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Economic Intelligence Memorandum

CAMBODIA'S DETERIORATING ECONOMY



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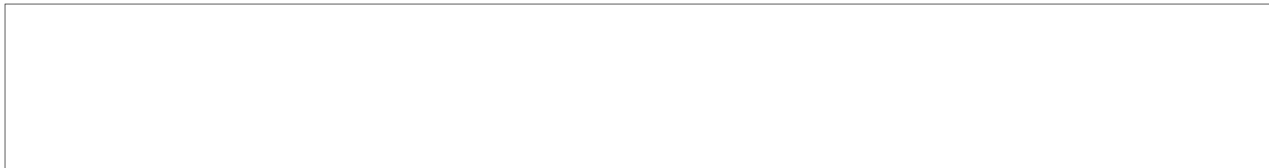
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CAMBODIA'S DETERIORATING ECONOMY*

Summary and Conclusions

The economic reforms announced in November 1963 by Prince Sihanouk, the Cambodian Chief of State, were designed to achieve a more effective control of Cambodian resources and to provide the financial capital for development of a viable socialist economy. Reforms announced during the period of his renunciation of US economic assistance provide for nationalization of the import-export trade by 1 March 1964 and for nationalization of commercial banking by mid-1964. In addition to the objective of reducing corruption, these measures were expected to transfer the capital and energy of resident Chinese and European businessmen from trade and finance to the development of industry and expansion of agriculture. A large part of the profits, which formerly accrued to foreign interests, hopefully would then be available to the state for use in financing needed social and economic infrastructure.

These new policies, rather than promoting economic gains, have disrupted internal distribution and export of rice, increased unemployment, all but eliminated short-term credit, further raised the cost of living, and widened dissatisfaction among both foreign and Cambodian entrepreneurs as well as high government officials. Although affecting a broad segment of Cambodia's population, none of these economic dislocations appears serious enough to be an immediate threat to the control exercised by Prince Sihanouk.

* The estimates and conclusions in this memorandum represent the best judgment of this Office as of 15 April 1964.

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I. Nationalization of Foreign Trade

Nationalization of Cambodian foreign trade was to have been effected on 1 January 1964, and to this end the National Export-Import Company (SONEXIM) was established in December 1963. When it became obvious, however, that the vital export of rice, which usually provides about one-third of Cambodia's total exports, could not be carried out by the newly organized SONEXIM, the effective date of complete nationalization of trade was delayed until 1 March 1964. SONEXIM, with a Chinese Communist adviser as a permanent staff member, is an autonomous company, funded jointly by the government (60 percent) and by private Cambodian capital. It is subject to the control of the Ministry of Commerce in policy matters and allocations of foreign exchange. According to Prince Sihanouk, SONEXIM will buy domestic commodities and products solely for export, domestic distribution remaining in the hands of private traders. Similarly, SONEXIM will act as an importer and wholesaler, and as in the past the retailing of imported goods will be left to private traders. Foreign exchange is to be made available to SONEXIM according to a schedule made up by the Ministry of Commerce. SONEXIM purchases import commodities with allocated foreign exchange according to orders submitted by the end-users. This organizational structure places the participating government and private officials in a position to profit from increased business in domestic trade through private firms in which they have an active interest.

The first problem faced by SONEXIM was the export of the important current rice crop. Cambodia's rice crop in 1963/64 turned out to be the largest crop ever, the estimated 2,065,000 tons* exceeding the 1962/63 record crop by about 22 percent. 1/** If harvesting was completed satisfactorily, the rice crop would provide 600,000 tons for export compared with 200,000 to 400,000 tons in former years. To harvest the rice, however, the Cambodian farmer needed to borrow money to pay his field laborers. The laborers were financed in the past through the advance sale of paddy to millers and exporters who received loans from commercial banks. The total requirement for short-term credits to cover the rice harvest had been 200 million to 300 million riels.*** Such credit has not been available this year because of restrictive banking legislation imposed in November 1963 and the uncertain prospects for businessmen engaged in foreign trade and commercial banking. The government, in an attempt to fill the credit gap, established a re-discount fund to finance credits to eligible clients instrumental in the rice harvest. 2/ To administer this fund, the government bought

* Tonnages are given in metric tons throughout this memorandum.

*** Riel values in this memorandum are given in current riels and may be converted to US dollars at the rate of 35 riels to US \$1.

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the private commercial Cambodian Bank (now the Cambodian Commercial Bank) and passed legislation permitting the Cambodian National Bank to enter the commercial banking field. The bureaucratic process for approval of loans to millers and exporters, however, proved too slow to satisfy the needs of the export markets. As a result, by early March SONEXIM had contracted for the purchase of only about 70,000 tons, whereas under normal marketing conditions the entire export rice crop would have been contracted for during January.

Further aggravation of the credit problems affecting the rice harvest developed when additional credit was needed in February to finance the harvest of tobacco and other field crops. Moreover, the shortage of jute bags, formerly imported under the USAID program, limited the capacity of farmers and millers to store and transport the export rice. Although a final report on the rice harvest has not been received, it has been reported that half of the export rice crop in Battambang Province has been lost in the fields. 3/ Although Battambang Province is the leader in total output and in export rice, the output of export rice is fairly widespread throughout Cambodia's rice growing provinces. The failure, therefore, of a large number of rice farmers throughout the country to sell export rice as a cash crop will restrict considerably the business usually generated by them in other sectors of the economy. The final impact of the problems of the rice harvest probably has not been felt. Distrust by the farmers and millers in the ability of the government, and particularly of SONEXIM, to handle export marketing and local financing also may lead to a reduced planting during the next season. Such a reaction occurred in 1962-63, when the failure of the government subsidy program for cotton resulted in a drop in output of cotton from 30,000 to 4,000 tons.

II. Nationalization of Commercial Banking

The projected nationalization of all Cambodian banking in mid-1964 has dried up almost all commercial credit. Cambodia had eight commercial banks, three of which were backed by Cambodian nationals, three by French interests, and two by the British. In December the Cambodian Bank of Phnom Penh closed when its director, Songsakd Kitchpanich, fled the country, taking with him a large portion of the bank's assets, including some government funds. This was a significant blow to private banking and implicated many high government officials who had received the bank's favors in the form of low-interest loans. As previously stated, private commercial banking was faced with competition by the government in December as a result of the nationalization of the Cambodian Bank and the authorization to the National Bank to conduct commercial transactions. The fate of French and British commercial banks now operating in Phnom Penh is not yet known, but their banking activities have been curtailed, and apparently they will be compelled to close unless a change in legislation is made before July 1964. At any

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rate, the absence of commercial credit has touched off a general decline in business and construction. Moreover, with the cutoff of US economic assistance, new developments in agriculture and industry, electric power, and transport will depend on economic assistance made available largely by France and by the Communist countries. In an effort to forestall additional disorganization of the private business sector, guarantees against nationalization have been authorized for manufacturing industries and agricultural enterprises. 4/ Recent nationalization moves, however, have poisoned the private foreign investment climate, and little has been forthcoming even with these formalized guarantees.

III. Decline in Economic Activities

Although the effects of the new economic policies on exports of rice and the rice harvest have been the most dramatic, the new marketing and banking policies have had other adverse effects on the Cambodian economy. There has been a general decline in business activity. Unemployment has increased in the urban areas and is expected to reach 30,000 (17 to 20 percent of the urban labor force). The unemployed include a large number of students completing their studies and seeking white-collar employment and those service personnel formerly employed by foreign businesses and residents. In addition, the three operating state-owned factories built with Chinese Communist aid have reduced their total work force by one-third, adding more than 800 to the unemployed. A compulsory work law has been passed, giving the government the authority to employ workers where they are needed, but the small number of jobs available in remote areas are primarily physical labor, not particularly suited to the city-bred worker. 5/ Public and private construction has been curtailed by a drop in imports of construction materials, a lack of financing, and restrictions on issuing new building permits. Although imports of petroleum products (formerly supplied under the USAID commodity import program) are being continued by foreign oil companies with guaranteed payments by the Cambodian government and although local distribution reportedly is not to be nationalized, the availability of petroleum is limited. Civilian use of gasoline has been discouraged by doubling the price. This increase in price has particularly affected truckers and bus companies, who have not been granted commensurate increases in freight and passenger rates. 6/ Trucking is to be nationalized gradually beginning in 1964, a move that probably will result in a general decline in the efficiency of transport services. 7/

Recent status of gold and foreign exchange reserves has not been reported. At the end of October 1963 these reserves stood at about \$96 million, having been built up to this relatively high level with the help of the US commodity import program. 8/ It is known that in December at least \$3 million of foreign exchange reserves were drawn to pay for imports of petroleum, annual imports of which have been

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about \$7 million. The total adverse balance of trade during 1963 may have reached \$25 million, calling for a further reduction of reserves. Unrealistic projections for trade during 1964 estimated an export surplus. The reduced exports of rice, along with the lower output of corn, beans, and other export crops and the low price of rubber, will make a significant increase in exports unlikely. Imports will be lower than in 1963 because of strict government restrictions and the dislocation of normal import activities. Thus trade during 1964 may be balanced but probably will not yield a significant surplus.

The proposed government budget for 1964 indicates a deficit of about \$50 million, some 28 percent of the total budget. Of this amount, \$23 million is to be advanced by the National Bank. Anticipated, but indefinite, foreign borrowings from France, the USSR, Yugoslavia, and Czechoslovakia are to account for the remainder. 9/ Borrowings from Communist countries are under existing long-term credits, and increases in French assistance are under negotiation. A planned reduction of imports, however desirable from the point of view of the balance of payments, will have an adverse effect on government receipts, for customs duties make up about 25 percent of total government revenues.

Currency in circulation increased to 4 billion riels by November 1963, an estimated increase of 27 percent above 1962. An additional printing of currency of 500 million riels was reported to have been ordered in January 1964 to provide funds to pay the armed forces. 10/ These additional money issues will further raise consumer prices, which had increased markedly during 1963. The cost-of-living index and the food price index for the working class in Phnom Penh in 1963 both rose about 12 percent above 1962 and have continued to rise during 1964. 11/ Turnover taxes on rice and meat, which were rescinded in early 1963, were reestablished in January 1964. It was reported that the pay of Foreign Ministry officials had been delayed for January and that employees of the Ministry of Public Works were not paid for 6 weeks. A recent report indicates that treasury funds for payment of government salaries are adequate to cover only about 2 months at the current rate of spending. 12/

IV. Aid and Trade from Communist Countries

Since the renunciation of US aid, Prince Sihanouk has looked for additional economic assistance from both Communist countries and countries of the Free World. The only new economic aid proposed by a Communist country has been that offered by East Germany. Military assistance has been provided by the USSR and Communist China and is forthcoming from Czechoslovakia and Yugoslavia. Soviet military assistance, consisting of 24 antiaircraft guns with auxiliary equipment and 4 MIG aircraft given in late 1963, will be augmented by additional military aircraft, artillery, and small arms. Soviet technicians are training

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Cambodians in the use of this equipment, and Cambodian pilots have been trained in the USSR. 13/ Communist China's military aid, first received early in 1964, has thus far consisted of 100 vehicles and small arms to equip 3 battalions. A mission headed by Cambodian Minister of Defense Lon Nol was in Peking during March 1964 and probably succeeded in obtaining further military aid. This mission has been to the USSR probably for the same purpose. 14/

Economic assistance from Communist countries during 1964 will be provided under existing grants and credits. Soviet assistance will include final drawings on the grant for a technological institute, and drawings under a \$12.2 million credit for the Kamchay Dam hydroelectric facility. Yugoslav credits totaling \$6 million also will provide work on hydroelectric power facilities and possibly other projects still under consideration. Under Czechoslovakia's credit of \$4.5 million, a sugar refinery, a tractor assembly plant, a tire factory, and a munitions plant are in early stages of construction. In addition, under the Czech credit, an 18,000-kilowatt thermal electric generating plant may get underway during 1964. Chinese grants should provide for completion of the cement plant at Chakrey Ting and, if agreement can be reached, may finance additional industrial plants. Cambodia seeks economic assistance for the construction of an oil refinery and an automobile assembly plant and for the expansion of port facilities at Sihanoukville. Another pressing need is for financing to complete the Phnom Penh - Sihanoukville Railroad.

Other recent Communist activity in Cambodia's economy has included sending a number of Chinese technical advisers to assist in planning for the progressive nationalization of the economy. In December 1963 a civil air agreement was concluded with China to permit weekly flights between Phnom Penh and Peking via Vientiane, Hanoi, and Canton. Implementation of this agreement was postponed, however, because of the inability to get overflight rights from Laos. An East German delegation visited Cambodia early in 1964 and has offered economic assistance for construction of irrigation works, for mechanization of saw mills, for construction of pottery and china factories, and for improvement of facilities at Sihanoukville. 15/

Trade with the Communist countries increased during 1963. During the first 9 months, 15 percent of Cambodia's total exports went to Communist countries (valued at \$63 million) compared with 11 percent for the same period in 1962. Similarly the Communist countries supplied 19 percent of Cambodia's total imports (valued at \$82 million for the 9-month period) as opposed to 16 percent in 1962. Increases in Soviet Bloc* trade were accounted for primarily by larger purchases of Cambodian rice, which in 1963 accounted for about 30 percent of all

* Excluding Albania.

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Cambodian exports of rice and rice flour. 16/ East Germany initiated trade with Cambodia during 1963, but the total volume was only about \$300,000 during the first 9 months of the year. A trade agreement was signed with North Korea calling for an exchange of about \$1.4 million of goods each way.

V. French Assistance

Although economic aid comes from several countries of the Free World, French presence in Cambodia continues to be strong and represents the major Western influence in the country. French financial interests are considerable and include ownership and operation of most of the rubber plantations,* partial ownership of a number of small industrial installations, the operation of three commercial banks, and an interest (40 percent) in the Royal Cambodian Airlines. The French military training mission consists of about 250 instructors; the cultural mission includes 70 university teachers and about 256 teachers in lower schools; and the technical aid mission provides 40 experts in the fields of health and public works. 17/ A French mission headed by French Army Minister Pierre Messmer, in early January 1964 established the basis for further grants of military and economic assistance. About 100 military vehicles, 18 training and transport aircraft, and 18 tanks with auxiliary equipment for an armored battalion of the Cambodian Army are being provided by the French. Other aid offered by the French included construction of a teacher-training school in Phnom Penh and assistance in establishing a national agricultural college. The estimated value of the new French military and technical assistance is about \$7.5 million. The established cultural, technical, and military missions represent an annual grant of about \$3 million. Although no commitment has been obtained from France, financial guarantees or long-term credits have been sought by Cambodia to underwrite the completion of the Phnom Penh - Sihanoukville Railroad and the expansion of the port facilities at Sihanoukville. Negotiations on French assistance have been stalemated for the past 2 years by Cambodian refusal to recognize the French currency devaluation of 1958.

* Rubber is Cambodia's second important export crop, accounting for roughly one-third of total exports by value.

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