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**DIRECTORATE OF  
INTELLIGENCE**

# Intelligence Memorandum

*Cambodia's Financial Prospects For 1971*

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CENTRAL INTELLIGENCE AGENCY  
Directorate of Intelligence  
May 1971

## INTELLIGENCE MEMORANDUM

## CAMBODIA'S FINANCIAL PROSPECTS FOR 1971

Introduction

1. The findings of a recent International Monetary Fund (IMF) mission are very pessimistic regarding Cambodia's prospective financial position. The mission estimates that because of lags in deliveries of imports financed by US AID, the government's 1971 budget deficit may be far in excess of the 6.0 billion riels officially projected. The IMF mission, however, did not concern itself with the details of the Government of Cambodia (GKR) budget and did not address itself to the question of military expenditures, the principal source of the projected deficit.

2. In a previous analysis of the GKR's 1970 wartime budget projections, we found that expenditures were substantially overstated, largely because of inflated military personnel costs. This memorandum examines the GKR's 1971 budget projections, particularly military allocations; adjusts official estimates of the budget deficit accordingly; and estimates the net effect of the adjusted expenditures on liquidity in 1971 under alternative assumptions concerning the amount of deliveries of US AID commodities. The other major influences on Cambodia's financial situation - the likely size and composition of exports and imports - also are evaluated.

Summary

3. Cambodian projections of budget expenditures in 1971 appear to be substantially overstated largely because of inflated estimates of average military personnel costs. By employing a more realistic cost factor, estimates

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

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of military expenditures are reduced by 2.5 billion riels, or some 13%. Further reductions may result from the current campaign to verify military payrolls. Projected civil expenditures remain at prewar levels despite substantial losses of population and territory under government control; political considerations presumably prevent a reduction.

4. Counterpart receipts from the sale of US AID commodities also appear to be seriously overstated. Of the \$78.5 million in US economic aid obligated to Cambodia for US fiscal year (FY) 1971, only a very small portion has actually arrived. By the end of calendar year (CY) 1971, actual US aid deliveries could amount to between \$30 million and \$60 million but almost certainly will be less than the \$70 million anticipated in the official import plan. The GKR has insufficient foreign exchange reserves to make up for the probable shortfall in US AID deliveries. Reserves have fallen from about \$60 million at the end of December to about \$50 million by the end of March, and further drawdowns will be necessary to finance certain critical items ineligible for AID financing. Export earnings are expected to amount to only \$14.3 million, compared with average annual earnings of \$80 million in 1965-69. Consequently, imports in 1971 are likely to fall short of the planned goal by a substantial margin.

5. Since overstatements of both expenditures and revenues tend to compensate for each other, the official projection of the budget deficit -- 6.0 billion riels -- does not appear to be far off the mark. With the deflated projections of military personnel costs, we estimate that the GKR budget deficit for 1971 could be held to between 4.2 billion and 6.8 billion riels, depending upon US AID deliveries.

6. Because the rate of government expenditures is likely to level off, payments arrears should stop growing and the cash deficit probably will not be much different from the accounting deficit in 1971. We estimate that currency in circulation will increase by 34% to 55% during 1971. With the money supply continuing to expand at rapid rates, upward pressure on prices is bound to increase. In the coming months, the fragile confidence in the economy that so far has prevented hyperinflation could easily be shaken. Depleted stocks, delays in US assistance, and insecure lines of communication will probably hold down supplies of goods at a time when monetary demand is booming.

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DiscussionExports

7. Cambodia's export earnings are officially projected at only \$14.3 million for 1971, compared with average annual earnings of \$80 million in the period 1965-69. Despite a large rice surplus -- perhaps as much as 200,000 tons -- from the harvest just completed and at least 150,000 tons of exportable rice left over from last year's harvest, transport problems are expected to limit rice exports to some 120,000 tons, valued at \$7.3 million. Production of rubber, normally Cambodia's second largest foreign exchange earner, was halted in mid-1970 because of enemy occupation of the plantations and extensive damage to processing facilities. Production is not expected to resume in the foreseeable future -- a considerable loss to Cambodia's economy. Livestock (\$1.1 million), corn (\$1.0 million), and kapok (\$0.6 million) are expected to constitute the bulk of remaining exports. The export plan, drawn up prior to the March 1971 attack on the oil refinery, included \$0.8 million in fuel oil and naphtha exports, which will not be realized. Since there is some possibility of an agreement with the Government of South Vietnam whereby rubber plantations in friendly hands, such as the Krek plantation, could resume production of raw latex for shipment to South Vietnam for processing, and since hopes that Battambang rice might be shipped via Thailand have been revived in recent weeks, export earnings substantially in excess of \$15 million are possible. Nevertheless, it is far too early to adjust official projections upward.

Imports

8. For 1971 the GKR plans imports at \$91 million, somewhat less than prewar levels (imports amounted to \$104 million in 1968 and \$96 million in 1969). The fact that a significant portion of Cambodia's industry either has been damaged or has fallen into enemy hands raises requirements for certain goods, such as fertilizer, cement, paper, and refined petroleum. Increased imports of tires may also be necessary because production at the state-owned tire factory (SONAPNEU) may soon be halted for lack of rubber. On the other hand, planned imports for 1971 are more than double the level actually achieved in 1970.

9. The broad categories employed in available import data cannot readily be classified in terms of final uses of the imports. Rough calculations suggest, however, that capital goods imports are to increase more than consumer goods imports, as shown below.

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	1971		1970		1970	
	<u>Current Plan</u>		<u>11-Month Imports</u>		<u>Prewar Plan</u>	
	<u>Million</u>	<u>Per-</u>	<u>Million</u>	<u>Per-</u>	<u>Million</u>	<u>Per-</u>
	<u>US \$</u>	<u>cent</u>	<u>US \$</u>	<u>cent</u>	<u>US \$</u>	<u>cent</u>
<i>Total imports</i>	90.8	100	35.5	100	66.7	100
Consumer-oriented	52.7	58	23.9	67	43.4	65
Industrial/ capital-oriented	32.0	35	9.6	27	21.1	32
Uncategorized	6.1	7	2.0	6	2.2	3

10. The following tabulation shows the sharp increases planned for a few selected categories of capital goods.

	<u>Million US \$</u>		
	<u>1971</u>	<u>1970</u>	<u>1970</u>
	<u>Current</u>	<u>11-Month</u>	<u>Prewar</u>
	<u>Plan</u>	<u>Imports</u>	<u>Plan</u>
Industrial machinery	5.4	0.9	1.1
Electrical equipment	4.1	1.0	1.3
Cement	1.8	0.5	1.5
Steel	8.1	1.8	7.2
Construction-related	5.0	2.8	3.1

Planned imports of \$5.4 million in industrial machinery and \$4.1 million in electrical equipment, compared with last year's imports of \$0.9 million and \$1.0 million, respectively, are particularly difficult to explain in the present economic climate. Much of the \$15 million in planned imports of cement, steel, and construction machinery, however, will probably be used to rebuild roads, bridges, and other infrastructure. Planned cement imports reflect the need to replace stockpiles in Phnom Penh. Although a six-month stockpile of cement is said to be on hand at Cambodia's Chakrey Ting plant, it is cut off from the capital by enemy interdictions to Route 3. Reports that a sharp decline in construction activity had left a stockpile

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of reinforcing bars in Phnom Penh lead us to speculate that some portion of planned steel imports probably will consist of barbed wire, heavy wire mesh, and other steel products required by the military.

11. A comparison in the accompanying tabulation of planned imports of selected consumer goods in 1971 with levels planned and achieved in 1970 also reveals some large increases.

	Million US \$		
	1971 Current Plan	1970 11-Month Imports	1970 Prewar Plan
Food	7.2	0.8	N.A.
Tobacco	3.6		N.A.
Cotton fiber and yarn	8.1		1.0
Motor vehicles	7.2	0.6	1.1
Motorcycles	3.6		0.2
Bicycles	0.5		0.2
Pharmaceuticals	7.6	4.7	6.3
Petroleum	7.8	7.1	11.2

12. A very large increase in food and tobacco imports is anticipated. Food imports are to consist largely of milk powder, sugar, and wheat flour, stocks of which were reduced drastically in 1970, and demand for which has been raised by the expansion of the population and the armed forces. Demand for tobacco products will increase for like reasons. Cambodia normally imports small quantities of tobacco -- about 50 tons annually -- for blending with locally grown varieties and, in fact, was a net exporter of tobacco products before the war. Current stocks are low, however, and heavy military action in the tobacco-growing regions of Kompong Cham will probably cut production.

13. The import plan makes no provision for cotton cloth and finished fabrics. Development of the local textile industry caused imports of cotton cloth to decrease from \$8.2 million in 1965 to less than \$1 million in 1969. Finished textiles are subject to prohibitively high protective tariffs, but certain kinds, such as mosquito netting, knitwear, and carpets, are

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eligible for importation under "compensated exchange," a system whereby official holdings of foreign exchange are not affected. 1/

14. Planned cotton fiber and yarn imports amount to \$8.1 million. The sharp increase over the 1970 level is the result of a very poor cotton crop, coupled with an increased demand for locally produced textiles. Cambodia's state-owned textile factories at Battambang and Kompong Cham have been operating with three shifts in order to meet requirements for military uniforms.

15. Shortages brought about by military confiscation of trucks, buses, and cars during 1970 are largely responsible for projected vehicle imports of \$11 million. Included in this total, however, are \$3.6 million for motorcycles, reflecting an anticipated increased demand for such luxuries.

16. Imports in 1971, however, are not likely to reach the planned level of \$91 million. The actual volume will depend upon several factors, including the level of exports, the composition of the US Military Assistance Program, particularly the unobligated portion of the \$20 million allocated for economic-related commodities, and the level of third-country assistance. The dominant factor will be the rate at which US AID commodities are delivered. Of the \$78.5 million in US economic aid obligated to Cambodia for US FY 1971, only a very small amount - composed entirely of petroleum products - has actually arrived. No delivery has been made on that portion to be financed under PL 480 (\$8.5 million), and none is expected before June. By the end of CY 1971, actual US AID deliveries could amount to between \$30 million and \$60 million, but will almost certainly be less than the \$70 million anticipated in the official import plan.

17. Expectations of a substantial shortfall in US AID deliveries for CY 1971 are due, on the US side, to delays in setting up from scratch an aid program for a country with which diplomatic relations have only recently been established and, on the Cambodian side, to what appear to be unusual administrative deficiencies. Under the \$20 million reimbursable grant portion of US AID obligations, the Cambodians reportedly have had great difficulties in complying with US AID procedural requirements. Clandestine sources also report that during the absence from Cambodia of Ly Kim Heng, head of SONEXIM (the organization handling all US AID imports) much infighting took place within the organization for positions of influence regarding the distribution of AID goods, with relatively little progress being indicated in the placing of import orders.

*1. Under this system, a portion of earnings from the export of certain commodities may be retained and used to finance imports from an approved list of items.*

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18. The GKR has insufficient foreign exchange reserves to make up for the probable shortfall in US AID deliveries. Requirements for debt servicing and replacement of depleted stocks of imported goods have caused reserves to decline from about \$60 million at the end of December to about \$50 million by the end of March. Further drawdowns will be necessary to finance critical items, such as certain pharmaceuticals, chemicals, and plastics, that are ineligible for AID financing. Commodities originating in developed countries other than the US are also ineligible under present arrangements. Since Japan and France accounted for about half of Cambodia's imports during 1966-69, it appears that, at a minimum, Cambodia will be required to use some of its own foreign exchange for imports of spare parts. Moreover, AID reimbursement procedures will have a significant negative effect on GKR reserves at least for several months. For the reimbursable grant portion of the US AID program (\$20 million), the GKR must temporarily use its own foreign exchange to import eligible items. Since Cambodia as yet has no line of credit with foreign banks, reserves are drawn down when an order is placed, while reimbursement is not effected until the goods are delivered. Furthermore, government reserve policy has been extremely cautious and is likely to become even more so as reserve drawdowns are more closely watched by the business community. Last year's prewar plan calling for only \$67 million in imports, for example, reflected a considerable amount of belt-tightening caused by extremely poor export earnings in 1969. <sup>2/</sup> Even this relatively frugal import plan was abandoned, however, when exports again were severely curtailed, this time due to disruptions caused by the war. Actual imports in 1970 amounted to only \$37.5 million, or 39% of 1969 imports.

#### GKR Military Budget for 1971

19. The new GKR budget recently approved by the Council of Ministers calls for total expenditures in 1971 of 18.7 billion riels (\$337 million), of which 11.5 billion riels, or 62%, are allocated to the Ministry of Defense. The budget has now been submitted to the National Assembly, where it is expected to be approved substantially in its present form.

20. The defense appropriation allocated 10.5 billion riels (\$189 million) for personnel costs. For a projected force level of 220,000 for all of 1971, per capita personnel costs would come to 48,000 riels (\$865), approximately the same cost factor implicit in the last peacetime budget - for 1969 - and only slightly lower than that used in the mid-year projections for the second half of 1970. While a per capita cost factor of 48,000 riels may have been appropriate for a mature peacetime army

2. *Cambodia had an exceptionally poor rice harvest in 1969 and actually had to import rice before the end of the year.*

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composed largely of professional soldiers whose pay and allowances were well above minimum levels, it substantially overstates average personnel costs for a force composed largely of new recruits, without dependents, whose basic annual salary and allowances would approximate 24,000 riels.

21. In an earlier analysis of the GKR's midyear 1970 budget, 3/ we derived more reasonable cost estimates by applying an annual cost factor of 48,000 riels per man only to the first 35,000 men (the approximate size of the prewar army) and by evaluating average yearly costs for the remaining troops on the army payroll at 35,000 riels per man. On this basis, personnel expenditures for 1970 were estimated at 4.2 billion riels (for a force averaging 107,000 men for 1970) as opposed to the GKR's midyear estimate of over 5 billion riels for the second half of 1970 only (see Table 1). Actual budget expenditures for 1970 are not yet available, but the fact that the latest GKR budget revision shows military personnel costs of 4.9 billion riels for all of 1970 confirms that their previous projections were indeed inflated.

22. In fact, [redacted] actual appropriations for pay and allowances in February 1971 averaged 3,022 riels per man, or about 36,264 riels per man per year. Projecting this cost factor, annual personnel costs for a 220,000-man force in 1971 would amount to 8.0 billion riels, or 2.5 billion riels less than the current allocation (see Table 2). Although this projection contains no allowance for maturation of the grade structure in the course of the year, that factor probably will be more than offset by a shortfall in the average force level, such a shortfall [redacted] that 218,000 were on the payroll in mid-February and that a reduction to 210,000 was targeted for March.

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*3. For a comparison of the GKR midyear budget projections, the CIA adjustments to it, the GKR's revised 1970 budget, and its 1971 projections, see Table 1.*

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24. The balance of the 1971 military budget, 1 billion riels (\$18 million), has been allocated for materiel. Although this allocation is equivalent to less than 10% of personnel costs -- the normal peacetime ratio -- and (according to the most recent budget revision) is even lower than materiel expenditures for last year, it should prove adequate in view of expected deliveries of over \$200 million in US military assistance to Cambodia during the next 12 months.

#### Civilian Expenditures

25. Civilian expenditures have remained extremely stable, despite the war. In the GKR's mid-1970 budget revision, civilian expenditures were projected at 6.2 billion riels, not including supplemental funds of 1.3 billion riels specifically allocated to cover civilian needs brought about by the war, such as repair of roads, bridges, and railroad and telecommunications lines. Since it appeared that little in the way of repairs was actually being undertaken at the time, we estimated that only 100 million riels would actually be expended. Although a breakdown of civilian expenditures in the yearend budget is not available, it appears that this estimate was too low (see Table 1).

26. While it was recognized that substantial losses of territory and of population under government control should logically reduce requirements for the civilian budget, no significant adjustments were made to the midyear projection in arriving at new estimates, primarily because we considered it politically infeasible for the GKR to make parallel reductions in the civil service. In retrospect, this seems to have been the case. A comparison of ministerial allocations in the revised budget with those made prior to Sihanouk's ouster reveal virtually no effort to trim civil expenditures. For example, funds for education were not cut, despite the large number of students entering the military. Allocations for tourism and public works were reduced by less than 10%.

27. The government now projects civilian expenditures for 1971 at 7.2 billion riels, or at about the 1970 level. Since cuts in civilian expenditures would be no less politically sensitive this year than last, no adjustments were made to the official projections (see Table 2). A detailed breakdown is available only for the original draft as submitted to the Cabinet, which called for civilian expenditures of 7.8 billion riels, including substantial increases for the Ministries of Education, Public Works, and Interior. It is not known wherein the Cabinet effected its reduction of 600 million riels.

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28. To some extent, civilian expenditures are used for military purposes. In many instances, individuals are serving in the military while continuing to receive pay from state agencies, organizations, and enterprises in which they were formerly employed.

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### Receipts

29. Revenues for 1970, according to the government's latest budget revision, amounted to 4.7 billion riels (see Table 1 and Footnote d), slightly above the midyear estimates despite the fact that imports were some \$7 million below midyear projections. Although no details are available, it appears the Cambodians were more successful at collecting taxes than had been anticipated.

30. The GKR estimates total 1971 revenues at 12.7 billion riels, based on counterpart receipts from US AID commodities of 5.8 billion riels (\$70 million converted at 83 riels per US \$1). However, actual counterpart receipts in 1971 will probably amount to between 2.5 billion and 5.0 billion riels (see Table 2) because of expected delays in AID deliveries. Projections of revenues assume implementation of proposed rate increases of up to 50% in certain turnover, sales, and amusement taxes. If the proposals are not accepted, 1971 revenue estimates would have to be reduced by about 1.3 billion riels.

### Budget Deficit

31. With the deflated projections of military personnel costs, we estimate that the GKR budget deficit for 1971 could be held between 4.3 billion and 6.8 billion riels. <sup>4/</sup> The deficit would approach the lower or higher end of the range, depending upon whether US AID deliveries were closer to \$60 million or \$30 million, respectively. If military personnel costs were as high as planned, however, the deficit would be substantially larger. Under the most pessimistic assumption about AID deliveries - that is, only \$30 million - the budget deficit could reach 9.3 billion riels.

*4. Net changes in liquidity and budget deficits under various sets of assumptions regarding military expenditures and the level of US AID deliveries are projected in Table 2.*

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### Cash Deficit

32. Monetary data reveal that the actual cash deficit ran well behind budgeted deficits in 1970. The actual cash deficit is estimated at about 5.4 billion riels for the year, leaving some 3.7 billion riels of 1970 obligations to be financed in 1971. In 1971, however, the cash deficit probably will not be significantly below the accounting deficit and it could be larger if the tinelag in government outlays is reduced. Although central bank advances to the state on a month-to-month basis have been very erratic, they have already reached a cumulative total of 3.0 billion riels for the first three months of 1971. Because expenditure rates will tend to even out in the last half of the year -- provided the force level ceiling is not exceeded -- it is unlikely that the carryover of unspent funds will increase much, if at all.

### Money Supply

33. During 1970 the steady infusion of money printed to finance the war resulted in an 88% increase in currency in circulation by the end of the year. Currency in circulation increased an additional 15% during the first three months of 1971, reaching 13.3 billion riels.

34. Huge monthly deficits will continue to dominate the monetary situation in the coming months. We estimate that, by the end of 1971, currency in circulation will have increased by 3.9 billion to 6.4 billion riels -- or 34% to 55% -- depending on deliveries of US AID goods (see Table 2). With the money supply expanding at rapid rates, prices are bound to increase considerably.

35. Inflation thus far has been held in check by conservative spending habits, availability of essential commodities (especially food), and, more recently, the confidence-building influence of the commitment of US economic assistance. Nevertheless, whatever confidence is left in the economy is fragile at best and may be easily shaken in the coming months. Depleted stocks, delays in US assistance, and insecure lines of communication will probably hold down supplies of goods at a time when monetary demand is booming. A further deterioration of the security situation could cause severe shortages of goods, although it might also discourage spending. On the other hand, a decline in the level of hostilities might not ease the pressure on prices. Indeed, the experience in South Vietnam suggests that pressure on prices would probably increase. The velocity of money (the rate at which money changes hands) in South Vietnam has generally decreased in times of sharp conflict and increased in times of relative security.

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Table 1

Cambodia: Official Budgets for 1970 and 1971 and CIA Estimates for 1970

	Billion Riels			
	1970			
	1971 GKR Budget	GKR Yearend Revision	Midyear Projections	
			CIA	GKR
<i>Total expenditures</i>	18.7	13.8 <i>a/</i>	11.9	18.2
Civillian	7.2	7.0	6.1	7.5
Personnel			3.8	3.8
Materiel			2.2	2.4
Add-on			0.1	1.3
Military	11.5	6.3	5.8	10.8 <i>b/</i>
Personnel	10.5	4.9	4.2	5.3
Materiel	1.0	1.4	1.1 <i>c/</i>	5.5
Paramilitary			0.6	
<i>Total revenues</i>	12.7	4.7 <i>d/</i>	4.4	4.4
Import-related	2.3		1.5	
Other	4.6		2.9	
US AID counterpart	5.8 <i>e/</i>			
<i>Accounting deficit</i>	6.0	9.1 <i>d/</i>	7.6	16.6
<i>Net change in liquidity</i>			4.6	
Cash deficit		5.4 <i>d/</i>	5.4	
Plus value of exports			1.7	
Minus value of imports			2.5 <i>f/</i>	

a. Some reports have indicated total expenditures of 13.8 billion riels, but detailed information compiled from several sources accounts for only 13.3 billion riels. The Ministry of Surface Defense, which was disbanded during the year, was allocated 500 million riels in the original prewar budget. It is not known whether this is the cause of the discrepancy.

b. Projections for the second half of 1970 only. The midyear projections made no mention of military expenditures in the first half of the year.

c. Estimated at 25% of personnel costs.

d. Embassy sources have reported total revenues for 1970 of 6.6 billion riels, an accounting deficit of only 7.2 billion riels, and a cash deficit of only 4.0 billion riels. However, [redacted] the official budget contains an entry for 1.9 billion riels called "fiscal depreciation," which appears to be treated in the budget as a deficit-financing item. The reason for the discrepancy in the cash deficit is unknown. [redacted]

[redacted] cumulative government borrowing in 1970 as measured by central bank advances to the state amounted to 5.4 billion riels in 1970.

e. Estimates counterpart receipts from US AID imports at only 5.8 billion riels, that is, it assumes that only \$70 million in US AID goods will be sold locally at a previously agreed upon rate of 83 riels per US \$1. (GKR's fiscal year coincides with the calendar year.) Actual deliveries and the contribution to the budget from US counterpart receipts is somewhat overstated. For more realistic assumptions, see Table 2.

f. Assumed a net foreign exchange drawdown of 15 million riels in 1970.

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Table 2

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## Estimated Government Expenditures and Revenues in 1971 and Net Changes in Liquidity

	Billion Riels					
	Official Budget <sup>a/</sup>			Budget with Adjusted Military Personnel Costs <sup>a/</sup>		
	A	B	C	A	B	C
<i>Total expenditures</i>						
	18.7			16.2		
Civil	7.2			7.2		
Military	11.5			9.0		
Materiel	1.0			1.0		
Personnel	10.5			8.0		
<i>Total revenues</i>	11.9	10.6	9.4	11.9	10.6	9.4
Customs	1.1	1.1	1.1	1.1	1.1	1.1
Excise	1.3	1.3	1.3	1.3	1.3	1.3
Other	4.5	4.5	4.5	4.5	4.5	4.5
US AID counterpart	5.0	3.7	2.5	5.0	3.7	2.5
<i>Net change in liquidity</i>	6.4	7.7	8.9	3.9	5.2	6.4
Budget deficit	6.8	8.1	9.3	4.3	5.6	6.8
Plus value of exports	0.8	0.8	0.8	0.8	0.8	0.8
Minus value of non-US AID imports <sup>b/</sup>	1.2	1.2	1.2	1.2	1.2	1.2

a. With alternative assumptions of actual US AID deliveries of: A, \$60 million; B, \$45 million; and C, \$30 million.

b. Equal to \$21 million of non-US AID imports calculated at the official rate of 55.5 riels equals US \$1. The official estimate of customs duties (1.1 billion riels) is too large to be based on a taxable import base of only \$21 million. Apparently, the Cambodians intend to attach normal duties to at least a portion of US AID goods over and above the 50% "war tax."