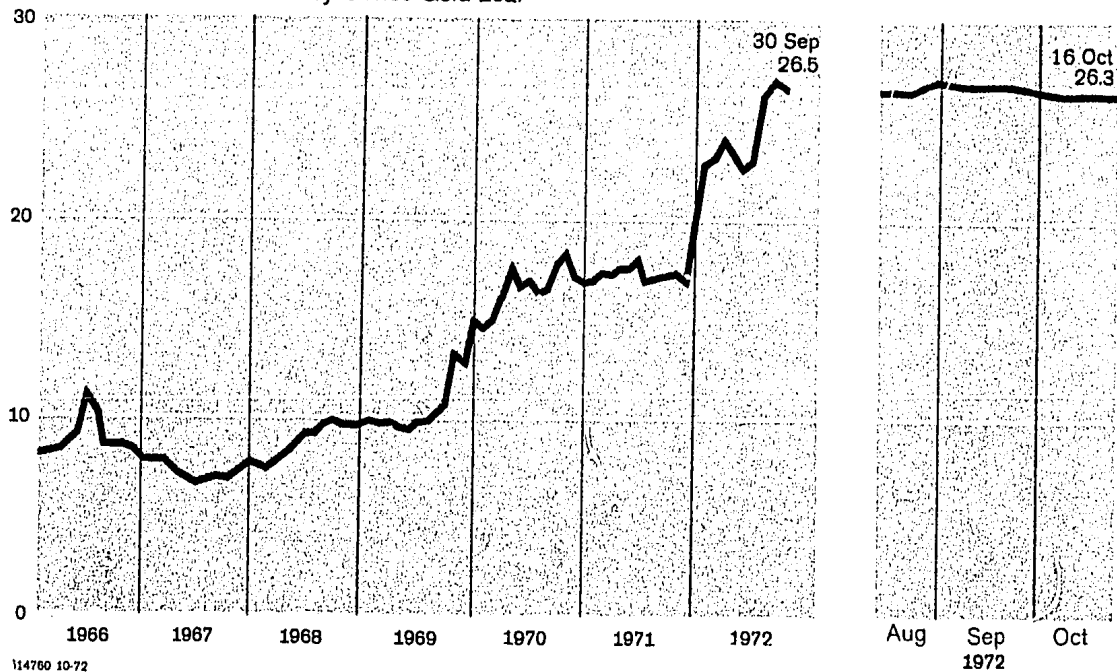
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Figure 4

Free Market Gold Prices

Thousand Piasters Per Troy Ounce Gold Leaf

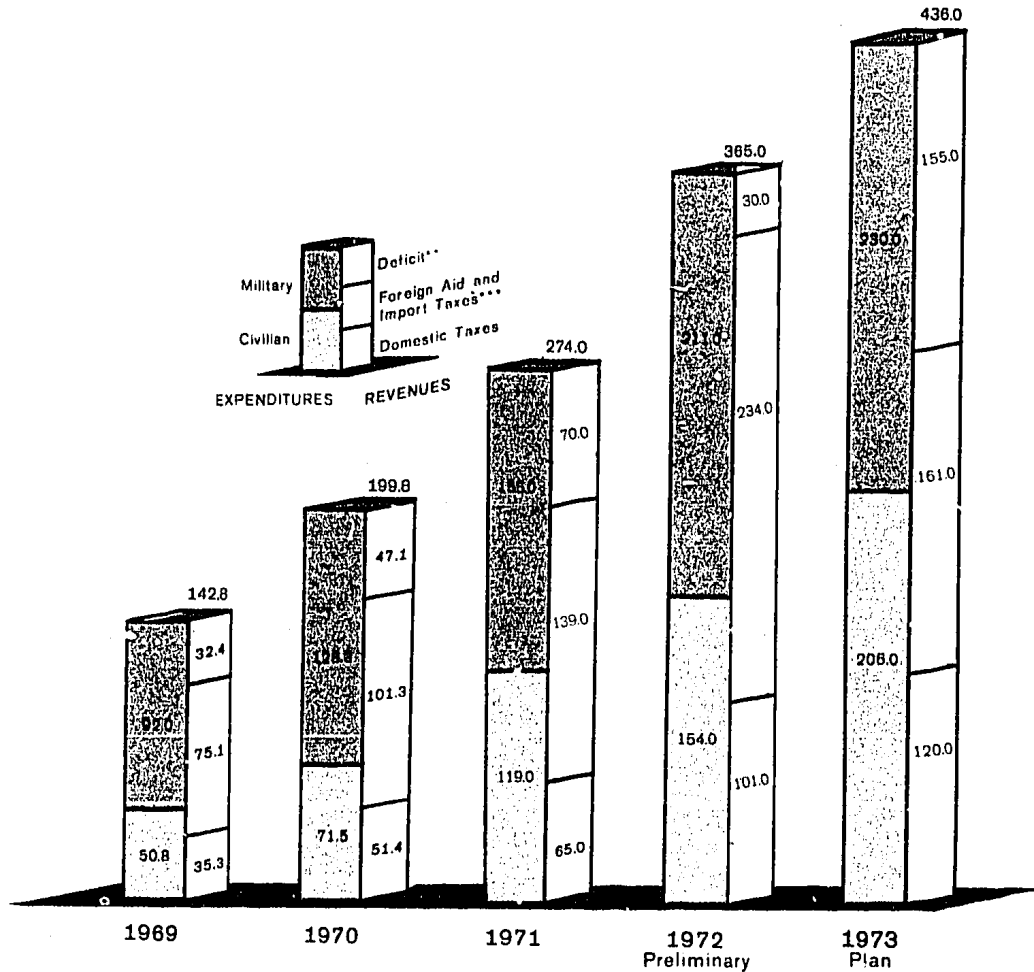


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SOUTH VIETNAM Government Budget*

Billion Piasters

Figure 5



*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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