INTERNATIONAL MONETARY FUND

KHMER REPUBLIC

Recent Economic Developments 1/

Prepared by P. Chabrier (ASD), H. Handy (ASD), M. Braulke (ASD), and I. Kapur (ETR)

Approved by the Asian Department and the Exchange and Trade Relations Department

November 27, 1974

Contents

1/ This report has been prepared on the basis of information gathered by a Fund mission which visited Phnom Penh during the period November 7-15, 1974.

Contents

Tables in the Text

Contents

Khmer Republic: Basic Data

Area: 172,500 km^2 (66,600 sq. miles)

Population: Total (1973 estimate) 7.3 million

	1970	1971	1972	1973	1974
Agricultural production ('000 metric tons)					
Paddy	2,732	2,138	953	655	493 1/
Rubber	13	1	8	22	14 2/
Maize	121	80	73	15	...
Industrial production index (1969 = 100)	108	90	84	55	42 1/
Price indices (end of year, 1949 = 100)					
Consumer (working class)	523	828	1,095	3,907	12,837 3/
Consumer (European class)	475	1,105	1,362	3,460	12,039 3/
Government budget accounts (mn. KR)					
Domestic receipts	4,889	4,733	6,536	10,151	17,472 3/
Expenditures	11,380	17,239	30,808	43,167	65,489 3/
Deficit	6,491	12,506	24,272	33,016	48,017 3/
Foreign aid counterpart funds	--	43	9,548	14,956	...
Money supply (end of period, mn. KR)	13,515	20,533	28,902	39,964	67,644 4/
Currency	11,479	17,121	22,704	31,270	48,261 4/
Demand deposits	2,036	3,412	6,198	8,694	19,383 4/
Credit (end of period, mn. KR)					
Claims on public sector	7,899	18,496	31,943	49,334	77,561 4/
Claims on private sector	3,652	4,621	8,300	12,803	12,489 4/
Balance of payments (mn. SDR)					
Trade balance	-27.4	-42.0	-59.1	-152.9	-144.9 5/
Foreign aid	...	25.9	66.6	183.7	175.9 5/
International reserves (end of year, mn. SDR)	54.1	28.0	20.8	23.6	25.6 3/

IMF

Quota: SDR 25 million

SDR net cumulative allocations SDR 8.5 million

No par value has been established for the Khmer riel

Source: Data provided by the Khmer authorities.

1/ Estimates.
2/ To end-October 1974.
3/ As of October 1974.
4/ As of September 1974.
5/ January-October 1974.

I. Introduction

For the last four years the hostilities have dominated the domestic scene, and the economic situation has been deteriorating as increasing demands have been placed on the country to satisfy the needs of a wartime economy. Output has declined in all sectors, communication lines are frequently cut, and the country, once a major exporter of rice, is now heavily dependent upon imports of rice and other essentials. At present, the Government controls no more than 20 per cent of the land area.

The war is exerting heavy stress on the budget. Revenues have declined in real terms and priority has been given to military outlays which now represent about 60 per cent of budget expenditures. Development expenditures are almost nonexistent. Even though the sale of foreign aid helped to absorb part of the liquidity generated by the substantial and increasing budget deficits, which grew from KR 6.5 billion in 1970 to KR 33 billion in 1973 before foreign aid, money supply expanded by 40 per cent in both 1972 and 1973; in view of average annual rates of inflation of nearly 120 per cent over the period, this implied a significant decline in real money balances. The budget situation has continued to deteriorate in 1974, mainly as a result of a decline in financial discipline and reduced foreign exchange supplies (and thus related revenues) compared to 1973. For 1974, the budget deficit (before foreign aid) is now provisionally estimated at some KR 69 billion (or 150 per cent of the stock of liquid assets in the hands of the public in December 1973), and money supply in the first nine months of 1974 grew at an annual rate in excess of 100 per cent, i.e., more than twice the annual rate recorded in 1973. At the end of October 1974, consumer prices were 290 per cent above their October 1973 level, and there was no sign that inflation was abating.

Exports fell from an average of $75 million per annum during 1967-69 to $11 million in 1973, i.e., only 8 per cent of 1973 imports. Between end-1970 and end-1973, official reserves fell by more than 50 per cent to $28 million, equivalent to just 1 1/2 months' imports. Thus the balance of payments has become crucially dependent upon foreign aid. In 1973, foreign aid amounted to about $220 million; the bulk of which consisted of substantial shipments of rice under the PL 480 program of the United States.

The resources made available in the form of cash grants by a number of donor countries and the Khmer Republic itself to the Exchange Support Fund (ESF) in 1974 have been less than in 1973 (about $22 million compared to $35 million) partly because fewer donors participated in the ESF and the United States and the Khmer Republic itself made lower contributions. The operation of the ESF was also hindered during 1974 because some donors were slow to disburse their contributions. The prospects are that U.S. commodity aid (apart from PL 480 rice) will also be lower in 1974 (and 1975) than in 1973. Although U.S. AID is hoping to provide about $78 million in commodity aid (apart from PL 480) in calendar 1974, the aid request for the present U.S. fiscal year (starting July 1974) is still awaiting Congressional approval. Even if the full request is approved, the bulk of these funds will be absorbed by freight payments on PL 480 rice shipments (estimated to be at least $50 million during U.S. fiscal 1975) and the cost of imports of petroleum products (about $27 million in the same period).

The shortage of foreign exchange provided under aid during 1974 has been compounded by the fact that rubber exports, the only significant source of official foreign exchange receipts, came to a virtual standstill in mid-1974; moreover, throughout 1974 foreign exchange reserves have remained at such a low level that the authorities ruled out the possibility of a supplementary contribution to the ESF during 1974. At the same time, the substantial amounts of liquidity generated by the budget deficit during 1974 led to a steady increase in the demand for foreign exchange in the first half of the year, despite devaluations of the riel in January (from KR 302 to KR 375 per U.S. dollar) and again in April (to KR 420 per U.S. dollar). In view of continued high demand for foreign exchange in 1974, the authorities found it necessary to control administratively the demand for foreign exchange and this involved the arbitrary rejection of applications for imports eligible in principle. Further, in May 1974, the authorities extended the negative list of imports for the Nouveau Marche. Monthly sales of foreign exchange on the Nouveau Marche, which averaged $3 million during 1973, were reduced to $1.3 million in the first eight months of 1974. From September onwards, sales of exchange on the Nouveau Marche have been at much higher levels.

A number of additional exchange measures were introduced on September 19, 1974, including the establishment of a three-tier foreign exchange market. A Marche Libre is operated by the commercial banks which is supplied with funds from export receipts and other market supplies and is authorized to sell foreign exchange for certain specified transactions; sales of exchange for other purposes require prior authorization by the National Exchange Office. The exchange rate for this market, initially set at KR 1,200 per U.S. dollar, is to be adjusted by the authorities in accordance with supply and demand conditions. The Nouveau Marche is supplied through ESF and sells foreign exchange for certain specified transactions. The exchange rate in the Nouveau Marche is determined by auction and a predetermined amount of exchange is sold to the highest bidders; bids have to be above a 'floor rate' which was set initially at KR 1,110 per U.S. dollar; this rate is adjusted regularly to a level at least 5 per cent above the free market rate. Thus, on September 19, the exchange rate on the Nouveau Marche depreciated from KR 420 to KR 1,110 per U.S. dollar; by October 31, the lowest rate at which exchange was sold on the Nouveau Marche was KR 1,600 per U.S. dollar. Exchange is sold at the rates which have actually been offered by the individual bidders thus leading to a multiplicity of exchanges rates at which the various transactions take place. In the third market, imports under the CIP program of the United States are financed at a preferential exchange rate some 17 per cent above the official floor rate.

The economic difficulties facing the Khmer authorities in recent years have been exacerbated by the need to provide for an increasing number of refugees. Current estimates of the number of displaced persons are as high as 2 million, of which about 1.1 million people were registered with the Khmer authorities as refugees at the end of September 1974. About 50 per cent of the registered refugees are located in Phnom Penh. The problems, both social and of coping with such a large number of displaced persons, which account for more than a quarter of the country's total population have been immense. In the first year of the war (1970), the problem was greatly alleviated by the strength of family ties in the Khmer Republic, and many of the early refugees were assisted in housing and other provisions by close relatives. However, since 1971 the majority of refugees have had to be accommodated in camps which have been established in Phnom Penh and the two other principal towns, Battambang and Kompong Cham.

The financial burden of providing for such large numbers of refugees has been considerable for the Khmer authorities; the exact cost is difficult to estimate, since most of the expenditures associated with refugee relief have not been included in the budget. For 1974, the cost is estimated at some KR 15 billion and may be expected to more than double in 1975; these costs are not included in the current budget forecasts. External aid to deal with the refugee problem has been provided by a number of humitarian organizations and by some bilateral donors.

In February 1974, the Khmer Government established the Resettlement and Development Foundation to assist in the resettlement and relocation of refugees. Though its activities have been small in scale so far (some 6,500 families were assisted in resettlement during February-June 1974) the goal for 1975 is 30,000 families, or 20 per cent of the total number requiring resettlement. As soon as the hostilities cease, the resettlement of large numbers of refugees, as well as the provision of certain basic items such as building materials, agricultural equipment and livestock, will call for a very considerable effort on the part of the Khmer Government and donor countries.

II. Production

National account statistics have not been published since 1969. Nevertheless, available statistics on production of the main agricultural commodities and estimates of industrial production show that the war has led to pronounced declines in virtually all sectors of the economy and that it continues to erode the remaining economic base. While production losses were moderate in the early stages of the war, the rising levels of hostilities from 1972 onwards and the resulting destruction of many infrastructure and production facilities, the dislocation of the labor force due to the mounting insecurity in rural areas, intermittent or permanent cuts in vital supply lines, as well as difficulties in the supply of raw materials and intermediate products, have accelerated the decline in agricultural and industrial output. The decline in activity in the tertiary sector, with the possible exception of government services, has probably been in line with the trends in the primary and secondary sectors. As a whole, it is estimated that in the second half of 1974, total output was, at an annual rate, some 30 per cent of its prewar level.

1. Agricultural production

Widespread fighting since mid-1973 and the struggle for some strategic positions in 1974 have led to a mass movement of population from the countryside to the cities and to the destruction of water control facilities, draft cattle and other productive assets on farms. As a result, agricultural production in government controlled areas has declined drastically. In crop year 1973/74 (ending March) the output of all major agricultural products was less than half the prewar levels and the output of rice was less than 25 per cent of that level (Table 1). A further decline in the output of all crops is expected in the present crop year ending March 1975.

Table 1. Khmer Republic: Cultivated Area and Agricultural Production by Main Crops 1/

	1968	1969	1970	1971	1972	1973	1974 Estimates
Acreage (1,000 hectares)							
Paddy	2,427	2,458	1,880	1,571	818	570	501
Maize	102	106	94	67	62	11	...
Green beans	62	54	31	36	29	9	...
Peanuts	22	23	16	17	14	1	...
Sesame	14	16	15	11	10	2	...
Tobacco	22	25	15	14	8	--	...
Jute	8	14	8	6	5	3	...
Cotton	6	12	1	--	--	--	...
Rubber (tapped)	43	48	...	...	...	...	...
Production (1,000 tons)							
Paddy	2,503	3,814	2,732	2,138	953	655	493
Maize	118	137	121	80	73	15	...
Green beans	32	34	20	28	18	7	...
Peanuts	26	23	17	24	14	1	...
Sesame	9	11	10	8	6	2	...
Tobacco	14	16	10	9	5	--	...
Jute	6	9	9	4	5	4	...
Cotton	6	7	1	--	--	--	...
Rubber (processed)	51	52	13	1	8	22	14 2/

Source: Ministry of Agriculture, Phnom Penh, Khmer Republic.

1/ All data are based on crop years beginning April 1, except for rubber which is on a calendar year base.

2/ Actual production in first ten months of 1974.

a. Rice situation

Rice is of paramount importance for the Khmer Republic. Besides being the staple food, rice used to be the principal agricultural product and a leading export. This situation, however, was reversed radically after 1970 when increasingly large quantities of rice had to be imported to compensate for the mounting shortfall in domestic output.

Average paddy production was about 2.5 million tons in the late 1960s; these levels were sufficient to allow exports of about 100-200 thousand tons annually. Production declined rapidly after the start of the hostilities and the fall was particularly rapid after 1971 as the Government progressively lost control of traditional surplus areas in the provinces Kompong Cham, Kompong Thom, and Takeo. The only major surplus area still under Government control is Battambang, but, there also, the surpluses have dwindled. It is presently estimated that the 1974/75 crop in the Battambang area will decline to a level just sufficient to meet the local requirements of the population in that region. The overall production of paddy in government-controlled areas in the 1974/75 season is currently projected at 493,000 tons, but this estimate appears optimistic as heavy rains after a period of drought have reportedly affected standing crops in some regions.

The decline in total production of paddy has been caused by the reduction in planted acreage due to loss of territory or insecurity, and also by a falling trend in yields. At 1.3 metric tons per hectare in prewar years, the yield was already comparatively low. It fell to less than one metric ton per hectare in 1974 as a result of the destruction of farm machinery, the difficulties of maintaining water control facilities, shortages of seeds and fertilizers and also the unfavorable ratio between the costs of fertilizer and pesticide and the official procurement prices of paddy. After prewar stocks of fertilizers were exhausted and in view of the limited imports of such products, in the past two years, fertilizer prices were decontrolled in 1974. While the price of fertilizers (in riel terms) rose more than one hundred times between the 1970/71 and 1974/75 crop seasons, the official procurement price of paddy increased abouty sixty-fold during the same period.

Due to the initial inflexibility in the procurement price policy, the official procurement agencies SATRAR and SORAPA faced substantial competition from private rice traders which resulted in a sharp decline in official procurement of rice in 1973. Despite a substantial shift in policies, including a decree in July 1973 which required owners of private rice stocks in the Battambang province to sell their stocks to the official procurement agencies, procurement in 1973 fell to 25,000 tons, or around 2.6 per cent of the estimated crop, as against 55,000 tons in 1972 (Table 2). The announcement of an attractive floor price at the beginning of the 1973/74 crop season and the adoption of a more flexible buying policy thereafter resulted in the procurement of 31,000 tons in 1974, thus raising the share of official purchases to total production to 4.7 per cent (Table 2).. In September 1974, the authorities announced another substantial increase in the official floor price for the current season (1974/75). The official procurement price was set, at that time, at a level higher than the price paid in neighboring Thailand, the objective being to check the illegal exports of rice to that country.

Table 2. Khmer Republic: Paddy Procurement Prices and Official Paddy Procurement

	1972		1973			1974			1975
	Floor price[1]	Actual price	Floor price[1]	Actual Prices May	Actual Prices August	Floor price[1]	Actual Prices March	Actual Prices July	Floor Price[1]
Paddy procurement prices according to rice quality (in riels per picul)[2]									
1-15	280	400	686	1,750		2,400	3,600	4,600	10,880
1-25	260	380	656	1,600	2,300 to	2,300	3,400	4,400	...
1-50	250	350	626	1,400	2,500	2,200	3,300	4,300	...
2-50	220	250	586	1,200		2,000	3,000	4,000	...
Official procurement through SATRAR and SORAPA[3] (in 1,000 tons)	54.6		25.1			30.6[4]			
(as per cent of crop)[5]	2.6		2.6			4.7			

Sources: Ministry of Agriculture and Ministry of Commerce, Phnom Penh, Khmer Republic.

1/ Floor prices are usually announced before harvest time, i.e., before the start of the calendar year.
2/ One picul = 68 kgs.
3/ SATRAR is an affiliate to OFFINACO (Office Nationale de Cooperation) and was before the war the sole procurement agency in charge of procurment for domestic consumption; SORAPA, and affiliate to SONEXIM (Societe Nationale d'Exportation et d'Importation), used to procure paddy and rice solely for exports.
4/ January-October, 1974
5/ Calculated as a percentage of the previous crop which is harvested around December.

When the results of the poor domestic paddy crop of 1972/73 became known, it became clear that with the emergence of worldwide rice shortages in 1973 and growing transportation difficulties, the Khmer Republic would face the formidable task of procuring sufficient amounts of rice on world markets in order to meet its growing domestic deficit. Estimates made in July 1973 of scheduled arrivals of rice from abroad and of prospective shipments from the Battambang area showed that these quantities would be insufficient for the remainder of 1973. Despite a series of emergency measures, including a rice airlift, a loan of some 60,000 tons of rice from Viet-Nam and Korea, and a drastic cut in the daily rice allocation, official rice stocks dwindled to about one week's distribution by end-September 1973, and to less than three days' needs by mid-October. In the last two months of 1973, however, substantial rice arrivals under the PL 480 program of the United States helped to alleviate the rice shortage and to stem the rapid upward trend in the free market prices of rice. A sustained increase in rice imports under the PL 480 program improved the rice situation in Phnom Penh and other government-controlled deficit areas in 1974 (Table 3). This permitted a substantial increase in the daily official distribution from an average of 517 metric tons in 1973 to 678 tons in the first ten months of 1974, and the maintainance of official stocks of rice in 1974 at a level of more than one month's distribution. By mid-November 1974, rice stocks were estimated to be equal to about 45 days' needs. With a further decline in domestic production in the 1974/75 crop year, the Battambang area, on present estimations, will not have any surplus rice with which to supply the deficit areas in 1975. The rice situation is thus likely to deteriorate in the course of 1975. The total domestic rice deficit for 1975 is estimated to increase to almost 400,000 metric tons. It is expected that through end-June 1975, imports of about 185,000 tons can be contracted on concessionary terms under the PL 480 program. A further 80,000 tons might be added on a grant basis from the United States for refugee relief.1/ Total rice imports could reach 205,000 tons in the first half of 1975.2/

b. Other crops

The production of many seasonal crops, particularly those which used to be planted along the fertile river banks, has been greatly affected by the insecurity. The decline in output of maize, one of the leading foreign exchange earners before the war and, in general, a potential substitute for rice has been particularly marked. Although no estimates have been made for the current crop year 1974/75, the downward trend in the output of agricultural commodities is expected to continue.

c. Rubber

Rubber production 3/ virtually ceased in 1971; but since 1972, when processing facilities which previously had been situated near the major plantations were established in Phnom Penh, it has recovered somewhat. Intensified fighting during

---

1/ Currently, the Government and voluntary agencies distribute rice freely to about 600,000 refugees in the Phnom Penh area; total annual distribution is roughly 60,000 tons.

2/ If the 80,000-ton import program for refugee relief is approved, there is likely to be a reduction in the 185,000-ton program, although not by the same amount.

3/ The rubber plantations are situated in areas outside government control, and thus total raw rubber production is unknown. All data on rubber production after 1970 refer only to rubber shipped to, and processed in, Phnom Penh.

Table 3. Khmer Republic: Rice Imports 1/

(In thousands of metric tons)

Origin	1971	1972	1973	1974
PL 480	--	30.2	47.1	262.3 2/
Thailand	--	60.5	29.4	--
Japan (grant)	--	26.2	4.8	--
Viet-Nam (loan)	--	--	44.9	40.1 3/
Korea (loan)	--	--	20.0	--
Total	--	116.9	146.2	302.4

Source: SONEXIM, Phnom Penh, Khmer Republic.
1/ On an arrival basis and net of repayments of loans in kind.
2/ Includes expected arrivals of 50,000 tons in the last two months of 1974.
3/ Includes a loan of 12,000 tons expected to arrive around end-November 1974.

July-September 1973 and interruption of transportation led to a virtual halt in the supply of unprocessed rubber from the plantations, as well as from existing stocks in Kompong Cham, to the processing plants in Phnom Penh. As a result, monthly production of processed rubber dropped to almost zero in September. Resumption of deliveries in the following months permitted rubber production to reach 21,600 tons in 1973 as against 7,900 tons in 1972 and some 50,000 tons in prewar years. During the first seven months of 1974, deliveries of raw rubber amounted to 12,350 tons (processed rubber equivalent), i.e., about 62 per cent of total deliveries in 1973. In July 1974, however, deliveries of unprocessed rubber from the plantations came to a complete halt following the nationalization of the plantations by the Khmer Rouge and a rejection of the previous method of payments for raw rubber. A compromise was worked out with some plantations in mid-September 1974 according to which a basic price for unprocessed rubber expressed in terms of U.S. dollars was agreed upon between the two sides. Approximately 80 per cent of the actual payment for raw rubber deliveries is to be made in the form of goods and the remainder in Khmer riels, the amount being established at the current exchange rate. A similar agreement with the other plantations was expected in November. Although deliveries were partly resumed after September, the total production of processed rubber in 1974 will not reach the earlier estimate of 25,000 tons and may even be below the volume achieved in 1973. The value of exports, however, may be somewhat higher than the $10 million achieved in 1973 reflecting the higher average prices for rubber prevailing in world markets this year.

The extent of the area presently tapped is not known. Based on statistics on existing plantations from 1970 and estimates of losses as well as of reported replanting, the exploitable plantations would amount to about 60,000 hectares with a potential annual production of 75,000 tons to 80,000 tons. The processing capacity in Phnom Penh is presently about 40,000 tons and could easily be expanded by another 20,000 tons.

d. Forestry and fishing

Forestry production, which is generally affected by insecurity and transportation difficulties, recovered slightly during 1973 from the very low levels of previous years, but declined again in 1974 (Table 4). Official exports of timber from areas near the Thai border as well as of forestry products resumed on a small scale; total exports, valued at $410,000 in 1973 increased to $585,000 during the first eight months of 1974. It is estimated that sizable illicit exports of timber from the forests along the borders are taking place.

Table 4. Khmer Republic: Forestry Production

(1969 = 100)

	1968	1969	1970	1971	1972	1973	1974 Provisional 1/
Timber	91	100	27	19	20	32	17
Firewood	93	100	23	34	26	21	13
Charcoal	87	100	39	19	35	26	8

Source: Ministry of Agriculture, Phnom Penh, Khmer Republic.
1/ Based on actuals for January-June 1974.

Fish production, particularly fresh water fishing, reached almost prewar levels in 1972 and exceeded those levels afterwards (Table 5). Salt water fish production is officially estimated at only 50 per cent of its prewar volume; indications are, however, that a substantial part of the actual catch is exported clandestinely. The landed catch has declined substantially, resulting in a sharp drop in official exports and a 60 per cent underutilization of the newly built fish meal factory at Kompong Som which has a daily capacity of 20 metric tons.

Table 5. Khmer Republic: Fish Production

(In thousands of metric tons)

	1969	1970	1971	1972	1973	1974 Provisional 1/
Fresh water fish	67	41	55	66	74	74
Salt water fish	20	15	12	14	10	10

Source: Ministry of Agriculture, Phnom Penh, Khmer Republic.
1/ Based on actuals for the period January-October 1974.

2. Industrial production

Before the war, the manufacturing sector accounted for about 20 per cent of total GDP. Despite a rapid decline of output in the manufacturing sector after 1972, its share in total GDP may have slightly increased over the period reflecting a more rapid decline in primary production. Production in some major plants, like the oil refinery, a paper plant and a fertilizer factory, came to a halt in 1972 due to the hostilities. But total manufacturing remained relatively unaffected throughout 1972 because a major part of the manufacturing capacity of the country (except for the large subsector processing agricultural products) was concentrated around Phnom Penh. Some firms benefitted from large orders from the armed forces (e.g., beverages, textiles, etc.). Since 1973, however, the disruptions in transportation and the shrinking markets for industrial output attributable to loss of territory, the pronounced fall in the purchasing power of consumers, and a falling off in orders from the armed forces, led to a rapid decline in the output of the manufacturing sector (Table 6). This development was further aggravated by shortages of foreign exchange, frequent changes in the import system, and a lack of familiarity with the CIP import regulations, which adversely affected the supply of raw materials and spare parts. The sharp increases in gasoline prices have recently given an impetus to such industries as bicycle production and parts.

3. Mining

With the exception of precious stones, mining in Government-controlled areas has declined to very low levels. It is estimated that salt production in areas under government control fell in 1974 to about 8,000 tons or somewhat less than 10 per cent of its prewar volume. Quarrying of limestone stopped altogether in January 1974 when the cement factory was destroyed. A new phosphate factory was recently built and started operations in August 1974.

The only sector which has experienced a substantial increase in output is the mining of precious stones in the area of Pailin near the Thai border. Operations are carried out either by refugees with primitive methods or by entrepreneurs using sophisticated heavy equipment. Recent estimates place the increase in the annual value of output from about $1.5 million in prewar years to about $10 million in 1973. The value of output is estimated to have continued to increase in 1974. Practically all precious stones are exported illegally, and all attempts to encourage the repatriation of foreign exchange receipts through official channels have failed so far.

Table 6. Khmer Republic: Production Index of Manufacturing Sector 1/

(1969 = 100)

	Weight	1969	1970	1971	1972	1973	1974
Foodstuffs Tobacco etc.	54	100	124	95	78	53	39
Textiles	16	100	95	83	107	43	42
Chemicals including rubber	7	100	102	113	111	94	81
Metals Machinery	11	100	104	87	75	36	34
Wood, paper and other	12	100	61	70	71	76	36
Total	100	100	108	90	84	55	42

Source: Ministry of Industry, Phnom Penh, Khmer Republic.
1/ Based on preliminary findings of a survey carried out in mid-1974; production outside government controlled areas is excluded starting from April 1970.

4. Transportation

Virtually all main roads which link Phnom Penh with other vital sections of the country have been closed for many months. As a result, a large number of small airline companies have commenced operations. Insofar as possible, the Mekong and Tonle Sap rivers have been used as substitute transportation routes. During the rainy season, the use of the Tonle Sap river to establish a link between the province of Battambang and Phnom Penh has been successful; however, the declining water levels during the dry season will again make transportation by boats vulnerable to interception. The cost of all forms of transportation has continued to soar. Many transport companies require payment for their services in the form of foreign exchange.

III. Prices and Wages

1. The general price level

The pace of inflation, which was already exceptionally high during 1973 compared with the first years of the war, accelerated further in 1974 to an annual rate of close to 300 per cent. In the past two years the rate of inflation as measured by the rate of change in the consumer price index in Phnom Penh has been consistently larger than the increase in money supply resulting in a substantial decline in real money balances (Table 7); real money balances declined by 77 per cent between December 1970 and September 1974. Although this development is in part attributable to the parallel decline in real output, there are signs that the riel is gradually losing its function as a unit of value since negotiated prices are now often expressed in terms of foreign exchange and then converted at the going (black market) exchange rate into domestic currency units at the date of settlement. Furthermore, there are indications that barter is becoming more widespread and that many transactions are settled directly in foreign exchange. As these practices continue, both the official and the black market exchange rates gain further importance as yardsticks of, and as an additional cause for, domestic inflation.

The rapidly widening budget deficits and the shrinking economic base have been the principal causes of the accelerating pace of inflation. These inflationary forces have been reinforced by the climate of widespread uncertainty which has encouraged speculation, temporary shortages due to the fall in output and the disruptions in transportation, and the growing number of refugees in government-controlled areas 1/ which have to share in existing supplies. At the same time, the composition of aid-financed imports has shifted during the past two years in favor of essentials like rice, which, in contrast to general imports cannot be priced so as to maximize counterpart generation. Indeed, the subsidization of rice imports has assumed major proportions. Furthermore, substantial amounts of imported rice are distributed freely. Thus the absorption of liquidity through generation of counterparts, resulting from the sale of foreign aid has become less effective in combating inflation. The positive aspect of this shift in policy, however, is a relatively more stable supply of food to the population; as a result, since the second half of 1973 rice prices as well as food prices in general have increased at a much slower pace than prices of other goods (Table 7).

2. Administered prices

In order to protect the lower income groups from the most serious consequences of domestic inflation, the price of a number of essentials is controlled, most notably rice and salt. The prices of milk and sugar were decontrolled only recently. Official selling prices for rice were unchanged from mid-1973 until mid-September 1974, when they were virtually tripled (Table 8). But despite this substantial price increase, rice remains heavily subsidized; at the current official exchange rate , the official retail price is equivalent to about \$105 per ton, or only 20 per cent of recent actual procurement costs,

---

1/ For example, the population of Phnom Penh is currently estimated at about 2 million as compared with an indigenous population of about 600,000 before the war. About half of Phnom Penh's present population are refugees, most of whom receive free rice rations from the Government or voluntary agencies.

Table 7. Khmer Republic: Consumer Price Index, Price of Rice and Money Supply

	1970 Dec.	1971 Dec.	1972 Dec.	1973 June	1973 Dec.	1974 June	1974 Sept.	1974 Oct.
Levels of:								
Consumer price index 1/	523	828	1,095	1,733	3,907	6,372	11,188	12,837
Food price index	625	1,003	1,400	2,221	5,491	8,679	12,694	15,442
Price of rice 2/	8	10	28	65	125	180	223	299
Money supply 3/	14	21	29	34	40	58	68	...
Annual rates of percentage change in:								
Consumer price index	50	58	32	140	257	268	284	290
Food price index	85	60	40	167	292	291	212	...
Price of rice	...	33	178	423	346	176	197	...
Money supply	73	52	41	41	38	73	87	...
Real money supply 4/	...	-4	-7	-42	-61	-53	-51	...

Sources: National Institute of Statistics, and National Bank of Cambodia, Phnom Penh, Khmer Republic.

1/ Base year 1949 = 100. Phnom Penh area index for working class.

2/ Average price of rice qualities 1 and 2 in riels per kg. in Phnom Penh on the free market.

3/ In billions of riels.

4/ Derived by deflating the nominal money supply with the consumer price index for the working class.

including freight, of PL 480 rice. On the basis of the new procurement floor prices for paddy from the forthcoming crop announced in September 1974, rice retail prices will have to be at least doubled again if losses on official sales from domestic procurement are to be avoided in 1975. The issue is still pending.

Table 8. Khmer Republic: Official Retail Prices of Rice

(Riels per kilogram)

Qualities	1971 December 13	1972 September 12	1973 June 15	1974 September 16
1-15	... 1/	26.0	57.0	165.0
1-25	... 1/	24.0	55.0	155.0
1-50	7.5	22.0	50.0	143.0
2-50	7.0	20.0	45.0	137.0
Brokens 1/2	... 1/	10.0	37.0	... 2/
Brokens 3/4	... 1/	5.0	25.0	... 2/

Source: Ministry of Commerce, Phnom Penh, Khmer Republic.
1/ Before September 1972, only the two most popular rice qualities were subject to official price fixation.
2/ Not quoted.

Other products subject to price control are bandages and jute bags. The subsidization of school books was only recently discontinued. Temporary substantial subsidization has also occurred in the case of POL products, the prices of which were adjusted frequently but by small amounts throughout early 1974. Even after the recent increase in the price of such products in September 1974, prices of petroleum products are still relatively low if valued at the current exchange rate (see below).

Postal tariffs and electricty and water tariffs are also controlled and are generally low. Reportedly, the average monthly telephone bill for a subscriber in Phnom Penh is the equivalent of about $0.30. Electricity and water tariffs were last adjusted in January 1974. Although petroleum products account for more than 80 per cent of total production costs of electricity and despite the two substantial price increases of POL products since the beginning of this year, no increase in electricity tariffs have been approved so far; as a result the state electricity company (Electricite du Cambodge) is incurring operational losses which will eventually have to be borne by the

3. Wages and incomes

The substantial and continuing fall in real domestic output has resulted in a pronounced decline in the standards of living for most income groups. Real wages in the public sector have generally been falling, although it has been Government policy to grant compensatory salary increases whenever the official retail price of rice was adjusted. Accordingly, in mid-September 1974, when the official sale price of rice was tripled, the Government granted as an immediate relief a salary increase to all civil servants. Retroactive to September 1, the basic salaries of civil servants were raised by 90 per cent and the cost-of-living premium was increased by a flat rate of KR 4,500 per month per civil servant, bringing the total increase to slightly more than 100 per cent on average. At the same time, basic salaries of military personnel were raised by 100 per cent, while cost-of-living premia remained unchanged, except for soldiers and officers at the front who were granted an addition to the combat premium of between KR 1,500 and KR 10,000 per month.

A recent study showed that immediately after the mid-September increases in the price of rice and petroleum products, the cost of a minimum diet of a six-member family (two adults, four children) was KR 28,700 per month; with inflation continuing, this minimum diet had already increased to KR 35,100 per month by mid-November 1974. Only very few persons in the private sector and even less in the public sector earn such an income. A survey of salaries in the private sector revealed that the average monthly income in June 1974 was KR 25,600 and it is estimated that it has since increased to roughly KR 33,000. This amount is inadequate to provide for the minimum diet, apart from other essential expenditures, like clothing, housing, etc. The situation in the public sector, which pays generally less than the private sector, is even more difficult. As a result, savings have been drawn down considerably. The closeness of Khmer family ties has also helped to mitigate some of the hardship. Many workers and civil servants now hold a second job. In addition, production, at the family level, of many essential goods including pork and poultry, has expanded considerably in the past two years.

IV. The Oil Situation

Khmer Republic relies almost exclusively on oil to satisfy its energy requirements. Since the country has no oil-producing or refining capacity of its own, its oil needs must be met entirely through imports of refined petroleum products. Some 70 per cent of total oil consumption is used directly by industry and to power the diesel generators used to produce electricity; about 10 per cent is used as aviation fuel. In 1973 some 18 per cent of petroleum products (in value) took the form of gasoline, but in 1974 it is expected that this proportion will decline to around 14 per cent (Table 9).

Table 9. Khmer Republic: Imports of Petroleum Products 1/

(In thousands of U.S. dollars)

	Gasoline	Kerosene	Gas Oil	Diesel Oil	Fuel Oil	Total
1971	1,066	458	1,042	2,320	1,262	6,148
1972	1,585	1,500	1,357	2,349	1,976	8,767
1973	1,607	1,865	1,928	1,964	1,670	9,034
1974 2/	1,924	3,222	4,415	1,417	2,118	13,096
1974 3/	2,393	4,335	5,171	2,145	3,046	17,090

Source: Ministry of Finance, Phnom Penh, Khmer Republic.
1/ Imports for civil consumption only, f.o.b.
2/ To September 25, 1974.
3/ Projection.

In recent years, the bulk of oil imports have been financed under United States' Commodity Import Program assistance (CIP). In 1973, the total value of oil imports is estimated to have amounted to $9.0 million, representing about 230 million litres (Table 10), equivalent to 5 per cent of total imports in that year. For 1974, the value of oil imports is projected at $17.1 million representing 169 million litres or just over 9 per cent of total projected value of 1974 imports. Thus, although the value of oil imports is projected to increase by 90 per cent in 1974 compared to 1973, the volume of oil imports in 1974 will be only some 73 per cent of 1973 levels.

The average procurement price of the principal petroleum imports rose from about KR 8 per litre in mid-1973 to KR 42 per litre in September 1974 (Table 11). Escalating freight and insurance costs associated with the increasing difficulty of shipping goods into Phnom Penh as well as the cost of war-risk cover have added considerably to the cost of oil imports.

The Khmer authorities have implemented a number of policy measures designed to restrict the demand for petroleum products. These measures include both rationing and a series of substantial price increases. In late 1973 and early 1974, gasoline consumption was cut back by more than 50 per cent. As shown in Table 12, there has been a substantial reduction in the consumption of all the main categories of petroleum products in 1974, averaging about 30 per cent. The only product for which consumption increased during 1974 was aviation fuel, reflecting the increasing difficulties in gaining access to Phnom Penh through surface links.

Table 10. Khmer Republic: Imports of Petroleum Products 1/

(Millions of litres)

	Gasoline	Kerosene	Gas Oil	Diesel Oil	Fuel Oil	Total
1971	26.5	9.7	30.1	54.7	30.2	151.2
1972	42.4	35.1	37.0	64.5	66.1	245.1
1973	39.2	38.6	47.0	50.0	55.0	229.8
1974 2/	19.4	28.2	44.0	14.5	25.9	132.0
1974 3/	23.4	37.7	50.5	21.5	35.9	169.0

Source: Ministry of Finance, Phnom Penh, Khmer Republic.
1/ Imports for civil consumption only.
2/ To September 25, 1974.
3/ Projection.

Table 11. Khmer Republic: Import Prices of Petroleum Products (c.i.f. Phnom Penh)

(Riels per litre)

	Gasoline	Kerosene	Gas Oil	Diesel Oil	Fuel Oil
December 1972	5.57	6.34	5.32	5.20	4.27
June 1973	8.14	9.81	8.31	8.17	6.10
December 1973	14.81	19.67	17.18	14.28	13.25
June 1974	35.74	48.37	39.31	37.50	32.04
September 1974 1/	43.79	45.69	42.74	42.05	35.53

Source: Ministry of Finance, Phnom Penh, Khmer Republic.
1/ Prior to the exchange rate depreciation of September 19, 1974.

Table 12. Khmer Repuolic: Civil Consumption of Petroleum Products

(Millions of litres)

	Gasoline	Kerosene	Gas Oil	Diesel Oil	Fuel Oil	Total
1971	33.7	16.5	36.8	71.2	39.3	197.5
1972	42.5	35.9	38.1	69.4	69.5	255.4
1973	44.5	41.8	50.8	46.4	57.7	241.2
1974 1/	19.2	27.3	37.8	22.3	25.2	131.8
1974 2/	22.2	36.8	49.3	30.3	34.7	173.3

Source: Ministry of Finance, Phnom Penh, Khmer Republic.
1 / To September 25, 1974.
2/ Projection.

The retail prices of all petroleum products have been sharply increased in a number of steps since December 1972 (Table 13). During the period January 1973 to September 1974, the retail price of diesel oil rose from KR 5 per litre to KR 200 per litre and the price of gasoline was increased from KR 16 per litre to KR 350 per litre. The percentage increases in the retail prices of the major petroleum products (ranging from 2,000 per cent to 4,200 per cent) have greatly exceeded the increases in the import prices (which averaged about 700 per cent over the same period).

Table 13. Khmer Republic: Retail Prices of Petroleum Products

(Riels per litre)

	Gasoline	Kerosene	Gas Oil	Diesel Oil	Fuel Oil
September 16,1971	16.00	9.00	8.00	5.00	3.00
February 14, 1973	28.00	16.00	16.00	15.00	10.00
March 9, 1973	25.00	15.00	15.00	14.00	9.00
July 3, 1973	28.00	18.00	18.00	17.00	12.00
December 8, 1973	68.00	38.00	40.00	40.00	23.00
May 11, 1974	100.00	70.00	80.00	80.00	52.00
September 15, 1974	350.00	180.00	210.00	200.00	130.00

Source: Ministry of Finance, Phnom Penh, Khmer Republic.

Petroleum products are presently subject to six taxes: customs duty (ad valorem); customs duty (flat rate); turnover tax (ad valorem); two surcharges; and a sales tax. Although these taxes remained unchanged between September 1971 and early 1973, there has been a substantial increase in total taxes applied to petroleum products during 1973 and 1974 (Table 14). The authorities are currently considering replacing the six taxes on petroleum products with a single ad valorem tax.

Table 14. Khmer Republic: Taxes on Petroleum Products

(Riels per litre)

	Gasoline	Kerosene	Gas Oil	Diesel Oil	Fuel Oil
September 16, 1971	5.07	4.06	1.56	1.61	1.29
Feb. 14, 1973	9.00	8.73	3.55	3.42	2.76
March 9, 1973	8.99	8.72	3.54	3.42	2.75
July 3, 1973	12.49	12.19	5.54	5.23	3.84
December 8, 1973	21.25	22.98	10.43	10.06	7.47
May 11, 1974	42.42	42.21	23.44	22.63	19.56
September 15, 1974	106.81	115.73	61.38	59.22	51.19

Source: Ministry of Finance, Phnom Penh, Khmer Republic.

Although the price increases were implemented in stages, the bulk of the increase took place on September 16, 1974. Subsequently, on September 19, 1974, a number of important exchange measures including a substantial depreciation were implemented. Thus, the exchange rate for CIP imports depreciated from KR 336 per per U.S. dollar to KR 910 per U.S. dollar, and the exchange rate on the Nouveau Marche (in which most gasoline imports have been financed since June 1974) was devalued from KR 420 to KR 1,110 per U.S. dollar. The authorities are planning to link the retail prices of petroleum products to movements in the exchange rates.

V. Fiscal Policy

Since 1970, the continuing hostilities have placed an increasingly heavy burden on government finance. Budget expenditures have grown rapidly and, at the same time, there has been a substantial change in their structure. Military expenditures absorbed 55 per cent of total government expenditures in 1973 compared with 25 per cent of budget outlays in the 1960s; this share is expected to increase to about 60 per cent of budget expenditures in 1974 (Table 15). Subsidies on the sales of certain products, notably rice, have grown rapidly and the share of development outlays has fallen to insignificant amounts. Budget revenues, which consisted largely of indirect taxes and depended on the flow of imports fell by one third in 1970 but, following the introduction of various domestic tax measures and the recovery in the local currency value of imports from end-1971 onwards, they grew again after 1971, although to levels well below those of government expenditures; in 1973, such revenues covered only 23.5 per cent of expenditures. As a result the budget deficit, which had averaged KR 1.4 billion a year in the 1960s, widened substantially. By 1973, the deficit amounted to KR 33 billion and the 1974 budget deficit is provisionally estimated at KR 69 billion.

Table 15. Khmer Republic: Budget Accounts of the Government

(In millions of riels)

	1970	1971	1972	1973	1974 10 months
Expenditures	11,380	17,239	30,808	43,167	65,489
Of which:					
Civil	(5,794)	(6,944)	(13,403)	(20,320)	(29,336)
Military 1/	(5,586)	(10,295)	(17,405)	(22,847)	(36,153)
Revenues	4,889	4,733	6,536	10,151	17,472
Of which:					
Domestic taxes	(2,928)	(2,838)	(3,487)	(4,402)	(8,275)
Import taxes	(1,961)	(1,895)	(3,049)	(5,749)	(9,197)
Deficit	-6,491	-12,506	-24,272	-33,016	-48,017
Financed by:					
Aid counterpart funds	--	43	9,548	14,956	...
Net bank borrowing	5,510	10,597	13,447	17,391	...
Treasury resources	981	1,866	1,277	669	...

Source: Data provided by the Khmer authorities.

1/ The greater part of defense outlays is financed directly through U.S. military aid.

Until 1971 the rising budget deficits had been mostly covered by net bank financing. However, with the receipts of substantial foreign aid after 1971, considerable amounts of counterpart funds generated from the sales of such aid to the public have been transferred to the budget. Indeed, the generation of large amounts of counterpart funds after 1971 was the main contractionary factor offsetting the expansionary impact of rising budget deficits on liquidity.

Another development in fiscal policy in recent years which deserves emphasis is the growth in extrabudgetary government expenditures. The most important of these expenditures are those relating to refugee relief, rice subsidies, and agricultural credit. They have been financed for the most part directly through the release of counterpart funds. To this extent, of course, the real public sector deficit has been understated in the budget accounts. There are at present no reliable statistics on total public sector transactions.

1. <u>The 1973 budget</u>

The draft budget, which was approved by the Cabinet in March 1973 and by the Parliament in May 1973, called for initial expenditures of KR 34.7 billion, a level of some 12 per cent above actual expenditures in 1972 and for total revenues of KR 11.6 billion, or 80 per cent higher than in 1972. The resulting budget deficit of KR 23.1 billion was approximately equal to the actual deficit incurred in 1972. The budget provided for an increase in military expenditures of about 30 per cent compared with the 1972 actuals, while civilian expenditures were estimated at roughly the same level as in 1972. These projections however, were based on the assumption that salaries and allowances for both civilian and military personnel would remain unchanged from January 1, 1973 and that the number of men on the military payroll would not exceed 253,000 during the year. The draft budget also excluded substantial amounts of subsidies. The increase in budget revenues was to result from higher levels of imports in local currency terms, increases in taxes on petroleum products, higher excise taxes on cigarettes manufactured locally, and the imposition of an excise tax on imported cigarette paper.

On August 9, 1973, the Ministry of Finance submitted a supplementary budget ("collectif") to the Cabinet which later came into force through Presidential Decree. The "collectif" amounted to KR 13.8 billion, and total budget expenditures for 1973 were planned at KR 48.5 billion. The main additional expenditures included under the "collectif" were on account of (a) additional personnel expenditure of KR 4.7 billion, reflecting adjustments of all government salaries to compensate for an earlier increase in the official price of rice; (b) the introduction of a "combat" premium of KR 1,500 per month for about 70,000 troops at the front; (c) increased subsidies on imported foods, particularly rice, resulting from higher import prices and quantities; and (d) refugee relief and repairs of war damage, as well as generally higher costs connected with the substantial price increases. At the same time, the authorities decided to eliminate subsidies on PL 480 imports other than rice, representing a saving to the Government budget of KR 1 billion in a full fiscal year. On the revenue side, besides increases in some tariffs, the specific sales taxes applying to the various categories of cigarettes were replaced by a unique ad valorem tax of 60 per cent, yielding some KR 0.8 billion in revenue in the remainder of 1973.

Actual budget expenditures amounted to KR 43.2 billion in 1973, i.e., 40 per cent higher than in 1972 but still some KR 5 billion less than had been approved in the "collectif." This shortfall was due in part to the tardy approval of the budget, which delayed some programs, and to stricter controls on expenditures. Actual revenues in 1973 were 55 per cent above those of 1972, reflecting some improvement in tax collection, the impact of various tax increases,and the rapid growth of domestic and import prices in riel terms. As a result, the budget deficit, at KR 33.0 billion, was some KR 9 billion larger than in 1972. About 45 per cent of the deficit was financed by counterpart funds and virtually all of the remainder through central bank credit.

2. The 1974 budget

The 1974 budget originally envisaged total expenditures of KR 71.6 billion, an increase of 66 per cent over the 1973 actuals while revenues were forecast at KR 22.9 billion, more than double the 1973 actuals. As a result, the deficit was projected to increase from KR 33 billion in 1973 to KR 48.7 billion.

Delays in obtaining Parliamentary approval for the budget resulted in a corresponding delay in implementing a number of tax measures aimed at increasing revenue. These measures consisted of the abolition of the six taxes applied to petroleum products and their replacement by a unique ad valorem tax, an increase in stamp duties, an increase in the "war effort tax" on some products, a tax on motor vehicles, an entertainment tax, and an increase in profits and turnover taxes. In addition, the authorities indicated their intention to abolish the exemption of import duties on certain products.

Results during the first few months of 1974 indicated a shortfall in government revenues compared with the estimates, largely as a result of a decline in taxable imports as well as frequent interruptions in the production of dutiable items (cigarettes, alcohol) due to shortages of raw materials. In subsequent months, an increase in the arrivals of commodity aid imports coupled with the budgetary effects of a depreciation of the official exchange rate, helped to boost revenues from both domestic and import sources and by the end of October total revenues amounted to KR 17.5 billion.

The exchange reforms introduced on September 19 were accompanied by a number of major tax changes. In particular, the authorities decided to abolish import duties, excise taxes and the "war effort tax" on all but a limited number of luxury products. At the same time, the revenue measures originally envisaged in the 1974 budget (listed above) were postponed. Finally, there were substantial increases in tax free allowances in respect of income taxes. The full effects of the recent measures on budget receipts will not be evident before the end of 1974; in the interim, tax receipts will be sustained by those items in the pipeline. The final outturn of government revenues is estimated at KR 21 billion for 1974, i.e. double the 1973 results. This is still a modest performance when compared with the increase in domestic prices and in the total import bill in terms of riels.

Government expenditures which were originally estimated at about KR 72 billion for 1974 had already amounted to about KR 66 billion by October and, in view of the decision taken in September to double the salaries of civil servants and military personnel 1/, the final outturn for 1974 is now projected at about KR 90 billion, representing a doubling of total expenditures compared to 1973. During 1974, military and civilian expenditures grew at approximately the same rates. The new measures are expected to add some KR 51 billion to total expenditures in a full fiscal year.

On the basis of the revised revenue and expenditure estimates, the budget deficit for 1974 is now projected at about KR 69 billion which is equivalent to 150 per cent of the stock of liquid assets in the hands of the public at the end of December 1973.

The exchange rate depreciation of September 1974 will, of course, have significant implications for the generation of counterpart funds arising from the sale of foreign cash and commodity aid which, as shown in the section dealing with monetary policy, represent the major contractionary influence on changes in net domestic credit. Counterpart funds are generated largely by the sale of most CIP aid and ESF funds. The greater part of the counterpart generating effect of PL 480 assistance is reduced by the fact that the Khmer Government sets the selling price of PL 480 rice (which constitutes 80 per cent of total PL 480) at a rate (KR 155-165 per kilo) significantly below the current procurement price (about KR 780 per kilo).

Counterpart funds differ from regular budget receipts in that they are legally owned by the respective donor countries until they are formally released for budgetary support. There has been a growing tendency in the past few years for counterpart funds to be used directly to finance extrabudgetary expenditures. This practice has increased the difficulty of determining the actual size of the public sector deficit. It is estimated that counterpart funds financed some KR 4 billion of expenditures not included in the budget in 1973; and during the first three quarters of 1974, some KR 30 billion of extrabudgetary expenditures have been financed in this manner. The greater part of these expenditures have been concerned with refugee support programs, subsidies on domestic rice, and agricultural credit.

The deterioration in the budgetary position both in respect of receipts and expenditures is currently being studied by the authorities. Additional measures are being considered to boost government receipts in 1975 including the reintroduction of customs and excise taxes on most imports, the replacement of the six taxes currently applied to petroleum products by a single ad valorem tax, a scheme to link the wholesale price of petroleum products to movements in the exchange rate, and substantial increases in the prices of public utilities (electricity, water, etc.). On the expenditure side, the authorities intend to exercise more vigilant controls by bringing all budgetary expenditures within the budget and through the recently created Joint Military Budget Review Committee which is composed of representatives of the Khmer Government and the United States. Nevertheless, in view of the present economic situation and the continuing decline in the real value of aid (excluding rice), the scope for a significant improvement in the budget is limited. Preliminary estimates of the 1975 budget indicate expenditures of some KR 150 billion (even excluding any salary adjustment) plus extrabudgetary expenditures of perhaps KR 50 billion. At this stage it would be difficult to make an estimate of government receipts for 1975.

1/ Wages and salaries presently account for 82 per cent of total budget expenditures.

VI. Monetary Policy

1. Institutional framework

The financial system of the Khmer Republic is characterized by few institutions and a limited range of financial assets. The system centers on the National Bank of Cambodia which is the Central Bank and is responsible for the implementation of monetary policy. In the conduct of monetary policy, the National Bank is assisted by the National Credit Council which comprises representatives of the various economic ministries and the major commercial banks as well as the National Bank itself; the Council meets every three months to decide on the major lines of credit policy. A second official institution is the Banking Control Commission which is engaged in supervising the activities of the commercial banks and ensuring that the banks are operating in accordance with official regulations governing banking practices.

There are two state-owned commercial banks, a Development Bank of Cambodia and a recently created state-sponsored savings bank. There are a few small private banks and financial institutions which include a newly established military bank. Some of the private banks, which are not registered as banks, are not subject to the official banking regulations; at the same time, however, they do not have recourse to rediscount facilities with the National Bank nor the right to engage in foreign currency transactions. The National Bank does not normally extend credit directly to public enterprises or to the private sector but offers rediscount facilities to the authorized commercial banks; in addition it provides credit facilities for certain operations of state agencies and to the Development Bank.

Financial assets are almost exclusively limited to currency and riel sight and time deposits with the banks. Although the banking system has sought to increase sight and time deposits, their efforts have met with limited success partly owing to the state of confidence in the currency and also to the low nominal rates of interest offered to depositors. In September 1974, demand deposits constituted about 24 per cent of total liquid assets, compared to 14 per cent at the end of 1970. The proportion of time deposits to total liquid assets increased from 6 per cent to 10 per cent during the same period. In real terms, both categories of deposits have fallen significantly during the period. Private deposits in foreign exchange can be authorized for institutions or individuals to finance approved external operations or financial transfers.

In general, monetary policy in the Khmer Republic has been subject to two major limitations. First, the economy is only partially monetized and many transactions take place outside the monetary sector. Secondly, since some 75 per cent of the money supply is held in the form of cash rather than bank deposits, the greater part of monetary transactions are not financed through the institutions which are subject to control by the monetary authorities. In addition to these basic impediments to the effectiveness of monetary policy, the public sector has, during the past five years, incurred substantial and increasing deficits which have been largely financed by central bank credit, thus reducing the scope for monetary policy.

The principal instruments of monetary policy which are available to the authorities are: (a) interest rates; (b) a minimum required reserve ratio for the commercial banks calculated as a percentage of their current and time deposit liabilities of which one third is to be held in the form of deposits with the National Bank and two thirds in the form of Treasury Bills; (c) selective controls prohibiting the banks to finance some types of operations; (d) the use of advance import deposit requirements; (e) the granting of rediscount facilities by the National Bank; and (f) moral suasion. A certain lack of coordination in the use of these instruments has been evident from time to time in recent years.

2. Monetary developments and policies

The standard presentation of the monetary survey is summarized in Table 16. The major categories of assets and liabilities have been regrouped in Table 17 in order to highlight the main factors contributing to changes in net domestic credit.

The sharply rising budget deficits after 1970 have been the main factor contributing to the expansion of net domestic credit (Table 17). In addition, particularly during 1972 and 1973, credit to the private sector, which is largely directed toward the financing of imports and inventories, was also a significant expansionary force. The substantial total credit expansion during the period 1970-74 has produced a high and increasing aggregate domestic demand which has been translated into pressures on the foreign exchange market and higher prices given the supply situation. At the same time, the sale of foreign aid, provided in the form of cash and commodities, has permitted the absorption of substantial amounts of liquidity from the public through the net generation of counterpart funds, i.e., total counterpart funds arising from the sale of foreign aid minus those counterparts subsequently used by the donors.

The net effect of these monetary movements has been to produce a considerable expansion in net domestic credit in each year since 1971. Moreover, the change in net domestic credit has been accelerating and it appears from an analysis of the monthly data for 1974 that this trend continued in the third quarter of 1974.

Changes in net domestic credit are represented by changes in the holdings of domestic and foreign assets. The holding by Khmer residents of foreign assets is severely restricted and movements in "other items" largely reflect changes in capital and other liabilities (including profits) of the banking system. Thus, changes in net domestic credit are the dominant factor influencing changes in the money supply. Liquid assets in the hands of the public (i.e. money supply plus quasi-money) which more than doubled between December 1970 and December 1972, rose by a further 40 per cent in 1973, and have been rising at an annual rate in excess of 100 per cent during the first nine months of 1974. In the context of the very high rates of inflation which have been recorded in recent years and the corresponding erosion of the purchasing power of domestic currency, there are dangers that in the event that these trends continue, a flight from domestic currency could ensue. As noted earlier, there are indications already that the riel is gradually losing its function as a unit of account, that barter is becoming more widespread and that settlements in many transactions are made in foreign exchange.

Table 16. Khmer Republic: Monetary Survey, 1970-74

(In millions of riels)

	1970 Dec.	1971 Dec.	1972 Dec.	1973 June	1973 Dec.	1974 Mar.	1974 June	1974 Sept.
Net foreign assets	4,272	6,665	7,934	8,634	10,580	13,512	13,703	43,388
Net claims on Government	7,899	18,496	31,943	42,667	49,334	59,386	69,910	77,561
Net claims on state enterprises and the private sector	3,652	4,621	8,300	8,616	12,803	16,710	12,702	12,489
Assets = liabilities	15,823	29,782	48,177	59,917	72,717	89,608	96,315	133,438
Quasi-money	918	1,529	3,451	4,335	5,686	7,791	9,531	11,773
Counterpart funds	--	2,572	4,784	11,234	9,943	12,952	9,042	15,005
Net other items	1,390	5,148	11,040	10,804	17,124	21,783	19,615	39,016
Money supply	13,515	20,533	28,902	33,544	39,964	47,082	58,127	67,644
(Demand deposits)	(2,036)	(3,412)	(6,198)	(7,462)	(8,694)	(9,694)	(13,905)	(19,383)
(Currency in circulation)	(11,479)	(17,121)	(22,704)	(26,082)	(31,270)	(37,388)	(44,222)	(48,261)

Source: National Bank of Cambodia, Phnom Penh, Khmer Republic.

Table 17. Khmer Republic: Factors Determining Changes in Net Domestic Credit

(In billions of riels)

	1971	1972	1973	1974 1/
I. Credit expansion	+11.6	+17.1	+21.9	+28.0
Credit to public sector	+10.6	+13.4	+17.4	+28.3 2/
Credit to private sector	+1.0	+3.7	+4.5	-0.3
II. Credit absorption				
Net generation of counterpart funds 3/	-2.5	-2.2	-5.1	-5.1
III. Net domestic credit expansion (=I - II)	+9.1	+14.9	+16.8	+22.9
Represented by:				
Change in foreign assets (- = increase)	-2.3	-1.2	-2.7	-32.8 4/
Change in money and quasi-money	+7.6	+10.4	+13.3	+33.8
Change in other liabilities	+3.8	+5.7	+6.2	+21.9

Source: Table 16 above.

1/ First nine months.

2/ This figure underestimates the size of the actual public sector deficit to the extent that counterpart funds are used to supplement the budget and other extrabudgetary expenditures (see footnote 3/).

3/ Total counterpart funds from the sales of foreign cash and commodity aid, less counterpart funds used for budgetary support or local expenditures by the donors.

4/ Reflects the depreciation of the riel on September 19, 1974.

After mid-1972, the substantial deterioration in the budget accounts and renewed strong demand for imports led the authorities to tighten credit policy progressively. For instance, interest rates were increased in January 1973 (Table 18). The rate of advance import deposits on cash imports was progressively increased to 500 per cent in January 1973, while in that month the minimum reserve requirement was raised from 30 per cent to 33 per cent; it was further raised to 35 per cent on April 17, 1973 but reduced temporarily to 33 per cent between May 25 and July 14, 1973. Also in May 1973, restrictions were placed on bank financing of certain imports (automobiles, motorcycles) and of customs duties. These measures and the climate of uncertainty caused by mounting fighting and the decision by the United States to halt bombing as of August 15, 1973 led to a slower demand for imports and bank credit. Indeed, in the six months to June 1973, bank credit to the private sector rose by only KR 316 million (3.8 per cent). Accordingly, the authorities eased some of the restrictions applied earlier. The rate of advance import deposits on cash imports was progressively lowered to 100 per cent on August 13, 1973 and advance import deposits on commodity aid imports were reduced to 10 per cent on imports from the United States and to 25 per cent on imports from non-U.S. sources.

In the last months of 1973, there was a recovery in the demand for bank credit from the private sector. While some companies resorted to bank credit to finance their working capital and import bills, a large part of the increase in private sector credit represented the financing of purchases of rice by public corporations. The heavy demand for bank credit--which was facilitated by a substantial increase in bank liquidity--and the pressures on the exchange market prompted the National Bank to raise the reserve ratio further to 38 per cent in October 1973 (later reduced to 35 per cent on January 16, 1974), and, as of October 25, 1973 to introduce special advance import deposits for cash imports at a rate of 300 per cent with the amount frozen with the National Bank for a period of three months starting from the opening of the letter of credit; this latter provision was eliminated late in November 1973 and the rate of import deposits was reduced to 200 per cent in early 1974.

In view of the shortage of CIP funds in the first half of 1974 and of the strong demand for imports, it was decided to increase the advance deposits on CIP imports to 100 per cent from March 28, 1974 (except for petroleum products and sugar). Moreover, from that date the National Bank refused to rediscount operations involving commercial bank credit for CIP imports, which until that date could be refinanced for up to 90 per cent of the c.i.f. cost.

During the first nine months of 1974, a very substantial increase in credit to the public sector, which took place at a time when foreign exchange supplies both from aid and export receipts were declining, placed an increasing strain on the foreign exchange market and on the price level. These events led to the introduction of a number of measures in the exchange field in September 1974, including a very substantial depreciation of the riel (see below). These exchange measures were accompanied by the elimination of advance import deposits on imports financed through the Nouveau Marche, the Marche Libre and the United States CIP program (apart from the compulsory 100 per cent riel payment representing the payment of exchange purchased). The depreciation of the riel in September had important implications for bank liquidity since the riel value of a constant dollar import bill financed through the banking system virtually trebled. Moreover, according to present regulations the commercial banks cannot discount bills of exchange relating to imports under the CIP program with the National Bank. Largely for these reasons, the National Bank intends to ease credit selectively in the coming months to facilitate imports of essential commodities through the Nouveau Marche and U.S. aid programs. The National Bank, however, has instructed the commercial banks not to provide finance for imports of nonessentials or for the financing of stocks. The authorities are also exploring the scope for generating increased savings through an extension of branch banking as well as a further increase in interest rates.

3. Interest rates

In general, interest rate policy has been passive in the Khmer Republic in recent years. In spite of high rates of inflation during the past four years, interest rates have increased relatively little (Table 18) and throughout the period real interest rates paid to savers have been consistently highly negative. Correspondingly, the cost of borrowing has been negative in real terms and this fact has benefitted importers and traders holding stocks of goods financed by credit.

Although interest rates were increased on two occasions during 1973, the increases were very moderate. On January 2, 1973, interest rates on time deposits were set at 8.25-15 per cent, depending on the maturity of the deposits. In addition, commercial banks were authorized to issue certificates of deposits (bons de caisse), bearing the same interest rates as those on time deposits. Their denomination varies from KR 5,000 to KR 500,000 with a maximum of KR 1 million per person. Lottery savings deposits were also created. Lending rates for nonpriority credits were raised from 12 per cent to 18 per cent per annum, although an interest rate of 10 per cent was maintained for credits extended to exporters and a rate of 12 per cent was retained for loans to finance stocks of raw rubber. The preferential interest rate for aid imports which was 5 per cent in the first half of 1973 was eliminated in August 1973. While these higher levels of interest rates did little to restrain the growth of bank credit to the private sector, they increased somewhat the attractiveness of time and savings deposits in spite of the fact that real interest rates remained highly negative.

Interest rates were raised further in September 1973 with the rate of time deposits being increased from 15 per cent to 20 per cent and of nonpriority lending rates from 18 per cent to 24 per cent. Apart from some minor modifications subsequently introduced in January 1974, the structure of interest rates has remained unchanged now for a little over a year. The authorities are currently considering a further increase in interest rates.

Table 18. Khmer Republic: Interest Rates

(In per cent per annum)

Transactions	Prior to Nov. 1 1971	From Nov. 1, 1971	From Jan. 2, 1973	From Sept. 17 1973
National Bank of Cambodia				
Rediscount of commercial paper	3	6	8-9	12
Temporary lending against deposits of commercial paper (mise en pension)	3.5	7	9-10	13
Rediscounts of overdrafts (mobilisation de decouvert)	4.5	7.5	9.5-10.5	14
Advances guaranteed with foreign exchange	4.5	7.5	10.5	14
Rediscount of import bills under CIP	--	5	2.5	--1/
Rediscount of export bills	--	6	5	7
Financing of raw rubber stocks	--	6.5	6	8
Lending to the Government				
Ordinary	--	1.25	1.25	1.25
Extraordinary	--	0.25	0.3	0.3
Commercial banks				
Interest rates on deposits				
Savings deposits	3 3/	5 4/	7.5	10
Time deposits 2/				
3 months	5	5.5	8.25	11
6 months	6	6.5	9.75	13
12 months	7	10	15	20
Demand deposits	2	1	1	1
Lending rates				
Nonpriority lending	8	12 5/	18	24 5/
Priority lending	8	10 5/	10-12	14-16
Financing of CIP aid imports	--	5 6/	5	...1/

Source: Data provided by the National Bank of Cambodia, Phnom Penh, Khmer Republic.

1/ These facilities were eliminated in August 1973.
2/ On savings accounts with KR 50,000 minimum balance.
3/ Prior to July 1, 1971.
4/ From July 1, 1971.
5/ A quarterly commission of .25 per cent is charged on the highest debt balance registered during any quarter but not exceeding 25 per cent of the earned interest.
6/ From February 21, 1972.

VII. Balance of Payments

During the 1960s, the Khmer economy experienced reasonable balance of payments stability and official reserves remained at a comfortable level throughout the decade, amounting to about seven months of imports. The outbreak of war, in March 1970, had an immediate impact on exports but with strict import licensing, imports were also curtailed and the loss of reserves in 1970 was small. Imports were cut further in 1971, but with substantial inflows of aid they rose to SDR 65.5 million in 1972. In the meantime, large deficits were being recorded on invisible account. By the end of 1972 reserves had fallen to SDR 20.8 million, or 36 per cent of their prewar level, and were only equivalent to about two months imports of the prewar level. This decline occurred despite an IMF drawing of SDR 6.25 million in March 1972 under the Compensatory Financing Facility.

The economy has become progressively dependent upon foreign aid to finance imports; the substantial increase in imports in 1973 largely reflected the high levels of foreign aid, particularly rice imports. A resumption of rubber exports began in the second half of 1972, continued through 1973, and for the the latter year such exports amounted to SDR 8.5 million which was 68 per cent of total exports for that year. The overall deficit on the balance of payments was held at SDR 3.3 million for 1973. Partly as a result of a second drawing on the Fund's Compensatory Financing Facility for SDR 6.25 million in April 1973, there was an increase in foreign exchange reserves of SDR 6.6 million during that year.

During the first ten months of 1974 there was a modest increase of SDR 2 million to SDR 25.6 million in international reserves, but the balance of payments situation has deteriorated further. A shortage of foreign exchange provided under various aid programs during 1974 has been compounded by the fact that rubber exports, again the only significant source of official foreign exchange earnings, came to a virtual standstill in mid-1974. In addition, there are two other factors aggravating the balance of payments problem: world inflation together with a decline in the nominal supply of aid (excluding rice) have combined to produce a shortage of funds to finance essential imports, and the increased debt service burden is already beginning to absorb an increasing proportion of available foreign exchange.

1. Exports

Prior to the war, the Khmer Republic was a major exporter of rice and rubber. Substantial amounts of maize and cattle were also exported. Other exports included forestry products, kapok, and a wide variety of commodities in minor quantities, such as fruit and vegetables. The war resulted in domestic shortages of major food commodities and their export was prohibited in 1971; other principal exports fell drastically. The deteriorating security situation through 1974 has caused the exports of minor commodities, which made up almost half of total exports in 1971 and 1972, to drop sharply in the past two years.

With the resumption of production on some rubber plantations and the construction of rubber processing plants in Phnom Penh, rubber exports resumed in 1972 after a hiatus of one year; from SDR 0.8 million in 1972, they rose to

SDR 8.5 million in 1973 and SDR 8.0 million for the first eight months of 1974. Total receipts from merchandise exports amounted to SDR 12.4 million in 1973, and are estimated to have been about SDR 9.4 million in January-August 1974 (Table 19). During the period June-August 1974, supplies of rubber from the plantations (located in areas outside Government control) were being interdicted but, following recent agreements rubber exports began to move again after September.

Table 19. Khmer Republic: Merchandise Exports,1/ 1969-74

(In millions of SDRs)

	1969	1970	1971	1972	1973	1974 (End-August)
Rice	14.6	16.1	2.6	0.3	--	--
Rubber	23.6	8.2	--	0.8	8.5	8.0
Maize	3.7	2.0	0.6	--	--	--
Cattle	4.5	2.8	0.3	--	--	--
Forestry products	2.8	1.1	0.1	0.4	0.3	0.5
Kapok	1.2	0.9	0.6	0.5	0.4	0.2
Others	15.5	10.1	8.9	4.4	3.2	0.7
Total	65.9	41.2	13.1	6.4	12.4	9.4

Source: Data provided by the National Bank of Cambodia, Phnom Penh, Khmer Republic.

1/ Based on official export receipts. A substantial volume of exports, particularly of precious stones, is known to be made through unofficial channels.

2. Imports and foreign aid

The application of strict import controls reduced imports in 1970 to 69 per cent of their 1969 level with a further reduction in 1971. Despite these reductions, foreign exchange reserves were falling rapidly late in 1970 and early in 1971; it was clear that unless foreign aid became available, imports would have to be further restricted. Accordingly, a first grant under the United States Commodity Import Program (CIP) was made available in March 1971.

However, the procedures for obtaining CIP imports were complex and time-consuming. Administrative delays in obtaining imports under the program as well as the unfamiliar sources of supply deterred Khmer importers from using CIP funds. As a result, the demand for cash imports remained high relative to the availability of free foreign exchange. It became clear that tied commodity aid was not a perfect substitute for cash imports. Substantial amounts of cash aid was provided in conjunction with the stabilization program of October 1971. This led eventually to the establishment of the multilateral Exchange Support Fund (ESF) in 1972. The resources of the ESF are used to make payments for imports and import-related services. During 1972 the size of the ESF approximated SDR 32 million, of which SDR 1 million remained unused at the end and was added to the resources for 1973. The demand for foreign exchange was kept within the bounds of available supplies, during 1972 and 1973, largely by a combination of exchange depreciation and the imposition of advance import deposits.

The Exchange Support Fund was renewed in 1973 and 1974 when its total size amounted to SDR 29 million and SDR 18.4 million respectively (Table 20). The replenishment of the ESF during 1974 has been difficult and a number of donors, who indicated their intention to participate in the ESF for 1974 were not able to disburse their contributions until the second half of 1974. The sales of exchange had to be restricted in the first half of 1974 and cash imports during that period were running at less than half the rate of the corresponding period in 1973. By mid-November 1974, there was a possibility that, at the rate of sales in the period September-October (SDR 2 million per month), the ESF would be exhausted by early December.

Table 20. Khmer Republic: Contributions to Exchange Support Fund

(In millions of SDRs)

	1972	1973	1974
United States	11.5	14.4	9.0
Japan	4.6	5.8	5.8
Australia	0.9	0.8	--
United Kingdom	0.5	0.4	0.4
Thailand	0.2	0.2	0.2
New Zealand	0.1	0.1	0.1
Malaysia	0.1	-- 1/	--
Khmer Republic	13.8	7.1	2.6
Total	31.7 2/	28.8	18.4 3/

Source: Data provided by the National Bank of Cambodia, Phnom Penh, Khmer Republic.

1/ SDR 8,000.

2/ SDR 1 million remaining at the end of 1972 was added to the 1973 ESF resources.

3/ Contributions received as of end-October 1974.

In view of the shortage of foreign exchange available through the Exchange Support Fund in combination with other domestic factors, the authorities depreciated the exchange rate in January, April, and September 1974 and administratively restricted the sales of foreign exchange and, thereby, imports (see Section VIII). This severe shortage of foreign exchange from the ESF has been accompanied by, and partly exacerbated by, a shortage of aid funds under the U.S. Commodity Import Program. For 1974 as a whole, CIP funds are expected to amount to SDR 65 million, compared to about SDR 40 million last year. However, the projected increase in CIP funds for 1974 will be largely absorbed through the increased cost of petroleum and related products (total cost, including freight, estimated at SDR 19 million) and freight costs on PL 480 shipments (estimated at SDR 30 million for 1974).1/ Consequently, CIP funds available in 1974 for import costs other than rice, petroleum products, and PL 480 freight, at SDR 16 million are significantly lower in both value and volume than in 1973 (SDR 26.5 million). The uneven flow of commodity aid availability during 1974 also contributed to the difficulty of ensuring a smooth flow of imports.

By the end of May 1974, CIP funds provided in U.S. fiscal year 1974 (ending June) had been almost entirely utilized and no further funds were to become available before the beginning of the 1975 U.S. fiscal year (July 1, 1974). As a result, a number of commodities (including fertilizers and milk products) were transferred to ESF financing. In spite of the severe shortage of CIP assistance over 1974, the authorities have continued to maintain a preferential exchange rate for CIP imports. The premium varied from 15 to 25 per cent in the first nine months of 1974. In April, the authorities sought to limit the demand for CIP imports by raising the advance deposit requirements on such imports from 10 to 100 per cent.

The deteriorating security situation greatly increased the need for rice imports in 1973. In that year, rice imports are estimated to have amounted to about SDR 120 million and accounted for as much as 75 per cent of total imports. The bulk of 1973 rice imports (some 146,000 tons) were provided under the U.S. PL 480 program. It is estimated that about 300,000 tons of rice will be provided to the Khmer Republic during 1974 under the PL 480 program. Aid provided under PL 480 had hitherto taken the form of grants; a change in the U.S. regulations as of July 1974 requires that PL 480 assistance takes the form of a dollar-denominated loan to be amortized over 40 years (for details, see below).

3. Invisibles

Reliable data on services and capital transfers are not available for the years before 1971, but there appear to have been substantial net inflows of capital as well as growing revenues from tourism. With the outbreak of war, these sources of revenues disappeared. At the same time, there has been a very sharp increase in the costs of freight and insurance on imports. In 1973 these costs were almost three times their 1972 level, and during the current year they have risen sharply again. The costs for freight and insurance

1/ PL 480 import freight was financed out of ESF funds in 1972 and 1973; most of it was shifted to CIP financing in 1974.

Table 21. Khmer Republic: Balance of Payments, 1969-74

(In millions of SDRs)

	1969	1970	1971	1972	1973	1974 January October 1/
1. Trade (f.o.b.)						
Exports	65.9	41.2	13.1	6.4	12.4	11.9
Imports 2/	-99.2	-68.6	-55.1	-65.5	-165.3	-156.8
Balance on trade	-33.3	-27.4	-42.0	-59.1	-152.9	-144.9
2. Services 3/						
Receipts	...	...	12.8	7.4	10.4	6.6
Payments						
Freight and insurance on imports	...	...	-6.4	-9.8	-26.6	-31.3
Government service payments	...	...	-8.8	-11.2	-7.0	-3.2
External debt (net)	...	...	-4.2	-2.9	-1.3	-0.4
Other payments	...	...	-5.0	-7.5	-5.3	-5.9
Balance on services	26.1	20.6	-11.6	-24.0	-29.8	-34.2
3. Foreign aid 4/	...	...	25.9	66.6	183.7	175.9
4. Adjustments 5/	...	...	-1.5	0.2	-4.3	5.2
5. Allocation of SDRs	...	3.2	2.7	2.7	...	...
Total items 1-5	-7.2	-3.6	-26.5	-13.6	-3.3	2.0
6. Monetary movements (increase in assets -)						
Gold and foreign exchange	...	10.0	21.4	9.6	-6.6	-2.3
Bilateral payments agreements	...	--	0.4	0.2	-0.1	--
IMF position	...	-4.8	4.8	--	--	--
Use of IMF credit	...	--	--	6.3	6.3	--
Change in SDR holdings	...	-1.6	-0.1	-2.5	3.7	0.3
Total	7.2	3.6	26.5	13.6	3.3	-2.0

Source: Data provided by the National Bank of Cambodia, U.S. AID, and staff estimates.

1/ Staff estimates.

2/ Aid imports are recorded at the time of arrival and cash imports at the time of purchase of foreign exchange by importers. Arrival of cash imports generally occurs within a month of the purchase of foreign exchange. Imports shown do not include imports financed under foreign military assistance or humanitarian aid programs.

3/ Includes private transfers and capital.

4/ Commodity aid is recorded at the time of arrival of the goods being financed. Other aid is recorded when foreign exchange is received by the Khmer authorities.

5/ Adjustments for timing of aid payments and receipts, revaluation of reserves, errors and omissions, as well as certain unidentified invisible receipts.

on PL 480 imports have been financed partly through the Exchange Support Fund and partly by CIP funds. Freight costs of PL 480 rice shipments in 1974 are estimated to be SDR 33 million and total freight costs may exceed SDR 38 million. Substantial net outflows have been recorded on the invisibles account, reaching SDR 30 million in 1973, and estimated at SDR 41 million for 1974 (see Table 21).

4. External debt

National Bank statistics indicate that the total debt outstanding, including both principal and interest, amounted to SDR 50.9 million on October 31, 1974. Of this total amount, approximately SDR 41.1 million consisted of debt outstanding in convertible currencies (Table 22). A predominant part of the debt has been incurred in connection with railways, port facilities, and the oil refinery, but aircraft purchases and a variety of other public works and factories also accounted for large segments of it.

The Khmer authorities have taken steps to reduce the burden of external debt servicing on the balance of payments since the hostilities began in 1970. Debt service payments to Eastern European creditors were suspended in 1970. Other external debt obligations of the Khmer Republic were renegotiated twice under the multilateral auspices of the Paris Club in January and November 1972. These renegotiations applied to debt service payments falling due during 1972 and 1973; discussions for additional debt relief in respect of debt repayments falling due during 1974 have been in progress since November 1973. Even though the debt relief discussions have taken place in a multilateral forum, the overwhelming part of the Khmer Republic's external debt is accounted for by one creditor country, France, followed by Germany and Japan. The Franco-Khmer bilateral debt rescheduling agreement, signed on June 28, 1974, and later accepted as the basis for the German-Khmer bilateral settlement, resulted in the consolidation of that debt equal to 96 per cent of principal plus interest falling due in 1974.

Repayments on external debt falling due during 1974 amounted to SDR 3.6 million, prior to the bilateral debt relief agreements with France and Germany. Out of this total, SDR 2.8 million was owed to France, and about SDR 0.2 million was to be repaid to Germany under bilateral credits. An additional SDR 0.2 million was to be repaid to France and a much smaller amount to Germany under repayments falling due as a result of previous debt relief exercises. The remainder of the debt servicing for 1974 resulted from debt arising out of the multilateral agreement for the financing of the Prek Thnot project, of which Japan was the largest creditor with about SDR 0.1 million falling due in 1974. The actual debt service payments made during 1974 were then SDR 0.1 million in the case of France and just over SDR 8,300 in the case of Germany; the relief obtained therefore amounted to about SDR 2.9 million from both countries (Table 22).

The issue of PL 480 funding has taken on the characteristics of a serious problem during 1974. It is estimated that the Khmer Republic will import about 300,000 tons of rice under the PL 480 funding during 1974. Until recently, aid provided under the PL 480 program has taken the form of grants. The recipient government has, however, been required by the United States regulations to pay into interest-bearing accounts in local commercial banks

Table 22. Khmer Republic: External Debt, as of October 31, 1974

(In millions of SDRs)

	Debt Outstanding October 31, 1974		Projected External Debt Service Payments						
	Principal	Interest	1974 1/	1975	1976	1977	1978	1979	1980
Convertible currencies									
France	19.761	3.897	0.431	3.669	3.051	2.657	2.459	2.127	1.696
Denmark	4.074	--	--	--	0.113	0.226	0.226	0.226	0.226
Japan	3.575	1.006	0.125	0.273	0.360	0.351	0.342	0.334	0.325
Germany, Federal Republic of	4.185	1.317	0.036	0.347	0.320	0.312	0.333	0.395	0.386
Italy	0.742	0.167	0.077	0.075	0.074	0.072	0.070	0.069	0.067
United Kingdom	0.694	--	0.036	0.036	0.036	0.036	0.036	0.036	0.036
United States (PL 480) 2/	...	...	...	...	...	...	...	...	...
Asian Development Bank	1.406	0.358	0.016	0.042	0.091	0.140	0.140	0.140	0.140
Clearing account currencies 3/									
Yugoslavia	4.503	0.607	0.393	0.383	0.373	0.363	0.353	0.343	0.003
Czechoslovakia	2.132	0.322	0.243	0.244	0.177	--	--	--	--
U.S.S.R.	1.344	0.386	0.034	0.034	0.034	0.034	0.034	0.034	0.034
Germany, Democratic Republic of	0.371	0.069	0.009	0.009	0.040	0.039	0.038	0.037	0.037
Total	42.787	8.129	1.400	5.112	4.669	4.230	4.031	3.741	2.950

Source: Data provided by the National Bank of Cambodia, Phnom Penh, Khmer Republic.

1/ Projection takes account of debt relief obtained from France in respect of bilateral loans maturing in 1974 and of the debt rescheduling agreement with the Federal Republic of Germany concluded in September 1974.
2/ Service payments on this debt undetermined, see text for details.
3/ Service payments on clearing account credits have been suspended by Government decree.

the equivalent in local currency converted at the highest official exchange rate. The counterpart funds thus generated have in large part been subsequently granted to the Khmer Government by the United States in the form of budgetary support. As of July 1, 1974, however, new U.S. regulations require that PL 480 assistance take the form of a dollar-denominated loan to be amortized over 40 years with a 10-year grace period. An interest rate of 2 per cent is charged and payable during the grace period and it rises to 3 per cent for subsequent years. In view of the estimated PL 480 rice shipments during the second half of 1974, a debt of about SDR 70.5 million will be created in that period alone. In addition to the service payments to the United States resulting from the PL 480 debt there will be bilateral debt service payments of about SDR 4.4 million due in 1975 to various creditor countries. Two outstanding drawings on the Fund's Compensatory Financing Facility will also have to be repurchased according to established procedure.

5. External reserves

At the end of 1969, the official international reserves of the Khmer Republic amounted to SDR 57.7 million, equivalent to about seven months of that year's imports (Table 23). By end of October 1974, reserves had fallen by some 55 per cent and stood at SDR 25.6 million (equivalent to 1.8 months imports). This decline in official reserves took place in spite of two drawings, totaling SDR 12.5 million under the Fund's Compensatory Financing Facility.

Table 23. Khmer Republic: International Reserves, 1/ 1969-74
(End of Period)

(In millions of SDRs)

	1969	1970	1971	1972	1973	End-October 1974
Monetary gold	23.6	17.8	14.4	14.4	14.4	14.4
Foreign exchange (net) 2/	34.1	29.9	11.9	2.2	8.7	11.0
Reserve position in the Fund	--	4.8	--	--	--	--
SDRs	--	1.6	1.7	4.2	0.5	0.2
Disposable reserves 3/	57.7	54.1	28.0	20.8	23.6	25.6
Use of Fund credit (cumulative)	--	--	--	6.3	12.5	12.5

Source: Data provided by the National Bank of Cambodia, Phnom Penh, Khmer Republic.

1/ National Bank only.

2/ Foreign exchange holdings are given net of short-term liabilities of the National Bank to the Nouveau Marche.

3/ Excludes blocked French francs equivalent to SDR 8.7 million as of June 30, 1973.

VIII. Exchange and Trade System

During the 1960s, a highly centralized trade system was in effect in the Khmer Republic with state agencies responsible for almost all external trade. The exchange system was complex, with a variety of effective exchange rates. Beginning in 1969, the authorities undertook a liberalization and simplification of the exchange and trade system, leading to the reforms associated with the stabilization program of October 1971. These measures were accompanied by a substantial liberalization of imports. The basic reform of the exchange system of October 1971 was approved by the Fund (on October 22, 1971) for a period of one year. The Fund approved a change to a unitary exchange rate for all transactions to be adjusted to meet changing circumstances. On January 17, 1972, a preferential exchange rate for certain commodity aid imports and related services from the United States was introduced in order to speed up the flow of such imports.

In early 1974 a substantial increase in the budget deficit coincided with a shortage of foreign exchange available through the Exchange Support Fund. The resulting pressure on the exchange markets, despite depreciations of the exchange rate in January and April, led the authorities to impose comprehensive restrictions on the sale of foreign exchange in the first half of 1974 and take further measures in September 1974. The latter involved the creation of a three-tier exchange system and a substantial depreciation of the exchange rates. Although these measures were accompanied by the removal of customs duties and taxes on many imports, the new system resulted in a considerable intensification of exchange restrictions.

1. Exchange rate system

No par value for the riel has been agreed with the Fund. Details of the exchange and trade system prior to 1974 are presented in previous reports on the Khmer Republic (SM/74/156, June 26, 1974, and SM/73/251, November 9, 1973), and in the 25th Annual Report on Exchange Restrictions.

a. The system before September 19, 1974

Until September 19, 1974, the exchange rate structure comprised a basic rate and a preferential rate. The basic or general selling rate was set twice weekly in the Nouveau Marche des Changes which had been established in connection with the October 1971 stabilization program. On Mondays and Thursdays of each week commercial banks, acting on behalf of their customers, submitted bids for foreign exchange for imports. The application described the goods to be imported, the amount of foreign exchange requested, and the maximum exchange rate (in riels per U.S. dollar) that the importer was prepared to pay. The National Bank examined the bids. After taking into account the availability of foreign exchange, it set the exchange rate, and those importers who had bid at that rate or higher had their requests for foreign exchange granted at the exchange rate set by the authorities. The same exchange rate applied to exports and invisible receipts and to authorized invisible payments, including transactions with clearing account countries.

The National Bank bought foreign exchange at a rate of 0.4 per cent below the selling rate. The preferential exchange rate was applicable only to aid imports and related services procured directly from the United States (other than imports under U.S. PL 480). On September 18, 1974, the basic rate was KR 420 per US$1, and the the preferential rate was KR 336 per US$1, and therefore 25 per cent appreciated over the basic rate.1/ The preferential exchange rate was not maintained at a constant distance from the basic rate throughout.2/ On the supply side of the Nouveau Marche, funds were provided through the ESF which, in turn, was supplied by contributions from foreign donor governments and the Khmer Government. On the demand side, foreign exchange was purchased by commercial banks on behalf of their clients to finance eligible imports except for those that were either financed under the U.S. Commodity Import Program and PL 480 Program or were made <u>sans devises</u>; in addition, some eligible payments for invisibles and capital were channeled through this market. Other such payments were made out of the resources of the National Bank. Effectively, therefore, the system consisted of two official exchange markets; the Nouveau Marche des Changes, and the market for CIP imports.

Since early 1974, with a fall in resources accruing to the Nouveau Marche, the authorities limited the sales of foreign exchange for cash imports through discretionary cuts or rejections of the bids and later, in May 1974, through the enlargement of the existing negative lists. Foreign exchange sales which averaged just below $400,000 per market in 1973 were reduced to an average of $240,000 per market in the first quarter of 1974, further to an average of $50,000 during June-July, and allowed to increase in August 1974 to about $230,000. During this period, despite strong inflationary pressures, the exchange rate was kept stable through April and then, after being depreciated by 10 per cent, was again kept unchanged until mid-September 1974. Since the beginning of 1974, the differential between the effective Nouveau Marche rate (including customs duty and taxes) and the black market rate increased substantially; this differential had been almost negligible in the previous year. In view of the excessive liquidity generated by the budget deficits, demand for the relatively cheaper foreign exchange available on the Nouveau Marche built up to unprecedented levels (Table 24).

It was against this background that, in September 1974, the authorities introduced a major change in the exchange system. The new measures resulted in the establishment of a three-tier foreign exchange system, a substantial depreciation of the official exchange rates and the elimination of duties and taxes on a wide range of imports.

1/ An effective exchange rate of KR 55 = US$1 resulted from the payment of a subsidy on the basic rate and was applicable to government transfers to Khmer diplomatic, consular, and religious missions abroad and to transfers by students for the purchase of text books. As part of the exchange reform on September 19, 1974, this preferential rate was abolished.

2/ On October 22, 1973, the official rate was depreciated to KR 302 per US$1 and the preferential margin was set at KR 45. The basic rate was depreciated to KR 375 per US$1 on January 3, 1974, and further to KR 420 per US$1 in April 1974. The preferential rate was set at KR 302 and KR 306 per US$1, respectively on those dates, implying a general increase in the preferential margin to about 20 per cent.

Table 24. Khmer Republic: Demand for and Sales of Foreign Exchange on the Nouveau Marché, January-October 1974

(In thousands of U.S. dollars)

	Demand for Exchange	Sales of Exchange 1/	Number of Markets	Average Demand Per Market	Average Sales Per Market	Exchange Rate 2/
January	1,517	1,517	9	168	168	375
February	2,382	2,382	7	340	340	375
March	3,716	1,513	7	531	216	377
April	6,354	981	8	794	123	420
May	6,851	1,555	9	761	173	420
June	5,821	402	8	728	50	420
July	16,741	436	9	1,860	48	420
August	20,414	1,855	8	2,552	232	420
September	20,224	1,248	6	3,370	156	1,689
October	12,619	3,598	8	1,577	450	1,700

Source: Data provided by the National Bank, Phnom Penh, Khmer Republic.

1/ In addition, approximately $3,040,000 went to finance the purchase of banknotes.
2/ Exchange rates at end of period, except for September and October; the latter refer to highest rates at which exchange was sold on Nouveau Marché.

b. The system after September 19, 1974

As of September 19, 1974, the exchange system consists of three markets: the Marche Libre, the Nouveau Marche, and the market for CIP imports. The Marche Libre is operated by the two principal commercial banks and the rate is set twice a week by the authorities at a level determined, in principle, by demand and supply conditions. The exchange rate in this market is intended to serve as the leader rate for setting exchange rates in the other two markets. Initially, the exchange rate on the Marche Libre was set at KR 1,205 per US$1; subsequent depreciations have brought the rate to KR 1,630 per US$1 on November 11, 1974. The supply of foreign exchange on the market is out of export earnings, receipts from tourism, other invisibles and capital transactions. On the demand side, operations that cannot be financed on the Nouveau Marche or the market for CIP imports can, in principle, be financed on this "free" market subject to prior approval for outward transfers.

As regards purchase of exchange by the Marche Libre, it deals with all operations involving the transfer of foreign exchange from any source or origin, carried out by persons of any nationality, resident or nonresident. The Marche Libre was intended to provide the foreign exchange necessary for financing the following operations, without prior authorization from the National Exchange Office: (a) the import of goods on a specific list to be published by the Ministry of Commerce; (b) all expenditures abroad of the Khmer Government (diplomatic, consular and other missions, educational grants, postal and telegraphic expenses, etc.); (c) subsistence and all medical expenses for students and trainees abroad without grants; (d) payments for services rendered by a foreign source. Other transactions can be financed through the Marche Libre only if approved by the National Exchange Office. As regards imports, access to transactions on the Marche Libre is restricted to importers meeting requirements laid down by the Ministry of Commerce in 1971.

The Marche Libre was introduced with a view to liberalize the buying and selling of foreign exchange and thereby eliminate the black market that was channeling funds out of the official system. Initially, the exchange rate on the Marche Libre was set at a level close to the black market rate of exchange, and the exchange rates on the other two official markets were, in turn, linked to the Marche Libre rate at appreciated levels. In fact, however, a list of authorized imports for the Marche Libre was published and issued only after the market came into operation. The list was found inadequate, since it contained mainly nonessential commodities for which there was very little demand, and was soon withdrawn. Within a week a new list of permissible commodities was released which contained those goods eligible on the Nouveau Marche. As it has operated recently, the import of goods on the Marche Libre is based on arbitrary authorization by the authorities and, in fact, only one transaction was permitted (Table 25). The market failed in its primary purpose of eliminating the black market, largely because a very limited number of transactions were approved for financing. Over the period September 19-November 8, 1974 total purchases of exchange by the market amounted to $3.2 million while sales amounted to $1.8 million thus leaving the Marche Libre as a substantial net purchaser of exchange (Table 26). Once the sales of exchange were severely limited, purchases of foreign exchange by the authorities also fell off, as the hoped for diversion in the surrender of export receipts from unofficial to official channels did not materialize. The Marche Libre attracted proceeds only from transactions which were surrendered in any case to the National Bank, such as export earnings from rubber and foreign exchange conversions by embassies.

Table 25. Khmer Republic: Operations on the Marché Libre de Change During the Period September 19-November 8, 1974

(In U.S. dollars)

Purchases		Sales	
Nature of Operation	Amount	Nature of Operation	Amount
Rubber exports	915,563	Imports through Marché Libre[1/]	299,914
Other exports	672,121	Government transfers	643,523
Insurance payments	63,426	Transfers for students and trainees	96,635
Other invisibles (mainly conversions by embassies)	1,342,732	Reutilization of exchange from insurance payments	53,591
Unutilized exchange for imports	113,677	Freight for POL products for Khmer Armed Forces	210,000
Sales of exchange for '*sans devises*' imports	67,400	Other invisibles (airline tickets, travel expenses of tourists, etc.)	428,826[2/]
		Imports under the '*sans devises*' system	67,400
Total	3,174,919	Total	1,799,889

Source: National Bank of Cambodia, Phnom Penh, Khmer Republic.

1/ Refers to one transaction only, undertaken on October 1, 1974. No further import transactions have been authorized.

2/ Includes US$203,000 travel costs for military personnel.

Table 26. Khmer Republic: Purchases and Sales of Foreign Exchange on the Marche Libre des Changes

(In thousands of U.S. dollars)

1974	Purchases	Sales	Net Purchases	Exchange Rate
September				
19-23	321	86	234	1,204.80
24	101	6	95	1,285.00
25	28	14	14	1,285.00
26	143	12	131	1,285.00
27	48	23	25	1,285.00
28	226	18	207	1,285.00
30	92	69	23	1,285.00
October				
1	95	8	87	1,285.00
2	84	26	58	1,285.00
3	168	342	-174	1,285.00
4	243	9	234	1,285.00
7	56	67	-11	1,285.00
8	149	9	140	1,285.00
10	62	15	46	1,285.00
11	165	53	112	1,285.00
14	47	30	17	1,285.00
15	4	8	-4	1,285.00
16	14	11	3	1,285.00
17	51	23	28	1,285.00
18	9	11	-2	1,495.00
19	1	6	-5	1,495.00
21	111	17	94	1,495.00
22	31	4	27	1,495.00
23	55	27	27	1,495.00
25	56	15	41	1,495.00
28	140	3	137	1,495.00
29	114	12	102	1,495.00
30	25	5	20	1,495.00
31	221	217 1/	4	1,495.00
November				
1	29	7	22	1,495.00
4	51	32	19	1,495.00
5	95	85	10	1,620.00

Source: National Bank of Cambodia, Phnom Penh, Khmer Republic.

1/ Includes $210,000 for POL freight of the armed forces.

The black market continues to exist and the exchange rate on this market has been fluctuating between KR 2,200 and KR 2,800 per US$1 in the first half of November 1974. Though the actual magnitude of the black market is unknown, the wide fluctuations in the exchange rate over short periods of time would suggest, prima facie, that it is fairly narrow.

The Nouveau Marche des Changes, in principle, sells foreign exchange for all commodities not on a specific list. All financial transactions are carried out on the Marche Libre. Since September 19, 1974 the Nouveau Marche operates on an auction format where a predetermined amount of exchange is sold to the highest bidders. For each market the authorities set a "floor rate" above which bids have to be made. This floor level was initially set at the substantially depreciated rate of KR 1,110 per US$1 (on September 19, 1974) and is adjusted in the light of developments in the Marche Libre rate. In principle, the floor exchange rate on the Nouveau Marche is set at a level 5 per cent appreciated over the Marche Libre rate, but in practice the rate has varied between 5 per cent and 13 per cent appreciated over the Marche Libre rate. Since foreign exchange is sold, on the Nouveau Marche, at the rate offered by each bidder, if his bid has been accepted, there is in fact a considerable multiplicity of exchange rates on the market. The difference between the "floor rate" on the Nouveau Marche and the highest rate at which exchange is sold has on occasion been as much as KR 350 in the recent past. On November 15, 1974, the "floor rate" was KR 1,570 per US$1.

The third official exchange market is for transactions dealing with imports under the U.S. Commodity Import Program procured directly in the United States. Importers may have access to this market only through SONEXIM. The exchange rate on this market is, in principle, set at a level some 20 per cent appreciated over the Marche Libre rate expressed in riels per U.S. dollars; in practice it has moved around this percentage. The reasons for the appreciated rate are the cumbersome administrative formalities and the long delivery times that occur for imports under the CIP. Imports under the CIP aid program procured outside the United States (Code 941 countries) are effected in principle at a rate 5 per cent appreciated over the exchange rate on the Marche Libre. Imports under the U.S. PL 480 program are effected at the exchange rate prevailing on the Marche Libre; the freight charges for such imports are converted at the preferential CIP-market rate for cargo carried on U.S. ships.

2. Administration of control

Exchange control is administered by the National Exchange Office, an autonomous agency within the National Bank; this office is empowered to authorize all operations related to settlements with foreign countries, to foreign investments, and to nonresident accounts. The Ministry of Commerce is in charge of the administration of import and export controls.

3. Prescription of currency

Settlements with five countries with which the Khmer Republic has bilateral payments arrangements are made through bilateral accounts. Those maintained for Czechoslovakia, Eastern Germany, and the U.S.S.R. are denominated in pounds sterling and those for Bulgaria and Poland in U.S. dollars. Settlements with other countries take place in convertible currencies.

4. Nonresident accounts

The following categories of account may be maintained for nonresidents: Foreigners' Accounts in Riels, Capital Accounts, Nonresident Accounts, and Foreign Currency Accounts. In addition, Khmer nationals staying abroad temporarily but not recognized as nonresidents, and foreigners staying in the Khmer Republic but not recognized as residents, may maintain Internal Accounts of Nonresidents. There are seperate regulations concerning nonresident accounts that may be used to finance transactions in the free trade area of Kompong-Som.

a. Foreigners Accounts in Riels may be opened, without permission, for foreigners residing outside the Khmer Republic. They are related to the country of residence of the account holder. They may be freely credited with (1) proceeds from the sale on the Phnom Penh exchange market of the currency (but not banknotes) of the country of the account holder; (2) payments for authorized imports (including incidental expenses) from the country of the account holder; (3) earnings on investments in the Khmer Republic and receipts from repayments on Khmer stocks and bonds and on other investments made in the Khmer Republic after May 1956; and (4) interest paid by the banks on funds kept in the accounts. These accounts may be freely debited for normal expenses in the Khmer Republic and, provided that it is quoted on the Phnom Penh market, for purchases of the currency of the country of the account holder (except in the form of banknotes). Transfers between Foreigners' Accounts in riels related to the same country may be made freely.

b. Capital Accounts may be opened without permission. Subject to authorization, these accounts may be credited with (1) proceeds from the sale in the Khmer Republic of Khmer stocks and bonds; (2) proceeds from the sale in the Khmer Republic of participations in corporations other than by purchases of stocks and bonds; (3) contractual or advance repayments of Khmer stocks and bonds; (4) proceeds from the sale through an authorized notary of real estate or businesses located in the Khmer Republic and in the possession of a nonresident since January 1, 1955 or acquired by him at a later date either through inheritance or with the permission of the National Exchange Office; (5) repayment of loans granted to residents prior to January 1, 1955, or after that date with the approval of the National Exchange Office; and (6) transfers from another capital account related to the country of the account holder. Capital accounts may be freely debited for (1) living expenses of the account holder or his family up to KR 1,000 per person a day, and up to a maximum of KR 50,000 monthly, and (2) expenses connected with the administration of foreign assets in the Khmer Republic (stocks and bonds, buildings, land, etc.). Subject to authorization from the National Exchange Office, these accounts may be debited for (1) purchases in the Khmer Republic of Khmer stocks and bonds; (2) subscriptions to, or increases in the capital of, a Khmer firm; (3) purchases through an authorized notary of title to real estate or businesses located in the Khmer Republic; (4) loans in riels to residents; (5) transfers to another capital account related to the country of the account holder; (6) living expenses in the Khmer Republic of the account holder's employees if the account is held by a firm (corporation, bank, etc.); and (7) gifts to individuals and to social, cultural and religious associations.