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THE FINANCIAL INSTITUTIONS OF AFGHANISTAN

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Description and Analysis

by

Maxwell J. Fry

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THE FINANCIAL INSTITUTIONS OF AFGHANISTAN

Introduction

In 1295 (1916) an American working in Afghanistan noted:

> No Afghan would trust his money in a bank, nor would he take paper money - except, of course, a merchant who uses and is familiar with the Indian paper money. Many of them have Russian notes (which could be got for a song in Kabul during the last years of the war). Barats are issued on the treasury for money, and the mirzas pay all salaries in rupees; no Afghan ever receives his pay without the mirza getting a percentage.
> [9, p.285]

Rupees were hauled up from India on donkey for pay day and hauled down again to buy commodities on the Indian market. The route through the Khyber Pass was particularly hazardous for these convoys.

This situation which existed only 50 years ago must be borne in mind when examining the developments of the financial system since then. The complete absence of foreign banks and indeed of any foreigners working in the domestic banks until very recently, the strong religious antagonism towards the business of banking, the lack of social prerequisites such as a code of business ethics, attitudes favouring cooperative endeavours, mutual trust and a legal system ill-suited to the task of supporting modern business transactions and enforcing contracts combined to produce an environment which could hardly have been less conducive to financial development. Nevertheless, Afghanistan produced one man who not only tried but succeeded in laying the foundations of the present financial system.

The first modern financial institution established in Afghanistan was Bank Millie.[1] Permission to establish the original joint-stock company, Shirkat-i-Sahami-i-Afghan, to regulate foreign trade and develop

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[1] At present the Bank uses three spellings, namely, Bank Millie, Banke Millie and Bank Melli, interchangeably. In the past, the Bank has used a variety of alternative spellings, as have other authors, one of the most popular being Bank-i-Milli. Although the form Bank-e-Melli is probably the closest phonetic transliteration, the spelling Bank Millie will be adopted throughout since it is used on the Bank's most recent balance sheets and appears on a set of blue signs, one of which is displayed outside each of its domestic branches.

the domestic economy was granted by the King, Nadir Shah, in 1309 (1930) to a group of merchants from Herat led by Abdul Majid Zabuli. As part of the arrangement, they were given the monopoly for sugar, petrol and motor vehicle imports and cotton, karakul and wool exports [7; 14, p.411; 43, p. 1]. The Shirkat-i-Sahami-i-Afghan was founded with a capital of Afs 2.5m, of which Afs 1.7m was subscribed by the Government [39, p. 182]. The company opened for business in the following year [31, p. 316].

Reorganisation took place in 1311 (1932) in which the name of the company was changed. "In Saur 1312 (April/May 1933), Bank Millie was established with capital invested by the Government as well as founders of the Bank" [6, p.6]. This reorganisation involved raising the capital to Afs 7.1m. By 1316 (1937), this figure had been increased by stages through Afs 35m to Afs 60m [39, p. 182]. Thereafter, the Bank's capital was progressively increased to Afs 500m by 1329 (1950) [15, p. 39]. Although there has been no increase in capital since then, total capital and reserves have risen steadily from Afs 519m in 1330 (1952) to Afs 839m in 1350 (1972) [5; 8].

For the first six years, the success of Bank Millie was dramatic, particularly when viewed against the backcloth of the Great Depression.

> When people were introduced to the idea of pooling their resources and interests, when representative money and large-scale commercial credit were introduced and the first results obtained, the effect was amazing. During the first six years the Afghan National Bank [English translation of Bank Millie Afghan] increased its capital one hundredfold."
> [14, p. 411]

In 1314 (1935) Afghanistan adopted a fixed exchange rate and foreign exchange transactions were supervised by Bank Millie [6, p. 7]. Due to a deteriorating balance of payments situation, the Bank recommended tighter exchange control regulations. In 1317 (1938) earnings from karakul exports were required to be surrendered to the Bank and importers were obliged to export an equal value of commodities before placing their import orders [54, pp. 123-33].

The fixed exchange rate system adopted in 1314 (1935) was designed in part to eliminate seasonal fluctuations in the rates. Bank Millie agreed to buy 100 rupees for Afs 396 and to sell for Afs 400. This rate was maintained until 1322 (1943) when Da Afghanistan Bank assumed its foreign exchange responsibilities. It was still around Afs 400 in 1325 (1946). Apparently, this fixed rate undervalued the afghani. Domestic prices remained stable. By 1322 (1943) there was such an inflow of foreign exchange that Da Afghanistan Bank faced with a shortage of afghani banknotes had to postpone conversion for four to six months [7].

Responsible for the country's exchange rate system, the Bank supplied all Government requirements of foreign exchange at the fixed rate from 1314 (1935) onwards [39, p. 182].

The inflow of specie enabled the Bank to back the issues of Treasury banknotes which started in 1314 (1935). This was the first time banknotes were issued in Afghanistan [39, p. 182]. The paper currency was convertible into silver afghanis and initially soldiers and civil servants who received payment in banknotes immediately converted them into coins. However, after the first year silver coins began to be accumulated. Within three years Afs 60 million of Afghan and Iranian coins had been collected by the Bank. Balance of payments surpluses which started in 1315 (1936) resulted in gold inflows which were also used to back the paper currency [7].

Despite problems of trade imbalance, considerable growth in the volume of both imports and exports took place. The expansion of Afghanistan's foreign trade and level of economic activity during the Great Depression can to a large extent be attributed to the dynamic and unfettered development of Bank Millie [52, pp. 60-62].

Along with these fundamental measures, the Banke Milli diverted special attention towards organizing banking affairs. It afforded

> facilities in carrying out financial transactions and executing drafts in the shortest possible time. It offered prompt and satisfactory service to customers. The Bank also offered facilities in granting loans to traders. It introduced cheques as well as exchange and transfer drafts. All this attracted customers in a wonderful way, enabling fixed deposits and current and deposit accounts to increase considerably within a short period.
> [6, pp. 8-9]

The most important activity of Bank Millie in these years was its involvement and participation in the establishment of industry in Afghanistan. Joint-stock companies were established to engage in trade (cotton, karakul and wool exporting), cotton ginning, oil extracting, sugar refining and textile manufacturing [6, pp. 9-30]. Between 1311 (1932) and 1313 (1934) 30 joint-stock companies were organised under the auspices of Bank Millie [31, p. 315]. By 1317 (1939), the total capital of these subsidiary companies had reached Afs 292m [54, pp. 123-33]. By 1325 (1947) Bank Millie held interests in 50 trading and industrial companies.

> The same important merchants who held shares in the bank were the majority stockholders of these companies. In addition to a virtual monopoly in the major commodities of the Afghan export-import trade, the Bank-i-Milli and its president, Abdul Majid Zabuli, gained control of most of the industry of the kingdom, both the well-established state-owned enterprises and the budding new firms.
> [31, p. 363]

Bank Millie also extended credit, granting loans of all kinds at 12 per cent interest. For example, after it had received the monopoly over motor vehicle imports it extended credit to purchasers:

> The first vehicle owners were people from the Jajl tribe. Vehicles were sold for Afs 12,000 on instalments over 18 months. The Jajls did a great job and took over the transportation business from the Indians.
> [7]

There was of course no insurance on the vehicles, appalling road conditions and unskilled drivers. Bank Millie contended with the latter problem by establishing a special driving school.

Abdul Majid Zabuli founded the first joint-stock company in Afghanistan in 1303 (1924) together with other Herat associates to engage in trade with Russia. Between 1304 (1925) and 1308 (1929) Zabuli lived in Moscow as the company's representative. The political riots in 1307 (1928) against Amanullah's reforms and the brief reign of the bandit, Bacha Saqao, 1307-1308 (1929) resulted in severe economic disruption and almost complete cessation of foreign trade [31, pp. 263-75; 35, p.424].

> The political upheaval and military conflict that took place in 1930 led to a flight of capital from the country mostly in the form of gold and silver coins that constituted the only form of money at that time.
> [39, p. 182]

Four weeks after Bacha Saqao was overthrown, Zabuli returned to Kabul [7]. On arrival, he was summoned before the new King, Nadir Shah, and asked to prepare a plan for economic recovery. According to Zabuli, the King said:

> Today we are in our own country [illegible]. Import, transportation, [illegible] and [illegible] also are done by foreigners; only shopkeeping is left for our people. This situation is intolerable and we must [illegible] engaged in all these activities throughout the country. We must find a way to cut off the hands of the foreigners.
> [8]

Zabuli stayed in Kabul for [illegible] to prepare an economic plan which included a [illegible] to this proposal, the Minister of Finance [illegible] strongly objected [illegible]. Zabuli [illegible] was well aware of the religious [illegible] although [illegible] [illegible] opposed by the [illegible] office of the treasury [illegible] was [illegible] had proposed.

Two years later, before Zabuli's economic plan ran into difficulties, he was asked to repeat his performance. The price inflation was once again the

foundation of a bank and [illegible] the northern part of the country. As part of his conditions for [illegible] in Afghanistan, Zabuli required government support for his plan to establish the bank. Zabuli returned to Afghanistan towards the end of [illegible] and directed his first efforts [illegible] to found a bank which could [illegible] currency, [illegible] for developing entrepreneurial [illegible] in the country. The [illegible]

One of the [illegible] at this stage was the religious [illegible] opposition was led by the Minister of Justice. [illegible] a solution was found whereby [illegible] obliged to [illegible] thus [illegible]

In [illegible] the [illegible] power wielded by [illegible]

[illegible]

> proved to be yielding great margins of profit, the government rescinded some of the bank's monopoly rights and ordered an investigation into its activities, as well as those of a few major shareholders. Attention was particularly focused on the karakul trade and foreign exchange. (Among other things, the investigation led to a six-year prison sentence for one of the prominent shareholders.)
> [31, pp. 367-68]

Part of the cause of these phases of hostility appears to have sprung from the Bank's concentration of its investment in the north [19, p. 318]. The Pushtun majority in the Government from the south wanted investment in its area. This pressure eventually resulted in the Helmand Valley project, a scheme opposed by Zabuli on economic grounds from its conception.

To allay some of the fears of a Bank Millie take-over of the country, Da Afghanistan Bank was established in 1318 (1939) with a capital of Afs 120m, of which 93 per cent was owned by the Government.[2] This venture was supported by Bank Millie and part of the Government's participation was actually financed through its sale of Bank Millie stock which was warmly welcomed by the other major shareholders. Da Afghanistan Bank was given responsibilities of acting as the fiscal agent of the Ministry of Finance, controlling the currency issue, regulating bank credit,

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2 The name is Pushtu rather than Dari thus tending to support the racial interpretation of Bank Millie/Government disputes.

controlling foreign exchange dealings and promoting investment in the national interest [16]

In 1319 (1940) the Bank started to issue banknotes [3, p. 98] and by mid-1327 (October 1948) had an issue of Afs 800m [18, p. 436]. The foreign exchange business was transferred from Bank Millie in 1322 (1943) [6, p. 7]

Relations between Bank Millie and Da Afghanistan Bank and the Government have not always been cordial. However, in the early stages it was natural that Bank Millie should supply a number of personnel to Da Afghanistan Bank. One of the main bones of contention has been over foreign exchange transactions. [illegible] of Bank Millie's [illegible] was Governor of Da Afghanistan Bank, an enquiry into the [illegible] of Bank Millie's foreign exchange earnings [illegible]. Such [illegible] which blew up between the Government and Bank [illegible] that the former [illegible] Within a few months he had resigned [illegible] Bank Millie. In [illegible] the Government again accused Bank Millie of illegal appropriation of foreign exchange earnings from cotton, karakul and wool sales. To eliminate further possibilities of such wrongdoing, Da Afghanistan Bank opened branches in London and New York to supervise the surrender of foreign exchange proceeds itself.

During the Daoud regime, 1332-1341 (1953-1963), antagonism between Bank Millie and the Government appears to have been intensified, particularly between the personalities of Khair Mohammad, President of Bank Millie, and Abdul Malek, the Minister of Finance. After considerable harassment over a number of years, which included an invasion of the Bank by soldiers and exhaustive investigations, some reconciliation reportedly occurred. However, a few months later the Minister was imprisoned on charges of spying.

During this administration, a banking boom took place in Afghanistan. Each government ministry wanted a bank. The Ministry of Public Works already had the Mortgage and Construction Bank established in 1326 (1948). The Ministry of Commerce set up Pashtany Tejaraty Bank in 1333 (1954) and the Ministry of Agriculture formed the Agriculture and Cottage Industries Bank in the same year. The Ministry of Mines and Industries under its Minister, Dr. Yousuf, apparently asked Bank Millie to become its industrial bank. Although willing to participate in the establishment of such an institution, Bank Millie was quite naturally uninterested in the original proposition. Thus, the Industrial Development Fund set up in 1336 (1957) was the last in the field.

In a decade, one commercial (Pashtany Tejaraty Bank) and three specialised banks had opened their doors alongside Bank Millie and the

central bank, Da Afghanistan Bank. By 1336 (1957), however, the fortunes of this infant financial sector were already on the decline. The currency/money ratio had reached its lowest point in 1334 (1955) at 0.64; thereafter it rose to 0.81 in 1341 (1962) only falling to 0.76 by 1350 (1971) [25, Table 9, p. 28]. A serious bout of inflation hit the economy in 1333 (1954) continuing until 1337 (1958) [25, Table 4, p. 16] which in part both explains and is explained by the trend in the currency/money ratio.

With an inflationary situation, never conducive to financial development, and a rising currency/money ratio, it is not surprising to discover that the new financial institutions were not performing as had been hoped. Political interference, weak management and legal impediments to securing loans in addition to unconducive economic conditions resulted in a high rate of attrition. The Agriculture and Cottage Industries Bank ceased its lending activities in 1337 (1958), the Industrial Credit Fund had virtually exhausted its resources by the end of its first year of operation, the Mortgage and Construction Bank gradually contracted its business until it was only providing small medium-term loans to Government employees, and Pashtany Tejaraty Bank appears to have maintained only an extremely tenuous existence which any significant net deposit withdrawals would seriously jeopardise.

Foreign aid to the financial sector in the form of technical assistance started in 1349 (1970) after the establishment of the Agricultural Development

Bank in 1348 (1970) under German management financed by a loan from the World Bank. The AgBank, as it is commonly known, replaced the defunct Agriculture and Cottage Industries Bank. Similarly, the Industrial Development Bank was finally incorporated in 1351 (1973), years after plans had been drawn up to replace the Industrial Credit Fund by a new institution to provide finance to the industrial sector. The latter has expanded rapidly since the enactment of the Foreign and Domestic Private Investment Law of 1346 (1967). The new Industrial Development Bank is another World Bank project.

Although the banks dominate the limited financial sector in Afghanistan, an historical sketch would not be complete without reference to the insurance companies, the pension fund, the credit cooperatives in Baghlan and Kohdaman and, most important, the money bazaars of Kabul and Kandahar. Prior to the formation of the Afghan Insurance Company in 1342 (1963) there were three very small insurance agencies in Kabul, one representing the Sterling Insurance Company of New Delhi, one for the Northern Insurance Company, the third for Ingosstrakh, the overseas branch of the Soviet Insurance Trust. Most marine insurance, which constituted virtually the only type of insurance in Afghanistan, was placed on the foreign insurance markets [61, p.1; 62, pp. 28-33]. These three agencies are still in operation, although the Northern Insurance Company was taken over by the Commercial Union in 1348 (1969) [59, p. 40]. The insurance market in

Afghanistan is still minute. Nevertheless, all the institutions have fared well, perhaps as a result of strong links with parent companies abroad which have provided ex-patriate management from the start.

The Pension Fund was established in 1323 (1944). Its total assets at the end of 1350 (1972) were Afs 108m. As contributions are not sufficient to finance all Government pensions an additional Afs 100m was provided by the Government in both 1350 (1971) and 1351 (1972).

The Project on Agricultural Credit and Related Services through Cooperatives in Afghanistan (PACCA), a joint venture of the Food and Agriculture Organisation of the United Nations and the Swedisth International Development Authority began in 1347 (1968). By 1351 (1972) the Kohdaman cooperative had 812 members and capital and reserves of Afs 253,797 and the Baghlan cooperative which began in 1350 (1971) had 354 members in 1351 (1972) although it has still not raised any equity or become a fully-fledged cooperative [11, pp. 4-8].

Information on the money bazaars of Kabul and Kandahar with respect to their relative importance in the financial sector is unavailable. However, from many interviews with the dealers a rough historical picture can be constructed. Foreign exchange dealing in Kabul has taken place for as long as anyone can remember. Until relatively recently, the business

was in the hands of Jews and was conducted entirely in currency until 1325 (1946) when, it is reported, the first cheque was accepted. In 1336 (1957) the existing site, Saray Shozda, was constructed and three or four Jewish dealers moved in. A few Hindus started dealing and by 1339 (1960) there were apparently about fifteen dealers in the saray. At present there are about 35 dealers, all of them Hindus or Afghans, the latter having entered the business within the past five years. Apart from the dealers there are about twice that number of partners and agents operating on commission. The origins of the foreign exchange market in Kandahar are obscure but appear to go back many years since Kandahar has always been an important trading centre. Before dealers moved into the existing site, Saray Tara Singh, in 1342 (1963) business was conducted on the streets. In that year, however, three dealers opened offices in the saray. The number of offices has increased to five and partners and agents solicit business at the entrance as in Saray Shozda. The Kandahar market, although important for trade with the Indian sub-continent, is far smaller than the Kabul market; only six currencies are traded in Kandahar. For more details on the money bazaars, the interested reader is referred to another paper by this author [26]. A non-institutional credit network of considerable magnitude exists in Afghanistan. However, nothing resembling rotating credit associations or the like have been found. Various studies have presented information on the mechanics of

these non-institutional networks [23; 51; 53]. Some interest rate figures have been recorded but no quantitative estimates on the volume of credit involved are available.

This brief historical sketch of the financial sector has described two periods of apparent expansion during the decades of the 1310s and 1330s (1930s and 1950s) and two of contraction during the 1320s and 1340s (1940s and 1960s). Bank Millie grew rapidly during its first years but met with increasing opposition later. The Government sponsored developments in the 1330s (1950s) were shorter lived since collection rates were far below the survival threshhold. There are several reasons for these apparent fluctuations. The first is there was in reality only one period of growth - the dynamic early years of Bank Millie. The second is that all banks established after Bank Millie were Government banks closely linked to parent ministries and staffed by ill-trained, badly paid civil servants. Given that the environment itself was unconducive to financial development, these additional internal handicaps made survival virtually impossible.

Afghanistan has embarked on the second round in the institution-building process within the financial sector. Internal conditions of the Agbank and the Industrial Development Bank are a vast improvement over those of the Agriculture and Cottage Industries Bank and Industrial Credit Fund, as a result of both ex-patriate management and a reasonable degree of

autonomy from the Government ministries. Nevertheless, collection rates on AgBank loans, now a reflection only of the external environment, are still too low for complacency. The problems of lending, i.e. the external environment, are discussed below. A major improvement in this environment could be achieved during 1352 (1973) by the enactment of banking laws to include a Negotiable Instruments Act and a Security Interest Act now being drafted.

II Overall View of the Financial System

The existing financial system is dominated by the three commercial banks, Bank Millie, Da Afghanistan Bank and Pashtany Tejaraty Bank and the Kabul money bazaar. Table 1 gives a list of Afghanistan's financial institutions. Omitting the money bazaars for which data are unavailable, Table 2 provides a rough quantitative comparison of the financial institutions, and Table 3 shows numbers of people working in them.

It can be seen that the three commercial banks hold virtually all the assets of the financial system. Da Afghanistan Bank, which combines certain central banking functions such as the issue of banknotes with commercial banking activities alone holds over three-quarters of the total assets of the financial system.

In 1900, the banking system in the U.S.A. accounted for 63 per cent of total assets of the financial institutions. By 1963 this had fallen to 38 per cent [30, Table 1-3, pp. 24-25]. A comparative picture of the percentage of assets of central and commercial banks in a selection of countries is provided in Table 4. The high proportion of total assets held by the banks in Afghanistan reflects both the low level of economic development and the even lower level of financial development. The expectation of a declining share of the banks' assets in the total of the

TABLE 1

Financial Institutions of Afghanistan

Institution	Establishment	
Banks:		
Private		
Bank Millie	1311	(1932)
Industrial Development Bank	1351	(1973)
Government		
Da Afghanistan Bank	1318	(1939)
Mortgage and Construction Bank	1326	(1948)
Pashtany Tejarety Bank	1333	(1954)
Agricultural Development Bank	1348	(1970)
Other Financial Institutions:		
Private		
Afghan Insurance Company	1342	(1963)
Three Insurance agencies		
Kohdaman Credit Cooperative	1348	(1969)
Baghlan Credit Cooperative	1350	(1971)
Kabul Money Bazaar		
Kandahar Money Bazaar		
Government		
Pension Fund	1323	(1944)

TABLE 2

Total Assets of the Financial Institutions in Afghanistan

1340-1350

(Millions of Afghanis, End of Year Figures)

	1340	1341	1342	1343	1344	1345	1346	1347	1348	1349	1350
Da Afghanistan Bank	5,482 (77%)	7,741 (81%)	9,288 (82%)	8,689 (79%)	9,103 (76%)	9,467 (76%)	9,269 (75%)	10,704 (77%)	13,927 (80%)	15,107 (80%)	16,498 (78%)
Other Commercial Banks	1,512 (21%)	1,631 (17%)	1,794 (16%)	2,079 (19%)	2,612 (22%)	2,689 (22%)	2,907 (23%)	3,004 (21%)	3,172 (18%)	3,328 (18%)	4,130 (19%)
Specialised Banks	104 (1%)	100 (1%)	102 (1%)	113 (1%)	129 (1%)	122 (1%)	137 (1%)	127 (1%)	134 (1%)	131 (1%)	497 (2%)
Pension Fund	75 (1%)	76 (1%)	78 (1%)	79 (1%)	87 (1%)	93 (1%)	107 (1%)	108 (1%)	108 (1%)	108 (1%)	108 (1%)
Afghan Insurance Company	-	-	-	23 (-)	30 (-)	25 (-)	28 (-)	32 (-)	66 (-)	55 (-)	66 (-)
TOTAL	7,173 (100%)	9,548 (100%)	11,262 (100%)	10,983 (100%)	11,961 (100%)	12,396 (100%)	12,448 (100%)	13,975 (100%)	17,407 (100%)	18,729 (100%)	21,299 (100%)

Source: International Financial Statistics: 1972 Supplement and balance sheets of the financial institutions

TABLE 2A

Total Assets of the Financial Institutions in Afghanistan in Constant Prices, 1340-1350

(Millions of Afghanis, 1340 Prices, End of Year Figures)

	1340	1341	1342	1343	1344	1345	1346	1347	1348	1349	1350
Da Afghanistan Bank	5,482 (77%)	6,361 (81%)	7,878 (82%)	5,931 (79%)	5,146 (76%)	5,104 (76%)	4,989 (75%)	5,742 (77%)	7,131 (80%)	6,635 (80%)	7,035 (78%)
Other Commercial Banks	1,512 (21%)	1,340 (17%)	1,522 (16%)	1,419 (19%)	1,477 (22%)	1,450 (22%)	1,565 (23%)	1,612 (21%)	1,624 (18%)	1,462 (18%)	1,761 (19%)
Specialized Banks	104 (1%)	82 (1%)	87 (1%)	77 (1%)	73 (1%)	66 (1%)	74 (1%)	68 (1%)	69 (1%)	58 (1%)	212 (2%)
Pension Fund	75 (1%)	62 (1%)	66 (1%)	54 (1%)	49 (1%)	50 (1%)	58 (1%)	58 (1%)	55 (1%)	47 (1%)	46 (1%)
Afghan Insurance Company	-	-	-	16 (-)	17 (-)	13 (-)	15 (-)	17 (-)	34 (-)	24 (-)	28 (-)
TOTAL	7,173 (100%)	7,846 (100%)	9,552 (100%)	7,497 (100%)	6,761 (100%)	6,682 (100%)	6,700 (100%)	7,497 (100%)	8,913 (100%)	8,225 (100%)	9,083 (100%)

Source: Figures in Table 2 were deflated by a purchasing power parity price index in M.J. Fry, Has Velocity in Afghanistan Been Constant? (Kabul: United States Agency for International Development, mimeo, March 1973), Table 4, p. 16.

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TABLE 3

Number of Persons Working in the Financial Institutions

at the End of 1351

(Excluding Servants)

Institution	Number	(of which Foreigners)
Da Afghanistan Bank	1,803	6
Other Commercial Banks	615	-
Specialised Banks	237	10
Credit Cooperatives	92	5
Money Bazaars	110[a]	-
Pension Fund	58	-
Afghan Insurance Company	24	3
Insurance Agencies	10	2
TOTAL	2,949	26

[a] Approximate

Source: Information provided by the financial institutions themselves.

TABLE 4

Percentage of Total Assets of the Financial Institutions Held by Central and Commercial Banks in Sixteen Countries in 1963

Country	Percentage
Afghanistan[a]	97
Israel	53
Jamaica	66
Japan	49
Mexico	35
Pakistan	78
Philippines	67
Puerto Rico	58
Rhodesia	40
Spain	65
Sweden	35
Thailand	88
Trinidad	77
Turkey[b]	71
U.S.A.	38
Venezuela	56

[a] 1971

[b] 1968

Source: Afghanistan - Table 2 above

Turkey - M.J. Fry, Finance and Development Planning in Turkey (Leiden: Brill, 1972), Table 1, p. 38

All other countries - R.W. Goldsmith, Financial Structure and Development (New Haven and London: Yale University Press, 1969), Appendix IV

financial system as economic and financial development proceeds has been elaborately reasoned in the works of Gurley and Shaw [36; 37].

Over the period 1340-51 (1962-73) there has been an increase in the proportion of total domestic credit allocated to the public sector from 53 per cent at the end of 1340 (March 1962) to 68 per cent at the end of 1351 (March 1973) as can be seen from the figures in Table 5. Indeed, using a purchasing power parity price index [25, Table 4, p. 16], which as a result of improving terms of trade probably understates the change in prices over this period [26, pp. 59-61], domestic credit in real terms extended to the private sector has fallen from Afs 2,162 at the end of 1340 (March 1962) to Afs 1,710 at the end of 1351 (March 1973) in 1340 (1961) prices.

Table 6 provides a broad picture of the volume of domestic credit in Afghanistan over the past twenty years. In Table 7 these figures have been deflated by a purchasing power parity price index to produce estimates of domestic credit expressed in constant prices. To the extent that the deflator is accurate, an indication of movements in the real volume of credit is given; it appears to have increased from 1330 to 1342 (1952 to 1964), downward fluctuations then occurred, a rapid increase in 1351 (1972) however leaving a final figure for the end of 1351 (1973) virtually the same as that for 1342 (1964).

TABLE 5

Monetary Survey, 1340-1351

(Millions of Afghanis, End of Year Figures)

	1340	1341	1342	1343	1344	1345	1346	1347	1348	1349	1350	1351
Foreign Assets	1,007	1,100	2,279	2,278	2,443	2,374	1,891	2,225	2,203	2,211	2,888	2,986
Domestic Credit	4,573	5,496	[illegible]	[illegible]	[illegible]	[illegible]	6,798	[illegible]	[illegible]	[illegible]	10,671	12,110
Net Claims on Government	2,411	3,312	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	6,359	6,635	7,242	8,177
Claims on Private Sector	2,162	2,114	1,707	1,855	2,198	2,289	2,349	[illegible]	2,865	2,772	3,529	3,933
Money	2,920	3,608	4,538	5,300	5,338	5,194	5,529	5,351	7,011	7,383	7,693	9,117
Quasi-Money	285	236	348	600	1,081	1,096	759	867	882	1,085	1,356	1,741
Foreign Liabilities	190	233	235	478	547	731	525	771	758	828	678	635
Other Items (Net)	2,185	2,065	3,205	1,660	1,788	1,388	1,871	[illegible]	[illegible]	2,293	3,834	3,516

Source: International Financial Statistics: 1972 Supplement and International Financial Statistics, 26(6), June 1973

TABLE 5A

Monetary Survey In Constant Prices, 1340 - 1351

(Millions of Afghanis, 1340 Prices, End of Year Figures)

	1340	1341	1342	1343	1344	1345	1346	1347	1348	1349	1350	1351
Foreign Assets	1,307	934	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	1,398
Domestic Credit	4,573	4,492	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	3,365
Net Claims on Government	2,411	2,755	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	1,655
Claims on Private Sector	2,162	1,737	1,448	1,334	1,243	1,234	1,264	[illegible]	[illegible]	[illegible]	[illegible]	1,710
Money	2,920	3,030	[illegible]	3,618	3,018	[illegible]	2,976	[illegible]	[illegible]	[illegible]	[illegible]	3,968
Quasi-Money	265	194	205	418	611	591	600	660	[illegible]	[illegible]	975	157
Foreign Liabilities	190	191	193	326	309	394	283	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Other Items (Net)	2,185	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	1,525

Source: Figures in Table 5 were deflated by a purchasing power parity price [illegible] (Robert Gulbas [illegible] for International [illegible] March 1973), Table 4, p. 16.

TABLE 6

Domestic Credit, 1330-1351

(Afs millions, current prices, end of year figures)

Date	Claims on Government (net)	Claims on Private Sector	Total
1330			1,126
1331			1,209
1332			996
1333			1,510
1334			1,816
1335			2,084
1336			2,014
1337	832	1,527	2,359
1338	421	2,037	2,458
1339	1,063	2,244	3,307
1340	2,411	2,162	4,573
1341	3,312	2,114	5,426
1342	4,376	1,707	6,083
1343	4,009	1,955	5,964
1344	4,063	2,198	6,261
1345	3,745	2,289	6,034
1346	4,449	2,349	6,798
1347	4,013	2,760	6,773
1348	6,058	2,863	8,921
1349	6,605	2,772	9,377
1350	7,142	3,529	10,671
1351	8,177	3,933	12,110

Source: 1330 - 1336 from J.R. Brooks, Recommendations for a Bank for Industrial Development of Afghanistan (Washington, D.C.: International Cooperation Administration, Office of Private Enterprise, mimeo, 1960), p.8

1337 - 1351 from International Financial Statistics: 1972 Supplement and International Financial Statistics 26(6) June 1973

Table 7

Domestic Credit in Current Prices, 1330-1351

(Millions of Afghanis, 1961 Prices, End of Year Figures)

Date	Claims on Government (net)	Credit to private sector	Total
1330	[illegible]	[illegible]	[illegible]
1331	[illegible]	[illegible]	[illegible]
1332	[illegible]	[illegible]	[illegible]
1333	[illegible]	[illegible]	[illegible]
1334	[illegible]	[illegible]	1,[illegible]
1335	[illegible]	[illegible]	1,[illegible]
1336	[illegible]	[illegible]	1,[illegible]
1337	[illegible]	[illegible]	1,824
1338	[illegible]	[illegible]	2,[illegible]
1339	[illegible]	[illegible]	[illegible]
1340	[illegible]	[illegible]	4,575
1341	[illegible]	[illegible]	4,[illegible]
1342	3,[illegible]	[illegible]	5,159
1343	2,[illegible]	[illegible]	4,071
1344	2,297	[illegible]	3,539
1345	2,019	1,234	3,253
1346	2,395	1,264	3,659
1347	2,167	1,481	3,634
1348	3,[illegible]	1,466	4,568
1349	2,[illegible]	1,217	4,118
1350	3,046	1,505	4,551
1351	3,555	1,710	5,265

Source: Figures in Table 6 were deflated by the purchasing power parity price index in M.J. Fry, Has Velocity in Afghanistan Been Constant? (Kabul: United States Agency for International Development, mimeo, March 1973), Table 4, p.16

The proportion of domestic credit absorbed by public and private sectors has changed substantially over the period 1337 - 1351 (1959 - 1973), for which sectoral data are available. In 1337 (1959) the public sector received 35 per cent of total domestic credit. By 1351 (1973) the proportion had risen to 68 per cent, one of the highest figures to be found in any non-socialist country.

The shift in the proportion of domestic credit allocated to public and private sectors between 1340 (1962) and 1350 (1972) resulted in a 50 per cent increase in the real volume of credit for the public sector and a 30 per cent decrease for the private sector. The results of this were noted in a recent Survey of Progress:

> The full brunt of credit restriction is placed on the private sector, the result of which is that private enterprises which need short-term credit must either do without or borrow from other sources at unnecessary high rates.
> [14, p. 18]

The effects of the contraction in the real volume of institutional credit to the private sector in 1350 (1972) would have also involved attention.

> Some of the near-failures could have been avoided if the companies concerned had been able to obtain adequate working capital to finance [illegible]

> losses. The underlying projects were basically sound and could have been salvaged if normal commercial banking facilities had been available.
> [55, p. 3]

> The scarcity of domestic financial resources was a major factor behind the slow rate of growth during the Third Plan.
> [46]

Some of the reasons for the decline in private sector credit are considered in more detail in Section VI below.

Institutional interest rates, i.e. interest rates of the financial institutions, have remained low and stable. Savings deposits have received 6 per cent interest, tax-free for the past two decades. Loans to the public sector carry 2 to 6 per cent and to the private sector 8 to 10 per cent. Institutional interest rates are low for two main reasons. First, the effective demand for loans is small because of the legal inadequacies making loans difficult to secure. Thus, lending is not such an attractive proposition as it could be. Legal reform to secure loans and enforce collection might produce a strong incentive to expand banking operations.

The second basic reason why interest rates are low lies in the nature of the market structure of Afghanistan's financial sector. The inter-locking

ownership and control throughout the financial system is worth documenting. The Supreme Council of Da Afghanistan Bank consists of the Minister of Finance (Chairman), the Minister of Mines and Industries, the Minister of Planning, the Acting Minister of Commerce, the President of the Industrial Development Bank, a representative of the Prime Minister's Office, the Governor, Deputy Governor and the two Vice Presidents of Da Afghanistan Bank. The Board of Directors of Pashtany Tejaraty Bank includes the Minister of Finance, the Acting Minister of Commerce, the President of the Pension Fund, the Governor of Da Afghanistan Bank, the President of the Agricultural Development Bank, the President of Bank Millie, a member of Bank Millie's Board and four other traders. The members of the Board of Directors of Bank Millie naturally do not include any representatives of the Government but three members of its Board also sit on the Boards of other banks. The members of the Supreme Council of the Agricultural Development Bank are the Minister of Finance, the Minister of Planning, the Acting Minister of Commerce, the Minister of Agriculture and Irrigation, the Governor of Da Afghanistan Bank, the Vice Chairman of the Board of Directors of Bank Millie, the President and General Manager of the Agricultural Development Bank and three other elected members. The Board of Directors of the Industrial Development Bank consists of the President of Pashtany Tejaraty Bank (Chairman), the President of Bank Millie, the President and General Manager of the Industrial Development Bank, representatives of Chase, National Westminster and the World Bank and two

Industrialists. The Supreme Council of the Mortgage and Construction Bank consists of the Minister of Finance, the Minister of Public Works, the Governor of Da Afghanistan Bank and four elected members. The Board of Directors of the Afghan Insurance Company includes the President of Pashtany Tejaraty Bank (Chairman), the Vice Chairman of the Board of Directors of Bank Millie and a representative of the Guardian Assurance Company. The Pension Fund has invested funds in the form of equity participation in the Afghan Insurance Company, the Mortgage and Construction Bank and Pashtany Tejaraty Bank and has a loan from Da Afghanistan Bank. Shares of the Mortgage and Construction Bank are held by Da Afghanistan Bank.

This rather lengthy documentation of inter-locking directorships and equity participation simply indicates that not one financial institution in Afghanistan is independent from the others. There are, furthermore, informal links between the institutions including, apparently, representation of Bank Millie's views on the Supreme Council of Da Afghanistan Bank. One can, therefore, assume that there is no competition between the financial institutions. Hence, interest rates have remained low and stable, advertising is negligible and there is no search whatsoever for business. Bankers wait for customers, who on the loan side have had to meet increasingly stringent collateral requirements, and do not contemplate any innovations or other action which might disturb the market share

balance. So far, the equilibrium has been preserved from any external disruptions, the most serious of which would be competition inside Afghanistan from a foreign bank. The banking fraternity has to date ensured that no serious threat of this kind has materialised.

The result has been financial stagnation over the past two decades. The early years of Bank Millie have long been forgotten as bankers have settled down to a stable, low-level non-competitive equilibrium. This has been facilitated not only by inter-locking ownership and control within the financial institutions but also by complacency on the part of the Ministry of Finance and the conspicuous lack of indigenous credit arrangements such as rotating credit associations, pawnbrokerage, and simple financial instruments such as promissory notes, etc. This is not to imply that non-institutional credit is unimportant but that there are no sophistications to basic lending operations such as an indigenous negotiable instruments, elementary cooperative groups, etc. In fact, the only traditional financial instruments are essentially non-negotiable. They include the hawala, a simple draft, the barat, a bill of exchange, the hujat, a promissory note and the sanad, a receipt. These are only known to a small proportion of urban traders. The majority of the population has never even heard the words.

The lack of even simple indigenous financial instruments and institutions highlights one of the major obstacles faced by the embryonic modern financial

system should an attempt at expansion be made, namely, the total lack of understanding by the vast majority of the population of basic concepts of credit. As the Agricultural Development Bank has discovered, when the distinction between a loan and a grant is unclear even an aggressive, German-managed financial institution is still in a precarious position when it attempts to expand considerably its lending activities.

Two matters of significance in analysing Afghanistan's financial system have received much attention in the literature of recent years. The first concerns economies of scale in banking, the second competition. Table 8 provides a comparative picture of Afghanistan's banking system with those of the neighbouring countries of Iran, Pakistan and Turkey. Total assets and total deposits of the banking system are extremely small on any criterion. At the end of 1967, for example, Kaufman lists 171 banks in the world with total assets over $ 1 billion. Of the 151 banks for which further data were available, assets per bank averaged $ 3,239 million and assets per branch $ 8.626 million [38, Table 2, pp. 104-9].

Population per bank branch was 4,618 in Iran in 1350 (1972), 53,039 in Pakistan in 1967 and 14,957 in Turkey in 1967. Using the official population estimate of 17.5 million for Afghanistan gives 190,217 people per branch. A population estimate of 8 million gives 86,957 - still considerably greater than even Pakistan.

TABLE 8

Banks, Branches, Assets and Deposits

In Afghanistan, Iran, Pakistan and Turkey

($ million)

Country	Bank Assets	Bank Deposits	Number of Banks	Number of Branches	Assets per Bank	Assets per Branch	Deposits per Bank	Deposits per Branch
Afghanistan A (1350=1972)	49.940	23.785	2	33	24.970	1.513	11.892	0.721
Afghanistan B (1350=1972)	158.960	73.386	3	93	52.987	1.709	24.462	0.789
Iran (1346=1968)	2,817.333	1,734.667	25	3,407	112.693	0.827	69.387	0.509
Pakistan (1967)	1,926.150	962.960	36	2,285	53.504	0.843	26.749	0.421
Turkey (1967)	2,774.056	1,167.500	46	2,210	60.306	1.255	25.380	0.528

Note: Bank assets are total consolidated balance sheet figures. Afghanistan A provides figures for Bank Millie and Pashtany Tejaraty Bank. Afghanistan B includes assets of Da Afghanistan Bank excluding those covering currency and bankers' deposits. Iran and Turkey include all banks other than the central bank. Pakistan only includes the scheduled banks.

Bank deposits include both public and private sector demand and time deposits. Inter-bank deposits are excluded.

Note (Cont'd)

Domestic currency figures were converted into U.S. dollars using the following exchange rates:

Afghanistan	$1 = Afs 82.70
Iran	$1 = Rls 75.00
Pakistan	$1 = Rs 10.00
Turkey	$1 = TL 18.00

Source: Afghanistan - International Financial Statistics: 1972 Supplement, p.229, and balance sheets of the banks for number of branches.

Iran, Pakistan, Turkey - Regional Cooperation for Development, Manual on Banking (Tehran: RCD Secretariat, 1969).

Benston recently estimated a cost elasticity for banking of 0.93 indicating that a 10 per cent increase in deposits resulted on average in a 9.3 per cent increase in costs [10]. He explained the economies of scale by the fact that large banks were able to use a larger proportion of lower skilled labour, needed fewer processing and administrative officers and could shift to technology only economical for large scale operations [10, p. 339]. In another recent publication, Baltensperger showed that uncertainty also produced economies of scale:

> ... if it is true that uncertainty is a major source of economies of scale in banking, then, since the degree of uncertainty involved in different types of banking activities varies widely, the extent of these economies should be considerably different for different types of banking services. This again, it seems, should show up in the relative degrees of concentration of different types of services. We should expect that in the long run those services with relatively large scale economies become much more concentrated in the hands of a few large banks than those having only insignificant economies.
> [4, p. 475]

In an empirical analysis of the Swiss banking system, Baltensperger found support for his hypothesis. He concluded:

> ... the fact that the high-risk services are more concentrated in the hands of the largest firms than the low-risk services implies that, on the average, a relatively large part of a large bank's business takes place in the high-risk department, and a relatively large part of a small bank's business in the low-risk department.
> [4, pp. 484-85]

From the work of Baltensperger and Benston, it could be expected that even if Afghanistan's financial system were competitive and efficient, banking would be relatively high cost and prone to greater risk-aversion than other financial systems simply because of its small size.

The fact that Afghanistan's financial system is not competitive suggests, a priori, that it is unlikely to be efficient and furthermore has remained much smaller than a competitive system would have done. This alone suggests advantages from competition might accrue. Recent work on American and British banking suggests that the absence of competition has produced high social costs [32; 33; 34; 56]. In both countries regulations and restraints on competition are in the process of being removed since the recognition of the fact that the dangers of competition are much less serious than the banking communities try to make out and that the benefits of competition are considerably greater. Afghanistan could well take note of this move towards competitive banking in any attempt at financial development.

III The Central Bank

Da Afghanistan Bank, founded in 1318 (1939), is the central bank of Afghanistan in that it "has the monopoly and privilege of issuing bank-notes throughout Afghanistan" [16, Article 1, p.1] and acts as bankers to "the Government, Municipalities and all other Governmental Departments in Afghanistan as well as abroad" [16, Article 11 (b), p.3]. However, the Bank has no powers to control in any way other financial institutions. In the absence of standard central and commercial bank legislation, there is in fact no special control over other financial institutions. This is unnecessary at present for monetary policy purposes for two reasons. First, there is essentially no money multiplier process, i.e. multiplied relationship between high-powered money and the money supply, since three-quarters of the money supply, broadly defined to include time deposits, is currency. Furthermore, 31 per cent of the deposit component of the money supply is held at Da Afghanistan Bank; Table 9 presents balance sheet data for 1340-1350 (1962-1972). Second, in the absence of borrowing possibilities for the public sector outside the financial system, monetary policy is determined almost exclusively by fiscal policy.

Da Afghanistan Bank opened its first branch office in 1321 (1942) in Kandahar and opened five more during the 1320s (1940s). During the 1330s (1950s), 14 more branches were established and 35 in the 1340s (1960s).

TABLE 9

Assets and Liabilities of Da Afghanistan Bank, 1340-1350

(Millions of Afghanis, End of Year Figures)

	1340	1341	1342	1343	1344	1345	1346	1347	1348	1349	1350
ASSETS											
Foreign Assets	989	1,063	2,205	2,177	2,370	2,263	1,789	2,059	1,815	1,833	2,633
Claims on Government	3,058	4,380	5,759	5,162	5,239	5,472	5,870	6,661	9,068	9,870	10,947
Claims on Private Sector	1,017	968	552	538	560	581	584	842	979	927	1,052
Claims on Commercial Banks	122	70	70	71	72	175	91	73	432	724	239
Unclassified Assets	296	1,260	702	741	862	976	935	1,069	1,633	1,753	1,627
ASSETS=LIABILITIES	5,482	7,741	9,288	8,689	9,103	9,467	9,269	10,704	13,927	15,107	16,498
LIABILITIES											
Reserve Money	2,957	3,707	4,632	5,325	5,445	5,270	5,592	5,832	7,123	7,657	7,803
Quasi-Money Deposits	204	147	198	203	361	436	161	156	192	172	156
Foreign Liabilities	190	233	235	478	547	731	525	771	758	828	678
Government Deposits	478	863	1,171	1,016	1,070	1,607	1,267	2,439	2,827	3,085	3,625
Counterpart Funds	104	81	242	102	43	6	94	74	29	0	4
Capital Accounts	733	826	668	741	804	666	673	703	1,087	936	1,404
Unclassified Liabilities	816	1,923	2,336	891	920	753	957	674	1,854	2,380	2,711

Source: International Financial Statistics: 1972 Supplement, p.229

At present in 1352 (1973) there are eight branches in Kabul, 51 provincial branches together with the Trading Company of Afghanistan, Inc., established in 1333 (1954) in New York and the Trading Company of Afghanistan, Ltd., established in 1334 (1955) in London.

Despite the steady increase in branches, the facilities normally offered by a branch network are absent. No branch makes any loans, only a dozen accept savings accounts and there is no cheque clearing system. By and large, the branches of Da Afghanistan Bank serve almost exclusively as the Ministry of Finance's cashier. During the first six months of 1351 (1972) there were 930 transactions totalling Afs 1,763 million between the head office and the branches and 747 transactions totalling Afs 1,359 million between the branches and the head office. There was an average of 43 chequing accounts, eight fiduciary, i.e. temporary non-chequing, non-interest bearing accounts, and 27 savings accounts per branch at the end of 1351 (March 1973). Whilst 17,222 savings accounts were held at the head office, 1,600 were held in the branches. In certain other respects, including the salary scales of its employees, Da Afghanistan Bank is treated as an organ of the Ministry. The problems created by the sub-subsistence salaries which the Bank is obliged to pay are no different from those in all Government offices.

One of the internal constraints to expansion and greater autonomy lies in the quality of the Bank's personnel. Generally, the staff have had inadequate education before joining the Bank and little methodical on-the-job

training upon recruitment. Hence, there is general recognition that to improve the efficiency of operations on-the-job training must be given to almost the entire staff. Staff at the very top have generally received considerable training abroad but are thwarted in any efforts to apply their high level training by the eternal stream of mundane tasks which they are obliged to perform, including for example writing simple business letters and deciding which damaged banknotes are exchangeable. It is therefore doubly important to initiate training at lower and middle levels not only to increase the Bank's operational efficiency but also to free senior staff to devote more of their time to policy issues, etc.

Da Afghanistan Bank plays a relatively important role in foreign trade with offices in London and New York primarily to facilitate and supervise the karakul trade. Estimates presented by the author elsewhere [26, Table 14, p.53] suggest that Da Afghanistan Bank accounts for 28 per cent of the total annual turnover of foreign exchange, excluding clearing currencies. In addition to the $ 71 million foreign currency exchanged in 1351 there was an additional business in clearing currencies amounting to over $ 50 million. Da Afghanistan Bank not only has a monopoly in clearing currency accounts but also in $ 36 million of foreign exchange bought and sold at the so-called official rate.

In its foreign exchange operations and in its private sector credit policy, Da Afghanistan Bank is surprisingly unfettered. Although obliged

to provide all funds required by the Government subject only to the physical constraint of banknote availability, foreign exchange reserve policy and private sector credit are matters entirely within the Bank's responsibility. Efforts seem to have been made to counteract the more violent swings in Government funding through compensating changes in reserves and private sector credit supply. This is taken up again in the subsequent section.

IV Money Supply

The afghani was introduced in 1306 (1927) as a silver coin to replace the Kabuli rupee. It was sub-divided into puls and krans with 50 puls to the kran and two krans to the afghani. Twenty afghanis equalled one gold tilla [31, p. 403]. Indian and Iranian gold and silver coins also circulated in Afghanistan. The Law on Banknotes in Circulation in Afghanistan, enacted 4 Aqrab 1314 (26 October 1935), authorised the first note issue. The Law enabled the Ministry of Finance to issue paper notes itself or through Bank Millie. The arrangement actually reached between Bank Millie and the Ministry resulted in an issue of Treasury notes in 1315 (1936) which according to Article 6 of the Law could be converted " ... into Afghan coins in all government treasuries and in Bank Millie with no difficulty."

Notes issued by the end of 1315 (1937) equalled Afs 20m. By the end of 1318 (1940) Treasury notes totalled Afs 180m. In this year Da Afghanistan Bank was founded with the right to issue banknotes. Article 19 of its Statutes states:

> The Bank, in order to cover its short-term liabilities, shall be in possession of at least 30% of their face-value in the form of gold, silver, free foreign currencies, commercial bills payable within 15 days and bank-notes delivered by the "Committee of Bank-note Reserves" in accordance with clause 63 of these Statutes.
> [16, p. 6]

Section H of the Statutes also contains provisions on note issue and cover:

H. THE COMMITTEE OF BANK-NOTE RESERVES

62. In order to control the reserve of Bank-notes a special Committee composed of seven members is to be formed at the Bank as under:

Two members of Parliament
A member of the Cabinet
The President of the Supreme Court
The Governor of the Da Afghanistan Bank
The Chief Treasurer
The Government Auditor at the Bank

Term of Service

The term of office of the Government delegates and representatives is two years. Their appointment shall take place every year in the month of Hamal (March/April) at the occasion of the first session of Parliament and of the Cabinet. If Parliament does not sit at the aforesaid time, their nomination shall be postponed till the first session of the House is held.

63. This Committee has the following duties and powers:

(a) Inspecting and receiving the Bank-notes newly printed.

(b) Safe-keeping the Bank-notes and affecting their delivery to the Bank after examining the Legal Reserves and ascertaining that it is in proper ratio to the notes printed. The delivery of the Bank-notes to the Bank denotes, with regard to their cover that such notes are considered to be in circulation.

(c) Receiving the Bank-notes withdrawn from circulation as well as the worn and defaced Bank-notes; keeping the respective accounts for the same and proceeding to their

incineration with all necessary precautions. At the time of incinerating Bank-notes a protocol with full particulars of the procedure must be made in a spacial book. A copy of the protocol shall be forwarded to the Finance Minister.

(d) Controlling the account regarding the cover for the Bank-notes in accordance with the Rules and Regulations concerned. This Control Committee shall prepare a report at least once a month on the total value of notes in circulation and the coins, gold and silver bullions kept as cover for the same. This report shall be submitted to the Government which in its turn publishes it for the information of the public.

[16, pp. 15-16]

By the end of 1319 (1941) Afs 60m of Da Afghanistan Bank notes were circulating alongside the Treasury notes. The latter had now become the liability of Da Afghanistan Bank. They were virtually all withdrawn from circulation by the end of 1327 (1949) by which time there were nearly Afs 700m of Da Afghanistan Bank notes in circulation. It was presumably in 1318 (1939) that afghani notes lost their convertibility on being transferred to Da Afghanistan Bank. Nevertheless, there was clearly a strong desire for currency backing to prevent irresponsible recourse to the printing presses. The 1343 (1964) Constitution of Afghanistan follows up this concern with monetary stability. Article 64 provides that "the authorization to issue money ..... are within the competence of the Shura (Parliament)." By this time, however, the note cover had been reduced to 20 per cent [40, p. 77].

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Valued at either official or free market exchange rates, there has always been ample excess cover. In fact, the official exchange rate is used. Between 1341 (1963) and 1349 (1971) the gold and foreign exchange backing of currency in circulation averaged 45 per cent [42, Table 6, p. 81; 47, Table 94, p. 156].

The free market exchange rate vis-a-vis the U.S. dollar is presented in Table 10. Although the depreciating exchange rate suggests that domestic inflation has been generally greater than inflation in the U.S.A., the average annual rate of inflation has, in fact, only been 5.6 per cent between 1329 (1950) and 1351 (1972) [27, Table 5, p. 14]. This can be compared with 3.1 per cent in Iran, 1951-70, 2.9 per cent in Pakistan, 1950-70, and 7.2 per cent in Turkey, 1950-70 [28, Table 3]. Many underdeveloped countries have suffered considerably higher rates of inflation over this period.

Unfortunately, the relatively modest average rate of inflation has been accompanied by high variance. The standard deviation on the annual rates of inflation between 1329 (1950) and 1351 (1972) is 10.6. This high variance produces uncertainty as to the future direction of change and so makes money an extremely risky asset. Thus, if inflation <u>per se</u> has not been a major deterrent to money holding the variance in it certainly has. As the critical objective in any programme of financial development is to increase the

TABLE 19

Free Market Afghani/Dollar Exchange Rates

"Bazaar Rates"
1311 - 1351

(Annual Averages of Daily Buying Rates For Drafts and Cheques)

Date	Afghanis to One U.S. Dollar
1311	10.0
1315	9.8
1316	9.8
1317	10.8
1318	13.0
1319	13.1
1320	13.1
1321	13.1
1322	13.1
1323	13.1
1324	13.2
1325	13.7
1326	17.2
1327	27.0
1328	28.0
1329	39.0
1330	35.0
1331	37.0
1332	37.1
1333	42.1
1334	45.2
1335	53.8
1336	54.1
1337	54.7
1338	46.6
1339	40.8
1340	43.5
1341	52.8
1342	51.3
1343	63.6
1344	75.3
1345	76.4
1346	76.4
1347	74.8
1348	75.4
1349	84.8
1350	84.6
1351	[illegible]

Source: 1311 from V. Gregorian, The Emergence of Modern Afghanistan: Politics of Reform and Modernization (Stanford: Stanford University Press, 1969), p. 362 and A. Guha, "Economic Development of Afghanistan - 1929-1961," International Studies, 6 (4), April 1965, p. 426.

1315-1323 calculated from sterling/afghani rates in Statesman's Yearbook, 1936-1945 and dollar/sterling rates in American International Investment Corporation, World Currency Charts, 1973 (San Francisco: American International Investment Corporation, 1973).

1324-25 and 1327-28 from A.H. Kayoumy, "Monopoly Pricing of Afghan Karakul in International Markets," Journal of Political Economy, 77 (2), March/April 1969, Table 1, p. 221.

1326 from Ministry of Planning, Survey of Progress, 1960 (Kabul: Ministry of Planning, 1339 = 1960), p. 184.

1329-1351 from Research Department, Da Afghanistan Bank.

real demand for money [20; 21; 22; 24], efforts must in the future be directed at reducing not only the level of inflation but, more important in the Afghan context, also the variance.

For this task it is essential to understand the factors which have contributed to this high variance. The major exogenous factor against which it is difficult, though certainly not impossible, to take counter-acting measures is fluctuations in agricultural output. Indeed, this is particularly well illustrated at the present when, for example, the price of wheat flour is 28.5 per cent lower than it was a year ago and the price of mutton 46.4 per cent higher [13]. Although the stabilisation of meat prices is a long and complicated process, grain prices which are much more important in the cost-of-living index can be stabilised to a considerable extent through repeal of the Anti-Hoarding Law of 1346 (1967) and the implementation of a Government reserve stock programme.

Although agricultural fluctuations and seasonalities are probably the major cause of short-run (up to 18 months) price fluctuations, it is significant that a calculated series of expected inflation rates which uses a weighted average of inflation over four-year periods yields a standard deviation of 6.0 [27, pp. 13-15]. Thus, even if agricultural fluctuations contribute a maximum of 4.6 to the standard deviation of annual inflation

rates the major cause is still to be discovered. This is, in fact, undoubtedly changes in the money supply. Between 1331 (1952) and 1350 (1971) the average three-year increase in the money stock was 38.7 per cent; the standard deviation of the 18 observations is 26.9.

Regression of the simple relationship

$$\mathring{P}_t = a + b\,\mathring{M}_{t-1}$$

where $\mathring{P}_t$ is the three-year percentage rate of inflation over period t and $\mathring{M}_{t-1}$ is the three-year percentage change in the money stock over period t-1, yields the following results for the period 1331-51 (1952-72):

$$\mathring{P}_t = -8.88 + 0.77\,\mathring{M}_{t-1}$$

which, with $R^2 = 0.7592$ and $t = 6.877$ is a highly significant relationship, well over the 99.9 per cent confidence level. Thus, over three-quarters of the change in the price level during a three-year period is accounted for by changes in the money stock. The data used in this analysis are presented in Table 11. There are high standard deviations for both changes in the money stock and changes in the price level. Table 12 presents a somewhat longer series for currency and money stock on an annual basis. For an average annual increase in currency in circulation of 12.7 per cent, the standard deviation is 9.6, whilst for an average annual increase in the money supply of 11.6 per cent the standard deviation is 11.2. Both

TABLE II

Three-Year Moving Average Percentage Changes in the Money Stock and Purchasing Power Parity Price Index, 1331 - 1351

(Percentages)

Date	Money Stock	Purchasing Power Parity Price Index	Date
1331-34	64.6	50.51	1332-35
1332-35	84.7	37.05	1333-36
1333-36	55.7	30.47	1334-37
1334-37	13.9	-9.44	1335-38
1335-38	4.6	-23.29	1336-39
1336-39	10.0	-20.57	1337-40
1337-40	24.8	13.31	1338-41
1338-41	37.8	25.16	1339-42
1339-42	61.5	46.50	1340-43
1340-43	80.9	45.36	1341-44
1341-44	72.8	57.34	1342-45
1342-45	44.3	26.83	1343-46
1343-46	16.6	5.37	1344-47
1344-47	6.1	5.28	1345-48
1345-48	15.5	22.55	1346-49
1346-49	30.1	25.80	1347-50
1347-50	34.0	17.77	1348-51
Average	38.70	20.94	Average
Standard Deviation	26.87	23.76	Standard Deviation

Source: Money Stock - 1331-36 from Ministry of Planning, Surveys of Progress, 1958, 1959 and 1962-64 (Kabul: Ministry of Planning, 1958, 1959 and 1964), Table Money 7-30, Volume II; Table 47, p. 186, Volume IV; Table A-7, p. 106, respectively.

1337-50 from International Financial Statistics: 1972 Supplement, pp. 228-29 and International Financial Statistics, 26 (6), June 1973, pp. 40-41.

Purchasing Power Parity Price Index - M.J. Fry, Has Velocity In Afghanistan Been Constant? (Kabul: United States Agency for International Development, mimeo, March 1973), Table 4, p. 16.

TABLE 12

Currency and Money Stock 1315 - 1351

(Afs millions, End of Year Figures)

Date	Currency in Circulation	Money Stock (M2)	Percentage Change in Currency	Percentage Change in Money Stock
1315	20	n.a.		
1318	180	n.a.		
1319	240	n.a.	33.3	
1320	300	n.a.	25.0	
1321	372	n.a.	24.0	
1322	430	n.a.	15.6	
1323	500	n.a.	16.3	
1324	594	n.a.	18.8	
1325	680	n.a.	14.5	
1326	680	n.a.	0.0	
1327	687	n.a.	1.0	
1328	764	n.a.	11.2	
1329	900	n.a.	17.8	
1330	940	1,210	4.4	
1331	978	1,338	4.0	10.6
1332	989	1,339	1.1	0.1
1333	1,193	1,848	20.6	38.0
1334	1,474	2,345	23.6	26.9
1335	1,760	2,601	19.4	10.9
1336	1,889	2,360	7.3	-9.3
1337	1,849	2,473	-2.1	4.8
1338	1,881	2,700	1.7	9.2
1339	2,155	2,756	14.6	2.1
1340	2,607	3,205	21.0	16.3
1341	3,158	3,924	21.1	22.4
1342	3,884	4,886	23.0	24.5
1343	4,722	5,900	21.6	20.8
1344	4,644	6,419	-1.7	8.8
1345	4,624	6,290	-0.4	-2.0
1346	4,804	6,288	3.9	0.0
1347	5,238	6,788	9.0	8.0
1348	6,144	7,893	17.3	16.3
1349	6,532	8,468	6.3	7.3
1350	6,785	9,049	3.9	6.9
1351	8,180	10,858	20.6	20.0
Average			12.7	11.6
Standard Deviation			9.6	11.2

Note: Currency figures for 1315-1329 include vault cash. It can be assumed that this was very small during these years.

Source: 1315-18 from M.H.K. Zia, "From Brokerage to National Bank," Iqtisad Journal, 220, Saratan 1319, pp. 321-28.

1319-29 from balance sheet data provided by Da Afghanistan Bank.

1330-36 from Ministry of Planning, Surveys of Progress, 1958, 1959 and 1962-64 (Kabul: Ministry of Planning, 1958, 1959 and 1964), Table Money 7-30, Volume II; Table 47, p. 186, Volume IV; Table A-7, p. 106, respectively.

1337-51 from International Financial Statistics: 1972 Supplement, pp. 228-29 and International Financial Statistics, 26 (6), June 1973, pp. 40-41.

TABLE 12A

Currency and Money Stock in Constant Prices, 1318 - 1351

(Millions of Afghanis, 1966 Prices, End of Year Figures)

Year	Currency in Circulation	Money Stock (M2)	Percentage Change in Currency	Percentage Change in Money Stock
1318	201	n.a.		
1318	1,431	n.a.		
1319	1,858	n.a.	29.8	
1320	2,089	n.a.	12.4	
1321	2,292	n.a.	9.7	
1322	2,541	n.a.	10.9	
1323	2,922	n.a.	15.0	
1324	3,387	n.a.	15.9	
1325	3,266	n.a.	-3.6	
1326	2,126	n.a.	-34.9	
1327	1,264	n.a.	-40.6	
1328	1,425	n.a.	12.7	
1329	1,160	n.a.	-18.6	
1330	1,211	1,959	4.4	
1331	1,227	1,679	1.3	7.7
1332	1,255	1,698	2.3	1.2
1333	1,331	2,063	6.1	21.4
1334	1,527	2,430	14.7	17.8
1335	1,484	2,193	-2.8	-9.8
1336	1,538	1,922	3.6	-12.4
1337	1,469	1,964	-4.5	2.2
1338	1,751	2,514	19.2	28.0
1339	2,288	2,926	30.7	16.4
1340	2,607	3,205	13.9	9.5
1341	2,595	3,224	-0.5	0.6
1342	3,294	4,144	26.9	28.5
1343	3,223	4,027	-2.2	-2.8
1344	2,625	3,629	-18.6	-9.9
1345	2,493	3,391	-5.0	-6.6
1346	2,586	3,384	3.7	-0.2
1347	2,810	3,642	8.7	7.6
1348	3,146	4,041	12.0	11.0
1349	2,869	3,719	-8.8	-8.0
1350	2,893	3,859	0.8	3.8
1351	3,557	4,721	23.0	22.3
Average			4.2	6.1
Standard Deviation			16.1	12.6

Source: Figures in Table 12 were deflated by a purchasing power parity price index in A.J. Fry, Has Velocity in Afghanistan Been Constant? (Kabul: United States Agency for International Development, mimeo, March 1973), Table 4, p. 16.

standard deviations are extremely high. Table 13 provides a comparison with Iran, Pakistan and Turkey.

The question which now arises is: who was responsible for this erratic behaviour in the money stock? Elsewhere, it has been shown that the greater part of the fluctuations in changes in the money supply are determined by changes in high-powered money[3] [24, p. 21]. Furthermore, changes in public sector debt were found to have been even more volatile than changes in high-powered money, as can be seen in Table 14. Over the period 1338-51 (1960-73) the average annual increase in high-powered money was 11.3 per cent with a standard deviation of 9.6. Over the same period the average annual increase in public sector domestic debt was 18.8 per cent with a standard deviation of 28.8. The greater variability of changes in public sector domestic debt than in high-powered money is due to compensating changes in credit extended by Da Afghanistan Bank to the private sector and changes in its foreign exchange reserves. Net reductions in foreign exchange reserves enabled public sector domestic debt to increase by Afs 9,169m, while high-powered money only increased by Afs 6,452m.

Given that the Government financial requirements have always taken precedence over all other considerations, it would appear that the extraordinarily high

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[3] High-powered money or the cash base is defined here as currency in circulat and vault cash of the commercial banks.

TABLE 13

Average Annual Percentage Changes in Money and Prices

In Afghanistan, Iran, Pakistan and Turkey

(Percentages)

		Money Stock (M2)	Price Level
Afghanistan	1331-1340	11.0 (13.6)	3.1 (11.1)
	1341-1351	12.1 (9.2)	8.3 (10.4)
Iran	1950-1960	14.0 (7.3)	4.5 (9.7)
	1961-1971	16.3 (5.3)	1.9 (2.1)
Pakistan	1950-1960	8.6 (5.1)	2.7 (15.1)
	1961-1971	11.2 (5.5)	3.9 (4.8)
Turkey	1950-1960	18.4 (5.1)	8.5 (8.8)
	1961-1971	16.3 (4.9)	6.2 (4.1)

Note: Figures in brackets are standard deviations.

Source: Afghanistan from Table 12 above and M.J. Fry, Has Velocity in Afghanistan Been Constant? (Kabul: United States Agency for International Development, mimeo, March 1973), Table 4, p. 16.

Iran, Pakistan and Turkey from International Financial Statistics, 1972 Supplement; Monthly Statistical Bulletin, 12 (1), January 1964 (Pakistan Central Statistical Office); Pakistan Institute of Development Economics, A Measure of Inflation in Pakistan, 1951-61 (Karachi: Pakistan Institute of Development Economics, Monograph No. 4, 1961).

TABLE 14

Annual Changes in High-Powered Money and Public Sector Debt

1338-1351

Date	High-Powered Money		Public Sector Debt	
	Change in Afs m	Percentage Change	Change in Afs m	Percentage Change
1338	33	1.7	-11	-1.3
1339	267	13.3	642	78.2
1340	550	24.2	567	38.8
1341	633	22.4	1,351	36.3
1342	848	24.5	2,144	42.3
1343	654	15.2	-1,011	-14.0
1344	-32	-0.6	-355	-5.7
1345	-64	-1.3	-717	-12.3
1346	344	7.1	1,185	23.1
1347	219	4.2	-919	-14.5
1348	1,236	22.8	3,074	56.9
1349	571	8.6	424	5.0
1350	64	0.9	2,078	23.4
1351	1,129	15.5	717	6.5
Average		11.3		18.8
Standard Deviation		9.6		28.8

Source: International Financial Statistics: 1972 Supplement, pp. 228-29 and International Financial Statistics, 26 (6), June 1973, pp. 40-41.

annual variations in public sector domestic borrowing has been ultimately responsible for the variability in the money supply, with Da Afghanistan Bank attempting to and partially succeeding in dampening these fluctuations through private sector credit and reserve policies.

High variance in the rate of inflation, caused by the extreme volatility of public sector domestic borrowing, has been one factor contributing to financial stagnation. In addition, the rate of inflation itself, which can also be attributed to excessive public sector domestic borrowing, has suppressed financial development. Such borrowing can be regarded as a tax on money holdings since the inflation it has created reduced the real value of money held. The consequences of this tax on one of the most important products of the financial sector have been succinctly analysed by Shaw in the following extract:

> Real money balances can be regarded not merely as wealth from the standpoint of the money-holder but as social wealth, deserving a place on the social balance sheet with wealth in machines, inventories, structures, natural resource endowments and human skills. A fully monetized economic system can extract the highest yield from its productive capacities. Incomplete monetization constrains productivity. Afghanistan is among the least monetized of economies, yet it was public policy to tax money more severely than other forms of wealth. Put another way, it seems that policies were pursued to ensure that Afghanistan would remain a barter society.
>
> Strong emphasis is due on the interdependence of fiscal and monetary policy. A weak fiscal effort during 1341-1350 (1962-1971) forced Afghanistan to tax money. In the degree that fiscal savings are reduced by price-level inflation, the taxation of money can make the weak fiscal effort weaker still. By the end of this decade, Afghanistan teetered on the edge of a process that would close the flow from both fiscal and financial sources of savings to capital formation and economic development.
>
> [58, p. 6]

V Bank Millie and Pashtany Tejaraty Bank

Of the three banks, Bank Millie is generally regarded as the most efficient, Pashtany the least. Bank Millie is the only private bank, yet its relationship to the Government was very close from its establishment until the founding of Da Afghanistan Bank and it is still surprisingly closely linked to the Government. In particular, various failing enterprises of Bank Millie have been foisted off onto the Government in latter times, although the reverse process took place in the 1310s (1930s). Personnel policies also bear similarities with the Government's in that great emphasis is placed on security and little on payment according to merit. Salary scales themselves are not greatly above the Government's and again senior staff bemoan the lack of trained staff at the lower and middle levels. Not surprisingly, Bank Millie's lending policy is now the most conservative of the three banks.

Pashtany Tejaraty Bank suffers from Government civil service personnel policies and Government intervention since it is a Government bank, yet lacks note-issuing powers and/or rediscount facilities with Da Afghanistan Bank to ensure the maintenance of liquidity. This is likely to create a major problem at some future date.

Tables 15 and 16 provide some balance sheet data and banking ratios for these two institutions. The former generally indicates the small size of

TABLE 15

Assets and Liabilities of Bank Millie and Pashtany Tejaraty Bank 1340 - 1350

(Millions of Afghanis, End of Year Figures)

	1340	1341	1342	1343	1344	1345	1346	1347	1348	1349	1350
ASSETS											
Reserves	220	302	424	240	286	242	406	191	521	704	515
Foreign Assets	18	37	74	102	73	111	102	167	169	200	186
Claims on Private Sector	1,145	1,146	1,155	1,417	1,638	1,708	1,765	1,918	1,884	1,845	2,477
Unclassified Assets	129	146	141	320	615	628	634	728	598	579	952
ASSETS = LIABILITIES	1,512	1,631	1,794	2,079	2,612	2,689	2,907	3,004	3,172	3,328	4,130
LIABILITIES											
Demand Deposits	191	339	408	319	392	292	431	443	515	491	587
Quasi-Money Deposits	81	89	150	397	720	660	598	701	690	913	1,200
Government Deposits	169	205	212	137	106	120	154	209	183	180	180
Capital Accounts	984	1,006	1,019	1,035	1,061	1,117	1,203	1,264	1,283	1,195	1,217
Unclassified Liabilities	92	-5	7	194	332	498	516	389	501	550	946

Source: International Financial Statistics: 1972 Supplement, p. 229.

TABLE 16

Banking Ratios of Bank Millie and Pashtany Tejaraty Bank, 1340 - 1351

(Percentages)

	1340	1341	1342	1343	1344	1345	1346	1347	1348	1349	1350	1351
Ratio A	29	39	43	41	47	40	41	45	44	48	48	n.a.
Ratio B	50	48	55	28	23	23	34	14	38	44	26	13
Ratio C	76	70	64	68	63	64	61	64	59	55	60	n.a.

$$\text{Ratio A} = \frac{\text{Total Deposits}}{\text{Total Assets}}$$

$$\text{Ratio B} = \frac{\text{Reserves}}{\text{Total Deposits}}$$

$$\text{Ratio C} = \frac{\text{Outstanding Credit}}{\text{Total Assets}}$$

Source: International Financial Statistics: 1972 Supplement and International Financial Statistics, 26 (6), June 1973.

the two banks. Of interest in the latter has been the steady increase in the deposit/asset ratio, the wildly fluctuating reserve/deposit ratio and the apparent decline in the credit/asset ratio. The latter is not too informative in that a large proportion of Bank Millie's loans go to firms in which it has major equity interests.

There are many similarities between Bank Millie, Pashtany Tejaraty Bank and Da Afghanistan Bank. Lending is concentrated in the foreign trade sector, branches are no more than deposit and collection agencies, efficiency is low and, in certain Government banks, corruption has been reported. In general, the commercial banks present a sorry picture of stagnation.

VI Specialised Banks

The history of specialised banking in Afghanistan has been less than satisfactory. A new period, however, started in 1348 (1970) with the reconstitution of the former Agriculture and Cottage Industries Bank into the new Agricultural Development Bank (AgBank) with help from the World Bank. There are several striking differences between the activities of the Agricultural Development Bank and the commercial banks. Despite the fact that it is a Government institution, the AgBank has since the beginning of 1352 (March 1973) been operating under new personnel policies which take some major departures from the civil service procedures previously followed. Pay scales have been considerably raised, the civil service promotion system and titles abolished and an incentive scheme introduced.

The AgBank also differs from the commercial banks in that it is expanding rapidly as can be seen from the data in Table 17. These figures can also be compared to those of the Mortgage and Construction Bank given in Table 18. Recently, the AgBank has actively solicited the problematic job of distributing credit for fertiliser purchases and has devised new ways and means to increase the probability of prompt collection.

The accounting procedures used by the AgBank differ from those of the commercial banks and the Mortgage and Construction Bank not only in the fact

TABLE 17

Assets and Liabilities of the Agricultural Development Bank, 1350 - 1351

(Millions of Afghanis, End of Year Figures)

	1350	1351
ASSETS		
Cash and Deposits	118	229
Claims Abroad	24	49
Domestic Loans	91	384
Participations	16	16
Inventories and Goods in Transit	65	56
Other Assets	8	13
ASSETS = LIABILITIES	322	747
LIABILITIES		
Deposits	15	156
Loans from Government and Da Afghanistan Bank	6	142
Foreign Liabilities	53	18
Other Liabilities	32	13
Paid-up Capital	215	395
Reserves and Undistributed Profits	1	23

Source: Accounts Department, Agricultural Development Bank.

TABLE 18

Assets and Liabilities of the Mortgage and Construction Bank, 1334 - 1350

(Millions of Afghanis, End of Year Figures)

	1334	1335	1336	1337	1338	1339	1340	1341	1342	1343	1344	1345	1346	1347	1348	1349	1350
ASSETS																	
Deposits	5	4	4	4	9	8	9	5	6	19	18	9	22	6	14	19	25
Loans	66	62	64	66	62	63	67	66	71	68	79	85	87	92	90	86	85
Investments	2	2	2	2	2	2	4	4	4	4	5	5	6	6	6	6	6
Other Assets	29	31	34	35	31	29	24	25	21	22	27	23	22	23	24	20	20
ASSETS = LIABILITIES	102	99	104	107	104	102	104	100	102	113	129	122	137	127	134	131	136
LIABILITIES																	
Capital	61	61	61	61	61	61	61	61	61	61	61	61	61	61	61	65	65
Loan from Pension Fund	13	9	9	9	6	5	0	0	0	0	0	0	0	0	0	0	0
Loan from Da Afghanistan Bank	0	0	0	0	0	0	0	4	4	4	4	3	3	0	0	0	0
Deposits	0	0	0	0	0	0	0	0	0	0	5	5	5	5	5	5	5
Other Liabilities	28	29	34	37	37	36	43	35	37	48	59	53	68	61	68	61	66

Source: Mortgage and Construction Bank, Reports of the Executive Committee to the Annual General Assembly on the Activities for the Years 1334 - 1350 (Kabul: Mortgage and Construction Bank, 1335 - 1351).

that they are much more accurate and are audited by external auditors of international repute, but also in the important fact that bad debts are written off. No debt in any of the other banks has ever been written off. This alone results in such distortions as to make the balance sheets and profit and loss statements almost meaningless.

The Mortgage and Construction Bank has so reduced the scope of its activities that it is virtually defunct. A few small loans to Government employees are all that are now made.

The Industrial Development Bank of Afghanistan (IDBA) established after many years of planning and negotiations in 1351 (1973) has just started operations and hopes to make its first loans in 1352 (1973). Like the AgBank, the IDBA is managed by a foreign management team funded by the UNDP with the World Bank as executing agency. Unlike the AgBank, the IDBA is a private corporation with 40 per cent foreign participation. Bank Millie, Pashtany Tejaraty Bank and the Chamber of Commerce hold another 40 per cent of the equity. In relation to the equity capital of Afs 240 million, the IDBA is to receive an enormous subsidy from the Government in the form of an Afs 560 million loan at 2 per cent interest with repayment over 25 years, which includes a 10-year grace period, from Da Afghanistan Bank. The World Bank, through IDA, has provided a $ 2 million loan to the Government with a 50-year term, 10-year grace period,

at a service charge only of three-quarters of a per cent on the amount outstanding. The Government, in turn, is to extend foreign exchange to the IDBA at rates of 5½ and 7½ per cent, the former for relending at 8 per cent to small-scal firms, i.e. firms with less than $100,000 worth of equipment, the latter at 10 per cent to other borrowers. The foreign exchange conversion risk is in both cases borne by the borrower. Lending policy is likely to be conservative. The expected return on IDBA capital in the short run is 12-18 per cent. The anomalous effect of the spread of interest rates and returns in terms of income distribution has been noted by Shaw:

> .... If the IDBA achieves a portfolio equal only to funds initially committed and earns upon them, after allowing for expenses, a return of 7 per cent, the yield to stockholders will exceed 18 per cent. That is hardly comparable with the yield to taxpayers of 2 per cent on Da Afghanistan Bank's loan to the Bank.
> [58, p. 15]

VII Problems of Bank Lending

Not only has the volume of credit measured at constant prices which has been received by the private sector declinedconsiderably over the past decade, but the variety of loans has also contracted. Because of difficulties experienced by the banks in collecting loans on maturity, the types of collateral which are now acceptable against secured loans have been reduced. The difficulties in collecting debts have been mentioned in several publications:

> ... the banks are reluctant to widen their range of borrowers or to extend credit facilities to industry and agriculture, owing to inadequate protection under existing laws.
> /60, p. 106/

> Since the rights, duties and obligations of both borrower and lender are not clearly defined by law, neither commercial bankers as lenders nor the private sector as borrowers can be expected to fully mobilize the credit resources of the country to accelerate economic development.
> /44, p. 19/

> The lack of suitable laws as for example a civil code, credit security laws, a general banking law and the inexperienced administrative staff of the banks as well as that of the different commercial courts makes it difficult for the banks to promote the lending business .....
> /29, p. 8/

> ... the banking institutions have not been successful in distributing and collecting loans ..... The failure of the banking system in the distribution and collection of loans is mostly due to poor management, untrustworthiness of borrowers and the use of bank credit for consumption and non-productive purposes.
> [45, p. 19]

The three recurring problems which emerge from reports and interviews with the managers of credit departments in all the banks are:

A Legal

B Management

C Political

The legal problems appear to arise from the influence owners continue to hold over the disposal of their collateral, slow and inefficient court procedures, the political and social influence of the borrower, incompetent court officals and corruption. Management problems arise from inadequate training in audit and inspection procedures for bank employees, nepotism in promotion and incompetence in both branch and head offices. Similar defects in the borrowing institutions themselves and in the customs houses compound these difficulties. Political influence has been exerted on state-owned financial institutions to extend specific loans.

The histories of the specialised Government-owned banks well illustrate the problems of institutional lending in Afghanistan. One of the major

problems has been postponement of interest and instalment payments. The Industrial Credit Fund was established at the beginning of 1336 (1957) with a capital of Afs 205m. By the end of its first year it had lent out almost all its funds and thereafter "ceased to operate to all intents and purposes" [12, p. 15]. The Fund was later wound-up when it became evident that loans would never be repaid. The same fate has befallen all the other specialised banks. The Agricultural and Cottage Industries Bank established in 1333 (1954) had exhausted its funds by 1337 (1958):

> The Agricultural Bank continued giving loans till the end of 1337, but as many of these loans were not utilized in productive enterprises and as the bank could not recover the major part of its loans and interest of six percent, at last it decided to close the chapter of giving loans.
> [41, p. 12]

The peculiar problem faced by the Agricultural Bank in taking land titles as security is illustrated in the following passage on lending by nomads:

> In most cases the ordinary nomad today owns no land, but on the other hand often takes it on the so-called gerawi terms. This means that, against a once-for-all payment in the shape of a loan, the nomad takes a definite area of land as security. All rights to the land belong to the lender, and as he neither can nor will cultivate it, this is left to an Hazara on ordinary tenant conditions. If Islamic law is followed, the borrower (former owner of the ground) must not be employed as tenant.
> [17, p. 133]

Thus, land can only be given as mortgage if it is then farmed by someone other than the owner.

The AgBank and the Mortgage and Construction Bank have turned to the Government to support collection. Until recently, the AgBank's lending activities were confined to tractor and water pump loans to large farmers. It is however, attempting to extend activities. It will be distributing credit to groups of farmers for fertiliser purchases in 1352 (1973) and is planning to lend to small farmers under a system of supervised credit in the near future. In this, it is seeking assistance for supervision from Government extension services, PACCA, the Helmand-Arghandab Valley Authority (HAVA) and the cotton companies.

The main problems faced by the AgBank in its lending activities are best gleaned from two reports of the AgBank itself:

"II <u>Existing Problems Faced by the AgBank</u>

A <u>Problems Related to the Distribution of Credit</u>

The AgBank in following general principles of banking and its own regulations does not extend loans to borrowers who cannot meet certain requirements. As security, the AgBank has accepted the following items:

immovable property (land, shops, houses, etc.); movable property such as agricultural products, including animal products, merchandise and bonds; and guarantees from financial institutions and agro-business firms. To safeguard its loans, the AgBank has generally required immovable property as security for medium and long-term loans.

The provision of such security is still based on Government regulations concerning guarantees which were prepared by the Ministry of Finance and ratified by the Cabinet. To mortgage land, the owner swears in the presence of two witnesses in a court of law (mahkama-e-wasayeq) that he is placing a particular piece of his land under mortgage against the loan which is being provided by the Bank. On default, the Bank has the right to sell the mortgaged property without recourse to further judicial procedures.

In practice, a number of defects in this system does not encourage banks to accept such security (wasiqa) for the following reasons:

1 Since the cadastral survey has not been completed, the actual size and nature of the security is uncertain.
2 Incorrect land registration results in uncertainty as to whether the possessor of the title is in fact the owner of the land.
3 The variety of customary rights in different parts of the country over water use (haqaba) which is a major factor in determining

the value of the property adds to the uncertainty of the security.

4 Various standards of measurement (tukhum reiz, paikal, quiba, etc.) further add to the problem.

5 Finally, legal promissory notes do not conform to the Bank's requirements. Unclear handwriting of court officials can easily prevent the document from being officially accepted.

B Difficulties in Settling Loan Contracts

1 Loans are extended in accordance with the conditions laid out in the contract which after the provision of adequate security is signed by both parties. The contract sets out the rights and duties of both sides. The Commercial Law establishes that disputes arising from such contracts should be taken to the commercial courts. However, as a result of various problems such as the non-attendance of borrowers or the bank's attorney, contracts have not been registered in the courts. This, of course, creates additional problems.

2 The absence of commercial courts in many parts of the country in any case makes registration of contracts impossible.

3 Registration departments (wasayeq) create obstacles preventing speedy registration.

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C Collection Problem

Although the borrower vests the right to sell his security with the bank and his neighbours promise to buy the land in the case of default, the bank is often unable to sell the security because:

1 The inhabitants of the district refuse to buy the land through fear or compassion.
2 The immediate neighbours are not in a position financially to buy the land or they also want to help the borrower.
3 The judicial authorities will not transfer the security to the bank without the consent of the borrower. Even if it is transferred to the bank, the bank will not be able to manage the property: the establishment of a management team is too costly.
4 Loan collection is another area in which the bank does not possess any authority and at present this is undertaken by Government agencies. This has created many additional problems.

D Borrowers' Difficulties

In the absence of cooperatives, land titles and other securities, a large number of farmers are deprived of receiving agricultural loans. Even farmers with land titles who want to borrow are faced with severe difficulties arising from the costs of legal promissory notes and psychological factors.

IV Problems Regarding Security for Medium-Term Loans

Medium-term loans are generally given to farmers to help them buy immediate needs such as improved seeds, fertiliser, chemicals to combat insects, small tools, animals and to help them improve their marketing. In these cases, immovable property is held as security.

In this instance, the AgBank faces the following difficulties:

1 Preparation and distribution of credit for individual farmers possibly exceeding a million in number is a major problem.

2 Granting loans to farmers against their agricultural and animal products is not problem-free, both because the cooperative system is not common and also because the marketing system has not been developed, except for a few items such as sugar beet and cotton. Otherwise the sale of agricultural products is not controlled and the collection of loans is difficult.

3 Preparation of promissory notes for mortgages for short-term loans and also registration of the contracts related to these loans in the commercial courts create some problems in that they make the distribution of loans, which are increasing day by day, impossible. In particular, fertiliser will be needed

by over half a million farmers in the next season. Although the Afghan Fertiliser Company has been established to satisfy the needs of farmers, there are not enough storehouses throughout the country and therefore fertiliser cannot be distributed to all the farmers."

[2, pp. 3 - 12]

"3.2 Securities

At present, the only utilized form of security is mortgage on land. Land security is established through a legal act undertaken in the courts. A mortgage on land can be given only by a landowner. The Bank also accepts land mortgage of a person other than the borrower. The procedure involved in getting a land mortgage confirmed by the court is time-consuming and troublesome. From the security document finally issued by the court on the basis of the "Qabala", which does not show the actual status of ownership, AgBank cannot be certain that the land mortgage obtained will be a valid guarantee, from which prosecution can be started without any difficulty.

It is the desire of AgBank that steps should be taken to simplify the legal documents and procedures involved in order to give further encouragement to the farmers and to enable AgBank expand its loan activities.

If the farmer does not pay the loan when it falls due the Bank's only remedy is the possibility of selling the mortgaged land. Under the present security system the sale of land not only involves legal problems but also problems in the practical aspects of the sale. Since the security is based on the signatures of neighbouring landowners, who have to state that they would be willing to purchase the land in the case of prosecution, this normally results in the neighbours' refusing to comply, claiming they have no cash available, that they maintain a good relationship with the present landowner and therefore do not want to take away his land, and that in cases where a neighbour signed the mortgage and has since died, his heirs are not willing to fulfill the obligations agreed to by the deceased. If it actually comes to a sale it is also very difficult for an outsider to buy the land as he will face difficulties in the future with the neighbours. The AgBank's taking over the land under the present system would add more problems to the already existing ones.

For these reasons many Bank loans have been long overdue. There are many cases available in the Bank as proof.

Generally, besides land, farmers do not have anything else - such as shares in companies, governmental bonds, warehouse receipts for goods placed in government warehouses, guarantees obtained from other banks, or other movable property - of great enough value to serve as security for AgBank. In addition to the difficulties arising from the legal procedures in obtainin

land securities, the actual number of landowners in a position to obtain these securities on land is very limited, the reason being that only a minority of landowners has the land actually registered in their names and therefore can produce land titles. In many cases, the land belongs to several members of a family who have inherited the land from their father, grandfather, etc. In such cases, it would take the consent of all the family to put the land under mortgage. As experience has shown, this is also very difficult.

3.3 Collection

3.31 Short-term Loans

The collection rate of short-term credits disbursed to cotton companies, the PACCA Cooperative, and to agro-business enterprises with rates between 90 and 100 per cent is satisfactory. The collection rates for credits extended for fertiliser, however, are not at all satisfactory. For the disbursements of 1350, which were due on Mizan 1, 1351 up to Hoot 29, 1351, the average rate of collection was 63 per cent in the whole country, with variations from 28 per cent in Kabul Province to 100 per cent in Bamyan. The reason for this poor result is the fact that not enough efforts to collect have been made and more pressure should come from the RGA.

3.32 Medium- and Long-term Loans

The collection rates of AgBank of individual loans are also not satisfactory. In the first nine months of 1351, for instance, the recovery rate of medium-term loans fallen due in that period was only 76 per cent. The loans not collected when they fell due are transferred to the category of "loans overdue" where the collection rate is even lower. The difficulties AgBank is having with the system of securities as described above result in farmers knowing exactly that prosecution on land mortgages is more or less fruitless for AgBank. Additionally, it is widely known that the Government does not take a strong position in the collection of fertiliser credit. This naturally has side-effects on AgBank's collections."

[1, pp. 6-8]

The Mortgage and Construction Bank, established as the Construction Bank in 1326 (1947) and renamed the Mortgage and Construction Bank in 1333 (1954), enjoyed the longest period of activity amongst the specialised banks. However, operations have been severely contracted from a wide range of medium and long-term lending operations for private housing, hotels, cinemas, etc., and participation in the construction business to a small volume of loans to Government employees only for a period of five years at a rate of interest of five per cent. It is probable that bad debts will be recognised in the

near future and the Bank reorganised on the same lines as the Agricultural Bank was in 1348 (1970).

Various attempts at debt collection have been made by the Mortgage and Construction Bank but so far without success. The Bank received little help from the Ministry of the Interior which merely issued summonses on defaulters but did not facilitate the sale of the property. The result was that borrowers did not bother to repay their debts. In 1348 (1969), the Supreme Council of the Bank determined to take action by writing to all the defaulters demanding repayment within a month. Non-compliance would result in seizure and sale of their property by the Law Department of Kabul Province. Furthermore, the Council decided to hire a lawyer for a specific period. Defaulting borrowers were informed of these decisions but no other action was taken and the problem remained unchanged [48].

In the Annual Report of 1349 (1971), the problem of defaulting borrowers was again brought to the attention of the shareholders. The compounded interest on many loans had reached a level at which the debt exceeded the value of the mortgaged property. When sales had been attempted third parties claimed an interest in the property and so prevented the sales. A further problem was created in 1349 (1970) when the Cabinet approved a motion prohibiting the Bank from holding the titles (qabala) of mortgaged property. Furthermore, the Bank had not insisted on insurance being taken out on mortgaged property. When uninsured mortgaged property had been destroyed,

borrowers tended to assume that their obligations to repay were thereby dissolved [49].

Again in the Annual Report of 1350 (1972) considerable attention is paid to collection problems. The Parliamentary Committee on Public Works and Communications had considered the Bank's problems and had directed it to force the sale of mortgaged property immediately. Two representatives from the Bank were assigned to work with the Collection Department of the Ministry of the Interior. The latter had been instructed to collect the Bank's outstandinding loans by Cabinet Decree 962 which received the Royal Assent in Jauza 1345 (May/June 1966). It had made no steps to carry out these instructions and some ambiguity as to the intention of the Decree with regard to the responsibility for sale appeared to exist. The Parliamentary Committee again directed the Bank to make the appropriate sales itself. The Bank appealed to the Minister of Finance and there the matter rests with no one wishing to assume responsibility for debt collection [50].

The commercial banks have also suffered from excessive loan defaults. In particular, Pashtany Tejarety Bank has virtually exhausted its resources, faces a serious liquidity problem and is recognised to be in a difficult position as a result of the large number of loan defaults. The one private bank, Bank Millie, pursues very cautious lending policies and has not expanded

its activities by any significant amount over the past twenty years. Apart from some foreign trade finance, most of its funds are used to finance its own companies. The choice of lending policies, as seen by the banking fraternity, appears to lie between extreme conservatism and bankruptcy.

In the course of collecting a number of case histories of problematic loans, a pattern emerged of which the main elements are outlined below.

A A loan is granted against collateral consisting of shares in a few specified joint stock companies, jewellery or real estate mortgage. Unsecured loans are also extended in a few cases. Most loans made by the Afghanistan Bank are extended as a result of Cabinet decrees. This bank also discounts bills of exchange for importers. In these cases, import licences can be withdrawn if bills are not honoured.

B The loan is not repaid on the due date. After negotiation, an extension is usually granted.

C The bank finally realises the security. In the case of joint stock companies, [illegible] difficulties in that government [illegible] shareholders of all enterprises [illegible] [illegible] bank [illegible]

Unfortunately, customs clearance without the necessary documents has been possible on occasions through the judicious distribution of relatively small sums of baksheesh. Where goods are held up at customs houses, there is the problem that no fixed period is specified in any law or regulation after which they become the property of the bank. No specific regulations exist concerning loans for exports.

In the case of other secured loans, the borrower still appears to retain control over the disposal of his collateral. Thus, he may insist that a minimum price be realised from and even on the timing of a sale. Partly for this reason, Bank Millie has discontinued its former practice of lending against gold and jewellery. Where shares form the collateral, written authorisation indicating the name of the new owner must be obtained from the shareholder before a bank can dispose itself of them in the event of default. Land prices are often non-existent but where they do exist, and notwithstanding the basis for a mortgage loan, land valuation by the courts for the purpose, which is the main document required for land mortgages, is arbitrary and can be influenced by the landowner to the disadvantage of the bank. In the main, family transfers of land and equity is almost impossible in practice. Transfer of buyers of mortgaged land, if they wish, can quite easily be discounted.

In the case of unsecured loans, no precise regulations exist for loan repayment in instances of bankruptcy of the borrower. There are apparently no clear provisions for seizure of property or expropriation of collateral on the default of a borrower.

- In the few instances where a case reaches the courts, decisions can again be influenced through the use of baksheesh, social pressure or political influence. The banks have generally not received satisfaction from the courts.

It cannot, however, be concluded that all the problems of banking arise from bad laws and legal practices. The banks themselves suffer from inadequately trained staff and faulty loan agreements. Thus, for example, in the case of mortgage loans the borrower is not required to insure his property; lack of expertise often results in finance being provided unknowingly for higher risk foreign trade, etc. Political interference in the lending activities of the Agricultural and Cottage Industries Bank, the Industrial Credit Fund and Pashtany Tejarety Bank has also thwarted any pursuit of sound banking practices.

Bankers in Afghanistan are unaware of the need for legal protection in their lending operations. The following specific [illegible] have been mentioned:

A Law for securing bank loans

B Registration Office for legal registration of all bank loans

C Special court for enforcing repayment of bank loans

D Legal provisions for chattel mortgage

E Legal provisions for lien on crops

F Legal provisions for loans against letters of credit

G Cadastral survey

H Legal provisions for all financial instruments

I Detailed regulation concerning the absolute rights over and automatic transfer of ownership of collateral

J Detailed regulations concerning expropriation of property on default

K Legal provisions for real estate mortgage

L Specification of responsibilities of customs officials to release imports under bank security only against all necessary documents and a time period after which goods become the property of the bank

M Specification of how loans for barter imports should be secured

N Detailed regulations concerning repayment of loans for exports

O Detailed regulations concerning loan repayment in cases of bankruptcy

P Detailed regulations obliging courts to seize property in cases of default

The present Commercial Law enacted in 1334 (1955) contains provisions on negotiable instruments, security interests, etc. The Law itself is defective in a number of important respects. For example, the use of cheques has not developed because there are no penalties specified for writing a cheque against insufficient funds. However, the basic provisions for negotiability exist, yet no negotiable instruments circulate in Afghanistan. The reason for this is simply that virtually no one knows the Commercial Law - certainly no one working in and with the commercial courts. There, cases are decided on elementary principles of fairness, Shariat law and the whims of the judge. No one in the Government, the judiciary or the legal profession understands, for example, that the key to negotiability lies in the provision that a transferee of an instrument can receive better rights than his transferor. To illustrate this, the Ministry of Finance has recently decided to take a foreign exchange dealer to court in a case of disputed payment. The dealer is being involved solely because he cashed an endorsed cheque by which the payment was made. This also illustrates the point that more than just a change in the law is required.

VIII Non-Bank Financial Institutions

Little space need be devoted to Afghanistan's non-bank financial institutions since the size of their operations is insignificant. It is surprising, however, to find both insurance and cooperative activities so alien in a trading and agriculturally based economy. Gross insurance premiums totalling under Afs 150m in 1350 (1971), as can be seen in Table 19, are small in comparison to a money stock of Afs 8,759m and an estimated GNP of Afs 83,440m for the same year [25, Estimate C, Table 6, p. 20]. The ratio of insurance premiums to GNP of under 0.2 per cent can be compared with ratios for 14 developed countries shown in Table 20 below. Insurance business, like bank business, is not solicited in Afghanistan.

In terms of investible funds, insurance supplies almost nothing. Neither of the agencies makes any investments in Afghanistan and the Afghan Insurance Company holds most of its funds abroad. It has, however, an equity interest of about Afs 1m in the CAM (Coca-Cola) Company of Afghanistan and a nominal holding in the Inter-Continental Hotel. The main problem of investing in Afghanistan is again the lack of security. The Afghan Insurance Company apparently had a major task in persuading the CAM Company to take out fire insurance on its plant.

TABLE 19

Gross Insurance Premiums 1343 - 1350

(Millions of Afghanis)

Institution	1343	1344	1345	1346	1347	1348	1349	1350
Afghan Insurance Company	13	24	19	25	34	50	69	107
Commercial Union	-	-	-	5	5	8	9	10
Sterling General	-	-	6	7	8	7	8	10
Ingosstrakh	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Source: Information provided by each Insurance Institution

TABLE 20

Insurance Premiums as a Percentage of Gross National Product in Fourteen Developed Countries, 1971

(Percentages)

United States	7.1
Australia	5.5
New Zealand	5.4
Britain	5.0
Holland	5.0
Switzerland	4.9
Canada	4.8
S. Africa	4.6
Germany	4.5
Japan	4.2
Ireland	4.2
Denmark	3.6
Sweden	3.4
France	3.3

Source: The Economist, "Cinderella of the City: Insurance 1973 - A Survey," The Economist, 9 June 1973, p. 28.

The lack of interest in and understanding of insurance is almost pathological in Afghanistan. Property, whether owner-occupied or rented out, is virtually all uninsured and few vehicle owners take out any cover. It is surprising to find entrepreneurs, sophisticated in many other aspects of business, totally uninformed when it comes to insurance. Marine insurance, which accounts for by far the largest proportion, is taken out grudgingly at the banks' insistence before export or import loans can be received. As Trosper concludes:

> If there is adequate competition among the insurors in a particular community or country, the insurance companies will hire and train salesmen who themselves will do the job of educating the potential insurance buyer.
> /59, p. 65/

The Pension Fund receives about 43 per cent of its annual income from payments made by civil servants in the form of 3 per cent of their salaries, the first month's salary increment after promotion and any deductions from salaries for absence, etc. The remaining 57 per cent comes in the form of an annual allocation by the Government. Given that investment policy is non-profit seeking, e.g. equity holdings in the Afghan Insurance Company, the Mortgage and Construction Bank, Pashtany Tejaraty Bank and other Government enterprises, it can hardly be considered an attractive savings outlet to civil servants, even with the 57 per cent direct Government contribution. The return of perhaps 6 per cent in the inflationary environment of the past

two decades implies that the return to civil servants is low in real terms despite the Government's contribution.

The Baghlan and Kohdaman cooperatives are small pilot projects (covering just over 1,000 farmers at present) designed to be models, if successful, for Government agricultural cooperative projects at a later date. The success of the experiment so far has been due to the fact that it takes the form of an "integrated operation supplying credit, technical assistance and marketing advice" [53, p. iv]. The overall internal rate of return on efforts to improve vine yields has been around 33 per cent. Credit for a sizable part of the necessary investment has been supplied by the AgBank at an interest rate of 10 per cent.

Despite favourable results, the possible extension of an agricultural cooperative movement is probably rather a long way off. PACCA has encountered serious impediments in working both with the farmers and the Government. The introduction of cooperatives throughout Afghanistan will require not only a far greater commitment than previous Governments have shown in this field but also a build-up of well-trained and highly motivated extension agents before any programme of this kind could be launched. Hopefully, this will be an area of particular concern to the new Republican Government.

IX Conclusion

The picture of Afghanistan's financial institutions presented above is not one which can be viewed with complacency. Three forces have combined to prevent the development of a sound, efficient financial sector, namely, the external environment, the Government and the bankers themselves. The external environment has been unfavourable to financial development because of the absence of commercial laws, business ethics, wealth, etc., and the existence of a strong religious antagonism to interest. The Government has created an unfavourable environment by its inflationary and highly variable demands on the financial sector in the form of public sector domestic borrowing requirements. The bankers have done little to develop an efficient banking system through training programmes, etc., but have sustained instead uncompetitive market conditions by means of an interlocking network of ownership and control.

Towards the end of 1351 (1973), a Financial Development Committee was established in the Ministry of Finance. It was given a wide brief to prepare and implement a programme of financial development and reform. The most urgent measures were pinpointed; they included banking legislation and revision of the commercial law, training middle and lower level

bank employees, and laying the foundations for a strong, independent central bank. It was recognised that the latter required a substantial training programme as well as central banking legislation. None of these measures has been implemented; their importance remains.

Recently, the rate of interest received some attention by Da Afghanistan Bank and a proposal to raise deposit rates in order to attract more funds was brought before its Supreme Council. Hopes were raised that at long last some competition might be generated to awaken the dormant financial institutions. Two reports supporting the bank's initiative appeared urging it to take additional measures in conjunction with the deposit rate increase [27, 57]. Hopefully, this initiative will be revived under the aegis of the new Republican Government along with other vital components of the Financial Development Programme.

Economic development can be achieved only from the mobilization of resources into productive uses. By drawing together large numbers of savers and financing large numbers of borrowers, a dynamic financial system can meet not only the requirements of entrepreneurs but also the depositors' requirements of liquidity, security and a fair return on their savings. The more developed the financial system, the more efficiently can it perform the function of channelling savings into the most productive investment opportunities. Given that most Governments and foreign aid donors have

been so unsuccessful in this latter task, it is all the more imperative that it now be undertaken by Afghanistan's financial system. With concerted effort to remove the constraints and to promote financial development, economic development can move forward rapidly on an expanding supply of finance. Without this, the Afghan economy is likely to be confined to inflationary stagnation.

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