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BANKING SYSTEM OF AFGHANISTAN

By

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"BANKING SYSTEM OF AFGHANISTAN"

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ABSTRACT

A considerable progress is observed in different aspects of the Afghan society ever since that country became independent. Although awareness of the need for economic development was felt since 1919 it is only during the last two decades that the socio-economic structure of the Afghan community has witnessed any noticeable development.

Afghanistan is basically an agricultural country with almost 75 percent of the population earning their living from the farms. To meet its different needs for a better living, its trade had to improve so as to earn the foreign exchange necessary to satisfy these needs. Circumstances demanded that among other things financial institutions had to be established to organize the economy of the country on sound and stable basis. Due to a rapid pace of progress and the implementation of economic development plans the resources of the existing two financial institutions; Bank-e-Millie and Da Afghanistan Bank, the central bank; seemed to be inadequate for the fulfillment of the objectives of these development plans. Moreover, to avoid any discrimination and undesirable consequences arising from possible political influence on the operations of the central bank in granting credit to commerce, agriculture, industry, Da Afghanistan Bank found it quite appropriate to help the creation of separate specialized credit institutions to meet the needs of these sectors. Since private capital seemed inadequate to have

promoted their establishment, the Da Afghanistan Bank was authorised to provide a major portion of the capital of these specialized banks. This has entitled the Da Afghanistan Bank to be represented on the supreme council of these banks to influence the framing of their policies. As the Governor of the Da Afghanistan Bank states it; "Since specialization has engulfed every aspect of today's modern life, such credit institutions had to be created. But they are in fact separate specialized branches of the central bank of Afghanistan. Moreover, since there are in fact only two major banks, one a great government bank (Da Afghanistan Bank) and its specialized branches and the other a privately owned bank - Bank - Millie, the lack of a special banking legislation has not yet created a problem. The lack of central banking control and the pursuit of unsound banking policies with inadequate and incompetent banking personnel have not helped some of these banks to utilize their resources prudently.

Although, quarter of a century old the art of central banking has not been developed by the Da Afghanistan Bank.

The writer believes that if the banking system is to serve the economy of Afghanistan efficiently, workable bank policies have to be ~~formulated~~ and executed by a competent team of personnel in every bank. A special banking legislation has to be enacted so as to regulate their operations and organize the system.

As the monetary authority in the country Da Afghanistan Bank must develop its central banking activities and exercise proper and adequate control over the operations of the banking system. In this way it will not only regulate the volume of money supply but will also influence the course of economic activity in a manner which is compatible with the attainment of a maximum rate of balanced and stable economic growth.

TABLE OF CONTENT

	Page
ACKNOWLEDGEMENT	I
ABSTRACT	II
INTRODUCTION.	1
CHAPTER I.	
<u>THE ECONOMY OF AFGHANISTAN.</u>	6
A- LAND AND PEOPLE.	7
B- STRUCTURE OF PRODUCTION.	8
CHAPTER II.	
<u>EVOLUTION OF THE AFGHAN MONETARY AND BANKING SYSTEM.</u>	16
A- MONETARY SYSTEM.	16
B- BANKING SYSTEM.	24
CHAPTER III.	
<u>SOME FEATURES OF THE AFGHAN MONEY AND CAPITAL MARKET.</u>	33
A- MONEY MARKET.	33
B- CAPITAL MARKET.	37
CHAPTER IV.	
<u>DA AFGHANISTAN BANK (The Central Bank of Afghanistan).</u>	39
A- OBJECTIVE OF THE BANK.	39
B- FUNCTIONS AND OPERATIONS OF THE BANK.	37
C- DA AFGHANISTAN BANK AND THE REGULATION OF CREDIT.	51
D- DA AFGHANISTAN BANK AND THE EXCHANGE SYSTEM OF THE COUNTRY.	60
E- DA AFGHANISTAN BANK BRANCHES AND PURPOSES THEY SERVE.	66

VI

Table of Content cont'd.

	<u>Page</u>
F- DA AFGHANISTAN BANK'S ANNUAL BALANCE SHEET.	67
<u>APPENDIX.</u> FOREIGN EXCHANGE REGULATION IN AFGHANISTAN.	70
G- SUMMARY AND CONCLUSIONS.	83
 CHAPTER V.	
<u>BANK-E-MILLIE AFGHAN</u> (Afghan National Bank)	87
A- OBJECTIVES OF THE BANK.	87
B- ORGANIZATION AND ADMINISTRATION.	89
C- FUNCTIONS AND OPERATIONS.	92
D- BANK-E-MILLIE BRANCHES AND THEIR OPERATIONS.	98
E- THE ANNUAL BALANCE SHEET OF BANK-E-MILLIE	100
 CHAPTER VI.	
<u>PASHTANY TEJARATY BANK.</u> (Af Commercial Bank).	102
A- OBJECTIVES OF THE BANK.	102
B- ORGANIZATION AND ADMINISTRATION.	104
C- FUNCTIONS AND OPERATIONS	
D- PASHTANY TEJARATY BANK'S BRANCHES AND THEIR OPERATIONS.	117
F- THE ANNUAL STATEMENT OF PASHTANY TEJARATY BANK.	118
 CHAPTER VII.	
<u>AGRICULTURE AND COTTAGE INDUSTRY BANK.</u>	120
A- AGRICULTURAL SITUATION	120
B- OBJECTIVES OF THE BANK	122
C- ORGANIZATION AND ADMINISTRATION OF THE BANK.	123
D- FUNCTIONS AND OPERATIONS OF THE BANK	127

Table of Contents cont'd.Page.

E- AGRICULTURAL BANK, THE FARMERS COOPERATIVES AND THE HELMAND VALLEY AUTHORITY.	131
F- BRANCHES AND THEIR OPERATIONS OF THE AGRICULTURE AND COTTAGE INDUSTRY BANK.	134
G- THE ANNUAL STATEMENT OF THE AGRICULTURE AND COTTAGE INDUSTRY BANK.	134

CHAPTER VIII.

INDUSTRIAL CREDIT FUND

A- INDUSTRIAL INVESTMENT IN AFGHANISTAN.	136
B- THE INDUSTRIAL CREDIT FUND.	141
C- THE SHORTCOMINGS OF THE FUND.	145
D- PROSPECTS FOR AN INDUSTRIAL DEVELOPMENT BANK.	145

CHAPTER IX.

<u>MORTGAGE AND REAL ESTATE BANK.</u>	147
A- OBJECTIVES OF THE BANK.	147
B- ORGANIZATION AND ADMINISTRATION.	148
C- FUNCTIONS AND OPERATIONS.	151
D- BRANCHES AND THEIR OPERATIONS.	154
E- THE ANNUAL BALANCE SHEET OF THE BANK.	155

CHAPTER X.

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS.	156
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INTRODUCTION

The purpose of this thesis is to study the Banking System of Afghanistan. In particular, reference will be made to the rise and development of banking in that country, to the Central Bank and its policies and operation and to other banks operating in the Afghan money and capital markets, and to the nature of operation of these banks and their inter-relations.

Special attention is directed to the contribution of these financial institutions to the economic development of Afghanistan.

In the light of such a study and analysis the writer hopes to be able to suggest some recommendations aimed at improving the efficiency of the Afghan Banking System.

In every community there are people who for various reasons want to spend (i.e. consume and invest) more than their income and there are others who spend less. Some of these individual surpluses are likely to be utilized in different activities on an individual basis. But this is not always the case, for, some people are at times left with excess funds at their disposal.

Governments can step-in and tax out these surpluses and utilize them in what it considers to be the proper channels. But, it should be pointed out that up to a point social control runs contrary to the spirit of individual initiative of many people. The alternative would be to put the surplus funds of these who

spend less than their incomes in the hands of deficit spenders. To provide for a smooth flow of funds as between the surplus and deficit sectors of the population, the existence of some intermediary institutions is necessary.

It is here that the need for the services of banking institutions is felt. These institutions provide the channels through which saving funds flow, and which facilitate the transfer of goods and services from sellers to buyers. Their significance is further realized in their effect upon the distribution of wealth and in their power to direct available funds into new and different channels of production. This is of primary importance as far as balanced economic growth is concerned, and is especially true in underdeveloped economies where one sector, such as trade, seems to flourish at the expense of other sectors. This evidently, sets serious limitations on the prospects of a rapid and stable economic growth. Agriculture and industry, are almost neglected on the private level in an underdeveloped economy like Afghanistan. The scarcity of capital and the search of quick profits on the part of entrepreneurs make investment in these sectors inadequate from the point of view of economic development. As a result economic development is retarded and percapita income has either remained the same or fallen due to the rapid increase in the rate of population growth.

To improve the situation, and maintain a balanced growth of the economy special attention will be directed to the possibility of setting-up some specialized credit institutions to provide the capital needed for the rapid growth of the lagging sectors of the economy, particularly agriculture and industry.

The problem of inadequacy of private capital and the desire for a rapid rate of economic expansion which are felt in underdeveloped economies have induced an increasing measure of intervention on the part of the governments in the economic life of the society. The drift toward greater and greater governmental intervention as is discernable in many developing economies is believed to supplement and improve the operations of a competitive private-enterprise system.

Afghanistan, which is one of these underdeveloped countries, seems to have followed the same pattern. The government has actively participated in the economic life of the country since 1956, when the First Five Year Development plan was launched. A number of specialized credit institutions, partly owned by the government, were created in an attempt to meet particular financial problems in different sectors of the economy. The Afghan capital and money market, however, is still inadequate to meet the growing needs of various sectors of the economy.

According to some arguments the credit institutions which exist, though they have limited resources, have played a significant role in financing the numerous projects of the development

plan as well as meeting the needs of private individuals.⁽¹⁾ The Central Bank has taken the lead in this direction.

From the point of view of the national economy it is important for the writer to find out whether or not such participations by the government through the Central Bank and other members of the Banking System have actually helped to bring about a stable economic expansion, or whether they have caused or are likely to cause any undesirable effects on the initiative and efficiency of the private sector and other aspects of the economy. This is something which the writer will have to carefully look into before making any possible recommendations for a sound and better organization and operation of the Afghan Banking System.

A great deal of the information in this thesis has been obtained from publications, statistical reports, and studies made and published by different local and international financial and non-financial organizations. Since the publications, however, were not complete enough to provide detailed and adequate information, they have been supplemented with the information obtained by the writer through interviewing responsible officials of all banks in Afghanistan and the officials of the ministries of Planning, Finance and Commerce.

Chapter I outlines the main features of the Afghan economy.

Chapter II gives a historical background of the Banking System of Afghanistan.

¹Economic Review of Afghanistan, (page 117), Kabul, 1956-57

Chapter III discusses some features of the Afghan money and capital markets.

Chapter IV through IX studies the growth of the individual members of the Banking System, their organization, functions and operations and their relations with each other.

Chapter X presents a summary, conclusions and recommendations concerning the organization, policies and efficiency of operations of the Banking System of Afghanistan.

This thesis is an attempt to study the growth of the Banking System of Afghanistan and its contribution to the economic development of the country.

Banking, established only a quarter of a century ago, is still a young movement in Afghanistan. The shortage of studies, statistical reports and data has been compensated for by the information obtained through interviews so as to give the reader as complete and satisfactory picture of the Afghan Banking System as is possible under the circumstances.

CHAPTER I

THE ECONOMY OF AFGHANISTAN

A- LAND AND PEOPLE

- 1- Boundaries
- 2- Location
- 3- Area and population

B- STRUCTURE OF PRODUCTION

- 1- Agriculture
- 2- Mining
- 3- Forestry
- 4- Industry
- 5- Power
- 6- Transportation
- 7- Foreign trade

A- LAND AND PEOPLE

1- BOUNDARIES:-

Afghanistan, a completely land locked country, forms the north eastern portion of the great central asian plateau. It is bounded on the west by Iran and on the north by the USSR; at its eastern most point in the Wakhan strip it borders China's Sinkiang Province and has a southern frontage of about 40 miles on Jammu and Kashmir. The eastern and southern boundaries are with the North-West Frontier Provinces and Boluchestan, now under the administration of Pakistan. ⁽¹⁾

2- LOCATION:-

Afghanistan is situated wholly in the North temperature zone, between Parallels $29^{\circ} 30''$ and $38^{\circ} 30''$ of north latitude and $60^{\circ} 30''$ and $74^{\circ} 50''$ of east longitude. The shortest distance from the sea at present is about 500 kilometers (300 miles). The greatest length of Afghanistan from Wakhan in the northeast to Koh-e-Malikshdw in the southwest is about 1500 kilometers (950 miles), while its greatest breadth from Zulficar on the Herdt border to Torkham in the Khyber pass is nearly 1000 kilometers (600 miles).

3- AREA AND POPULATION:-

Afghanistan has an area of approximately 270,000 square miles, about as large as Japan, and has a population of 13,310,000

¹Map on page (180).

millions⁽¹⁾ giving a density of almost 49 persons per square mile. Due to a favorable climate there is a higher concentration of population in some areas of the south, east and north of the country. Of the 13,310,000 population some 1,500,000 live in towns and cities like Kabul (capital) 340,000, Jelalabad 200,000, Kandohar 190,000, Mazar-e-Sharif 150,000, Herat 170,000 and the remaining 450,000 in other cities of the countries. The rest of the population dwell in rural areas. Out of these some 25% are nomads who graze their stock and raise some grain and vegetables on the higher elevations in summer and migrate to the lower lands of Afghanistan and India for the winter. Almost all Afghans are Moslems. A large (though decreasing) percentage of the population, (now about 75%), for the last six hundred years has come to depend on a more or less primitive agricultural economy as the principal means of livelihood, and the remaining 25% are the nomade, shopkeepers, traders, artisians and civil servants.

B- STRUCTURE OF PRODUCTION

The gross national product of Afghanistan for the year 1956-57 was estimated at about 21,000,000,000 Afghanis. It was raised to 31,000,000,000 Afghanis after the First Five Year Economic Plan in 1961.⁽²⁾ Considering the changes in prices and the estimated increase in population, this shows a general increase

¹Economic Survey of Asia and the Far East (ECAFE, UN.) 1959

²Bulletin of the Central Bank, Kabul, 1962.

of 6.5 percent per annum on a per capita basis.⁽¹⁾ Of the total 72% was derived from agriculture, 8 percent from industry and forestry, 12 percent from trade and services and 8 percent from miscellaneous activities. The per capita income at the end of the First Five Year plan has been estimated at approximately 2384 Afghanis, or \$ 53 when exchanged at 45 Afghanis to a dollar - the free market rate at that period - and \$ 119 if exchanged at 20 Afghanis to a dollar - the official budget rate.

1- AGRICULTURES:

Since Afghanistan is an agricultural country the greatest emphasis is placed on the development of fertile land. Agricultural production consists both of subsistence and cash crops, chiefly, wheat, fruits, nuts, cotton, sugar beets and some other crop vegetables such as rice, maize and barley. The majority of the people live on unleavened bread made from wheat flours.

Although, Afghanistan is normally self-sufficient in food, shortages occur from time to time, largely because of drought, relatively poor transportation and the fact that much of the agricultural output is consumed on the farm.

Approximately 12.5 per cent of Afghanistan's total acreage is cultivated, of which about two-thirds is under irrigation. Of the total area under cultivation, three fourths is north of Hindu Kush in the sparsely populated valley of the Oxus

¹Survey of Progress. Ministry of Planning. Kabul, 1961.

River. The most productive agricultural land, as well as the most thickly populated area, is in the valleys adjacent to the Kabul River, reaching from the central eastern plateau toward the eastern province. To the southwest, the Helmand River supplies water to the futile lands whose arability is now being extended by large development projects.

Production as a whole is limited by uncertain rainfall and by the agricultural methods and equipment in use. In normal years, about 5 million acres are sown to wheat, with a yield of some two million tons annually.

The fact that only 18 percent of the population lives in towns of 10,000 or more, while 57 percent are sedentary farmers and about 25 percent are partial or complete nomads makes it important to concentrate on providing the agricultural population with a higher standard of living.

2- MINERAL RESOURCES AND MINING:

Experts agree that the great mountain ranges of Afghanistan contain a rich variety of mineral deposits.⁽¹⁾ The mining potential is great and can become, as it was a thousand years ago, one of the most important industries in Afghanistan.

Since a detailed study of the terrain has not yet been undertaken, most deposits are unknown and unexploited. There is

¹Economic Development in Afghanistan, U.S. Department of Commerce, Washington, 1959

however, small-scale production of coal, mineral salt, and talc. There is an estimated coal potential of 76 million tons of which at present only 60,000 tons are mined yearly.⁽¹⁾ The main problem in coal mining is the wide separation between layers of the coal beds, making full exploitation both difficult and costly. In the province of Kataghan, are found immense salt beds producing yearly 2,5000 tons of salt, a part of which is exported to Pakistan. Northern Afghanistan is rich in copper and lead, and iron is found in some areas.

The northern slopes of Hinu Kush also hide seams of good quality. Oil fields exist in Herat and Mazar-e-Sharif and are scheduled to be exploited under the projects of the development plane.

Badakhahan is noted for its exportation of precious and semi-precious stones in particular lapiz Lazuli, gold, rubies and amethysts. Although test mining of chromium, zinc, and a few other minerals is in progress, the great mineral wealth of the country is yet to be discovered.

3- FORESTRY:

At one time most of Afghanistan was covered with forests. However, as a result of continued cutting coupled with the absence of a forestration program, the forests have been greatly

¹Ministry of Mines and Industries, Quarterly Review, Dec. 1961

depleted. Afghanistan has substantial timber resources only in the eastern and southern provinces, but the use of these resources has been hampered by the lack of enough roads and of power to operate sawmills.

4- INDUSTRY:

Afghan industry is still in a primary stage of development. Existing industrial establishments include three giant cotton textile mills at Gulbahar, Jabal-us-Soraj and Puli Khumri, two woolen textile mills of Kandahar and Kabul, a carpet factory at Herat, two beet root sugar factories at Baghlon and Jelalahad, a bakery at Kabul, a fruit processing plant at Kandahar, two porcelain-ware factories at Kabul and Qunduz, two cement factories at Jabel-us-seraj and Ghury and a number of cotton gins and small industrial ventures distributed through-out the country.⁽¹⁾ Other industries in the country include a soap factory, furniture factories, a tanning and several small machine and repairs shops. Many of those ventures are operated as partnerships or shirkats (joint stock companies). In addition there are varied handicraft industries as well.

5- POWER:

The lack of an adequate and reliable power supply seriously hampers industrial activities. While substantial deposit

¹Quarterly Review, Ministry of Mines and Industries, 1960

of coal are available in Afghanistan, inadequate transportation facilities and a shortage of skilled workers and management tend to limit its production. The total deposits - mostly located in the north - are estimated at about 76,000,000 tons annual production in 1959-60 amounted to 41,400 tons. It is hoped to raise the coal production to almost 170,000 tons under the Second Five Year Plan.⁽¹⁾

A four-year petroleum prospecting program, covering an area of 43,000 km. is now in progress. A complete investigation including aerial, magnetic, seismographic and gravimetric surveys was started in 1958-59.⁽²⁾ Prospecting drilling is now in progress. As a result of the explorations carried out so far, two oil and gas deposits have been discovered in Shiberghan and Andkhoy. Exact amounts of reserves have not been determined as yet in these fields. It is hoped that these reserves will be large enough not only to satisfy the country's local expanding requirements but also will leave a surplus for export. The establishment of an oil refinery is tentatively planned under the second Five Year Plan if the results of the current investigations prove that the reserves are adequate.

One of the biggest factors behind Afghanistan's growing industrialization, of course, is electric power. The country now

¹ Afghanistan News. Vol. 5, pages 6-18, March 1962, London.

² Survey of Progress. Page 54, Ministry of Planning, Kabul, 1960.

has 13 hydro-electric plants and two steam generator electric plants supply some 118 millions kilowatt hours of electricity annually.⁽¹⁾ The electric power output has been raised from 27 million kilowatt hours before the First Five Year Plan to 118 at the end of the plan, showing an increase of about 315 percent.

6- TRANSPORTATION AND COMMUNICATION:

There are only around 6200 kilometers of all weather and seasonably motorable roads in Afghanistan.⁽²⁾ The main factor impeding the development of transportation in a land locked country like Afghanistan is the generally rugged topography that breaks here and there into high mountains ranges. There are no railways or navigable waterways. However, emphasis has been put to expand and improve internal as well as external air service.

7- FOREIGN TRADE:

Foreign trade has been Afghanistan's lifeline ever since the country has been a national and independent entity. In its foreign trade activities at present, Afghanistan is almost completely a supplier of raw materials and food stuffs and a market for consumer and capital goods. Its most important export commodities are hides and lamb skins, fruits and nuts, raw wool, ginned cotton and woolen carpets. "Because of the perishable

¹Afghanistan, Ancient Land and Modern Ways. Page 75, Ministry of Planning, Kabul 1961.

²Survey of Progress. Page 118, Kabul 1960.

nature of fruits and the lack of standerdization and proper packing, and the luxurious character of the lamb skin, foreign exchange earnings tend to be quite meager and somewhat unpredictable."⁽¹⁾

¹From an enterview with the governor of the Central Bank, Mr. H. Achekzai, Kabul, 1960.

CHAPTER II

EVOLUTION OF THE AFGHAN MONETARY AND BANKING SYSTEM

A. MONETARY SYSTEM:

Until 1935 gold, silver, copper and other metallic coins constituted the currency and were considered the only medium of exchange in Afghanistan.

Bank notes were introduced in 1941 by the Central Bank. Together with metallic coins they constitute the only currency in circulation at present. Treasury notes, the first to be introduced in Afghanistan in 1935, were in circulation only until the end of March 1948.

The basic monetary unit is the "AFGHANI" which is equal to one hundred "POULS". There is currently no metallic coin or paper note of one Afghani. Currency notes are issued in denominations of 2, 5, 10, 20, 50, 100, 500, and 1000 Afghanis. Coins, minted by the Treasury, in circulation are 25 and 50 pouls and recently 2 Afghanis coins were introduced.

Although a member of the International Monetary Fund since 1955, Afghanistan still fails to establish an agreed par value for the Afghani. A multiple exchange system is in operation⁽¹⁾ and all exchange transactions are controlled by the Da Afghanistan Bank (The Central Bank of Afghanistan).

¹A study of the exchange system is made in Chapter IV of this paper.

Currency overshadows deposit money. Although most banks have branches throughout the country it is estimated that deposit money is only one third of the total money supply.⁽¹⁾

There is no specific monetary legislation in Afghanistan. The sole right to issue currency notes is vested in Da Afghanistan Bank and is regulated by the statutes of this bank. Coins in circulation, however, are minted by the Treasury. According to the amendments made in the early resolutions of Da Afghanistan Bank, there has to be a 30% cover in gold, silver and foreign exchange against the bank notes issued.⁽²⁾ The rest of the cover is met by the other asset items. One may form an idea about the factors, which constitute the rest of the cover and which have contributed to the changes in the volume of currency issued, by conducting a balance sheet analysis. In this type of analysis it will be presumed that a change in any of the asset items appearing on the balance sheet of Da Afghanistan Bank (Tables 1 & 2) causes a corresponding change in the volume of notes issued, whereas a given change in any of the liabilities (apart from the notes liability) causes an opposite change in the volume of notes issued.

As it appears from Table 3, the increase in "Loans and Advances" and the increase in "Cash in Afghanis" seem to be the two most important expansionary factors in 1955-56. "Foreign assets"

¹From an interview with the governor of the Central Bank and supported by unpublished studies made, in 1960, by Dr. Hassanain, UN IMF economic and financial advisor to the Afghan Government.

²The currency cover was lowered in 1955 by the Supreme Council of the Bank from a 50 to 30%.

TABLE 1

CONSOLIDATED BALANCE SHEETS OF DA AFGHANISTAN BANK
FOR THE YEAR 1333-35 IN MILLIONS OF
AFGHANIS, END OF PERIOD

	1333 1954-55	1334 1955-56	1335 1956-57
<u>Assets</u>			
1. Gold	675.2	675.6	681.6
2. Silver	125.6	125.6	125.7
3. Foreign Assets	220.8	241.2	488.3
4. Afghani notes and coins	343.7	484.0	378.3
5. Treasury securities	2.0	2.0	2.0
6. Treasury notes guaranteed	175.7	175.7	175.7
7. Investments	430.9	565.0	566.7
8. Loans and advances	<u>1,095.4</u>	<u>1,350.5</u>	<u>1,474.3</u>
Private sector (including discounted paper & government guaranteed loans) <u>1/</u>	43.1	324.4	404.7
Government	597.3	667.6 <u>2/</u>	648.4 <u>3/</u>
Government enterprises & municipalities (including government-guaranteed loans)	455.0	354.5	338.7
Commercial banks <u>4/</u>	----	4.0	77.4
Other banks	----	----	5.1
9. Other assets	<u>11.1</u>	<u>1.2</u>	<u>5.3</u>
Total	3,080.4	3,620.8	3,897.9
<u>Liabilities</u>			
Deposits (in Afghanis)	668.1	642.5	614.8
Private sector <u>5/</u>	<u>188.4</u>	<u>232.2</u>	<u>144.9</u>
Current	138.9	206.9	109.3
Time & saving	47.5	25.3	35.6
Government	360.7	306.6	349.5
Current	338.9	255.3	294.8
Time	21.8	51.3	54.7

1/ No discounted paper.

2/ Includes equivalent of Afg.0.7 million in foreign exchange.

3/ Includes equivalent Afg. 58.3 million in foreign currencies (US\$ equivalent 2.1 million).

4/ Credit to the Pashtany Tejaraty Bank. No credit has been extended to the other commercial bank i.e., Banke Millie.

5/ Including municipalities.

(cont'd)

TABLE 1 (cont'd)

	1333	1334	1335
	1954-55	1955-56	1956-57
Government enterprises & municipalities ^{6/}	57.5	93.4	80.7
Current	43.0	91.3	78.2
Time	14.5	2.1	2.5
Commercial banks	63.6	10.3	39.7
Deposits (in foreign exchange).	202.0 ^{7/9/}	318.7 ^{8/9/}	364.5 ^{9/}
Private sector	114.6	221.6	45.1
Government	20.9	29.3	105.9
Government enterprises & municipalities	28.8	65.7	175.7
Commercial banks	37.5	0.4	38.0
Other banks	0.2	1.7	---
Bank notes	1,667.6	2,010.0	2,197.6
Treasury notes guaranteed by the Bank	180.0	180.0	180.0
Liabilities to nonresidents	n.a.	n.a.	n.a.
in U.S. dollars	n.a.	n.a.	n.a.
in other currencies	n.a.	n.a.	n.a.
Capital, reserves & undistributed profits	333.8	382.1	447.0
Other liabilities	28.9	87.5	94.0
Total	3,080.4	3,620.8	3,897.9

^{6/} Excluding municipalities.

^{7/} All time deposits are included in private sector.

^{8/} Breakdown available for current deposits totalling Afs.145.7 million, time deposits classified in the same ratio as those for current deposits.

^{9/} Exchange rates used in conversion were provided by Da Afghanistan Bank.

(TABLE 2)

DA AFGHANISTAN BANK BALANCE SHEET (1957/58 AND 1958/59)
(IN AFGHANIS)

ASSETS		1957/58	1958/59
1. Gold		811,673,045.98	828,744,511.86
2. Silver		149,496,998.16	149,496,998.16
3. Cash:			
A. In Afghanistan	505,180,499.94		1,178,449,912.75
Bank notes	326,007,155.00	986,966,999.00	
Treasury notes	175,718,494.00	175,718,494.00	
Coins	3,454,850.94	15,764,419.75	
B. In foreign currency	625,332,307.56	761,365,278.43	761,365,278.43
In Banks' Till and in foreign banks	625,332,307.56	761,365,278.43	
4. Credit accounts with other banks:			
A. Demand	--	--	--
In Afghanistan	--	--	--
In foreign currencies	--	--	--
B. Time	--	--	--
In Afghanistan	--	--	--
In foreign currencies	--	--	--
5. Loans			
A. In Afghanistan	1,398,106,325.10	1,473,838,543.68	
Government	633,657,180.82	632,539,489.32	
Government enterprises	300,436,065.39	309,116,157.26	
Mixed enterprises	--	--	
Municipalities	33,362,511.92	33,298,700.16	
Private enterprises	313,715,198.59	415,850,947.45	
Other banks	90,216,364.68	47,808,855.58	
Individuals	26,692,003.70	33,980,776.58	
Others	--	1,243,617.33	
B. In foreign currencies	50,708,660.47	49,269,718.34	49,269,718.34
Government enterprises	--	--	
Mixed enterprises	--	--	
Municipalities	--	--	
Private enterprises	--	--	
Other banks	--	--	

(TABLE 2 Cont'd.)

Individuals	17,100.00	--	--	--
6. <u>Investments:</u>				
A. Securities		--	--	--
B. Participations			663,033,263.81	664,928,263.81
In Afghans				
Government enterprises	--			
Mixed enterprises	377,988,088.81	--		418,533,263.81
Private enterprises	40,545,175.00	--		246,395,000.00
Other banks	244,500,000.00			
<u>In foreign currencies</u>		1,045,440.00		1,045,440.00
Government enterprises	--	--		--
Mixed enterprises	1,045,440.00		1,045,440.00	
Private enterprises	--	--		--
Other banks	--	--		--
7. Buildings			4,881,717.49	4,861,851.25
8. Equipment			19.00	21.00
9. Others			--	1,835,332.00
GRAND TOTAL	4,209,458,277.51		5,113,835,869.26	

Source: Research Department. Da Afghanistan Bank.

(TABLE 2)

17(e)

DA AFGHANISTAN BANK BALANCE SHEET (1957/58 AND 1958/59)
(IN AFGHANIS)

<u>LIABILITIES</u>	<u>1336</u>	<u>1337</u>	
1. Bank notes issued			2,256,848,110.00
2. Treasury notes issued			180,000,000.00
3. Demand Deposits:			
<u>In Afghanis</u>			738,918,501.25
Government	463,155,173.24		
Government enterprises	40,646,427.59	360,622,816.54	
Mixed enterprises	--	151,145,907.49	
Private enterprises	88,525,630.17	--	25,180,527.25
Other banks	9,274,236.37	73,978,836.92	
Individuals	137,317,033.88	177,364,539.55	
<u>In Foreign Currencies</u>			476,482,043.39
Government	182,222,295.00	187,555,184.42	
Government enterprises	211,750,694.00	270,415,045.18	
Mixed enterprises	--	--	
Private enterprises	79,392,820.00	33,546,717.09	
Other banks	--	--	
Individuals	--	--	
4. Time deposits:			
<u>In Afghanis</u>			110,940,857.64
Government	33,739,793.68	26,175,421.90	
Government enterprises	37,093,485.08	2,806,076.70	
Mixed enterprises	--	--	
Private enterprises	1,325,478.75	9,299,467.50	
Other banks	5,111,779.04	4,862,676.79	
Individuals	33,670,321.09	158,831,573.72	
<u>In foreign currencies</u>			--
Government	--	--	
Government enterprises	--	--	
Mixed enterprises	--	--	
Private enterprises	--	--	
			201,975,216.61

(TABLE Cont'd.)

17(f)

Other banks	--	--	--
Individuals	--	--	--
5. Advance and credit	--	--	--
<u>In afghanis</u>	--	--	--
Government	--	--	--
Government enterprises	--	--	--
Banks	--	--	--
<u>In foreign currencies</u>	--	--	--
Government	--	--	--
Government enterprises	--	--	--
Banks (Foreign)	--	--	--
6. Capital	240,000,000.00	240,000,000.00	240,000,000.00
7. Reserves	79,348,821.83	81,909,059.72	81,909,059.72
8. Undistributed profit	113,609,564.86	113,302,392.19	113,302,392.19
9. Other liabilities (branches)	13,310,378.54	86,222,049.83	86,222,049.83
GRAND TOTAL	4,209,458,277.51	5,113,835,869.26	5,113,835,869.26

• This total includes that of individuals.

Source: Research Department, Da Afghanistan Bank.

and "Gold" have contributed to an increase of 20.4 and 0.4 million Afghanis, respectively, in the volume of notes issued. The reduction in "Other assets" by 9.9 million Afghanis, however, has had an equal contractionary effect on the volume of notes issued.

In short as can be seen from Table (3), the net change on the liabilities side had a total contractionary effect of 198.0 million Afghanis and the net change on the asset side had a total expansionary effect of 540.4. This explains the net decrease in the volume of notes issued which amounted to 342.4 million Afghanis in the year 1955-56.

In 1956-57 all asset items (excluding "cash in Afghan notes and coins") increased by a total of 382.8 million Afghanis. The 105.7 million Afghanis decrease in "cash in Afghanis" reduced the expansionary change in assets to 277.1 million Afghanis.

The net expansion in the liability items, which had a contractionary effect on the volume of notes issued, was 89.5 million Afghanis, bringing the net change in "Notes issued" to 187.6 million Afghanis.

In 1957-58 certain assets, including, "gold", "silver," "Foreign assets" and investments increased by a total of 388.1 million Afghanis, thereby contributing to an expansion in the volume of notes issued by the same amount. However, the decrease of 76.8 million Afghanis in "cash in Afghanis", "Treasury securities", "loans and advances", and "other assets" gave rise to an equal

(TABLE 3)

FACTORS AFFECTING THE VOLUME OF
NOTES ISSUED AND OUTSTANDING
1955-1959, (In Million of Afghani)

	ASSETS:			
	1955-56	1956-57	1957-58	1958-59
Gold	+ 0.4	+ 6.0	+ 130.0	+ 17.0
Silver	--	+ 0.1	+ 23.8	--
Foreign Assets	+ 20.4	+ 247.1	+ 137.0	+ 136.0
Cash in Afghani	+ 140.3	- 105.7	- 48.9	+ 673.3
Treasury Securities	--	--	- 2.0	--
Investments	+ 134.1	+ 1.7	+ 97.3	+ 1.9
Loans and Advances	+ 255.1	+ 123.8	- 25.4	+ 74.2
Other Assets	- 9.9	+ 4.1	- 0.5	+ 1.8
TOTAL	+ 540.4	+ 277.1	+ 311.3	+ 904.2
Net Changes in Assets (Expansionary)				
1. <u>LIABILITIES (other than notes)</u>				
Deposits in Afghani	- 25.6	- 27.7	+ 235.0	+ 140.4
Deposits in Foreign Exchange	+ 116.7	+ 45.8	+ 111.9	+ 15.0
Capital, Reserves and Undistributed Profits	+ 48.3	+ 64.9	- 14.1	+ 2.2
Credit to the Bank	--	--	--	+ 55.5
Other Liabilities	+ 58.6	+ 6.5	- 80.7	+ 72.9
Net Changes in Liabilities (Contractionary)	+ 198.0	+ 89.5	+ 252.1	+ 286.0
2. <u>CHANGES IN NOTES ISSUED</u>				
TOTAL Increase in Liabilities	+ 540.4	+ 277.1	+ 311.3	+ 904.2
CHANGES IN NOTES OUTSTANDING: (1)				
	+ 202.1 or (1.526.0)	+ 293.3 or (1.819.3)	+ 108.1 or (1.927.38)	- 55.1 or (1.872.36)

¹ Notes outstanding equal notes issued, minus, notes and coins in vaults of Da Afghanistan Bank.

contractionary effect on the volume of notes issued. At the same time an increase in the liability items of 252.1 million Afghanis had a contractionary effect on the volume of notes issued; the outcome was an expansion of 59.2 million Afghanis in note issued.

In 1958-59 "gold" and "Foreign assets", increased the volume of notes issued by 17.0 and 136.0 million Afghanis, respectively. Other asset items had a total expansionary effect of 751.2 million Afghanis. The net increase in liabilities, which had a contractionary effect, was 286.0 million Afghanis; the outcome was an increase of 618.0 million Afghanis in the volume of notes issued.

Consequently, it can be inferred that, in general, the most important factors contributing to the gradual increase in the volume of notes issued were the expansion in the "Loans and Advances", "Foreign Assets" and "Investment" items of the balance sheet of the De Afghanistan Bank.

Table 4, shows the money supply between 1948-49 and 1958-59. It is evident from the table that currency in circulation is considerably less than the amount issued and available for circulation. Between 1948-49 and 1958-59 the Central Bank increased the amount issued by 370 percent. While the Central Bank holds from $\frac{1}{2}$ to $\frac{2}{3}$ of the non-circulating portion as cash reserves, it, however, can not exercise control over this portion. With relatively large fluctuations in export proceeds; it faces recurrent conversions of large amounts of foreign exchange into local currency and hence large reduction in its cash balance. Thus the non-circulating amount hangs over the monetary

TABLE (4)

MONEY SUPPLY IN AFGHANISTAN 1949-1959
IN MILLIONS OF AFGHANIS

<u>Years as of March</u>	<u>Bank Notes Issued*</u>	<u>Currency in Circulation</u>	<u>Demand Deposits</u>	<u>Total Money Supply</u>
1949	.775	.412	.478	890
1950	.845	.645	.311	956
1951	.968	.798	.310	1108
1952	1.098	.885	.272	1157
1953	1.173	.923	.310	1233
1954	1.210	.922	.415	1337
1955	1.668	1.083	.885	1968
1958	2.615	1.874	.820	2694
1959	2.875	1.811	1.071	2882

* Excluding 180 million Afghanis in government notes issued in 1935 and withdrawn between 1946 and 1948.

Source: Officials of Da Afghanistan Bank, Kabul 1960.

situation as a potentially disturbing factor.

The primary factors responsible for the rapid expansion of the money supply are:

- (1) The growing demands of the government on the resources of the Da Afghanistan Bank, as is revealed from the government position with the Da Afghanistan Bank and other members of the banking system.⁽¹⁾
- (2) The increase in the Da Afghanistan Bank's participation in the industrial and commercial enterprises, especially in the last few years.

Since 1938 the Da Afghanistan Bank has been required, by its statutes and the resolution of its supreme council, to maintain as backing for the currency notes issued at least 50 percent in gold, silver and foreign exchange. This rule empowered the Bank, as exclusive monetary authority in charge, to issue currency as it deems necessary. Unless the 50 percent reserve requirement was lowered or gold and foreign exchange earnings increased substantially, the bank was not able to meet the growing demand for money and had to refrain from increasing the money supply more than it was legally possible.

¹Since there is no founded public debt in Afghanistan, at present, the governments' total internal indebtedness consists of transactions with the banking system. The governments' net indebtedness to the banking system at the end of 1958-59 amounted to Afs. 644.8 millions. It's position with Da Afghanistan Bank resulted in an overall debt of Afs 102.1 millions during the same year. SURVEY OF PROGRESS. PP.157-170. Kabul, 1960.

This would have cramped the operation and success of the development program. Because of considerable uncertainty created by the shift in government policy towards business the Bank apparently felt that the time was appropriate for lowering the minimum reserve. The second alternative for relieving the situation, that is, a substantial increase in exchange earnings, was not possible since volume of exports showed little sign of improving the net balance between exports and imports. This dilemma spurred the government in September 1953 to revalue the gold and silver stock of the State Bank. The value of the gold stock had been previously entered on the books according to the price of gold and the exchange rates effective at the time of purchase. Some purchases were made at less than the equivalent of 35 dollars per ounce. (The rate adopted by the U.S. and used by the International Monetary Fund and other financial organisations).

In an act of faith in the soundness of the Afghan economy, the government announced the revaluation of gold - in the last quarter of the fiscal year 1953-54. This act led to an increased book value of gold and silver stock by 180 million Afghanis by March 1954, increasing the currency potential by twice that much, i.e. 360 million Afghanis. (1)

Thus the new government, formed in 1953-54, was able to launch the First Five Year Development Plan, that was subsequently put into effect in September 1956.

¹ Officials of the Afghan National Bank (Bank-e-Millie Afghan).
Kabul, 1960.

Nevertheless, the Bank found itself again in a pinch by the end of the fiscal year 1954-55. The revolution of the gold stock in September 1953-54 did not help much or not enough to meet the new demand. The expansion of the money supply, within one year (i.e. from 1953-54 to 1954-55), from 1,219.0 million Afghanis to 1,668.0 million Afghanis had brought the potential increase down to 80 million Afghanis. The need for further expansion of the money supply, apparently still existed for the same reasons, which were mentioned above; namely, increased participation in enterprises by the banks and increased demands by the government. The Bank would have been unable to further expand the money supply in 1955-56 by nearly 220 million Afghanis had it remained under the old 50 percent reserve requirement.

It was in the summer of 1955, therefore, that the Supreme Council of the Bank approved a lower reserve of 30 percent. It was not clear from the announcement whether the reduction applied to gold alone or to all three categories of currency backing, i.e. gold, silver and foreign exchange. However, the reference to 400 million Afghanis "additional" notes indicated that it applied only to gold. This raised the potential increase in currency issue, caused by the 1953-54 revaluation act, from 80 million Afghanis in March 1955 to almost 475 million Afghanis in September 1955, a net gain of 395 million Afghanis. Moreover, to provide for possible future expansion in the money supply, the Supreme Council of the Bank also approved, in 1955, that a 5 percent of foreign exchange earnings will have to be carried directly to the foreign exchange category of the currency cover.

In the above mentioned three actions taken by the government the way was open not only for internal monetary expansion but also for a part of the reserve to move into external transactions. Instead of expanding the internal monetary base, the Bank, however, could use some of the freed reserves for larger imports or settlement of some of the short-term foreign exchange debts. It chose internal expansion and relied on more effective exchange control to increase the country's foreign exchange earnings.

As a result of the recent increase in the gold and foreign assets, the reserves behind the note issue exceeds the new 30 percent legal requirement. Table 5, compares the note issue and the reserves in 1957-58 and 1958-59.

TABLE 5,⁽¹⁾

The Note Cover of Gold, Silver & Foreign Exchange.

(In Million of Afghanis)

	<u>1957-58</u>	<u>1958-59</u>
1- Total Gold, Silver & Foreign Exchange holdings.	1.586.5	1.739.6
2- Bank Notes issued.	2.256.8	2.875.0
3- Percentages of reserves.	70.3%	60.5%

This table clearly indicates that the ratio is far above the legal requirement, leaving a safe margin for a moderate expansion.

The government seems to favor further expansion of the money supply through similar measures. Unless it can also boast national production to the same extent, price inflation would be inevitable.

¹Officials of the Afghan National Bank (Bank-e-Millie Afghan) Kabul, 1960.

B. THE BANKING SYSTEM:

1. HISTORY⁽¹⁾

Afghanistan's awareness of the need for economic development started right after independence in 1919. One of the most important development schemes was to improve trade. Bilateral trade agreements were concluded with neighboring as well as European countries. A number of local trading companies were formed, jointly by private and public efforts, to help promote foreign trade activities and accumulate capital for various development projects. A few of these companies were allowed to deal in gold and silver transactions as well as to accommodate foreign exchange for the needs of both the private and public sectors. This trend of progress continued until 1928 during which year Afghanistan experienced an internal disturbance culminating by a revolutionary regime. As a result the country lost the accumulated gold and silver reserves at its disposal and hence was left with an impaired economic position. The regime was suppressed in 1929 and the result was the present constitutional monarchy. Since then there has been, although meager, yet a continuous progress in every aspect of social and economic life of the country. Among the stabilization measures taken by the government was the formation of a joint stock company (Afghan Joint Stock Co.) to secure and maintain the value of the Afghani in terms of foreign currencies.

¹The information for this section was provided by the governor of the Central Bank of Afghanistan. Kabul, 1960.

This was the first company to be formed after the 1928 revolution, and had an initial capital of 5.000.000 Afghanis. The purpose of this company was to provide short, medium and long-term loans for some of the development projects, and at the same time perform and control foreign exchange activities which were previously performed by a few private exchange dealers. This company was later, in 1932, promoted to the "Afghan National Bank" (Bank-e-Millie Afghan). It was the first financial institution to perform commercial and central banking activities throughout the country.

The bank was also empowered to engage in activities such as purchases of necessary producers and consumers goods for governmental institutions, foreign exchange transactions and the like. The main functions of the bank were, such as the accumulation of capital, extension of commercial credit, improving trade practices, strengthening and developing local industries.

The capital of the bank was then increased to approximately 35 million Afghanis.

Today, it is one of the biggest private financial enterprises in the country, with a total capital of 631 million Afghanis, and with offices in every province of the country.

Bank-e-Millie, whose major business in the past twenty years has been investment banking has supplied, during the last fifteen years, the necessary capital and management for the development of industries, particularly textile, karakul and carpets. The government had not, until very recently (1953) taken direct steps to promote

private initiative in different industries.

In September 1953, a new policy of government direction of trade and industry was inaugurated, and for the purposes of a balanced and stabilized economic development, various control measures were imposed on the activities of Bank-e-Millie. This was ultimately with a view to remove some of the weaknesses in the operations of the bank that had led to red tape and frustration of effort.⁽¹⁾

Meanwhile, the government has broadened its control over investment in new plants and has increased its own participation in industry through the Central Bank.

2. DEVELOPMENT OF THE PRESENT BANKING SYSTEM:⁽²⁾

At the time that Bank-e-Millie devoted its attention towards banking and credit operations, and started to grant loans to help local producers and opened offices in most provinces to facilitate the export of some major exporting items such as "Karakul" lamb skin, wool, cotton, fruits and carpets, it was also given the privileges of controlling the importation of items such as sugar, gasoline, and spare parts for vehicles into the country.

After the approval of the government in 1936, Bank-e-Millie Afghan established the first Afghan textile company and in 1940 the bank managed to invest and operate the first Afghan sugar factory.

¹Most important of these control measures were: the sale of at least 63% of the Bank's stock in the Northern Cotton Company to the Ministry of Industries, government control over textile selling prices, and the sale to the government of at least 51% of the Bank's stock in the general Electric Company.

²This brief information was privately obtained from an interview with the governor of the Afghan Central Bank in 1960. Kabul.

A major portion of the capital of this company is still owned by the bank.

In the later thirties, when Bank-e-Millie was over burdened with many activities, the government realized the need for and decided to establish a government monopolies organization and gave it all the privileges of controlling the importation of sugar, gasoline and others previously enjoyed by the Afghan National Bank.

According to the proposal of the Ministry of Finance in 1938, a decree was passed by the government prohibiting the purchase, sale and transfer of foreign exchange by individuals. It should be mentioned that in the beginning the small companies exporting Karakul and other items, could exchange certain amounts of their foreign exchange earnings into Afghanis by selling them to the Afghan National Bank. This practice gave rise to the accumulation of a sufficient amount of foreign exchange earnings for purposes of imports of necessary items and off-set any balance of payments difficulties that might arise.

The need for the existence of a central bank was felt, and after its statute was ratified by the National Assembly, it was established in 1939 with an initial capital of 120 million Afghanis. Almost 95 percent of the capital is owned by the government. A contract was signed during this year between the Bank and a foreign company to provide the bank notes it needed. Prior to this, government notes were in circulation. The government issued notes in 1935. The Bank became the treasury of the state and in 1940 was considered as the fiscal agent of the government.

Early in the forties some economists in Afghanistan were somehow convinced of the merits of centralizing all kinds of banking operations and thereby suggested the possible merger of Bank-e-Millie and the Central Bank. Others, aware of the spectacular growth of specialization in every aspect of social and economic life of the community, proposed the establishment of separate specialized credit institutions. The problem of raising funds for such organizations was so great that it seemed almost impossible to depend on the private sector. If any need for specialized credit institutions were felt by the government, it would have to be financed by the government itself.

Consequently, the government decided to establish the framework of these specialized credit institutions, and in 1947 with the approval of the Central Bank and the Council of Ministers, a Construction Fund (later known as the Real Estate and Mortgage Bank) was established. The initial capital of this fund was 30 million Afghanis and was administered by the Central Bank. The operations of this bank were mostly the granting of credit to homeless government employees to purchase land and construct homes. These loans were almost all unsecured. The bank also was ready to grant loans to those citizens of Kabul, who could offer reliable security. However, the security was not properly evaluated. It is mainly due to this and some other unsound banking practices that made the bank experience losses for more than two years, from which it still has not recovered. Moreover, it is still in the process of trying to recover any amount of its unsecured loans. At present, it is only granting real estate credit for commercial purposes and on the basis of an acceptable security.

The Agricultural and Cottage Industry Bank was established independent from the organization of the Central Bank in 1953. About 51 percent of the capital was subscribed by the Central Bank, while the rest by government and private enterprises. The bank was established with the purpose to assist agriculturists in different parts of the country. Moreover, it was established with the intention of increasing agricultural production for local consumption as well as for export purposes. This is mainly to stabilize the seasonal ups and down in prices and employment. The bank started operation by granting short and intermediate-term loans for purposes of making marketing of agricultural products possible. At present, the bank operates on the basis of helping farmers cooperatives rather than granting loans directly to individual farmers. This bank too experienced losses and encountered difficulties in recovering its loans that forced it to stop extending any credit on an individual basis. Losses were partly due to the lack of sufficient and accurate data about the land, partly due to difficulties in evaluating farmers' character and capacity and partly due to inefficient supervision of the loans. It was only very recently, 1957, that the bank succeeded, with the help of the Central Bank and the Ministry of Agriculture to encourage the farmers to form independent regional agricultural cooperatives. This objective has been accomplished in the capital, to a certain extent, and is expected to spread throughout the country. These cooperatives will be responsible in appraising the property and its location, and the character and capacity of the applicant farmer prior to granting any loan.

In the year 1953, when Afghanistan launched its First Five Year plan, great needs for foreign exchange earnings were felt in order to provide payments for the importation of capital as well as consumer goods. This need tended to increase the volume of foreign trade operations, and as a result foreign trade increased by 62 percent over that of the previous few years. Internal trade too had showed a satisfactory increase. Both of these factors had increased the volume of trade for Bank-e-Millie and the Central Bank to handle. As a result a new commercial bank under the name of the Pashtany Tegaraty Bank (Afghan Commercial Bank) was established in 1955 with an initial capital of 120 million Afghanis out of which 40 percent was subscribed by the Central Bank.⁽¹⁾ Despite the existence of Bank-e-Millie and Pashtany Tegaraty Bank, the Central Bank does some business in the commercial sector of the economy. Although the Central Bank does not handle such activities on a profit seeking basis, the new commercial bank considers such operations of the Central Bank completely and purely a competitive act. As a result there is very little sign of cooperation between the two banks.

As the development plan progressed, along side the agricultural and commercial projects, industrialization programs were also to be launched under the guidance of the government. Prior to the year 1956, industry was supposed to be financed by the Afghan National Bank. This was done on a limited scale, mainly, in the textile industry.

¹Articles of association, Pashtany Tegaraty Bank.

The contribution of the Central Bank was also negligible. It was then that the government upon the proposal of the ministries of Finance, Mines and Industries, and the Central Bank approved the formation of an Industrial Credit Fund. The initial capital of the Fund was 200 million Afghanis, out of which 50 percent was subscribed by the Central Bank and the other 50 percent by Bank-e-Millie.

The Fund operates as a separate department within the organization of the Pashtany Tegaraty bank and under the supervision of the Ministry of Mines and Industries. Up till 1959 it had granted a total of 119 million Afghanis to some major industrial undertakings such as the Kabul Hydroelectric project, which provides electricity for the City of Kabul, the Gulbabar Textile Mill, the Shaker Chinaware factory, the Afghan Textile company, and the Jangalak Repairing Plant.

All these banks are supposed to be operating under the supervision and directions of the Central Bank. It is believed that despite the rapid growth of these credit institutions and the completion of the First Five Year Economic Development Plan the Central Bank has been able to maintain a relatively stable level of prices, and has tried to prevent the value of Afghani from further depreciating against foreign currencies.⁽¹⁾ The cost of living based on price index which is an average of 23 retail price, 15 of which relating to food stuff, has changed from 100 in 1954 to 95 in 1955, 106 in 1956, 116 in 1957, 129 in 1958 and 132 in 1959.⁽²⁾

¹This is in so far as the argument and opinion of Mr. H. ACHECKZAI, the governor of the Central Bank of Afghanistan is concerned. The actual figures show an increase in prices of 32% in about five years.

²Ministry of Planning, Survey of Progress, p.160, Kabul, 1960.

3. SOME CHIEF CHARACTERISTICS OF
THE AFGHAN BANKING SYSTEM

It should be mentioned that the Afghan banking system is a branch system with headquarters of all banks in Kabul, the capital, and branches almost all over the country.

Due to certain economic and political factors branches of foreign banks are still not permitted to operate in Afghanistan. Despite the fact that foreign banks operate as correspondents to the members of the Afghan Banking System, many transactions abroad are handled by the branches of local Afghan banks incorporated under the laws and regulations of the countries where they operate.

There is no specific legislation, other than the Afghan Commercial Code, defining the banking profession. Banking operations, according to this code, are considered to be of an ordinary commercial nature and as such are subject to the provisions of the Afghan Commercial Code.⁽¹⁾

After this brief introduction, we may proceed to study and analyse the structure and operations of the Afghan Banking System. Of immediate concern will be a description of the Afghan money and capital markets.

¹Afghan Commercial Code. Chapter Three, Article 19, section f.

CHAPTER III

SOME FEATURES OF THE AFGHAN MONEY AND CAPITAL MARKET.

The purpose of this chapter is to describe the structure of the Afghan money and capital markets and to indicate how they compare with the more developed financial markets of the world.

A. MONEY MARKET

The allocation of resources in any economy is influenced by the development of communications and of the means and facilities for effecting such kinds of payment by which capital is transferred from the control of one party to that of another. The network of individual institutions through which the process of payment is carried out is known as the money market, which consists, in this sense, of a nucleus of specialized institutions, including the banks, the market for negotiable securities, the discount houses, the bill brokers and other specialized credit institutions providing funds for short-term uses.

It is apparent that there are markets of this sort in almost every country of the world. Some of these markets are highly developed while the large majority of them are not.

It would be in order to list some of the characteristics of a developed money market and observe whether or not they are found in the Afghan money market.

S.N. SEN listed in one of his books four major characteristics of a developed money market.⁽¹⁾

- 1- One of the characteristics of such a market is the presence of a highly organized banking system that forms the nucleus of the whole money market.
- 2- An organized money market tends to develop a number of sub-markets for specialized dealings in funds for various maturities and against different collaterals. There must be substantial supply of and demand for funds in all these sub-markets.
- 3- Another characteristic is that the whole organization should be an integrated structure in which every sub-market is dependent upon and is affected by the other part. There must also be an easy flow and movement of funds from one part to the other part of the market.
- 4- Because of its high degree of liquidity, such market tends to attract funds from abroad. Those who prefer to invest in highly liquid assets will send their funds to such a center even if they happen to live outside that country.

¹S.N. SEN, Central Banking in Undeveloped Money Markets.
pp. 15-20, Bookland, Calcutta, 1952.

The brief description of the Afghan banking in the previous chapter, bears ample witness to the underdeveloped state of the Afghan money market. It is known that banking in Afghanistan, in the strict sense of the expression, has not yet reached the masses. The thirteen and a half million population of the country has thus reasonably modern banking facilities at twenty stations only.

Moreover, the liquidity of this narrow market is not well assured, mainly because of the absence of banking legislation and lack of proper central banking facilities. There is apparently little cooperation and coordination between the members of the system and the central bank. Although, there are trade bills used as instrument for financing short-term transactions, the volume of such bills and the number of people using them is small, chiefly, due to the lack of confidence in the character and capacity of the traders. Moreover, a major part of the transactions is carried out on cash basis. There are no dealers or discount houses, primarily because the practice of discounting is not widely understood and rediscounting facilities are as yet non-existent. The discount market, therefore, is very limited in Afghanistan. Short-term self-liquidating transactions are financed by means of over-draft facilities. The discount market will tend to develop on modern lines, if trade bills are continuously used in financing short-term self-liquidating transactions, and if the Central Bank undertakes to provide rediscounting facilities and adequate liquidity for the banking system.

As far as the acceptance market is concerned, it can be said that although, Da Afghanistan Bank Pashtany Tejaraty Bank and to certain extent Bank-e-Millie have confined their operations to provide short-term credit, especially for foreign trade, nevertheless in almost 60% of such transaction a 40 to 100% predeposit is required. The balance, if any, is extended in the form of short-term loan bearing an interest rate of 9 percent.

Since the government has always financed its short as well as long term needs through taxes and loans borrowed from the Central Bank, the so called "Market for Government Securities" is practically unknown to the general public. (1)

The narrow and unorganized nature of the money market in Afghanistan has given rise to a market for private money lenders and usurers, which are not connected with or influenced directly by the changes in activities of such segment of the market as banks.

The foreign exchange market is not stable and reliable either, thus discouraging short and long term foreign capital investment in Afghanistan. The range at which the "Afghani" fluctuates during the course of one year, in terms of U.S. dollars, is from one to fifteen or eighteen units of the currency. (2)

¹Government position with the Da Afghanistan Bank has declined from - 5.3 million Afghanis in 1957-58 to - 107.4 million Afghanis in 1958-59. Its position with the banking system has declined from a surplus of 33.4 million Afs. to a deficit of - 46.7 million Afghanis during the same period.

²There is a multiple exchange rate ranging from 20 to 32 Afghanis per U.S. dollar. The market rate is sometimes as high as fifteen to eighteen Afghanis over the highest official rate of 32 Afghanis to a U.S. dollar.

B. CAPITAL MARKET

The security and share market, facilitating the finance of long term needs, is today considered to be a vital factor in the economic development of any nation - and can substantially further industrial expansion and greater productivity.

The lack of adequate provision of long-term capital in Afghanistan is largely responsible for the underdeveloped state of the Afghan industry as well as for the low agricultural productivity. To a significant extent this state of affairs is the result of the absence of an adequate banking organization and properly organized money and capital markets.

There are, as briefly mentioned earlier, a few specialized credit institutions, with small capital, established to finance long term needs for funds in industry, agriculture and real estate. As far as industry and commerce are concerned the joint stock company is the only type of organization that is likely to raise funds through equity financing. Yet, the practice of holding shares and bonds has not gained much popularity among the people. Commercial banks seem to be the only organizations to extend loans pledged by securities. The volume of such loans is, however, not very large to meet the need of most borrowers. Moreover, such advances are not made equal to full market value of the collateral. The percentage extended varies with the type of security pledged. It generally falls between 40 to 80% of the market value. As a result only a small portion of medium and long-term needs for funds is met by these specialized credit institutions, leaving a considerable part of such financing, especially in agriculture

and industry, to be done through borrowings from relatives, individual lenders and other means of financing. These lenders charge as high an interest rate as 50 or 60% and in certain case even 100% and above, without any regard to the bank rate. On the other hand, loanable funds available to these private lenders is limited, and when it comes to even short-term finance, especially in agriculture in busy seasons, there seems to be a considerable stringency of money. Borrowers, in agriculture, may be almost completely insolvent before the harvest is gathered, and have to pay for their finance whatever price their creditors may choose to ask.

The need for providing adequate short and long term credit and other banking facilities for agriculture and industry, in order to accelerate the rate of development of the country, is thus obvious.

CHAPTER IV

DA AFGHANISTAN BANK.

(The Central Bank of Afghanistan.)

A. OBJECTIVE OF THE BANK

A bank under the name of "Da Afghanistan Bank" was founded in 1938 as a joint stock company for the purpose of accelerating the economic development of Afghanistan. It has the sole privilege of issuing bank-notes in the country. ⁽¹⁾

The bank's initial authorised capital is one hundred and twenty million Afghanis, divided into twenty four thousand shares of five thousand Afghanis each. All shares are registered and fully paid up. ⁽²⁾

The government initially subscribed to 75 percent of the shares and had also the right to purchase the remaining 25 percent as well. However, this remaining 25 percent was initially offered for sale to Afghan subjects after the approval of the Council of Ministers.

The reserves of the bank on March 21, 1952 were Afghanis 65,876,328. and on March 21, 1953 it rose to Afghanis 94,698,841. On the same dates the undistributed profits stood at Afghanis 42,980,101 and Afghanis 65,470,097 respectively. The accumulated surplus increased

¹ Statutes of Da Afghanistan Bank, page 1, 1942.

² The capital was increased to four hundred million Afghanis in 1955.

from half a million Afghanis in 1948 to nearly 115 million Afghanis in March 1954.

Since the Bank expanded its participations in industrial ventures, both public and private, its authorised capital was raised in 1955 to Afghanis 400,000,000, out of which Afghanis 240,000,000 are fully paid up. The government is the major shareholder. At present, almost 97 percent of the paid up capital is held by the government.

The business of the bank is not divided in the usual fashion between an Issue Department and a Banking Department. However, the functions of note-issuing is supposed to be carefully supervised by the Supreme Council and the Committee on Bank-Note Reserves.

The management of the Bank rests with the following bodies:⁽¹⁾

- a. The General Assembly of Shareholders.
- b. The Supreme Council.
- c. The Governor.
- d. The Board of Directors.
- e. The Committee of Credit.
- f. The Committee of Supervision.
- g. The Government Auditor.
- h. The Committee of Bank-Note Reserves.

¹Ibid. p.6.

All the decisions of the Supreme Council, Board of Directors and Committees of Credit, Supervision and Bank-Note Reserves are recorded in Special registers and signed by the members of the above bodies.

In case of necessity the Supreme Council is authorised to appoint a sub-committee out of its own members for the purpose of executing certain duties. It should be mentioned that the joint signatures of the Governor and that of another member of the Board of Directors will legally make the bank responsible to the law.

a. THE GENERAL ASSEMBLY

The general Assembly of the Bank is composed of the shareholders of the bank whose names appear in the special register. The powers and duties of the general assembly are as follows:⁽¹⁾

- 1- To examine the annual report submitted by the Board of Directors.
- 2- To approve the annual balance sheet on the basis of the report prepared by the Board of Directors.
- 3- To fix the amount to be credited to the reserve fund account.
- 4- To take decisions put down on the agenda of the meeting.
- 5- To elect members for the Supreme Council.
- 6- To elect members for the Committee of Supervision.

¹Ibid., P.7

The above decisions are conducted on a ballot system. In case a majority is not obtained, those having received the highest number of votes shall be elected. In case of parity of votes, however, the election of the members shall take place by casting lots.

A copy of all the resolutions shall be forwarded to the Finance Minister.

b. THE SUPREME COUNCIL

The council is composed of seven members elected by the General Assembly for a period of three years. Two of the members are to be removed at the end of the first year. This, however, is effective five years after the establishment of the Bank.⁽¹⁾ Being almost the sole shareholder of the bank, the government in fact appoints all the members of the Supreme Council.

The rights and duties of the Supreme Council are as follows:

- 1- Determining size, form, etc., of the bank-notes to be issued and fixing the terms governing their withdrawals from circulation, their cancellation and the replacement of worn notes in accordance with the established rules.
- 2- Fixing the rate of interest on loans to banks and discount as well as the price for buying gold.

¹ Ibid., P.8

- 3- Adopting decisions on imports of gold and silver.
- 4- Examining and approving the general rules drawn up by the Board of Directors and making necessary amendments thereto.
- 5- Adapting decisions on matters proposed by the Governor.
- 6- Appointing the members of the Committee of Credit.
- 7- Approving the annual budget of the bank's expenditure.
- 8- Drawing, upon the proposal of the Board of Directors and after examining the report of the Sub-Committee appointed by the Supreme Council, rules and regulations concerning agreements with the customers on settlement of their accounts as well as the realization on cancellation of doubtful claims. The Supreme Council is entitled to demand from the Governor any information on the operations of the Bank which it deems necessary for the execution of its duties.

At present the Ministers of Finance, Commerce, Foreign Affairs, and Planning are among the seven members of the Supreme Council.

c. THE GOVERNOR OF THE BANK

The Governor is appointed on the proposal of the Finance Minister, approved by the Cabinet, under a Royal Decree, for a duration of five years. His removal may take place under the aforesaid procedure before that period.

The Governor possesses the supreme executive power of the bank. There will be one vice-governor and two assistant governors, the appointment and removal of whom is effected in the same manner as in

the case of the governor himself,

d. THE BOARD OF DIRECTORS.

The Board of Directors is composed of the governor, the vice-governor and two assistant governors and is empowered to execute all matters concerning the bank within the scope defined in the statutes.⁽¹⁾ These members, as long as they hold offices, shall not become members of Parliament nor government officials, nor engage in any private business. These members, before entering service, shall take a solemn oath in the presence of three ministers appointed by the Council of Ministers to observe strict secrecy in all matters concerning the bank.

e. THE COMMITTEE OF CREDITS.

This is an advisory committee formed of three members appointed by the Supreme Council out of its own members for the duration of one year. It is the function of this committee to express its opinion to the Board of Directors on the credit policy of the bank, including the volume as well as allocation of credit to be granted by the banks.⁽²⁾

f. THE COMMITTEE OF SUPERVISION.

This committee is composed of five members who are selected by the General Assembly for a period of one year.

¹ Ibid., p.12

² Ibid., p.13.

The chief function of this committee is to;

Exercise control over accounts and verify monthly reports published on the situation of the bank as outlined in the respective specimen to be drawn up by the Committee of Supervision; Exercise control over, and examine on different occasions, at least twice a year, cash-holdings, and balance in cash, documents, deposits, bank-notes and paper currency as well as the general inventory; examine the annual balance sheet and the profit and loss statements and prepare the annual report.

This committee has no executive powers, however, it forwards to the Supreme Council a full statement showing all its objections and observations and submit a copy of same to the Finance Minister.

g. THE GOVERNMENT AUDITOR

The government auditor is appointed by the Cabinet on approval of the Finance Minister for a duration of three years with a fixed salary to be paid by the government. He has a seat in the Supreme Council and the Committee of Supervision in an advisory capacity.

The duties and powers of the government auditor include:

- Cooperating with the Committee of Bank-Note Reserves.
- Checking whether all operation and transactions of the bank have been executed in strict conformity with the existing rules and regulations.
- Inspecting the general routine work of the bank and of its various departments in order to ascertain whether or not these departments have duly fulfilled their duties in keeping with the principles of national and public interest.

- Supervising the transactions and the accounts of the government with the bank.

h. THE COMMITTEE ON BANK-NOTE RESERVES

In order to control the reserves of the bank-notes, a special committee composed of seven members is to be formed at the bank comprising:

Two members of parliament.

A member of the cabinet.

The president of the Supreme Court.

The governor of Da Afghanistan Bank.

The chief Treasurer.

The government auditor at the bank.

The term of the office of the government delegates and representative is two years. Their appointment takes place every year in the month of Hamal (March and April) at the occasion of the first session of parliament and of the cabinet.

The committee has the following duties and powers;

- Inspecting and receiving the bank-notes newly printed.
- Safe keeping the bank-notes and effecting their delivery to the bank after examining the reserves and ascertaining that it is in proper ratio to the notes printed.

- Receive the Bank-notes withdrawn from circulation as well as the worn out and defaced bank-notes, keep account of and supervise the incineration of the bank-notes. A report with full particulars of the procedures must be made in a special book. A copy of the decision shall be submitted to the Finance Minister.

- Controlling the accounts regarding the cover for the bank-notes in accordance with the regulations in force. This committee shall prepare a report at least once a month on the total volume 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 turn, will publish it for the information of the public. So far the bank as a whole has not complied with this provision and has not often published information concerning the composition of the cover for the currency issued.

B. FUNCTIONS AND OPERATIONS OF THE BANK

The Afghanistan Bank was established to operate as the Central Bank of Afghanistan, and also perform necessary commercial banking activities for the purpose of developing the economic life of the country.

The main functions of the bank are:⁽¹⁾

- 1- Issuing bank-notes and regulating their circulation in conformity with the actual necessities and economic requirements of the country.

¹Statutes. Ibid., p.4

A recent figure shows total money supply for the years 1957/58 and 1958/59 amounting to 2695.2 and 2882.2 million Afghanis respectively. ⁽¹⁾ This indicates an increase of 187.0 million Afghanis or 6.9 percent for the period.

- 2- Fixing the bank-rate.
- 3- Handling fiscal operations with the consent of the national treasury in conformity with their respective rules and regulations.
- 4- Regulating exchange and money market.
- 5- Adopting, with the cooperation of the government, all necessary measures for the stability of the Afghan currency.

Since the Central Bank in Afghanistan is almost completely government controlled and run as the objectives of a planned economy requires, its primary concern, as the instrument of monetary policy, is to frame its policies and operations in such a way as to minimize the possible inflationary consequences of a sizeable development programme, and to evolve a credit policy so tailored that it serves and promotes development without breeding inflation.

In order to achieve the basic objectives of a sound monetary policy, namely; price stabilization, economic development and stabilization and exchange stabilization, it is provided in the statutes of Da Afghanistan Bank to advise - in accordance with the general regulations set jointly by the Board of Directors and the Supreme Council of the bank with the approval of the government - in the issue

¹MINISTRY OF PLANNING. Op.Cit. p.170

of any kind of securities by government departments and municipalities.

It is appropriate to point out that neither the bank nor the government has resorted to the issue of any type of securities in the market. The bank has financed public projects by direct loans to the government and government guarantees are secured for the financing of some private projects.

Table 6, shows the amount of loans granted by Da Afghanistan Bank to the government or to private institutions with government guarantees.

One of the statutory rights of the bank, is to participate directly or through the mediation of other institutions in all companies engaged in public works. Any such transaction, however, may only be undertaken with the approval of the Cabinet. On the basis of this provision the bank is free to grant short as well as long term credits to government, municipalities, banks, industrial and agricultural enterprises using raw material of the country and individual merchants. The loan to municipalities should be within the limits of 25% of their annual income, and to individual commercial companies and private individuals should in no case exceed 20 percent of the banks paid up share capital. Should, however, the credits applied for by these borrowers exceed those limits, the approval of the cabinet and the guarantee of the Ministry of Finance is considered essential.

(TABLE 6)

Internal Loans Granted by Da Afghanistan Bank
to the Government or with Government Guarantee.

By Agency
(In Million of Afghanis)

	End of 1337 (1958/59)			End of 1338 (1959/60)		
	Loans Granted	Amount paid back by borrowers	Balance out- standing	Loans Granted	Amount paid back by borrowers	Balance out- standing
Government Ministries and Departments	998.9	344.1	656.0	998.9	344.6	680.6
Government enterprises	395.6	87.0	309.1	475.7	82.0	392.4
Kabul Municipality	37.5	5.0	32.5	37.5	7.3	30.2
Herat Municipality	00.8	-	0.8	1.8	-	1.8
Industrial Institutions	-	-	-	218.1	12.8	220.2
Commercial Institutions and Banks	-	-	-	217.6	94.5	123.1
Total	1.432.8	436.1	998.4	1.946.6	541.3	1.448.3

Source:

Credit Department of Da Afghanistan Bank 1960.

Table 7, shows the bank's total loans to different categories of borrowers during the years 1954/55 through 1958/59.

The bank is the only body to buy and sell gold in coins or in bullion. The statutes provide that the export of gold as well as the import and export of silver, whenever necessary for the actual economic requirements of the country, is the sole monopoly of Da Afghanistan Bank. Such transactions^{are} being, however, subject to the authorization of the cabinet.

The bank is also authorized to buy and sell foreign exchange actually convertible into gold and realizable within ninety days.

The bank is entitled to buy and sell shares, securities and bonds for the account of a third party for the purpose of facilitating the development of a capital market. The bank has not yet performed this function. However, it has accepted in safe custody, on a commission basis, gold, silver, shares, securities, bonds, documents and various valuables.

The bank is empowered to open current as well as fixed deposit accounts, and is in a position to collect any ordinary or documentary bills as well as opening credit accounts of any kind at home or abroad for those depositors who are regular customers of the bank.

Finally there is a stipulation in the statutes that any credit obtained from abroad will have to be authorised by the cabinet.

With this somewhat constitutional background of Da Afghanistan Bank, I shall proceed to study the means of monetary management employed by the bank to achieve the end expressed in its statutes.

(TABLE 7)

Loans and Advance Granted and Collected by
Da Afghanistan Bank between 1954/55
and 1958/59. In Million of Afghanis
(1954/55)

	<u>Loan Granted⁺</u>
Government	597.3
Government enterprises ⁽¹⁾	455.0
Municipalities	-
Commercial institutions and banks	-
Private individuals	43.1
Miscellaneous	-
Total	<u>1.095.4</u>

+, No repayments were made during this year.

¹Such as the government monopolies for petroleum, cars, sugar and cigarettes.

(Continued on next page)

(TABLE 7 Cont'd.)

(1955/56) In Million of Afghanis

	<u>Loans Granted</u>
Government	-
Government enterprises	667.6
Municipalities	354.5
Commercial Institutions and Banks	4.0 ⁽¹⁾
Private individuals	224.4
Miscellaneous	-
Total	1.249.5

¹Credit to Paslitany Tegarity Bank. No credit has been extended to the other commercial bank i.e. Bank-e-Millie.

(Continued on the next page)

(TABLE 7 Cont'd.)

(1956/57)

(In Afghanis, U.S. Dollars and
Indian and Pakistani Rupees)

	<u>Loans granted</u>	<u>Loans paid back</u>
Government	41.286.860.09	5.030.589.64
"	--	1.092.810.90 ⁽¹⁾
Government enterprizes	24.229.220.11	64.917.373.39
" "	124.337.48 ⁽¹⁾	85.203.75 ⁽¹⁾
Commercial Institutions and Banks	466.094.562.29	258.943.790.80
" "	200/14/5 ⁽²⁾	200/14/5 ⁽²⁾
" "	--	8.782.71 ⁽¹⁾
Private Individuals	1.859.415.00	1.423.661.02
Municipalities	--	575.898.67
Total	Af. 53.347.057.49	Af. 330.890.813.52
	U.S.\$ 124.337.48	U.S.\$ 1.186.797.36
	Ind. & Pak. Rupees 200/14/5	Ind. & Pak. Rupees 200/14/5

¹In U.S. Dollars.²In Indian and Pakistani Rupees.

Cont'd. on the next page.

(TABLE 7 Cont'd.)

(1957/58)

In Afghanis and U.S. Dollars

	<u>Loans granted</u>		<u>Loans paid back</u>	
Government		633.657.180.82		3.395.000.00
"		50.961.560.47 ⁽¹⁾		302.000.00 ⁽¹⁾
Government enterprises		300.436.065.39		50.500.000.00
Commercial Institutions and Banks		403.931.563.27		456.578.000.00
Private Individuals		43.692.003.70		not available
Municipalities		33.362.511.92		222.000
	Total			
		Af. 1.415.079.324.40	Af.	510.695.000.00
		U.S.\$ 50.961.560.47	U.S.\$	302.000.00

¹In U.S. Dollars.

Cont'd. on the next page

(TABLE 7 Cont'd.)

(1958/59)

In Afghanis and U.S. Dollars

	<u>Loans granted</u>	<u>Loans paid back</u>
Government	632.539.489.32	1.265.295.14
"	49.269.718.34 ⁽¹⁾	not available
Government enterprises	309.116.157.26	85.791.515.20
Commercial Institutions and banks	463.659.803.35	354.940.007.66
Private Individuals	33.980.776.58	3.176.533.00
Municipalities	33.298.700.16	1.693.468.55
Miscellaneous	1.243.617.33	not available
Total	Af. 1.473.838.543.00	Af. 456.869.819.55
	U.S.\$ 49.269.718.34	

Source: Dates obtained personally from the Credit Department,
(Da Afghanistan Bank), 1960.

¹In U.S. Dollars.

C. DA AFGHANISTAN BANK AND THE

REGULATION OF CREDIT

The primary methods available to the Central Bank for the regulation of credit are; setting the discount rate, open market operations and varying reserve ratios.

Discount and loan operations: As far as the first method is concerned it is clear, from the statutes of Da Afghanistan Bank, that the bank is authorized to discount and rediscount commercial bills payable within ninety days bearing at least three "sound" signatures and emanating from "real" commercial transactions. In certain cases the bank may be even satisfied with two signatures provided one of these be given by a first-class bank or the third signature be substituted by a collateral deposited with the bank, such as bonds, securities, gold, silver in coin or bullion, or foreign currencies actually convertible into gold. Such guarantees should easily be negotiable and their value should exceed the credit granted by at least 10 percent.

By the use of this instrument, it is conceivable that the Central Bank will be able to control the cost of money to the public. "Despite the fact that under present day economic conditions there seems to be a much less scope for an effective discount rate policy than was formerly the case, the discount rate policy of the Central Bank still has a useful function to perform in certain circumstances. And although there are other very important controlling measures in

developing economies, nevertheless, bank rate and open market operations are at the heart of central banking; they are the means whereby the price of credit and the ease of obtaining it are governed. Every Central Bank should ensure that its legal powers in these directions are adequate and that they are applied."⁽¹⁾

In spite of the fact that the statutes allow the Da Afghanistan Bank to carry out discount operations, practically nothing has been done to develop the use of bills and so accommodate the money market. Although the discount and rediscount rates are announced by the bank to be 7/4% and 7% respectively, as against 8% for loans, yet most of the accommodation granted by the bank to the member banks and other financial and non-financial institutions have been in the form of loans and advances against the security of stocks, bonds and other collaterals. Little rediscounting operations have been undertaken. The undeveloped state of the Afghan money and capital market which was discussed in the previous chapter, has contributed to this phenomenon.

The small number of eligible bills, the self-sufficiency of the banks and the lack of confidence and cooperation between them are considered to be among the major factors. Moreover, the existence of a more convenient form of borrowing by means of overdrafts has hampered the use of discounting and rediscounting facilities.

¹R. S. SAYERS, Central Banking after Bagehot. p.123. Lodon , 1957.

As a result rates in both sectors of the money market, organized and unorganized, vary greatly and the amount of funds is not sufficient to meet the increasing demand of the remote needy areas of the country.

The rate at which the commercial banks are allowed to borrow from the Central Bank is equal to the effective rate of the market. This has been a further factor in the commercial banks attempt to avoid such loans lately and to try to maintain a more or less self-sufficient position by keeping sufficiently large cash reserves on hand.

Although the governor of Da Afghanistan Bank is a member of the Supreme Council of the Pashtany Tejaraty Bank, there exists an atmosphere of individualism and lack of cooperation between the two banks. This is mainly because it is claimed by the officers of the Pashtany Tejaraty Bank that as a Central Bank of the country, Da Afghanistan Bank should restrict itself entirely to central banking functions and refrain from any commercial activities. These officers, furthermore, demand that in making any loans to the commercial banks, Da Afghanistan Bank has to make a concession as far as the rate of interest is concerned, otherwise under ordinary circumstances the commercial bank will never be induced to borrow from and cooperate with the Central Bank and instead will try to maintain a higher cash position.

Despite the cloudy atmosphere that prevails between Da Afghanistan Bank and the Pashtany Tejaraty Bank over the commercial activities of the former, Da Afghanistan Bank has maintained its

position in the commercial section of the market and so in addition to short and long term loans to the government, municipalities and industrial and commercial concerns - both public and private - it extends loans to private individuals especially in the foreign trade section of the economy. Such loans are of short term self-liquidating nature and are extended both unsecured and against collaterals such as bonds and shares. Such loans are granted only to companies and individuals who are engaged in export and import businesses. However, the number and volume of such transactions concluded with the Central Bank are claimed to be comparatively small, mainly because a great majority of the individual applicants are referred to the Pashtany Tejaraty Bank and Bank-e-Millie.

Although, Pashtany Tejaraty Bank is the only commercial bank authorized to deal in foreign exchange transactions, nonetheless, all foreign exchange operations are controlled and conducted by Da Afghanistan Bank and its offices inside and outside the country. This is primarily so because the Central Bank is to keep account of foreign exchange earnings and expenditures of the country.

Open market operations: In view of the shortcomings of the discount policy, a second and most effective method of control at the disposal of the Central Bank in the more developed countries is open market operations. Under this method the Central Bank is entitled to sell and purchase certain of its assets, viz. Bills, securities, bonds, gold, silver and foreign exchange. These dealings are carried out with the view to affecting necessary variations in the supply of money and

to relieve the heavy pressure on the banks of seasonal as well as permanent shortages of funds. It should be mentioned, however, that the effectiveness of this weapon depends largely on the quality and volume of assets in which the Central Bank is likely to deal and which it can hold, general business and economic conditions and on the social and cultural standards of the society.

As far as the existence of the instruments for effective operation of this weapon of monetary policy is concerned, there is a lack of treasury and commercial bills and other such appropriate instruments in Afghanistan, mainly due to the factors mentioned in connection with the discount policy. There are also no Central Bank securities issued. Almost all short and long term needs of the majority of the borrowers are satisfied by loans (line of credit, overdraft, etc.) either from the banks or from the private money lenders. As a result the interest rates charged for these types of funds vary widely from case to case and from one locality to another. In the meantime export proceeds are very meager compared to the demand, and are subject to wide fluctuations. The Da Afghanistan Bank is therefore not able to buy and sell foreign exchange in large quantities so as to effect substantial variations in the supply of money.

Consequently it is apparent that the kind and limited availability of the assets on which the Central Bank is entitled to operate - more specifically, the narrowness of the security market, and the absence of a bill market - preclude the Da Afghanistan Bank from using open market operations as an effective mean of control either on interest rates or on the reserves of the commercial banks.

Therefore, the only significant sphere of operation left to the bank is its authority to manage public debts and the issue of new loans guaranteed by the Afghan government. These operations tend to have the same effect as an open market operation and so influence the cost and availability of credit.

Since the loan capacity of the banks increase or decrease by such operations of the Treasury and the Central Bank, they are supposed to receive instructions from the Central Bank regarding the quantity and quality of credit granted to different sectors of the economy.

Legal Reserve Ratio: In view of the very limited efficacy of the above mentioned two instruments and in addition to the authority of debt management, the Central Bank has been empowered, through a resolution of its Supreme Council, to keep with it a certain minimum percentage of time and demand deposits of banks. So for this applies mainly to the commercial banks. Nevertheless this instrument has had a wider scope of applicability than the first two weapons of monetary policy. "Since the use of discount rate and open market operations are very limited in most underdeveloped countries, these minimum reserve requirement are allowed to alter from time to time and from one bank to another as a means for effecting the liquidity position of the banking system and so influencing the cost and availability of funds for bank loans and investments."⁽¹⁾

¹PETER G. FOUSEK, Foreign Central Banking, p.45, N.Y. 1957.

Moreover, it will also affect the rate of multiple expansion of deposits in the entire banking system. In employing this technique it is likely that, "the aggregate supply of money will be insulated from the rise in the cash basis by an appropriate rise in the reserve ratio, and from a fall in the cash basis by an appropriate reduction of the legal reserve ratio".⁽¹⁾

Although not provided in the statutes of Da Afghanistan Bank, minimum variable reserve requirements are imposed upon some of the members of the banking system with the following objectives in view:

- 1- To ensure the liquidity and solvency of the banks.
- 2- To ensure that high cash holdings are avoided and that credit is sufficiently and cheaply provided to the most needy sectors of the economy.
- 3- To ensure for itself a supply of deposits and thus adequate resources for its local operations.
- 4- It is implied that this instrument should ensure the effectiveness of any other methods of credit control to be adopted by the Da Afghanistan Bank. A minimum of 8 percent of time deposits and 15 percent of demand deposits is to be kept with the Da Afghanistan Bank as the legal reserve ratio for the commercial banks.

Moreover, it should be pointed out that according to the statutory rights of Da Afghanistan Bank, it is authorised to participate

¹R.S.SAYERS, MODERN BANKING, p. 288, third edition London, 1958.

in the capital structure of all state banks and be represented in their Supreme Council. Apparently, the governor of the Central Bank represents the bank in all meetings of the Supreme Council of each of the four government owned banks. Da Afghanistan Bank, thus seems to influence the policies of the banks by setting reserve ratios and giving directions regarding the quantity and quality of credit to be extended.

Since the ratio differs from one bank to another and changes for the same bank from time to time, it is, therefore, the policy of the Da Afghanistan Bank, not to have a well advertised reserve ratio. It is decided upon to maintain a conventional ratio for every bank, where it is more flexible and at the same time admits a certain amount of secrecy.⁽¹⁾ Such an arrangement is thought by the Afghan authorities to be of utmost importance because a substantial part of the money created through deficit financing - both by direct loans from the Central Bank and through deposits created by the commercial banks - will find its way back to the banking sector. Deposits will tend to grow bigger in size, enhancing the capacity of the banks to create further credit in the form of loans, advances and overdrafts to whatever group and sector they please, regardless of the economic consequences.

This indicates that the problem of credit control in Afghanistan is not merely the regulation of total quantity and cost of credit. In the context of planning for a balanced and sustained economic development, selective credit control is also considered necessary to canalize

¹From an interview with the Governor of the Da Afghanistan Bank, Kabul, 1960.

bank credit to socially desirable and economically useful purposes. Da Afghanistan Bank has tried to achieve this objective by means of moral influence through the representation of its governor in the Supreme Council of the commercial and specialized banks.

It should be pointed out, however, that the regulation of credit in Afghanistan does not end with the application of the measures discussed above. These measures have been incapable to solve all banking problems. These measures have not only been ineffective within their own scope of operations, but they also fail to solve other problems such as the rate charged and paid by the banks and the like. To be more effective these measures are usually supplemented by other powers of the Central Bank, namely; control over the rates of interest paid or charged by the banks; control over the transactions of the banks; and the right to inspect the books and accounts of the banks. Although the last two measures are observed mainly because Da Afghanistan Bank is a big share-holder of the banks, yet, due to the lack of cooperation among the members of the banking system, the bank has not been able to maintain a uniform rate of interest within the banking system, so as to lead banks to compete not entirely on the basis of rates but on services as well. This is one of the reasons why Da Afghanistan Bank has engaged itself with ordinary commercial banks activities in order to reduce the wide ranges of interest rates within the so called organized sector of the money market. (1)

¹From an interview with the Governor of the Central Bank of Afghanistan, M. H. Achekzai. 1960.

D. DA AFGHANISTAN BANK AND THE EXCHANGE
SYSTEM OF THE COUNTRY.

Da Afghanistan Bank was primarily constituted to employ every possible measure so as to stabilize the value of "Afghani" in terms of foreign currencies. It is, therefore, expressed in the statutes of the bank as well as the Afghan foreign exchange regulations that all foreign currencies, earned through the visible and invisible exports of the country, shall be surrendered, after deducting all expenses, to Da Afghanistan Bank and sold against Afghani according to the articles of Exchange Regulations. (1)

The Afghan Exchange System has the distinction of having no payments restrictions. Licenses for imports and exports are required only in trading with bilateral agreement partners. (2)

There are practically no discriminatory practices prevalent either with regard to currency or to country. Proceeds of exports that are not under the surrender obligations can be used for payments to any currency are under the supervision of Da Afghanistan Bank.

Prior to 1930, there were no banks in Afghanistan. All banking and foreign exchange transactions were handled by private exchange dealers and money lenders set up in the market places of Kabul and Qandahar. It is estimated that in 1930 there were about 30 to 40 such dealers in Kabul and from 10 to 15 in Qandahar. Even the

¹Article 2. of the Exchange Regulations. A translation of these regulations will appear as an appendix at the end of this chapter on page (70).

²Afghanistan has concluded, since 1950, bilateral trade agreements with China, Czechoslovakia, U.S.S.R. and Poland.

governments' requirements of foreign exchange were bought from these dealers. The political upheaval and military conflict that took place in 1928 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. The country was thus exposed to the dangers of the disappearance of its only means of payments. The emergence of a new regime in April 1931 was accompanied by some reconstructive measures among which was the constitution of an organization whose immediate aim was to stop the loss of the country's resources of precious metals and at the same time to ensure the availability of the necessary foreign exchange needed by the public and private sectors.

When a new company (which was destined to become Bank-e-Millie) was first established in 1932 the number of market dealers was reduced by the government to 12 in order to strengthen the company's control over the exchange market. In 1934 all foreign exchange transactions were handled by this company. From 1935 onwards the government bought all its foreign exchange requirements through this company at a fixed rate of exchange. In 1939 the company (then Bank-e-Millie) allowed market dealers to function freely once more in foreign exchange. But these dealers were required to register with this bank.

There was a stipulation in the initial statutes of Bank-e-Millie to the effect that foreign exchange transactions were to be handled by this bank until a central bank was established. Despite the fact that this was done on March 21, 1938, it was not until 1943 that Bank-e-Millie relinquished its control over exchange matters to Da Afghanistan Bank.

The foreign exchange system was codified for the first time in 1938 but was revised in January 21, 1951 by decree no.2632. This decree still forms the basis of the country's exchange system.

Since its institution, the exchange system has undergone a substantial number of changes. These have, on the whole, been in the form of requiring exporters of Karakul, wool and cotton (and lately also other goods such as carpets and casings) to surrender all or part of their export proceeds at official buying rates with the proceeds to be made available to the government sector, for use both to finance government budget expenditures and certain industrial projects carried out by the private sector.

The buying rates applicable for the surrender of exports proceeds have usually been a mixture of a budget rate, an industrial rate⁽¹⁾ and some times the free market rate as well. On the selling side imports or payments made by the government or by the private industry approved by the government have taken place at the budget rate or the industrial rate, while those of others have taken place at the free market rates. The aim of this system has been to give preferred treatment to the government sector and to specific industrial projects considered particularly important from a national point of view.

While there are technically only three exchange rates, the actual number of exchange rates have increased in number over the

¹Under a budget rate - Afghanis 20:00 is exchanged for one U.S. dollar, while under an industrial rate Afghanis 28:00 equals one U.S. dollar.

years as the surrender requirements have become more involved for different export items combining one rate with one or two of the other rates at varying percentages has resulted in a number of different effective rates. The addition of taxes and levies to some selling transactions has also resulted in additional rates.⁽¹⁾ However, a large part of Afghanistans exports have consistantly been transacted at the free market rates, including in particular exports of fruits which form the most important single export item at present.

The budget rate - the buying budget rate was Afs. 14.00 to one U.S. dollar in 1948, depreciated to Afs. 16.80 per US dollar in September 1949, and again depreciated further to Afs. 20.00 in September 1956.

The Industrial Rate - was equal to the budget rate at the end of World War II. In April 1945 it was Afs. 13.0446 per US dollar, and again in September 1949 to 21.00 Afghanis per U.S. dollar. A further depreciation was introduced in September 1956 when the rate was fixed at Afghanis 28.00 per US dollar.

The following table traces the development of the two official rates for the period march 1943 to April 1959. - see Table 8 -

¹ e.g. The rate of Afghanis 35.20 to a dollar in 1960 which was made up of 40% at the industrial rate and 60 percent at the free market rate that applied to proceeds from sesame; and the rate of Afghanis 30.35 per U.S. dollar which is made up of the industrial rate plus Afs. 0.35 as selling commission and Afs. 2.00 as exchange taxes, could be noted. This rate is applicable to imports of consumer goods by the government monopolies and insurance of goods. A detailed list of such rates appear in the appendix on page (77)

(TABLE 8)
 Official Exchange Rates
 March 1943 to April 1959
In Afghanis per U.S. Dollars

<u>Date</u>	<u>Budget Rate</u>		<u>Industrial Rate</u>	
	<u>Buying</u>	<u>Selling</u>	<u>Buying</u>	<u>Selling</u>
March 1943	13.0446	13.4446	--	--
June 1943	--	--	15.4254	15.8005
Sept. 1943	--	--	15.2602	15.6997
Sept. 1943	--	--	14.8638	15.2290
Sept. 1943	11.5583	12.4446	--	--
Nov. 1943	--	--	13.0446	13.4446
Dec. 1943	13.0446	13.4446	13.7050	14.1168
Jan. 1944	--	--	14.2004	14.6210
Sept. 1944	--	--	13.7050	14.1168
April 1945	--	--	13.0446	13.4446
July 1956 ^(x)	16.8000	17.0100	21.0000	21.2600
Oct. 1957	20.0000	20.2500	28.0000	28.3500
April 1959	20.0000	20.2500	28.0000	28.3500

^xAt that time there was also a third category of official rate of Af. 30.00 buying and Af. 30.37 selling per U.S. Dollar.

Source: Foreign Exchange Department, Da Afghanistan Bank.

The so called free market rate has fluctuated widely. At the time of the introduction of the 1947 exchange system the rate was Af. 17.15/U.S. dollars, and since then it has consistently been more depreciated than the official budget or industrial rates. It stood at almost 62 Afs./U.S. dollar in early 1958. During 1959, and 1960, however, the rate appreciated significantly from an average of Af. 55.09 per U.S. dollar in 1958-1959 to Af. 46.67 in 1959/60 (15.3%) and again to an average of Afghanis 41.78 per U.S. dollars (10.5%) during the month of August 1960. It now stands about 55 Afs/US dollars.

The average annual free market rates of the four most important currencies quoted in Kabul are given bellow. - See Table 9 -

As the country's requirements for foreign exchange have grown, not only as the result of implementation of the First Five Year Plan, (beginning in September 1956) but also because of the general expansion in public works and industrial activities, exports had to be encouraged. One of the measures was to adjust the exchange surrender requirements. In making these adjustments, the authorities found it necessary to shift surrender requirements from the budget rate to the more depreciated industrial and lately even to the free market rate. These changes have become necessary as the surrender requirements at the more appreciated rates have been found to have undesirable effects on the country's incentive to produce and export.

At the same time it was also found necessary to transfer payments for imports from the budget rate to the higher industrial rate in order

(TABLE 9)

Annual Average of Free Market Rates of
Foreign Exchange in Kabul

In Afghanis per Unit of
Foreign Leading Currencies

Year-Currency(x)	U.S.\$		£		Ind. Rup.		Pak. Rup.	
		%		%		%		%
1956/57	54.13	-	146.76	-	10.7969	-	7.6255	-
1957/58	54.36	-0.4	149.80	-21	10.4111	-3.6	7.0148	-8.0
1958/59	55.09	-1.3	152.16	-1.6	10.4784	-0.6	7.1459	-1.9
1959/60	46.67	+15.3	128.66	+15.4	8.3539	+30.3	6.1699	+13.7
1960/(xx)	41.78	+10.5	115.35	+10.3	6.1978	+25.8	5.5612	+9.9

(x) Percentage show Afghanis appreciation (+) or depreciation (-) from preceeding year.

(xx) Average of seven months ending August 22, 1960.

Source: Foreign Exchange Department, Da Afghanistan Bank

to limit the demand for imports and to reduce the amount spent by the government in subsidising the imports of some items through exchange manipulation.

The effective rates, based on the official selling and buying rates are applied by Da Afghanistan Bank in most of its transactions while the other authorized bank (Pashtany Tejaraty Bank) deals in foreign exchange on the free market.

While Da Afghanistan Bank does not generally intervene directly on the free market through selling or buying exchanges, it does indirectly affect the rate prevailing in the market as well as that of the Pashtany Tejaraty Bank. However, in order to avoid too great a spread between the free market rates and that of Da Afghanistan Bank, the Bank adjusts its rates periodically in accordance with the prevailing trend in the market. The spread during the course of one year, is as high as 10 to 15 Afghanis.

As far as the international implications of the Afghan exchange system are concerned, it should be noted that bilateralism is one of the important features of the system. Afghan trading under bilateral agreements is relatively substantial and has recently shown an upward trend. Imports from and exports to countries concerned require licences. Currencies acceptable for payments are normally U.S. dollars or pound sterling. Bilateral agreements countries are Poland, Czechoslovakia, USSR and China. Trade and payments agreements have also been concluded with West Germany, India and the UAR.

E. DA AFGHAN ISTAN BANK BRANCHES
AND PURPOSES THEY SERVE

At present Da Afghanistan Bank has nineteen branches within and two branches outside the country. By opening these branches the bank is in the position and is entitled to effect any kind of payments and transfer both at home and abroad. Furthermore, it enables the bank to provide as many banking facilities as possible to the remotest areas of the country.

One of the most important public services performed by the branches of Da Afghanistan Bank in the provinces consists in the collection of taxes and handling of private and public deposit and credit accounts. The branches also serve as a center for the placing into circulation and withdrawal of bank-notes which are issued by the central office and are the legal tender all over the country.

The two foreign branches of Da Afghanistan Bank (in New York and London) are completely for purposes of improving and facilitating foreign trade activities. Moreover since Da Afghanistan Bank is the sole agency in charge of foreign exchange earnings and expenditures one of the major reasons of opening these two offices abroad is to see to it that all foreign trade transactions comply with the terms of the regulations.

These offices are established as separate corporations under the laws and regulations of the two countries concerned.

Although, foreign private investment regulations enacted in 1957 are expected to encourage more foreign capital to be invested in Afghanistan, nevertheless, these regulations do not apply to banking activities as such. There are no representation of foreign banks in Afghanistan. "This is attributed, in addition to the conservative foreign policy of the government, to the lack of a highly efficient central banking machinery so as to have been able to exercise a close supervision and control over the operations of branches of foreign banks in Afghanistan, and at the same time protect the new local banks in the face of any unfair competition."⁽¹⁾

F. DA AFGHANISTAN BANK'S
ANNUAL BALANCE SHEET

The business year of the bank commences on the first of Hamal and ends on the thirtieth of Hoot, corresponding to the 21th and 20th of March respectively.⁽²⁾ In addition to the monthly reports a balance sheet has to be issued at the end of every year.

Since the bank is not organized on the basis of two separate departments, the issue department and the banking department, a single balance sheet is prepared that portrays the entire operations of Da Afghanistan Bank.

¹ From an interview with the governor of Da Afghanistan Bank, Kabul, 1960

² Afghanistan follows the Al-Hejri solar calender which begins on the 21 of March and ends on the 20 of the same month.

Table 10 Presents a copy of the recent annual balance sheets of Da Afghanistan Bank as of March 21st 1957-58 and 1958-59.

Bank-notes outstanding in the year 1956-59 as shown in the balance sheets represent 56 percent of the banks total liabilities in that year. This amount is covered by gold and silver coins and bullion and foreign exchange all amounting to approximately Afghanis 1.739.00 million to the extent of almost 60 percent cover which is in excess of the 30 percent legal requirements. The rest of the cover is provided for by the loans investments and other asset items.

The net profits of each business year plus the balance of the profits of the previous years shall be distributed in the following manner:

- (a) At least 40 percent of the annual net profit shall be set aside as a "Reserve" until the total of the bank's reserves is equal to the whole share capital.

The amount fixed by the general assembly on the proposal of the Supreme Council shall be carried forward to next year's reserves account. This account was standing at an amount of almost 82,000,000 Afghanis in 1958-59.

- (b) The balance of the net profit shall be distributed among the shareholders as a dividend on their shares. So far, the bank has paid out dividends between 12 and 30 million Afghanis and an average tax burden of 6 to 10 million

(TABLE 10)

Da Afghanistan Bank Balance Sheets
(1957/58 and 1958/59, in Afghani)

<u>ASSETS: (1)</u>	<u>1957/58</u>	<u>1958/59</u>
1. Gold	811,673,045.98	828,744,511.86
2. Silver	149,496,998.16	149,496,998.16
3. Cash:		
A) <u>In Afghani</u>	505,180,499.94	1,178,449,912.75
Bank notes	326,007,115.00	986,966,999.00
Treasury notes	175,718,494.00	175,718,494.00
Coins	3,454,850.94	15,764,419.75
B) <u>In Foreign Currency</u>	625,332,307.56	761,365,278.43
In Bank's till & in Foreign Banks	625,332,307.56	761,365,278.43
4. Credit accounts with other banks:		
A) Demand	--	--
In Afghani	--	--
In Foreign Currencies	--	--
B) Time	--	--
In Afghani	--	--
In Foreign Currencies	--	--

Continued...

(TABLE 10 Cont'd.)

68 (b)

ASSETS: (2)5. Loans

		<u>1957/58</u>	<u>1958/59</u>
A) In Afghanistan			
Government	633.657.180.82	632.539.489.32	1.473.838.543.68
Government enterprises	300.436.065.39	309.116.157.26	
Mixed enterprises	--	--	
Municipalities	33.362.511.92	33.298.700.16	
Private enterprises	313.715.198.59	415.850.947.45	
Other banks	90.216.364.68	47.808.855.58	
Individuals	26.692.003.70	33.980.776.58	
Others	--	--	
B) In foreign currencies			
Government	50.691.560.47	49.269.718.34	49.269.718.34
Government enterprises	--	--	
Mixed Enterprises	--	--	
Municipalities	--	--	
Private enterprises	--	--	
Other banks	--	--	
Individuals	17.100.00	--	

Continued

(TABLE 10 Cont'd.)

68(c)

	ASSETS: (3)	
	1957/58	1958/59
6. Investments:		
A. Securities:	--	--
B. Participation:	--	--
<u>In Afghanistan</u>	663,033,263.81	664,928,263.81
Government enterprises	--	--
Mixed enterprises	377,988,068.81	--
Private enterprises	40,545,175.00	418,533,263.81
Other banks	244,500,000.00	246,395,000.00
<u>In Foreign Currencies</u>	1,045,440.00	1,045,440.00
Government enterprises	--	--
Mixed enterprises	1,045,440.00 (+)	1,045,440.00
Private enterprises	--	--
Other banks	--	--
7. Buildings	4,881,717.49	4,861,851.23
8. Equipments	19.00	21.00
9. Others	--	1,835,332.00
GRAND TOTAL	4,209,458,277.51	5,113,835,869.26

(TABLE 10)
De AFGHANISTAN BANK BALANCE SHEETS,
(1957/58 and 1958/59, In Afghanis)

LIABILITIES:			
1. Bank notes issued		2,256,848,110.00	2,875,095,110.00
2. Treasury notes issued		180,000,000.00	180,000,000.00
3. Demand deposits		--	--
<u>In Afghanis</u>		738,918,501.25	788,292,627.75
Government	463,155,173.24		360,622,816.54
Government enterprises	40,646,427.59		151,145,907.49
Mixed enterprises	--		--
Private enterprise	88,525,630.17		25,180,527.25
Other banks	9,274,236.37		73,978,836.92
Individuals	137,317,033.88		177,364,539.55
<u>In foreign currencies</u>		476,482,043.39	491,516,946.69
Government	182,222,295.00		187,555,184.42
Government enterprises	211,750,694.00		270,415,045.18
Mixed enterprises	--		--
Private enterprises	79,392,820.00 (1)		33,546,717.09
Other banks	--		--
Individuals	--		--
4. Time deposits:			
<u>In Afghanis</u>		110,940,857.64	201,975,216.61
Government	33,739,793.68		26,175,421.90
Government enterprises	37,093,485.08		2,806,076.70
Mixed enterprises	--		--
Private enterprises	1,325,978.75		9,299,467.50
Other banks	5,111,779.04		4,862,676.79
Individuals	33,670,321.09		158,831,573.72
<u>In Foreign Currencies:</u>		--	--

Continued

¹This Total includes that of individuals.

⁺Investments in foreign currency are expressed in Afghanis at an official budget rate.

(TABLE 10, Continued...)

LIABILITIES: (2)

Government	--		--	
Government enterprises	--		--	
Mixed enterprises	--		--	
Private enterprises	--		--	
Other banks	--		--	
Individuals	--		--	
5. Advance and credit:				
<u>In Afghanis:</u>				
Government	--		--	
Government enterprises	--		--	
Banks	--		--	
<u>In Foreign Currencies:</u>				
Government	--		--	
Government enterprises	--		--	
Banks (Foreign)	--		--	
6. Capital	--	240,000,000.00	--	240,000,000.00
7. Reserves	--	79,348,821.83	--	81,909,059.72
8. Undistributed profit	--	113,609,564.86	--	113,302,392.19
9. Other liabilities (branches)	--	13,310,378.54	--	86,222,049.83
GRAND TOTAL		4,209,458,277.51		5,113,835,869.26

SOURCE: Research Department, Da Afghanistan Bank Kabul, 1960

on a capital of 120 million Afghanis.⁽¹⁾ Since 97 percent of the capital is in the hands of the government, a major portion of any dividend declared and distributed will be considered as public revenue in addition to taxes.

The bank has not distributed any dividends since 1955. The undistributed profits' account stood at Afghanis 113.302.392,19 at the end of the business year 1957 (1958/1959).

¹All newly established business firms are exempted from income taxes for a period of three years. The tax liability on established business is mild: a flat 5% on all income (before dividends) of industrial companies, 10 percent on a commercial company's income. In addition, company reserves are subject to a 12 percent levy, but restrict the size of these reserves to 15, 20, and 25 percent of the registered capital of all commercial, agricultural, and industrial companies, respectively. The company income tax will be mildly progressive from 1 to 22% on brackets from 500,000 Afghanis to 50 million Afghanis and over. The increase in revenue yield is expected to double to 100 million Afghanis.

Source: Privately obtained from the Income Tax Department, Ministry of Finance, Kabul, 1960.

CHAPTER IV

APPENDIX

FOREIGN EXCHANGE REGULATIONS IN AFGHANISTAN.

(Text of the Decree No: 2632 (January 21, 1951))

In order to regulate and balance the export and imports of Afghanistan and fix the rate of Afghani against foreign currencies, the following rules are approved:

Article 1.

Buying and selling of foreign exchanges, transfer of foreign currencies to other countries, together with all transactions related thereto, are strictly prohibited in Afghanistan except in accordance with the following rules and regulations.

Article 2.

All foreign currencies earned through the export of goods shall be surrendered after deducting all expenses to Da Afghanistan Bank and sold against Afghanis according to the following rules.

- (a) The Council of Ministers shall fix, according to proposals made by the Supreme Council of Da Afghanistan Bank, the percentage of all foreign currencies earned through the export of merchandise to be surrendered to the bank.

- (b) Fixing and altering the Afghani rates for buying and selling of foreign currencies is the prerogative of the Council of Ministers which shall act according to the country's economic and monetary needs.

Article 3.

The foreign exchange needed by the government, according to the budget, prepared by the Ministry of Finance and approved by the Council of Ministers and other lawful bodies (parliament), shall be provided by the Da Afghanistan Bank.

Article 4.

Economic projects needing foreign exchange prepared by national institutions or government departments shall first be submitted to the Ministry of National Economy^(*) and then to the currency commission for investigation. The currency commission shall be constituted according to Article 6 below. Proposals shall then be submitted, after approval by the foreign currency commission and the Supreme Council of Da Afghanistan Bank, to the Council of Ministers for final decision.

Note: government budgetary needs shall have first priority claim over the country's foreign exchange holdings. The next priority shall be for projects under the approval of the development plans.

(*) The functions of this ministry were assumed in 1956 by the Ministry of Planning and Commerce.

Article 5.

The foreign exchange needs of productive institutions shall be referred first to the Ministry of National Economy. After approval of the foreign currency commission and the Supreme Council of Da Afghanistan Bank, the sums assigned shall be paid to the designated institutions.

Note: The foreign exchange needs of projects approved before this Act shall be payable after the consent of the currency commission and the Supreme Council of Da Afghanistan Bank, have been obtained.

Article 6.

The foreign currency commission shall be composed of five members, three of whom shall be appointed by the Finance Ministry, the Ministry of National Economy and the Bank-e-Millie respectively and the other two by Da Afghanistan Bank. The rank of the representatives of the Ministries shall not be less than deputy ministers and that of the central bank's not less than assistant president.

Article 7.

Any surplus or deficit in foreign currencies referred to in Article 2, both the total at the end of the year and amounts for individual projects, shall be reported by Da Afghanistan Bank to the Minister of National Economy. The said minister shall be empowered to investigate the matter through the authorities concerned.

Article 8.

The balance between the foreign exchange earned through the export of merchandise and amounts surrendered to the Bank shall be put freely at the disposal of merchants and firms earning it. Such balances shall be used for importing needed goods, into the country. In this case a guarantee shall be given to Da Afghanistan Bank that goods equal in value to the balance shall be imported.

Note: The manner in which these guarantees shall be given, the mode of transfer and the way in which the accounting shall be made should be set out in detailed regulations prepared specially for the purpose of Da Afghanistan Bank.

Article 9.

Every exporter shall be required either to import goods equal in value to a fixed percentage of the exported merchandise or to sell any excess foreign currency at a specified rate to Da Afghanistan Bank. The percentage shall be fixed in accordance with Article 2, of this decree after deducting real business expenses from the sale price of the merchandise.

Article 10.

Each merchant's sales prices of exported merchandise and purchase prices of imported merchandise shall be calculated after deducting the real business expenses incurred. Bill and invoices for exported and imported merchandise shall be subject to investigation by Da Afghanistan Bank. They shall be certified by the bank's representatives accordingly.

Article 11.

Merchants or other individuals earning foreign exchange in ways other than through exports shall be free to import goods to the amount of the exchange earned or sell it to the bank or merchants guaranteeing to import goods to the same amount.

Article 12.

Persons who travel to foreign countries ^{for} recreational, medical or other necessary purposes shall be permitted to export goods to the value of one thousand Afghanis without guaranteeing to import goods for that amount.

Article 13.

Export of gold and silver shall be strictly prohibited without the written consent of the Council of Ministers issued to the customs through the Ministry of National Economy and subject to the formalities of the customs.

Article 14.

Travellers to or from Afghanistan shall be permitted to take out or bring in not more than 5 hundred Afghanis in Bank-notes.

Note: Notes permitted to be taken out or brought in (up to the five hundred Afghanis allowed) shall be in two and five Afghanis bank notes only.

Article 15

Foreign subject entering Afghanistan shall declare the foreign currency in their possession to the customs officers at the Afghan border and such amount shall be certified in their passports.

Foreigners wishing to leave Afghanistan shall approach Da Afghanistan Bank to authorize deduction of the amount they have spent (according to their mode of living). They shall be allowed to take the rest of the above mentioned currency out of the country with written permission.

Note: Those living in Afghanistan as guests or earning their living expenses in the country shall be allowed to take with them the total amount they had imported.

Article 16.

Foreigners having come to Afghanistan as employees shall be required to exchange at least 30 percent of their foreign exchange income into Afghanis at the fixed rate of exchange in Da Afghanistan Bank.

Article 17.

Afghan nationals having to go to foreign countries for medical treatment shall be permitted to buy foreign exchange currency needed in conformity with the approved regulations (discussed later) provided the necessity for their treatment abroad is advised by the Ministry of Health.

Article 18.

Da Afghanistan Bank shall sell foreign currency at the bank rate when such currency is required for Afghan students studying abroad at their own or national institutions expenses, provided such expenses shall be certified by the Ministry of Education and provided that such expenses shall not exceed the expenses incurred by government students abroad.

Article 19.

Da Afghanistan Bank shall sell foreign currency as needed to the pilgrims of Haj and other holy places after the approval of the Ministry of Interior, the Ministry of National Economy and the currency commission.

Note: The Currency Commission shall determine the amount of foreign exchange needed for each pilgrim.

Article 20.

Da Afghanistan Bank shall sell foreign currency at a fixed rate of exchange to those buying professional and scientific books or magazines, with the consent of the Currency Commission.

Article 21.

As an exception to the foregoing article, Da Afghanistan Bank shall be empowered to export in bank-notes any foreign currency to be credited to its accounts abroad through any of its foreign dealers.

Travellers shall be permitted to export their foreign currency requirements in foreign bank notes - provided the said bank notes are supplied to them by Da Afghanistan Bank according to its rules and regulations.

Article 22.

The publication of all these rules shall automatically render all previous rules and regulations regarding exchange invalid and abrogated.

Article 23.

Da Afghanistan Bank shall be hereby authorized to apply these rules and made responsible for their application. However, Da Afghanistan Bank is allowed to formulate its own internal regulations to carry out these rules and put them into force.

THE SCHEDULE OF APPLICABLE EXCHANGE RATES:

The following list gives both the buying and selling rates as well as the types of receipt and payments which are transacted at the various rates. It will be noted that other taxes and levies are collected at the time of selling foreign exchange.

Exchange is BOUGHT at the following rates for each U.S. dollar or its equivalent in other currencies (effective August 24, 1960, when the free market buying rate was approximately Af 40.00 per U.S. dollar).

- 1- Af. 20.00: This is the budget rate. It applies to 30 percent of the salaries of foreign employees of the Afghan government and to all the exchange converted to the local currency by the Central Bank for all the diplomatic Establishment.

- 2- Af. 24.36: This is a mixed rate made up of 68 percent at the budget rate (20.00), 17 percent at the industrial rate (28.00) and 15 percent at the free market rate. It applies to proceeds from the exports of Karakul skins.

- 3- Af. 26.40: This is a mixed rate made up of 20 percent at the budget rate (20.00) and 80 percent at the industrial rate (28.00). It applies to the proceed of exports of cotton and wool to bilateral agreement countries other than India.

- 4- Af. 28.00: This is the industrial rate. It applies to conversion into Afghanis of foreign capital invested in Afghanistan and registered under the 1951 law. (The 1958 law legalized the conversion of new capital at the free market rate).

- 5- Af. 28.44: This is a mixed rate made up of 17 percent at the budget rate, 68 percent at the industrial rate and 15 percent at the free market rate. It applies to proceeds from exports of cotton and wool to other than bilateral agreements countries.
- 6- Af. 35.20: This is made up of 40 percent at the industrial rate and 60 percent at the free market rate. It applies to proceeds from exports of sesame seeds.
- 7- Af. 36.00: This is made up of 20 percent at budgetary rate and 80 percent at the free market rate. It applies to the proceeds of export of sheep skin and goat skins.
- 8- Af. 38.00: This is made up of 10 percent at the budgetary rate and 90 percent at the free market rate. It applies to the proceeds from exports of casings.
- 9- Af. 38.20: This is a mixed rate made up of 15 percent at the industrial rate and 85 percent at the free market rate. It applies to the proceeds from exports of carpets and flax seeds.

10. Af(x) or 40.⁽¹⁾ This is the approximate fluctuating free market rate. It applies to all other exports subject to an import obligation. It also applies to all other receipts in foreign exchange proceeds of Afghan nationals to tourists expenditures in the country and to various other receipts from Conversion of foreign capital invested under the 1958 law is undertaken at this rate.

Exchanges is SOLD at the following rates for each U.S. dollar, (or its equivalent in foreign currencies at an orderly cost rate.)

1- Af. 20.25: This rate is made up of the budgetary rate (20.00) plus of 8.25 as a selling commission It applies to expenditure by government including those by the Ministry of Court, the Ministry of Foreign Affairs and Purchases of monetary gold. Freight and insurance on these imports are also undertaken at this rate.

¹At this particular time,
i.e. August 24, 1960.

- 2- Af. 28.35: This rate is made up of the industrial rate (28.00) plus Af. 0.35 as selling commission. It applies to government imports including essential imports in connection with the development plans.
- 3- Af. 30.36: This rate is made up of the industrial rate plus Af. 0.35 as selling commission and Af. 2.00 as exchange taxes. It applies to imports of consumer goods by government monopolies department (sugar and petroleum products) and freight and insurance thereon.
- 4- Af. 32.35: This is made up of the industrial rate plus a commission of Af. 0.35, Af.2.00 as an exchange tax and an additional tax of Af. 2.00 as surcharge levied for the encouragement of exports. It applies to essential imports including freight and insurance thereof, industrial equipment, motor vehicles and parts, cotton piece goods for the government cooperative depots, imports by municipalities, other essential goods such as tea, cement and medicine to counter domestic price increases

business travel by industrialists,
medical expenses, students expenses abroad,
authorized pilgrims travel and repatriation
of foreign capital registered under the 1951
law, and profits thereon.

5- Af.(x)⁽¹⁾

approx. 0.50: This is the selling fluctuating free market
rate. It applies to repatriation of
capital and profits thereon permitted by
special licenses under the 1958 "Encoura-
gement of Foreign capital investment law".
It applies also to exchange payments for
other imports, freight and insurance
thereon, and to some other payments for
invisibles.

¹Free market rate. At this particular time, August 24, 1960, this
study was undertaken the rate was Af. 40.00 per U.S. Dollar.

G. SUMMARY AND CONCLUSIONS

To organize the financial system of the country, Da Afghanistan Bank was established in 1938 as the central bank of Afghanistan. It assumed responsibility for all the relevant duties of a central bank previously performed by a private financial institution. The government owns almost 97% of the capital. It is the function of the bank to perform all central banking operations for the purpose of accelerating economic development.

It is made up of and administered by a General Assembly of shareholders, a Supreme Council, that formulates the broad policies of the bank; the Governor; a Board of Directors and a Committee of Credit responsible to express its opinion to the Supreme Council and Board of Directors on the credit policy of the bank and the amount and sectors receiving it; a Committee of Supervision; the Government Auditor and a Committee of Bank-note Reserves.

In addition to central banking operations, Da Afghanistan bank is entitled to participate - with the approval of the cabinet - in the capital of certain companies and to conduct commercial banking activities, such as accepting deposits and extending credit to private individuals. However, such loans should not exceed 20 percent of the paid up capital of the bank.

As for the regulation of credit is concerned, although it has been indicated in the statutes of Da Afghanistan Bank, and that discount and rediscount rates are set, it has not yet carried out any

discounting or rediscounting transactions. All loans and advances are obtained on secured or unsecured basis at higher costs. This implies among other things that there is little sign of cooperation among the members of the system and the central bank. The maintenance of a high cash ratio is the indication of such a condition. Since there is not an active bill market with sufficient short-term instruments, the second weapon of monetary policy - open market operation - can not be employed either. However, to a certain extent, Da Afghanistan Bank regulates the quantity of credit through changes in public debt accounts. Since its establishment nearly two decades ago Da Afghanistan Bank has met the growing development expenditure of the government through deficit financing and so serving faithfully as its banker. However, it realized that part of the money so created will find its way back to the banks and will enable these banks to create more loans as deposits tend to increase. The consequence of such expansionistic credit policy might have been undesirable especially when most of these credits are not revenue producing investments. It was on this basis that the Da Afghanistan Bank required commercial banks to maintain with it a certain minimum percentage of their demand and time deposits. Da Afghanistan Bank also tried to control the rate at which credit could be obtained. The extension of loan to private individuals and companies at lower cost is an indication to induce the banks to follow a more or less stabilized and lower rates of interest.

One of the primary objectives, Da Afghanistan Bank was established for, was to take every possible measure so as to stabilize the value of Afghani in terms of foreign currencies. All foreign exchanges earned, from the exports of goods and services, will have to be surrendered to Da Afghanistan Bank. Proceeds of those export items not under the surrender obligation can be used for payments to any currency area.

Prior to 1930 all banking and foreign exchange transactions were handled by private exchange dealers. These dealers were, however, replaced by a financial institution (Bank-e-Millie) established by the people with the help of the government. With the establishment of Da Afghanistan Bank in 1938 Bank-e-Millie relinquished its control over exchange matters, to the former. A foreign exchange law was first codified in 1938 and was revised in 1951 which is still in use. Since its institution, the foreign exchange law has undergone a number of changes, such as requiring the exporters to surrender all or part of their export proceeds at different buying and selling rates. These changes can be attributed to the growing foreign exchange needs of the private and public sectors. In order to have encouraged the export of certain commodities the government has adopted a multiple exchange system, whereby the proceeds of different export items and imports of certain necessary goods are transacted at different rates. These rates start with Afghani 20:00 per US Dollars - as a budget rate - & ends ^{with} Afghani 28:00 per US dollar - as an industrial rate. The addition of taxes and levies to these rates and the combination of

certain percentages of one rate with that of another have resulted in a number of different effective selling and buying rates. These rates are periodically subject to adjustments in accordance with the prevailing trend in the market rates.

CHAPTER V

BANK-E-MILLIE AFGHAN

(Afghan National Bank)

A. OBJECTIVES OF THE BANK

Bank-e-Millie Afghan was found in May, 1933 as a joint stock company with the capital contributed partly by the government and partly by private investors of the bank.

The immediate purpose was to stabilize the foreign exchange rate of the Afghan currency and to promote local and foreign trade and internal industrial activities. Later on, some of its duties were transferred to special institutions. Bank-e-Millie, was thus left to engage itself only with commercial and industrial activities.

The operations of the bank are carried out by a head office in Kabul and branches throughout the country as well as major cities of the world.

The establishment of this private business concern in 1933 not only marked the beginning of modern banking in Afghanistan, but also the inauguration of joint stock companies as the dominant enterpraurial units in the business life of the country. It owes its origin to a combination of government and private effort. Prior to 1933, the business of exports and imports, and transactions in foreign exchange and gold were in foreign hands.

Afghan capitalists were neither wealthy nor enterprising enough as individuals to pool their resources for the control of the complex business of large financing. It took a government franchise to establish the first successful joint stock company with limited liabilities, for the contributors. It handled most of the financial matters of the country, such as stabilizing the value of Afghani and the like. This company was later transformed into the Bank-e-Millie Afghan. Because this was the first bank to be established it had to be more than a conventional bank. It not only assumed the position of the government bank and handled its note issue until 1943, when it was assumed by the Da Afghanistan Bank, but it also promoted the establishment and participated in the financing of at least 125 companies. In each case the government would approve the new venture and thereby protect the investment of Bank-e-Millie. Bank-e-Millie would also supervise the day to day working of the new firms, provide technical assistance and put its domestic and foreign branches at the disposal of these firms.

The initial authorized capital of the bank was Afghani 35,000,000 fully paid up. This initial amount however, has been increased by new stock issue and calls on the shareholders from time to time, until it attained the present figure of Afghani 500,254,000.00 in addition to Afghani 130,591,966.74 as reserve funds.

The shares of stock at present are held partly by the government and partly by private Afghan individuals and enterprises.

The capital is made up of 500.254 shares (Afghanis 1.000 each) of ordinary common stock and is fully paid up. All shares are issued to bearer and could be registered at the central office of the bank. The shares were at times sold above par at a high premium, when new capital was raised by issuing new shares of stock. This was especially due to high profits made by the bank. However, since the limitation of the privileges once enjoyed by Bank-e-Millie and the undesirable effects of its huge long term investment in high industrial plants during 1952-1957, the attractiveness of its shares to investors has diminished. Early in 1958 its shares were sold among the public at about half the par value. Only very recently when Gulbahar Textile Company and Sarobi Hydro-electric Power station started operation, did the attitude of the investing public towards Bank-e-Millie seem to change again.

B. ORGANIZATION AND ADMINISTRATION.

The policies and activities of the bank are formulated and executed by the following bodies:⁽¹⁾

- (a) The General Assembly of Shareholders.
- (b) The Supreme Council.
- (c) The Board of Directors.
- (d) The Board of Supervision.

¹Statutes, article 9, p.3.

a. THE GENERAL ASSEMBLY

The general assembly is composed of the shareholders of the bank whose names are shown in the special register.⁽¹⁾ The general assembly holds ordinary annual as well as extraordinary meetings. Extraordinary meetings would be held in the event of amending the provisions of the statutes of the bank, changing its equity capital, and liquidating it. All these meetings are to be held in Kabul and those in possession of twenty shares are entitled to cast one vote.

The general assembly has the right to:

- Examine the annual report and approve the annual balance sheet.
- Fix the amount of dividend to be distributed among the shareholders.
- Elect the members of the Supreme Council and the Board of Supervision whose terms of office have expired.
- Take decisions on questions put down on the agenda of the meeting.

b. THE SUPREME COUNCIL

The Supreme Council of Bank Millie is composed of at least seven members who are elected by the general assembly for a period

¹ Although, shares are issued to bearer, the administration requires the holder for purposes of dividends and meetings, to register his name in the special register of the bank.

of three years. The council in turn will elect its president as well as vice president and frames its internal rules and regulations. As far as the rights of the council are concerned it is the duty of the Supreme Council to elect the members of the Executive Committee, approving the annual budget of the bank's expenditures, and the establishment of offices and branches all over the country and abroad.

c. EXECUTIVE COMMITTEE

The Executive Committee composed of three members, a president and two assistants, is responsible to execute all the plans of the bank, and is directly accountable to the Supreme Council and the general assembly.

The members of this committee are elected from and by the Supreme Council for a period of three years.

The committee is responsible to prepare the annual report and balance sheets of the bank. It is empowered to purchase movable and immovable properties for the use of the bank and the different companies it possesses. It will represent the bank in all its affairs, and its members are not permitted to engage in any private profession which is likely to compete with the interest of the bank.

d. THE BOARD OF SUPERVISION

This board is composed of three members elected by the general assembly for a period of one year. As their term expires, members may be re-elected.

A major duty of this board is to supervise and control all the operations and transactions of the bank and see to it that they are conducted in conformity with the existing rules and regulations.

Moreover, it has to prepare a report on the balance sheet submitted to it by the executive committee. Both the balance sheet and a report have to be presented to the Supreme Council.

C. FUNCTIONS AND OPERATIONS

Since Bank-e-Millie was established as the first financial organization at a time when the economy of Afghanistan was disrupted, the government had to entrust it with additional tasks which were interconnected. Some of the important functions of Bank-e-Millie were, the procurement of foreign exchange and gold for backing of the Afghan currency. Later on, however, these additional duties were transferred to special institutions. For instance, after the establishment of the government purchasing office, the duties of procuring government's orders were passed on to that office. Later on when Da Afghanistan Bank was established in 1938 and was able in 1943 to take up foreign currency affairs as the central bank, Bank-e-Millie in accordance with instructions from the government, handed over foreign exchange matters to this new bank and as soon as organizations monopolizing the sale of motor vehicles, sugar, and gasoline, were established, Bank-e-Millie relinquished its monopoly of these affairs to these organizations.

Along with these additional duties it was expressly authorised in the beginning that Bank-e-Millie should also engage in ordinary banking business and provide banking services to the public.⁽¹⁾

In providing these ordinary services, Bank-e-Millie found it necessary and profitable to devote special attention to the expansion of commerce and the development of Afghan industries. Such activities form the major part of Bank-e-Millie's operations at present.

As a commercial bank, Bank-e-Millie provides the following facilities to the public:

- 1- Current Account: This is a checking account with over draft allowed to some customers up to a certain extent. A minimum amount of Afghanis 1.000.00 (\$20.00) is required to open such an account.
- 2- Safe Deposit Account: Bank-e-Millie accepts money for safe deposit by issuing to the depositor a "demand certificate to deposit". In this way the depositor can get the money at any time he wishes, by endorsing and surrendering the certificate. A minimum of one thousand Afghanis is required to open such an account. There is no interest allowed on such deposits. However, if the depositor wishes his money to earn an interest he can secure a "time certificate of deposit". On the basis of such an account, which is similar to a savings account, only with a shorter duration, Bank-e-Millie is liable to pay interest for that period. The length of the period can either be for three months, six months, nine months, or one year.
- 3- Savings account and time deposit: The principle underlying these types of deposits is that a little shall be deposited regularly in order that these accumulations with interest compounded may grow into a large amount.

¹Ibid., P.1

A pass book is issued if the initial amount deposited is more than 100 Afghanis (\$2.00) and a saving deposit certificate, if the amount is less than 100 Afghanis. Under no circumstances, however, can the depositor draw on his account more than Afghanis 200 at one time. This deposit bears an annual rate of interest of seven percent.

Despite the interest paid, this type of deposit is not a significant item on the balance sheet of the bank. The biggest item of deposits is demand deposit which has amounted to Afghanis 151.866.629.44. during the business year 1958-59. The bank experiences great fluctuations at certain times of the year when these deposits stand at their two extreme lincks. The lowest level is experienced expecially after the bank has distributed "lottery prizes" on these accounts and when money is needed during the religious and national holidays. "Since there are no short term bills in which the bank could invest, and no active money market, and since checking transactions are still not widely practiced, Bank-e-Millie is obliged to keep sufficient cash on hand to meet such demands for cash."⁽¹⁾

4- Loan operations: Another major and important service of Bank-e-Millie has been the extension of credit. Having, by its articles of association, the option of extending credit, Bank-e-Millie engaged mostly in financing foreign trade and some industries. It carries this operation i.e., extension of loans, in the foreign and internal trade section in the following manner:

(1) On the strength of a personal guarantee,

¹From an interview with the director of the current account section Bank-e-Millie. Kabul, 1960.

- (2) Promisory notes,
- (3) On two name paper, i.e. endorsed notes, or accepted trade bills, (some of the bills, such as those drawn by foreign individuals and companies on Gulbahar Textile Company, are not negotiable and have to be redeemed by Bank-e-Millie),
- (4) On the security of real estate mortgages, or on the promisory notes and drafts secured by customers' warehouse receipts.

Such loans are of short term nature and are mostly for periods not more than three to six months. The amount and duration of such loans are decided by the credit department and approved by the committee of executives.

Bank-e-Millie extends credit against ornaments made of precious metals such as gold and silver. It also opens letters of credit (mainly irrevocable) for its customers and stands ready to accept, to the amount agreed upon in the letter of credit, any draft drawn on it by foreign exporter, provided that 35 percent of the amount of the letter of credit, is paid to Bank-e-Millie in the currency agreed upon.⁽¹⁾ Furthermore, the importer is responsible to pay the remaining 65 percent of the amount before demanding the possession of the documents of the imported goods.

Although Bank-e-Millie extends credit on the security of trade bills, it has not been in the practice of discounting.

¹One of the requirements of the letter of credit.

Most of Bank-e-Millie's loans are given for export purposes against the security of Karakul lamb skin, cotton, wool and other exporting items as well as against the shares of various companies in which Bank-e-Millie has invested. In order to be on the safer side Bank-e-Millie requires that all such loans must have a pledge of collateral with a major margin of value over the amount granted. It is from 35 to 80 percent market value of bills and securities and 40 to 60 percent value of goods pledged.

These loans are extended at a minimum rate of interest of at least 10 percent per annum which is collectable at the end of the period or, on the few loans which the bank grants for longer than six or nine months, semi-annually.

The following table (TABLE 11) shows the amount of loans granted by Bank-e-Millie to the public (business firms and private individuals) between the years 1954-55 and 1958-59.

The decline in the amount of loans granted during the later years can be attributed to the fact that Pashtany Tejaraty Bank started offering such services at lower costs and enjoys some privileges in the business of foreign exchange. Nevertheless, all transactions involving foreign exchanges have to be handled under the supervision of the foreign exchange department of Da Afghanistan Bank.

- 5- Investment Operations of Bank-e-Millie: In order to promote domestic production and expand the export trade, Bank-e-Millie deemed it expedient from the very beginning to devote its attention to cutting imports and save the foreign currency spent thereon.

TABLE 11

LOANS GRANTED BY BANK-E-MILLIE
BETWEEN 1954-55 & 1958-59

(In Million of Afghani)

Years -	Unsecured Loans	Loans against Karakul	Loans against Securities & Misc. Collaterals -	Loans Against L/O
1954-55	728.4	597.3	526.3	253.1
1955-56	564.7	208.1	521.5	96.8
1956-57	1,212.45	235.62	529.87	52.12
1957-58	957.0	143.5	460.5	133.5
1958-59	903.9	47.1	262.5	17.1

SOURCE: Credit Department, Bank-e-Millie, 1960.

The economic development of the country depends to a significant extent upon industrialization. Under its statutes the Bank-e-Millie assumes the responsibility of encouraging industrial development and of promoting new industrial enterprises.

The Bank-e-Millie accordingly submitted to the government, from time to time, proposals concerning the establishment of factories. With the help of the government and a small group of private investors, Bank-e-Millie was able to establish companies such as the Textile Factory at Pulikhumri whose annual production for the year 1958-59 reached about 20.6 million meters of textile fabrics and 61.000 bundles of cotton yarn; the Textile Factory at Jabal-US-Saraj, which was later merged with that of Pulikhumri; the Afghan Sugar Factory at Baghlon, which produced over 4700 tons of sugar by processing 35000 tons of sugar beets in the year 1958-59; the Gulbabar Textile Factory that has an annual output of 35 million meters of textile fabrics. The output of the later and that of Pulikhumri is believed to meet a great part of the countries requirements and to give the opportunity to use the foreign exchange thus saved in other productive and economic development projects.

With the existence of the textile factory at Pulikhumeri and the establishment of the larger factory at Gulbabar, the question of supplying spare parts to these factories made Bank-e-Millie establish, with the cooperation of the Afghan Textile Company, the industrial factory at Jangalak to cast spare parts for the textile machinery as well as motor vehicles.

Bank-e-Millie has also participated in the capital of the Sarobi Power Station, that supplies the Gulbahar Textile Factory and the City of Kabul with almost 22,000 kilowatts hours of electricity. Moreover, Bank-e-Millie has investments in the capital of woolen mills in Kabul and Qandahar, motor repairs work-shop and a number of other private and government owned industrial and commercial concerns, such as, Da Afghanistan Bank, Electric Company, Afghan Cement Factory, Karakul and Carpet Company, Wool Exporting Company, Agricultural Bank, Industrial Credit Fund and others. Its total investment in all these companies, as revealed from the balance sheet, at the end of the year 1958-59, amounted to Afghanis 533,937, 585,23.

D. BANK-E-MILLIE BRANCHES
AND THEIR OPERATIONS

Bank-e-Millie established branch offices in various parts of the country for conducting banking transactions and also opened branch offices in India, Europe and the United States to organize forwarding business and to conduct banking affairs as well as to assist in the export and import activities of Afghan traders.

The aim of opening branch offices abroad was also to prepare the ground for placing export goods in the right market and for purchasing import goods directly from the origin at suitable prices and also for carrying out other requests made by the Afghan traders and private and public offices.

As the only natural route for the Afghan imports and exports trade was through India and Pakistan, Bank-e-Millie opened branch

offices, designated "The Afghan National Bank", at Chaman, Peshawar, Karachi and Bombay, in order to control the forwarding business of Afghanistan's export and import transactions.

The Afghan National Bank - Berlin, was opened as soon as Bank-e-Millie was established, owing to the importance of the volume of Afghanistan's business with Germany. This office carried out industrial and commercial transactions of Bank-e-Millie until the Second World War broke out, at which time Afghan National Bank - Berlin, was closed. Due to abnormal conditions prevailing in Germany, there was no branch office of Bank-e-Millie in that country until 1950-51.

Bank-e-Millie, however, opened a branch office at Hamburg, in 1950, as soon as the situation in W.Germany was favorable, after the War, for importing machinery and industrial products, conducting commercial transactions and selling Afghan exported goods. In addition to purchasing machinery and equipment for the Afghan Textile Company and Sarobi Power Station projects as well as for other industrial concerns, this branch office has also been carrying out commercial and banking transaction for Afghan traders in Germany and neighboring countries.

Aside from being one of the major centers for financial affairs, London was, up to the outbreak of World War II, the commercial center for the Afghan export goods, especially Karakul lamb skin. After the war, when the London market was gradually regaining its favorable position for the sale of Karakul lamb skin and other export goods, the Afghan National Bank again resumed functioning in London.

In the beginning of World War II the future of European markets did not appear to be favorable for the Afghan trade. Bank-e-Millie, therefore, took steps to open an office in the United States for the sale of Karakul lamb skin as well as for conducting other financial activities for the Afghan subjects.

In 1941-42 Bank-e-Millie succeeded in opening an office for carrying out commercial business in New York. This office was named "The Afghan American Trading Company Inc." During the war, as well as in post war period, this office performed noteworthy services in selling Afghan export goods, and purchasing import goods at suitable prices. The Afghan American Trading Company succeeded not only in selling Afghan Karakul lamb skin in the United States at very favorable prices during the war, but also in establishing a permanent market for these items there. There is still a great demand for the Afghan Karakul lamb skin in the United States, despite popularity of mink skins, competition from South West African lamb skin and certain other factors.

E. THE ANNUAL BALANCE SHEET
OF BANK-E-MILLIE

The business year of Bank-e-Millie begins on the first of Hamal (21st of March) and ends on the thirtieth of Hoat (20th of March). A balance sheet is issued at the end of this period. The Executive Committee is responsible to submit the annual balance sheet to the committee of supervision. Tables 12 & 13 show the latest balance sheets of Bank-e-Millie for the years 1957-58 and 1958-59.

(TABLE 12)
 Bank-e-Millies Balance Sheet for
 1957-58 and 1958-59
 (In Afghanis)

<u>ASSETS: (1)</u>	<u>1957-58</u>	<u>1958/59</u>
1. Cash:		
A. <u>In Afghanis</u>	82,222,696.27	85,134,253.89
Credit Balance with Central Bank	16,490,739.76	30,824,958.88
Bank notes	65,625,716.00	54,001,699.50
Coins	106,240.51	307,575.71
B. <u>In Foreign Currencies</u>	525,480.55	1,387,004.26
With Central Bank	525,480.55	525,480.55
In Banks Till	--	861,523.71
2. Credit Account in Other Banks		
A. Demand	--	412,613.37
In Afghanis	--	--
In Foreign Currency	412,613.37	355,300.75
B. Time	--	--
In Afghanis	--	--
In Foreign Currency	--	--

(TABLE 12 Cont'd.)

100(b)

ASSETS: (2)	1957-58		1958-59	
3. Loans				
A. In Afghanis				
Government	5,370,344.93	242,165,830.43	1,500,364.37	133,141,730.26
Government enterprises	3,161,072.11 ⁺		861,337.99	
Mixed enterprises	--		--	
Municipalities	--		--	
Private enterprises	233,465,654.86 ⁺⁺		95,556,848.64	
Other banks	168,758.53		35,223,179.26	
Individuals	--		--	
B. In Foreign Currencies				
Government	--	--	52,461.65	6,119,086.91
Government enterprises	--		14,642.73	
Mixed enterprises	--		--	
Private enterprises	--		--	
Other banks	--		1,002,400.44	
Municipalities	--		--	
Individuals	--		5,049,582.09	

+ This total includes that of municipalities.

++ This total includes that of individuals.

Cont'd.....

(TABLE 12 Cont'd.)

100(c)

<u>ASSETS: (3)</u>		<u>1957-58</u>	<u>1958-59</u>
4. Investment:			
A. Securities: --			
B. Participations			
Government enterprises	--	--	--
Mixed enterprises	--	--	--
Private enterprises	575.776.771.96	--	533.937.585.23
Other Banks	--	--	--
<u>In Foreign Currencies</u>	--	--	58.580.311.19
Government enterprises	--	--	--
Mixed enterprises	--	--	--
Private enterprises	--	--	58.580.311.19
Other banks	--	--	--
5. <u>Building and Equipment</u>	--	10.202.342.65	10.235.185.62
6. Others	--	--	83.010.593.77
7. Branches	--	--	29.009.659.35
Grand Total	--	Afs. 911.305.735.23	Afs. 940.910.691.23

(TABLE 13)
Bank Millies Balance Sheets for
1957-58 and 1958-59
(In Afghanis)

LIABILITIES:	1957-58		1958-59	
1. Deposits:				
A. Demand	--	--	--	--
<u>In Afghanis</u>	--	117,030,298.07	--	151,866,629.44
Government	669,720.96	--	725,000.70	--
Government enterprises	15,744,206.04	--	9,168,910.37	--
Mixed enterprises	--	--	12,162,466.17	--
Municipalities	--	--	4,064,656.23	--
Private enterprises	98,345,085.97 ⁺	--	32,630,536.58	--
Other banks	2,271,285.10	--	1,854,193.93	--
Individuals	--	--	91,260,865.46	--
<u>In Foreign Currencies</u>	--	25,348.23	--	25,348.23
Government	--	--	--	--
Government enterprises	--	--	--	--
Mixed enterprises	--	--	--	--
Private enterprises	--	--	--	--

+ This total includes that of individuals.

Cont'd.....

(TABLE 13 Cont'd.)

100(e)

LIABILITIES: (2)

1957-58

1958-59

B. Time deposits:

In Afghanistan

7,940,731.80

Government

213,286.09

Government enterprises

204,621.81

Municipalities

Mixed enterprises

Private enterprises

Other banks

Individuals

7,522,823.90

In Foreign Currencies:

Government

Government enterprises

Mixed enterprises

Municipalities

Private enterprises

Other banks

Individuals

2. Advances and credit to the banks

Cont'd.....

(TABLE 13 Cont'd.)

	LIABILITIES: (3)	
	1957-58	1958-59
<u>In Afghans</u>		
Government	1,778,759.98	—
Government enterprises	76,427.61	—
Mixed enterprises	—	—
Municipalities	—	—
Private enterprises	107,415,918.60	—
De Afghanistan Bank	—	—
Individuals	—	—
Other Banks	3,034,499.68	—
<u>In Foreign Currencies</u>		
3. Capital	—	500,254,000.00
4. Reserves	—	130,580,164.04
5. Net profit (undistributed)	—	43,169,587.22 ⁺⁺
6. Other Liabilities	—	—
7. Branches	—	16,984,187.32
Grand Total	Afs. 911,305,735.23	Afs. 940,910,691.23

⁺⁺ This item includes a net profit of Afs. 23,979,661.85 for 1957-58 and the remainder is the accumulated profit.

A glance at the balance sheets of the bank indicates that the absence of a well organized money market has caused it to keep large sums of cash in vaults and with other banks. Bank-e-Millie's deposit with the central Bank has never been below a certain required limit, which is a minimum of 15% for demand and 8 percent for time deposits. (1)

The second item on the liabilities side, "Advance and Credit to Bank-e-Millie, by the private sector", includes in addition to loans from private individuals, foreign loans as well, namely, loans received from German firms in connection with Gulbahar Textile Factory.

The capital account represents the amount subscribed and fully paid up by the shareholders. The reserve represent a percent of the annual profit set aside for emergencies. As it is stipulated in the articles of association of the bank, such reserves will be built-up until they equal the whole amount of paid-up capital, whereby the bank will be entitled to increase its share capital. (2)

Bank-e-Millie, due to its commitments with regard to Gulbahar Textile Factory and the Sarobi Power Station has not been able to distribute any dividends since 1955. All undistributed profits are used to finance these projects. This was one of the major factors that made Bank-e-Millie lose favor among the people who expect quick returns on their investments.

¹From an interview with the director of current account section, Bank-e-Millie, Kabul, 1960.

²Statutes, Op.Cit., p.17

CHAPTER VI

PASHTANY TEJARATY BANK (The Afghan Commercial Bank)

A. OBJECTIVES OF THE BANK

It is apparent that one of the major measures to develop the economic conditions of a society is to promote its trade activities, both internal and external. In order to enable the trade sector of the economy to contribute as much as possible to the rise in the level of national income, it is necessary to provide this sector with the proper institutions. It is the responsibility of these institutions to help the flow of goods (consumers as well as producers) to the point of demand.

It was on the basis of this principle that the government of Afghanistan paved the way for the establishment of a commercial bank which was intended specially to expand and develop the foreign trade sector of the economy. This immediate end was to be realized by enabling a larger number of Afghan traders to have more direct contacts with the commercial and industrial centers and markets of the world.

It was in July 1955 that a Bank under the name of "Afghan Commercial Bank" (Pashtany Tejaraty Bank) was created as a joint stock company. It was the object of this bank to improve and expand the commerce of Afghanistan. The operations of this bank is carried out by the head office in Kabul and branches within and outside the country.

The bank is allowed to open branches abroad with the permission of the Council of Ministers of Afghanistan.

The bank's initial authorised capital was 120 million Afghanis divided into 120,000 shares of Afghanis 100 each. This capital was subscribed to by the following organizations; Da Afghanistan Bank, Afghanis 40,000,000; Government Monopolies, Afghanis 20,000,000; the Government Cooperative Depot, Afghanis 1,000,000; the Pension Fund, Afghanis 5,000,000; the Agricultural Bank, Afghanis 5,000,000 and Afghanis 4,000,000 were to be offered for public subscription. Fifty percent of this capital was paid at the time of establishment and the remaining fifty percent at a later time when the sphere of the bank's activities expanded.

The need for more commercial credit was realized after the implementation of the First Five Year Plan. Credit secured from the central bank was not sufficient to meet this growing demand. The cost of the credit secured from the Pashtany Tejaraty Bank has been considered by the central bank to be excessive. On the other hand there has always been a controversy over the question whether or not the central bank ought to indulge in commercial banking activities and around the need for credit at lower interest rates than those charged by the central bank.

It was for these reasons that the Pashtany Tejaraty Bank demanded an increase in its equity capital. The capital of the bank was accordingly increased from 120 to 200 million Afghanis in 1957.

It is indicated that a total of 30 million Afghanis of this capital was unrestricted and could be subscribed to freely by the public.⁽¹⁾ The authorities of Pashtany Tejaraty Bank claim that this increase in capital does not in any way has any undesirable repercussions on the supply of money and the level of prices, mainly because this increase has simply utilized the boardings of the public.

By the end of July 1960 Pashtany Tejaraty Bank's fully paid up capital had reached a total of Afghanis 172,544,846.81. It was expected then, that the figure would reach the authorized amount of 200 million Afghanis after a period of about two years. Moreover, the shares were split and the price of each share was fixed at Afghanis 100, instead of the initial Afghanis 1000 per share.

B. ORGANIZATION AND ADMINISTRATION

Pashtany Tejaraty Bank is composed of and is administered by the following bodies:

- (1) The General Assembly of Shareholders.
- (2) The Supreme Council.
- (3) The Executive Committee.
- (4) The Board of Supervision.

¹ Statutes, Resolution No.2, dated March 13, 1957 of the Extraordinary General Meeting of Shareholders.

1- The General Assembly of the Shareholders:

The general assembly is composed of all the shareholders of the bank whose names appear in the special register. This assembly holds general meetings as well as extraordinary meetings at the head office in Kabul. Only those shareholders - who possess shares with a total par value of at least 1000 Afghanis - are entitled to participate in the meetings. Each group of ten shares entitles a shareholder to cast one vote. The chairman of the assembly will be elected from among the participants of the meeting. All minutes and resolutions passed at the meeting will be entered in a special register signed by all those present.

The general assembly will have the following rights and duties:

- (a) To hear the annual report of the Executive Committee and to approve the balance sheet on the basis of the report of the Board of Supervision.
- (b) To approve the annual income statement, and to set the amount to be credited to the reserve fund account.
- (c) To decide on the dividends to be distributed.
- (d) To elect members of the Supreme Council, the Board of Supervision and to approve the appointment of the members of the Executive Committee.

2- The Supreme Council:

The Supreme Council is composed of seven members who are supposed to be elected by the General Assembly for a period of three years. The Minister of Finance, the Minister of Commerce and the Governor of the Da Afghanistan Bank will be ex officio members of the Council. The chairman will be elected by the council by a majority vote. The governor of the central bank has held this post since the foundation of the Pashtany Tejaraty Bank.

The Supreme Council of the Pashtany Tejaraty Bank possesses the following powers and duties;⁽¹⁾

- (a) Examining and approving the organization drawn up by the Executive Committee and making necessary amendments thereto.
- (b) Approving the annual budget of the Bank's expenditures.
- (c) Making decisions for obtaining loans from domestic and foreign banks.
- (d) Making decisions concerning the proposals of the Executive Committee.
- (e) Providing for decisions about doubtful and irrecoverable loans.
- (f) Sanctioning purchases of real estate property which is to be limited to the operating need of the bank.

The chairman of the Supreme Council will be entitled, if necessary to file suits on behalf of the bank in any court of law against any third party including the members of the Executive Committee.

3- The Executive Committee:

The bank is administered by an Executive Committee composed of three members. One of them serves as president or managing director, while the remaining two serve as his assistants. Their term of office will cover a period of three years after which they can be re-elected.

The president of this committee will possess the supreme executive power of the bank. He will manage all affairs of the bank in accordance with the articles of association and instructions of the Supreme Council. He will also have the power to create and dissolve branches and appointing agents approved by the Supreme Council. He will have to prepare the annual report of the bank and submit proposals on the distribution of the annual dividends, and draw up the agenda for the General Assembly meetings.

Each member of the Executive Committee, as long as he holds office, cannot become a member of Parliament, hold a government office, engage in any business, hold a bank or commercial job, nor have any financial interest with any of the aforesaid types of professions or institutions.

4- The Board of Supervision:

The board of supervision will consist of five members elected at the meeting of the General Assembly for a term of one year. The board will perform the following duties; ⁽¹⁾

¹ Ibid., p.9

- (a) Control accounts and verify monthly reports published by the Executive Committee on the financial standing of the bank.
- (b) Control accounts and verify profit and loss reports which are submitted to the General Assembly.
- (c) Check and examine cash holdings, deposits and receivables.

Having no executive authority, however, the board of supervision will be bound to supervise all affairs of the bank and to make certain that the bank's operations and transactions are conducted in conformity with the provisions of the statutes of the bank. Any comments and objections that the board of supervision may desire to make will be submitted to the Supreme Council.

C. FUNCTIONS AND OPERATIONS

Being a specialized financial institution, Pashtany Tejaraty Bank's immediate concern was the development of commerce by granting credit, unsecured and against the security of negotiable documents and all bonds and instruments of a commercial nature. However, permission of Da Afghanistan Bank has to be obtained before seeking any credit from abroad.

The bank is, according to its statutes, entitled to discount short term bills, as well as accept money for time deposits and current accounts.⁽¹⁾

¹Ibid., P.1, Article 3.

Further more, as a commercial bank, it may effect payments and transfer of funds both at home and abroad (under the provisions of the Afghan Foreign Currency Regulation and Supervision of Da Afghanistan Bank). It is authorised to carry out any kind of foreign exchange transactions as well as opening current accounts and time deposits in foreign banks with the permission and under the control of Da Afghanistan Bank. It is entitled to issue bonds and securities - but not bank notes - and perform all banking affairs and transactions.

The bank has never done any discounting business simply because people are still unfamiliar with modern banking operations, and few transactions are made by means of eligible negotiable instruments. A great portion of transactions are performed by means of cash and overdraft facilities made available by the banking system. Although it is provided in the banking section of the First Five Year Plan that overdraft facilities must be replaced by the practice of discounting and rediscounting of commercial bills, it seems somehow difficult to resort to this practice on a large scale at least in the possible future. This is because under a system of finance based on discounting of bills the borrower is obliged to repay the loans promptly at the end of the period and because many commercial transactions are not evidenced by bills.

As a statutory right, Pashtany Tejaraty Bank began since its establishment, to accept the funds of the people in current and time deposits. It opens current accounts in Afghanis and major foreign currencies. There is no interest paid on such accounts. The bank's initial current - account liabilities in 1954-1955, composed of fifty

such accounts, amounted to Afghanis 3,480,262.25 and totalled to Afghanis 57,220,919.61 in 1958-1959, more than fifty percent of this figure came from private individuals. The bank also started to accept current deposits in foreign currencies in 1955-56 of which it had at the end of that year a total of \$5,560,86, £ 1654/-/- and Indian Rupees 9406/3/06. In 1957-1958 and 1958-59 these accounts totalled Afghanis 1,688,784.40 and Afghanis 906,869.07 respectively.

The bank does not have any savings deposit accounts it nevertheless, has offered the public its services of "safe deposits" (time deposits) bearing an annual interest rate of 6 percent. To enable the public to build up their small savings the Pashtany Tejaraty Bank opens such an account with a minimum of Afghanis 100.00. Furthermore to encourage a large number of people to hold such accounts, the bank has arranged for annual lottery prizes of as high as Afghanis 50,000.00. To begin with, Pashtany Tejaraty Bank had in 1954-1955 safe deposits totalling Afghanis 57,978.58. These deposits amounted to Afghanis 45,193,005.42 and Afghanis 53,926,793.55 in 1957-58 and 1958-59 respectively.

Since Pashtary Tejaraty Bank was found with the intention to help the Afghan businessmen to expand and develop local and foreign trade, the following types of credit could be granted by this institution.

- 1- Loans against immovable properties: This applies on a property (real estate) located within the limits of the City of Kabul. Such loans are granted to facilitate commercial operations of the borrowers and will under no circumstances exceed 60 percent of the value of the property

pledged as security. Pashtary Tejaraty Bank started with a total of secured loans of Afghanis 3,035.690.00 in 1954-55, and had an outstanding amount of Afghanis 10.215.399.70 in 1959-60.

2- Loans against the security of goods imported: In order to facilitate the operations of Afghan traders, who import in exchange for the items exported, and to ensure the highest possible price on exports, Pashtary Tejaraty Bank has undertaken to extend short-term credit so as to meet custom charges and enable the traders to take possession of the goods. This is a self-liquidating loan, in the sense that the proceeds of these goods, when sold, will in the first place provide for the repayment of the loan. Such loans may be extended up to 50 percent of the warehouse receipts or trust certificate - on the basis of which goods are partially cleared out from the custom house.

These loans have increased from an amount of Afghanis 151.459.00 in 1955-56 to Afghanis 33.686.059.62 in 1959-60.⁽¹⁾

Moreover, Pashtary Tejaraty Bank opens, mostly, irrevocable "letters of credit" for those import items that are duly insured. It honors the payment of any draft drawn on it under the terms agreed upon in the letter of credit. It also accepts the drafts of the exporters for collection purposes. In both cases all the documents of ownership have to be first surrendered to the office of the bank at home (Afghanistan) and abroad or to correspondents.

¹Credit Department, Pashtary Tejaraty Bank. Kabul 1960.

The importer is required to deposit, in cash with the bank from 35 to 100 percent of the amount of any letter of credit in the currency in which final settlement is to be made. If the deposit is a minimum of 35% Pashtany Tejaraty Bank will undertake to pay the balance of 65% together with custom and freight charges at an interest rate of 6 and 4 percent respectively. The importer must clear his account before demanding the possession of the goods.

- 3- Loans against the security of goods exported: Pashtany Tejaraty Bank has extended credit against the security of goods, such as Karakul lamb skin, sheep skin, wool, cotton, carpet, almonds and other items exported, under the supervision of its branches and those of Da Afghanistan Bank, to different markets of the world. Such loans are especially made to cover freight and marketing expenses of these goods and can be obtained in amounts not exceeding 45% of the value of the goods so exported. The level of these loans increased from an amount of Afghanis 6.163.849 in 1955-56 to Afghanis 16.191.848.61 in 1959-60.⁽¹⁾
- 4- Loans against ornaments: Such loans are extended equal to about 95 percent of the market value of the property. The values of different grades of gold are decided and announced by Da Afghanistan Bank from time to time. The figure outstanding for such loans during the financial year 1959-60 was Afghanis 793.489.00.
- 5- It was realized that in order to reinforce their financial position, a number of Afghan merchants have resorted to borrowing against the security of shares of different companies at their disposal.

¹Credit Department, Pashtany Tejaraty Bank, Kabul 1960 .

The percentage of market value of these shares - at which loans will be obtained - differs from one organization to the other and from time to time, depending on the general standing of that organization. The latest list of the companies whose stocks can be pledged as collateral indicates that loans could be obtained equal to 85% of the market value of the shares of Da Afghanistan Bank, 75% of the shares of Pashtany Tejaraty Bank, 60 percent of the Agricultural Bank, 55% of the industrial Credit Fund, 50% of Bank-e-Millie and 30 to 55% of the market value of shares of other companies.⁽¹⁾

The Pashtany Tejaraty Bank's loans against shares of stock of different companies increased from an amount of Afghanis 4.009.700 in 1955-56 to Afghanis 5.056.314.50 in 1959-60.

6- Blank Credit (Unsecured Credit): This type of credit is mainly offered on the basis of personal guarantee and moral as well as business standing of private individuals and enterprises. The total of such loans is determined by the Supreme Council of the bank. This type of credit increased from an amount of Afghanis 3.000.000 in 1954-55 to Afghanis 18.571.694.88 in 1959-60.

7- Line of Credit: Under this arrangement, Pashtany Tejaraty Bank established, after careful study, a line of credit whereby the borrower can use any amount of his "LINE" any time he wishes during the period agreed upon. The bank has stopped granting such loans since 1956-57. Nevertheless, it had a total outstanding amount of Afghanis 2.000.000 in 1958-59.

¹ Credit Department, Pashtany Tejaraty Bank, Kabul. 1960.

All the above mentioned types of loans fall due within a period of 3 months to one year; and, all, except the loans for Karakul export, are extended at an interest rate of 9 percent per annum, collectable at the end of the period. In order to help and encourage Karakul exporters it was decided by the Pashtany Tejaraty Bank to grant loans at a lower rate of 8 percent annually.

Pashtany Tejaraty Bank is not allowed to extend credit for the export and import of the following items: fuel, spare parts of motor vehicles and other machineries, industrial and agricultural machines and equipment and others. This is mainly because there are specialized institutions for such purposes.

Although Pashtany Tejaraty Bank is authorized to deal in foreign exchanges and honor payments or keep accounts in foreign currencies, yet all such transactions are supervised by Da Afghanistan Bank in conformity with the aforesaid provisions of the Afghan Foreign Exchange Regulations.

Due to the lack of an organized bill and securities market with sufficient instruments for investment, Pashtany Tejaraty Bank has been deprived of maintaining an investment portofolio for income purposes. Nevertheless, it has participated in the establishment of some business enterprises. Its investments in 1958-1959 totalled Afghanis 10.687.822.64. This figure was comprised of the following items; the Hotels company, Afs. 3,000,000; Aryana Afghan Airlines, Afs. 639,500; Ningaubar Wood Cooperative, Afs. 748,997; Fruit Exporting Company, Afs. 1,500,000; Pharmaceutical Plants Company, Afs. 3,000,000; Pashtany Tejaraty Bank's Branch in Amritsar, India, Afs. 1,024,325.64;

Pat Company, Afs. 375.000; and the Afghan Tourist Bureau, Afs. 400,000. Its investments in 1959-60 remained almost the same with the exception of the Pat Company that was increased to Afs. 1.500.000.

- Loans obtained from the Da Afghanistan Bank:

Since the operations of Pashtany Tejaraty Bank has been expanding at a fast rate the capital and deposit funds have not been enough to meet the demand for advances. The central bank, as lender of last resort, has, on the basis of an application by the Pashtany Tejaraty Bank and approval of the Ministry of Commerce, Council of Ministers and the Prime Ministry extended to the Pashtany Tejaraty Bank the following loans up till 1959-60 either as a public debt or through the increase of its capital structure.

LOANS GRANTED BY DA AFGHANISTAN BANK
TO PASHTANY TEJARATY BANK(in Afghanis)

<u>Y E A R</u>	<u>A M O U N T</u>	<u>D U R A T I O N</u>
1955-56	Afs. 4.000.000	6 Months
1956-57	50.000.000	9 Months
1956-57	30.000.000	One Year
1957-58	49.000.000	One Year Six Months
1957-58	25.000.000	One Year
1958-59	400.000/-/-(¹)	Two Months
1958-59	30.000.000	One Year
1958-59	10.000.000	One Year
1958-59	10.000.000	One Year
1958-59	10.000.000	One Year
1960-61	20.000.000	One Year

Source: Credit Department, Da Afghanistan Bank, 1961.

¹This amount was in Pakistani Rupees and was extended at a rate of 4 percent per annum.

Other than the Pakistani Rupees, all the rest of the loans bear an interest rate of 8 percent per annum. Although most of these loans - borrowed for short periods - have been repaid from the export proceeds yet, a government credit of Afghanis 30.000.000 still remains outstanding.

D. PASHTANY TEJARATY BANK'S BRANCHES
AND THEIR OPERATIONS

To facilitate internal and external commercial transactions of Afghanistan, Pashtany Tejaraty Bank has so far opened branch offices in six main cities of the country as follows:⁽¹⁾

1. City Branch, Kabul.
2. Branch office in Kadabar.
3. Branch office in Herat with an office in Torghundai.
4. Branch office in Mazar-e-Sharif with two offices on the northern border namely, in Klift and Afghan Tashkend.
5. Branch office in Kunduz.
6. Branch offices in Baghlan and Qataghan.

Almost the entire operation of these branches is the forwarding of goods to the export points of the country. Financing trade constitute only a minor part of their activities.

¹Files of the Secretariat of the Pashtany Tejaraty Bank.
Kabul, 1960.

Pashtany Tejaraty Bank maintains, so far, one branch office outside the country in Amritsar, India. All its transactions in other parts of the world are handled through correspondent banks. These correspondants are composed both of Afghan and foreign financial institutions.

F. THE ANNUAL STATEMENT OF
PASHTANY TEJARATY BANK

The financial year of the bank is from the first of Hamal (March 21) to the end of Hout of the solar year. The accounts of the bank are closed at the end of Hout, when the annual balance sheet will be prepared.

Tables 14 and 15 depicts the financial position of the bank for the years 1957-58 and 1958-59.

The bank's total cash in 1958-59 has increased approximately 380 percent over the year 1957-58. Similarly, its earning assets (loans and advances) have increased about 9.8 percent during the same period. At the same time demand deposits in Afs. increased about 81.7 percent, while time deposits increased only 19.3 percent.

The increase in cash items can be attributed to a decrease in "credit account in other banks" during the same year.

Although demand deposits increased by 81.7% over the previous year and time deposits increased about 19.3%, earning assets (loans) have not increased accordingly. This is simply due to the policy of the bank to keep a high cash ratio.

TABLE 14

PASHTANY TREASURY BANK'S BALANCE SHEET FOR THE YEARS
1957-58 and 1958-59. (In Afghanis)

<u>ASSETS (1)</u>	<u>1957-58</u>	<u>1958-59</u>
1. CASH		
A. <u>IN AFGHANIS</u>		
Credit with Central Bank	12,065,292.14	4,673,431.67
Bank Notes	14,896,872.00	34,900,000.00
Coins	17,000.99	2,860.00
B. <u>IN FOREIGN CURRENCIES</u>	23,897.00	63,240,245.54
With Central Bank	--	11,932.90
In Other Banks	--	63,137,100.54
In Bank's Till	23,897.00	91,212.10
2. CREDIT ACCOUNT IN OTHER BANKS		
A. <u>DEMAND</u>	99,017,156.75	6,709,970.36
In Afghanis	2,321,647.96	1,972,339.39
In Foreign Currencies	96,695,508.79	4,737,630.97
B. <u>TIME</u>	771,762.97	--
In Afghanis	--	--
In Foreign Currencies	771,762.97	--

TABLE 14 (cont'd)

<u>ASSETS: (2)</u>		<u>1957-58</u>	<u>1958-59</u>
3. LOANS:			
A. IN AFGHANIS			
Government	--	204,300,094.25	--
Government Enterprises	7,928,804.45 ⁽¹⁾	--	4,458,319.41
Mixed Enterprises	--	--	5,549,127.77
Municipalities	--	--	2,897,901.50
Private Enterprises	196,371,291.80 ⁽²⁾	--	39,625,621.02
Other Banks	--	--	--
Individuals	--	--	169,600,208.17
B. IN FOREIGN CURRENCIES		5,045,811.78	--
Government	--	--	--
Government Enterprises	--	--	--
Mixed Enterprises	--	--	--
Municipalities	--	--	--
Private Enterprises	--	--	--
Other Banks	--	--	--
Individuals	5,045,811.78	--	--

¹This total includes that of municipalities.

²This total includes that of individuals.

TABLE 14 (cont'd)

<u>ASSETS: (3)</u>		<u>1957-58</u>	<u>1958-59</u>
4. INVESTMENT			
A. SECURITIES			
B. PARTICIPATION			
In Afghanis			
		10,287,822.72	10,687,822.72
Government Enterprises	8,412,822.72	--	4,000,000.00
Mixed Enterprises	--	--	--
Private Enterprises	1,875,000.00	--	10,287,822.72
Other Banks	--	--	--
In Foreign Currencies			
5. BUILDING	--	8404,276.29 ⁽¹⁾	200,570.63
6. EQUIPMENT	--	--	2.00
7. OTHERS	--	--	365,400.73
8. BRANCHES	--	--	2,123,605.68
<u>GRAND TOTAL: Afs. 354,829,986.89</u>			<u>Afs. 347,314,748.38</u>

¹This total includes that of equipment and others.

TABLE 15

118(d)

<u>LIABILITIES: (1)</u>		<u>1957-58</u>		<u>1958-59</u>	
1. DEPOSITS:					
A. DEMAND					
<u>IN AFGHANIS</u>		31,477,777.73		57,220,919.61	
Government	--	--	1,023,103.46	--	--
Government Enterprises	3,111,812.21	--	9,032,156.71	--	--
Mixed Enterprises	--	--	6,038,809.14	--	--
Municipalities	--	--	118,687.12	--	--
Private Enterprises	27,921,648.87 (1)	--	9,792,283.61	--	--
Other Banks	--	--	64,970.17	--	--
Individuals	--	--	31,150,909.40	--	--
<u>IN FOREIGN CURRENCIES</u>		1,688,784.40		906,869.07	
Government	--	--	2,425.26	--	--
Government Enterprises	--	--	2,762.09	--	--
Mixed Enterprises	--	--	100.00	--	--
Municipalities	--	--	--	--	--
Private Enterprises	--	--	94,135.73	--	--
Other Banks	--	--	55,764.85	--	--
Individuals	1,688,784.40	--	748,681.14	--	--

TABLE 15. (cont'd)

118(e)

LIABILITIES: (2)1957-581958-59

B. TIME

IN AFGHANIS:

45,193,005.42

53,926,793.55

Government

9,406,685.35

--

19,666,767.62

--

Government Enterprises

--

--

6,111,654.90

--

Mixed Enterprises

--

--

6,182,666.66

--

Other Banks.

50,491.66

--

2,108,822.25

--

Municipalities

--

--

--

--

Private Enterprises

20,346,738.27

--

1,585,734.26

--

Individuals

15,394,090.14

--

18,271,147.86

--

IN FOREIGN CURRENCIES

2. ADVANCES & CREDIT TO THE BANK

IN AFGHANIS

115,216,364.68

74,360,398.90

Government

30,000,000.00

--

30,000,000.00

--

Government Enterprises & Municip.

--

--

--

--

Mixed Enterprises

--

--

--

--

Private Enterprises

--

--

--

--

The Central Bank

85,216,364.68

--

44,360,398.90

--

Other Banks

--

--

--

--

IN FOREIGN CURRENCIES

TABLE 15 (cont'd)1957-581958-59LIABILITIES: (3)

3. CAPITAL	120,326,748.47	130,036,613.03
4. RESERVES	5,386,210.54	10,610,341.05
5. UNDISTRIBUTED PROFIT	8,676,083.02	16,318,747.63
6. OTHER LIABILITIES	16,865,012.63	3,934,065.54

GRAND TOTAL:

Afs. 354,829,986.89

Afs. 347,314,748.38

SOURCE: Credit Department, Pantary Tejara ty Bank 1960.

As far as the annual profits are concerned, first a straight 10 percent company tax is deducted. If the remaining profit is above Af. 500.000 it pays a progressive tax of one to twenty two percent depending on which income group it falls into. Moreover, a one percent for municipality tax, and two percent for employees bonus reserve are deducted from the profit before the bank sets aside 40 percent of it for special reserves and distributes the remaining as dividends to the shareholders.

CHAPTER VII

AGRICULTURE AND COTTAGE INDUSTRY BANK

A. AGRICULTURAL SITUATION

Afghanistan is an agricultural country with about 75 percent of its 13.3 million people making a living from farming, including animal husbandary. Almost 72 percent of its national income is derived from agriculture.⁽¹⁾ It is an arid country and of its 160 million acres of land probably not over 6 percent is under cultivation in any one year. Although there are many villages where irrigation is possible and where most of the crops are produced, nevertheless a large part of the land area is in mountains and desert with very little ^{et} vegetation. This fact together with the underdeveloped and generally primitive methods of land cultivation and harvesting, among other factors, have resulted in low productivity of the farm population.

It is believed that one of the main problems of the agricultural group is that of providing an adequate supply of water at the proper time for the irrigation purposes. Dams and irrigation canals have been built in certain places, yet, in many areas the utilization of land and yield of crops are dependent on the quantity of annual rainfall.

There has been a practice of using underground water as well, but there has been no technical study as to the adequacy of this water.

¹U.S. Department of Commerce, Economic Development in Afghanistan. Washington, 1958.

The wells are constructed by primitive means. Many of these wells dry up in the hot seasons and very little is really known about their capacity to supply water. Moreover, in almost all places this subterranean water is lifted by means of animals which is not at all convenient and which is more expensive than the oil engines or wind power pumps so employed.

The lack of proper soil conservation is another problem facing the majority of the farmers in different areas, mainly due to the lack of the application of manures and fertilizers.

There are other important problems as well. The low quality of seeds, inefficient management of the farm, poor methods of cultivation, lack of technical know-how, and above all the financial needs of the farm population - that sets on its wheels the productive machinery of agriculture - are of great concern.

The presence of all these and other problems have hindered desirable growth and development of the agricultural sector of the Afghan economy.

The government of Afghanistan has realized that among other factors credit to farmers has always formed the major central problem in the scheme of agricultural and industrial development in the country. It has tried to find ways to solve this problem and organize a sound agricultural credit organization.

B. OBJECTIVES OF THE AGRICULTURAL BANK

It was on the basis of this urgent need for a sound agricultural credit program that the Afghan government established the "Agricultural and Cottage Industry Bank." It was found in Kabul in March 1954, as a joint stock company. The purpose of the bank was to make loans to farmers to improve and operate their farms, to finance farmers associations and make loans for the development of cottage industries.

The bank was incorporated with an authorized capital stock of Afghani 150 millions, divided into 1,500,000 shares of 100 Afghanis each. More than 55 percent of the capital was subscribed to and paid by the Da Afghanistan Bank on behalf of the Afghan government. With the State Bank and private individuals having provided the first part of the authorized capital, 25.5 million Afghanis, the new Agricultural Bank had made advances of over 20 million Afghanis, by the end of the first half of the year 1955-56.

With the rest of the paid up capital the bank has purchased investments in the newly established commercial and agricultural companies and the construction and commercial banks. The following Table 16 shows agricultural bank's participations in the capital of various companies.

It should be indicated that the bank's total funds then were obviously inadequate to meet the real needs for which it was created. But these investments were considered necessary to create a cooperative spirit among the farm population to pool their efforts and resources.

TABLE 16

AGRICULTURAL BANK'S PARTICIPATION IN DIFFERENT
 AGRICULTURAL INDUSTRIAL & COMMERCIAL ENTERPRISES

(In Afghanis)

Pashtany Tejaraty Bank	Afs. 5,000,000.00
Construction & Mortgage Bank	1,000,000.00
Cement Tile Company	100,000.00
United Cotton Company	8,813,953.59
Vegetable Cooperation	500,000.00
Eastern Wood Company	2,140,274.25
Eastern Industrial Company	1,514,009.42
Estalif Agricultural & Handicraft Cooperative	453,980.26
Pharmaceutical Plants Company	100,000.00
Qandahar Weaving Cooperative	148,867.60
Agricultural Bank's Women Society.	297,735.20

SOURCE: Credit Department, Agricultural Bank. 1960.

Moreover, these investments were undertaken, simply because many of these fields were not appealing to and exploited by the private sector.

Subscription to the stock by the public was authorised, but not many private individuals were interested in purchasing these shares. It was only in 1957-58 that the bank employed measures to increase the sale of its shares to the public. It declared its readiness to extend credit to farmers in order to free their mortgaged lands from private money lenders. By doing so, it required the borrowers, of Afghanis 20.000 and above, to purchase, with the loan extended, a minimum of ten shares of Afghanis 100.00 each.⁽¹⁾ Out of the authorised, 150 million Afghanis, capital the bank had by August 1960 a total paid up capital of Afghanis 85.581.560.15.

The bank has made no attempt to further sell securities for the purpose of raising additional funds.

C. ORGANIZATION AND ADMINISTRATION
OF THE BANK

The bank is organized of and is administered by the following bodies:

1. The General Assembly of the Shareholders.
2. The Supreme Council.
3. The Executive Committee.
4. The Supervisory Committee

¹Credit Department, Agricultural Bank. Kabul, 1960.

- 1- The General Assembly of Shareholders: This body, as in the other banks, is composed of those possessing the shares of the bank. Only those will be entitled to participate in the meetings whose shares have a par value of at least 1.000 Afghanis. Each group of ten shares entitles the owner to one vote.

This assembly may hold ordinary as well as extra-ordinary meetings. The general assembly of shareholders is entitled to;

- (1) Examine the annual reports submitted by the Executive Committee and to decide upon future operating policies;
- (2) Approve the annual balance sheet and fix the amounts to be credited to the reserve funds account, those distributed to the shareholders and employees in the form of dividends and bonuses;
- (3) To elect the members of the Supervisory Committee for a period of one year. It has a further right of electing the members of the Executive Committee and four out of eight members of the Supreme Council for a period of three years.

- 2- The Supreme Council: This council is composed of eight members, four permanent and four for a period of three years. The council has the responsibility for establishing the over-all policies of the bank.

The four permanent members of the Supreme Council are the Ministers of Finance, Commerce and Agriculture, and the President or Vice President of the Da Afghanistan Bank.

The other members are elected by the General Assembly of Shareholders. The Minister of Agriculture serves as ex officio chairman of the Supreme Council.

The President and Vice President of the Agriculture and Cottage Industry Bank are appointed by the Supreme Council and these officials will in turn appoint other officers and employees of the bank, with the consent of the Supreme Council.

The Supreme Council has the following rights and duties; fix the rate of interest and discount for the bank, to approve the annual budget of the bank's expenditures, to make decisions in borrowing funds from local and foreign banks.⁽¹⁾

The President of the Supreme Council, or in his absence, the vice president is entitled, if necessary, to file suits on behalf of the bank, in any court of law against any members of the Executive Committee and any other third party. Except when one of the members of the Executive Committee is unable to attend to his duties, members of the Supreme Council shall under no circumstances become members of the Executive Committee at the same time.⁽²⁾

- 3- Executive Committee: The bank is administered by an executive committee composed of three members. These three members are appointed for a period of three years by the Supreme Council subject to the approval of the General Assembly of Shareholders. The chairman of

¹ Any foreign loan has to be obtained under the permission of the Da Afghanistan Bank.

² Articles of Association, p.8 Kabul, 1954-55

the Executive Committee, who is at the same time the president of the bank, is responsible for conducting all activities of the bank in accordance with the articles of association and instructions from the Supreme Council. The Executive Committee has the following rights and duties:

Creating and dissolving offices and branches and appointing agents subject to the approval of the Supreme Council; preparing the annual budget of expenditures, determining salaries, making internal rules and regulations and their implementation, preparing the annual balance sheet and submitting proposals concerning the distribution of the annual profits and drawing up the agenda for the general meeting. Members of the Executive Committee cannot become members of the Parliament, hold government office, engage in any private profession, hold a bank or a commercial job, nor have any financial interest with any of the aforesaid activities or organizations.

4- The Board of Supervision: This board is composed of at least 5 members, two of whom are appointed by the Ministers of Finance and Agriculture and the other three are elected by the General Assembly for a period of one year. The Board of Supervision possesses the following rights and duties:

Controlling accounts, verifying monthly reports published on the financial standing of the bank and certifying, after careful examination, the annual report and balance sheet of the bank; checking and examining cash holdings and deposits. This board will be bound to

supervise all affairs of the bank, to make certain that the bank's operations and transactions are conducted in conformity with the articles of association and the various procedures, orders and amendments passed by the Supreme Council. However, it will have no executive authority or the right of direct intervention in the operation and administration of the bank.

D. FUNCTIONS AND OPERATIONS OF THE BANK

The main functions of the bank are as follows:

- 1- Extending credit to farmers, artisans and cottage industries. (It should be pointed out, however, that most such loans are usually extended at present mostly through the media of Farmers Cooperatives. Individual loans are also made against acceptable securities);
- 2- Accepting time deposits and current accounts; and
- 3- Accepting as a security for loans, any negotiable documents such as warrants, warehouse receipts and other such instruments entitling the possession of any agricultural and cottage industrial goods. (It is also authorised to discount any eligible bills. Since the majority of the people are not accustomed to financing by means of discounting bills, this practice of discounting and rediscounting has not gained much popularity in this sector of the economy either. Almost all loans are extended against the security of a collateral.)

The bank is authorised to accept money in the form of both demand and savings deposits. Only about Afghani 3.47988.17 were outstanding as demand deposits in 1958-59.⁽¹⁾

¹ Annual report of the Executive Committee, Kabul, 1960

The bank pays 2 percent interest on savings accounts, and had outstanding accounts of Afghani 3,123,148.17 in 1958-59. The bank has rented out safe deposit boxes to the farmers families with the hope of helping farmers children save their meager savings.

As far as loan operations are concerned the balance sheets of the bank indicate that funds for loans totalled about 42,053,874.39 Afghani in 1958-59. It is understood that a fairly large share of these are delinquent in payment of both interest and principal.

The bank has extended loans for different durations and for different purposes; short-term loans were mostly extended to owners of Karakul sheep to provide the flock with sufficient food supplies in the winter season, to those farmers who were in need of live stock, seeds and the like and to those artisans who needed raw materials. Intermediate loans were extended to owners of lands who wished to improve the lands, to the live stock cooperatives for the raising of live stock and poultry, to the cottage industrial concerns for improving and increasing the productivity of this sector, and to those who wished to cultivate barren lands and increase the greenery of dry places. Longterm loans were granted to the agricultural and cottage industrial establishments founded for the purpose of improving and developing this particular sector of the economy, and to the farmers and artisans in need of necessary equipment.

Loans extended for agricultural purposes bear an interest rate ranging from 4 percent for short term loans extended for purposes of

purchasing seeds and animals, to 9 percent for long term needs.⁽¹⁾

All these loans were made against the security of the land and other properties of the borrower and were further guaranteed by a third person. Since the artisans have usually no acceptable and adequate security, the bank tried to minimize cash loans to this group. Instead it imported the necessary raw material and equipment and supplied the artisans with them under a loan agreement bearing an interest rate ranging from 4 to 8 percent.

The maximum amount of a single loan to a private individual should under no circumstances exceed a total of Afghanis 50.000. Any amount above this figure has to be approved by the Supreme Council.

As it is revealed from Table 17 the bank reduced the extension of its overall and specially direct personal, credit after 1956-57, when it encountered some difficulties in collecting the interest and those instalments of the principal that were due.

Table 17 shows the total amount of loans granted to and collected from, agriculturists, artisans and cooperatives during the years 1954-55 and 1958-59. The decline in the volume of loans granted in later years is due to the fact that only a small percent of loans granted were collected, that weakened the financial position of the bank.

¹Credit Department, Agriculture and Cottage Industry Bank, Kabul, 1960

TABLE 17

LOANS GRANTED BY THE AGRICULTURE AND COTTAGE
 INDUSTRY BANK DURING 1954-55 to 1958-59
(In Afghanis)

<u>Y E A R S</u>	<u>LOANS GRANTED</u>	<u>LOANS COLLECTED</u>
1954-55	14,104,234.17	216,190.52
1955-56	32,574,874.40	5,914,300.39
1956-57	13,033,661.78	8,622,851.30
1957-58	8,607,083.85	3,934,804.53
1958-59	1,252,785.70	Not Available

Source: Credit Department of the Agriculture & Cottage
 Industry Bank, 1960.

The writer is of the opinion that the loan program of the bank has not been satisfactory and the bank has failed to achieve the purpose for which it was established, namely, to help improve the production of the small farmers in the country. It made loans through branches, established in various provinces, but a large proportion of the loans was made to individuals who are large land owners. Their security was a real estate mortgage and practically all loans were for periods of 5 years and above.

One of the weaknesses in the loan program of the bank was the failure to establish procedures to control the use of the loans proceeds. While the application for a loan indicated that the funds advanced were to be used for farm improvements and farm operations, it seems that a substantial part of the funds advanced were used for commercial and consumptive purposes and did not result in any marked improvement in agriculture. Or, that these loans were not prudently and effectively used. The misuse of these funds has placed many borrowers in a difficult financial position with the result that the bank has found collection difficult and has faced at times substantial losses on some loans.

As a result of the unsatisfactory handling of the loan program, the agricultural bank slowed down the extension of new loans. No significant amount of new loans has been made in the last two years and a half.

Early in 1959 there was a change in the management and policy of the bank. The new management has recognised that any new loans

program must be established on a wholly different basis if it is to be successful and if it is to result in the improvement of farming in Afghanistan.⁽¹⁾ Any new loan granted would consequently, be through the farmers' cooperatives.

The latter are not required to provide real estate security to obtain the loan from the bank. The property pledged as security for the loan is to be registered in the same district under the supervision of the cooperatives.

E. AGRICULTURAL BANK, THE FARMERS COOPERATIVES
AND THE HELMAND VALLEY AUTHORITY

- 1- Farmers Cooperatives and the Bank: After 1957-58 the Agricultural Bank realized the burden of the loans granted, in the sense that, first it found it difficult to collect the interest and principal for the past three years of its operation, and, secondly, it has been suffering from a shortage of adequate personnel that made it difficult to open branch offices in many parts of the country.

Consequently a new method of agricultural financing, that was provided for in the statutes of the bank,⁽²⁾ had to be adopted. Under this arrangement not all farmers, as was pointed out earlier, can secure loans directly from the Credit Department of the Agricultural Bank. Any loan received has to be through the farmers Cooperatives.

¹ A policy adopted, in line with the articles of association (article 6. p.3), at the annual meetings of the Supreme Council and General Assembly of the shareholders. Kabul, 1958-59.

² Articles of Association, page 3. article 6.

The Agricultural Bank expresses hopes that under this new arrangement adequate credit will be supplied, after a careful analysis, to a greater number of agriculturists and artisans.⁽¹⁾ This new arrangement will not only meet the demand of a greater number of borrowers and reduce the power and influence of the private money lenders, but will also establish and maintain a stability in the rate of interest and prices of agricultural produce.

Despite the adoption of this arrangement, the number of such cooperatives has not yet increased. Up till now, there have been four agricultural and handicraft cooperatives, namely, the Vegetable cooperatives of Lahgard and Kahdaman, Estalif's agricultural and handicraft cooperative and the Ghazni handicraft cooperative; all of which are engaged in producing and selling agricultural as well as cottage industrial products.

It is believed that in the near future the number of such cooperatives will increase.

- 2- The Helmand Valley and the Agricultural Bank: Under the Helmand Valley Authority lands of the Helmand Valley are being irrigated and developed for settlement. Two large dams and many miles of main canals, branch canals and distribution ditches have been constructed to irrigate lands for settlement and cultivation. Today, about two thousands landless farmers and nomads have been settled down in the area and in the years ahead a large number of families will move into

¹From an interview with the President of the Agricultural and Cottage Industry Bank. Kabul, 1960.

the area as settlers. This project represents an effort by the Afghan Government to provide farms for land-less people. The farm unit varies in size from $7\frac{1}{2}$ to 15 acres per family. The smaller farms have higher grade soils and the larger farms lower grades. The mark of selecting settlers is the responsibility of the Ministry of Interior and the assignment of land the responsibility of the Agricultural Department of the Helmand Valley Authority.

The cost of the land to the settler varies approximately from 400 Afghanis for class IV land to 800 Afghanis for class I land per acre. In addition to the land assigned to him, the farmer receives assistance from the government in the form of credit. The total amount of such credit is to be paid back in installments over a period of 20 years with interest.

While the Helmand Valley Authority has resources to make advances to the families at the time the land is settled, it lacks funds for additional credit which may be required for improvements and proper operation of farms in the years ahead. If funds are made available for additional credit to settlers in the Helmand Valley, the question arises as to what agency should assume responsibility for the administration of these funds and the making of loans to farmers. At present the Agricultural Department of the Helmand Valley Authority does not have the staff and facilities necessary for the administration of the credit program. For a better result it may be handled by the branch offices of the Agriculture and Cottage Industry Bank which is presumably in a better position for such an operation.

F. BRANCHES AND THEIR OPERATIONS OF THE
AGRICULTURE AND COTTAGE INDUSTRY BANK

In order to facilitate the work of the bank and have provided credit facilities for a greater number of farmers and artisans, most of whom are far away from the so called financial market and are always in need of help from the private money lenders the bank opened, after the approval of its Supreme Council, its branch offices first in the provinces of Ghazni, Paktya and Ningarbar and later in the provinces of Kataghan and its districts, Badakhshan, Mazar-i-Sharif, Maimana, Qandahar, Farah, Herat and Parwan. They are all engaged in extending loans to farmers and artisans. The total amount granted by these offices was 42.580.627.37 Afghanis in 1957-58 out of which a total of 30.313.215.79 Afghanis was still outstanding at the end of the same year.

G. THE ANNUAL STATEMENT OF THE AGRICULTURE
AND COTTAGE INDUSTRY BANK

The business year of the bank commences, like the other ones, on the first of Hamal and ends on the thirtieth of Hoot, solar year. All accounts and books of the bank will be closed at the end of Hoot, when the annual balance sheet will be prepared and submitted to the general assembly of shareholders.

The balance sheet of the bank for the year 1954-55 reveals that it incurred a loss of Afghanis 1,602.435.33 including Afghanis

713.333.93 for equipment. Although the bank made some profit in 1955-56, it was not sufficient to cover the losses for 1954-55.⁽¹⁾

Table 18 presents a recent comparative balance sheet of the agricultural bank for the years 1957-58, 1958-59.

The net profit of each year plus the balance of the profits of the previous years are distributed as follows:

After paying the necessary company taxes, at least 40 percent of the annual net profit will have to be set aside as reserves until the total of such reserves equals the whole paid up capital of the bank. The bank will then be permitted to increase its capital. Secondly, 2 percent has to be carried forward to the special bonus account set up for the benefits of the employees and officers of the bank.⁽²⁾

The balance of the annual profit is to be distributed as dividends to the shareholders. It should be pointed out that the bank has not distributed any profit to its shareholders. The annual profit, after necessary charges, has been carried forward to the next year to help the bank meet at least part of the additional demand for loans. As is indicated, in the balance sheet for the year 1958-59, the total undistributed profit for the past seven years has amounted to 4.428.510.77 Afghanis.

¹Credit Department and Accounting Section of the Agricultural Bank, 1960

²Articles of Association, Article 49, P.12

TABLE 18

135(a)

BALANCE SHEET OF THE AGRICULTURE AND COTTAGE INDUSTRY BANK
FOR 1957-58 AND 1958-59 IN AFGHANIS

	<u>1957-58</u>	<u>1958-59</u>
<u>ASSETS: (1)</u>		
1. CASH:		
A. <u>IN AFGHANIS</u>	34,475,351.86	33,061,239.99
Credit Balance with Central Bank	952,080.40	3,090,619.71
Bank Notes	279,556.00	225,907.95
Coins	23,015.06	---
With Branches	33,220,700.40	29,744,712.33
B. <u>IN FOREIGN CURRENCIES</u>	267,635.01	67,883.73
With Central Bank	267,635.01	67,883.73
In Bank's Till	---	---
2. CREDIT IN OTHER BANKS	---	---
A. DEMAND	917,460.56	150,611.80
<u>IN AFGHANIS</u>	917,460.56	---
<u>IN FOREIGN CURRENCIES</u>	---	150,611.80
B. TIME	50,000.00	2,107,353.76
<u>IN AFGHANIS</u>	50,000.00	---
<u>IN FOREIGN CURRENCIES</u>	---	2,107,353.76

Table 18 (cont'd)

		<u>1957-58</u>	<u>1958-59</u>
<u>ASSETS: (2)</u>			
3. LOANS:			
<u>IN ARGHANTS</u>		38,895,225.07	42,053,874.34
Government	---	---	---
Government Enterprises	---	---	---
Mixed Enterprises	---	---	---
Municipalities	---	---	---
Private Enterprises	628,548.94	---	9,385,861.48
Other Banks	---	---	---
Individuals	38,266,676.13	---	11,679,164.52
Sundry Debtors	---	---	20,988,848.34
<u>IN FOREIGN CURRENCIES</u>			
Government	---	---	---
Government Enterprises	---	---	---
Mixed Enterprises	---	---	---
Municipalities	---	---	---
Private Individuals & Enterprises	---	---	---
Other Banks	---	---	---

TABLE 18 (cont'd)

1957-581958-59ASSETS: (3)

4. INVESTMENTS:

A. SECURITIES

B. PARTICIPATIONS

	<u>IN AFGHANIS</u>				
	Government	--	18,439,373.68	--	20,068,866.73
	Government Enterprises	--	--	--	--
	Mixed Enterprises	--	--	8,814,000.00	--
	Private Enterprises	18,439,373.68	--	5,254,866.73	--
	Other Banks	--	--	6,000,000.00	--
	<u>IN FOREIGN CURRENCIES</u>	--	--	--	--
5.	BUILDING	--	--	--	668,506.00
6.	Equipment		399,651,777 (1)	--	1,249,466.81
7.	Others		--	--	--
	GRAND TOTAL:		Afs. 93,444,697.95		Afs. 99,427,803.16

¹This total includes that of building.

SOURCE: Credit Department, Agriculture & Cottage Industry Bank. 1960.

TABLE 18

135(d)

LIABILITIES: (1)1957-581958-59

1. DEPOSITS

A. DEMAND

IN AFGHANIS

Government

20,770.05

70.05

Government Enterprises

Mixed Enterprises

Municipalities

Private Enterprises

568,050.45

178,502.68

Other Banks

Individuals

430,755.21

169,415.44

IN FOREIGN CURRENCIES

B. TIME

IN AFGHANIS

Government

2,046,129.86

1,215,084.90

Government Enterprises + Municip.

Mixed Enterprises.

Private Enterprises.

Other Banks

Individuals

499,385.68

1,908,063.27

In Foreign Currencies

TABLE 18 (cont'd)

135(e)

<u>LIABILITIES: (2)</u>		<u>1957-58</u>	<u>1958-59</u>
2. ADVANCES & CREDIT TO THE BANK		--	--
<u>IN AFGHANIS</u>		--	5,955,295.90
Government		--	104,880.17
Government Enterprises		--	--
Mixed Enterprises		--	--
Municipalities		--	--
Private Enterprises		--	172,857.09
The Central Bank		--	5,100,022.50
Others		--	577,736.14
<u>IN FOREIGN CURRENCIES</u>		--	--
3. CAPITAL		--	85,572,860.15
4. RESERVES		--	--
5. UNDISPENDED PROFITS		--	4,428,510.77
6. OTHER LIABILITIES		--	--
GRAND TOTAL:	Afs. 93,444,697.95		Afs. 99,427,803.16

SOURCE: Credit Department, Agricultural & Cottage Industries Bank, 1960.

CHAPTER VIII

INDUSTRIAL CREDIT FUND

A. INDUSTRIAL INVESTMENT IN AFGHANISTAN

As is the case with the businessmen of countries of similar level of economic development, the Afghan business community is used to commerce and to the quick turnover, liquidity and large profits of mercantile trade. Other wealthy classes are used to investment in real estate, live stock, gold and other valuable metals. Capital owners, as in similar countries, are prone to disguise their wealth. Therefore, investment in industry which brings with it a lower liquidity of capital a long period of waiting before the investment begins to yield a profit, and in some cases a lower return on investment is alien to the general business thinking of the country. The fact that a manufacturing plant can not be hidden from the eyes of the public authorities adds to this reluctance.

This, however, does not mean that the businessmen of an underdeveloped country like Afghanistan lack initiative as compared with the businessmen of the more industrialized countries of the world. As William Diamond has indicated in his book on "Development Banks," "Given the appropriate climate - including generally accepted goal which can be attained by economic activity, access to capital, labor and skills, opportunity to enter industry and other factors -, entrepreneurs can emerge quickly in an environment in which they

were hitherto conspicuous for their paucity and timidity, as it was the case of France and Russia in the nineteenth century and with Mexico and Turkey in the twentieth.

Moreover, in almost all underdeveloped countries the attention is concentrated on the inadequacy of funds, because it is often considered the main obstacle to development. This is of course, neither always nor everywhere the case.

When people live on the fringe of subsistence, the savings may be insufficient. But they are never non-existing, relevant in this connection are the hoards accumulated from past savings, the often heavy expenditures for ceremonial purposes, the many other ways in which savings are wasted or left idle or used unproductively.

If then all the above mentioned factors are taken care of and the economic climate is not too unfavorable, local capital sometimes responds with unexpected readiness to the initiation of local entrepreneurs."⁽¹⁾

When studying the Afghan scene of industrial development, the past experience of investors should also be taken into consideration.

Approximately a quarter of a century ago the Bank-i-Millie, as pointed out earlier, was established with private capital. It

¹William Diamond, Development Banks, pp. 10-12

first ventured into foreign trade and, with profits accumulated in these ventures and the new capital raised entered the field of industrial investment.

As long as this holding company, (Bank-e-Millie) had the support and very close cooperation of the government it prospered. But when its privileges were reduced and especially when its investments in oversized industrial plants increased, the attractiveness of its shares to the investors was getting less and less. Bank-e-Millie was a successful business venture but from the point of view of economic development it committed two main errors;

- 1- Investment has been made in textile plants that need a huge concentration of capital. For example, the gulbahar cotton textile mill of 50.000 spindles and 1440 looms with the required finishing, dying and printing equipment necessitated an investment of approximately 30 million dollars, as it seemed extremely difficult to raise this sum from inside, outside sources were contacted. Despite the help from outside the erection of this plant was supposed to go for a number of years. Due to financial difficulties, Bank-e-Millie was not able to distribute return to its shareholders.
- 2- The large number of shareholders that were attracted by various means to this bank, and its industrial empire could not as entrepreneurs take part in the management of these few but huge enterprises. What in fact they could do was to elect the management and wait for the dividends.

As a consequence of the preceding two points, the writer feels, the industrial investment of the Bank-e-Millie created the popular opinion that industrial investment could not yield a return for a very extended period of time and these investments have not been successful, due to their concentration on a very few number of projects, in creating an entrepreneurial class.

It could be easily argued that the production of cotton textiles will increase much more rapidly through the establishment of the 31.000 spindles Pulikhumri Plant and the 50.000 spindles Gulbahar plant, and this increase in production will, by reducing the import of cotton textiles, have a very positive effect on the balance of payment and foreign exchanges.

There seem to be no doubt that the above statement is valid; but the main factor in economic development is not a spectacular increase in the production of certain commodity or its balance of payments effects. The most important factor for economic development is, the writer believes, a change of the attitudes of the people, i.e., they should be educated to become innovators and are so willing to accept entrepreneurial challenge and risks. I wonder if these two large plants would contribute to a change of attitude in Afghanistan. It might in a very limited way. The real change in the economic climate of the country would have been possible with the entrepreneurial class.

An investment of 30 million dollars could have given birth to almost 50 medium-sized manufacturing plants.

The establishment of 50 medium-sized, privately owned, plants could have contributed towards the establishment of an entrepreneurial class and thus assist economic development more effectively.

An investment program should have been worked out. The Bank-e-Millie could take lead and seek the willingness of potential investors in undertaking individual projects which have, by the cooperation of the Ministry of Mines and Industries and the central bank, been identified, investigated and found to be sound to the economy of the country. Bank-e-Millie which has had an established reputation could prepare a feasibility prospectus for each of the project. It could not only start with them by itself, but it could also attract a number of local and foreign investors. Such projects were most likely to have enjoyed some important concessions made by the government, such as various tax and custom duty exemptions, protection against unfair competition, direct subsidies, excessive taxation, guarantees for financing and a variety of other privileges.

The opportunity for industrial investment in Afghanistan in the near future will not be through large privately and/or publicly held cooperations - which seem to be premature for this country - but through investments in small or medium sized industries by individuals or small groups of partners.

The industrial sector of the Economic Development Plan pursues two main objectives. The first is a rapid expansion in the production of essential consumer goods by the establishment of new concerns and by the modernization and expansion of the existing ones.

When production of these goods increases, their imports will be reduced and thus valuable foreign exchange will be saved for the import of more capital goods. The second objective is the creation of a solid base for the further and continuous industrialization of the country by the development of power, coal, petroleum and the other basic industries.

Since private capital is not considered adequate enough for the attainment of these two objectives, the government decided to take the responsibility of developing the basic industries.

The consumer goods industry was left mainly to the private initiative and capital. However, the government has been trying to bring about the proper environment with a pleasant climate for private investments by undertaking social overhead expenses, such as power, transportation, irrigation, education projects and the like. To attain a favorable climate for private investment furthermore, necessitates that sufficient funds, skills, and equipment have to be provided for the private sector.

B. THE INDUSTRIAL CREDIT FUND

One could argue that it was on the basis of the above mentioned phenomena that a "Credit Fund" was established in March 1957.

- 1- Objectives of the Fund: It is the objective of the fund to supply credit for working capital and investment of the small and medium sized industrial enterprises.

The fund has an authorised capital of 200 million Afghanis of which only 103 million Afghanis have been paid in Da Afghanistan Bank has paid 98 million Afghanis and Bank-e-Millie has paid in only 5 million Afghanis. The fund was authorised to receive 25 percent of the net profit of the government commercial and industrial enterprises. This amount has never been put at the disposal of the fund.

The fund is made-up of and administered by the following bodies:

(a) Board of Credit

(b) The Auditors

a. The Board Of Credit:

The board of credit is composed of four members, two of them are appointed by the Cabinet from their own members and are likely to be the Ministers of Commerce and Industries; and the other two are permanent members of the board and are the Governor of Da Afghanistan Bank and the President of the Bank-e-Millie Afghan.⁽¹⁾ They are likely to lay out the policies of the Fund.

The President of the Fund is the chief executive officer. He is appointed as per a proposal of the Minister of Mines and Industries and the approval of the Cabinet.

¹Articles of Association, Article 8, P.3. Kabul, 1957.

For the time being the fund is indirectly administered by the Pashtany Tejaraty Bank and the acting President of the Fund is the President of the Pashtany Tejaraty Bank.

b. The Auditors:

The auditors include four persons from the Ministry of Mines and Industries, Ministry of Commerce, Da Afghanistan Bank and the Bank-e-Millie, appointed for three years. These auditors have no executive duties. They are supervisors of the transactions of the Fund and the accounts maintained by the Fund. They submit a balance sheet and other financial reports to the Board of Credit.

2- Functions of the Fund: The functions of the fund are as follows:

- (a) To make loans for purchasing equipment, machinery and other capital goods.
- (b) To make loans for the development of existing industrial institutions.
- (c) To carry on with other banking operations as approved by the Board of Credit.⁽¹⁾

As for loans are concerned the fund only acts on loans recommended by the Ministry of Mines and Industries. The fund does not have the necessary staff to process loan applications. In theory its board of credit could reject the recommendations of the Ministry of Mines and Industries, in practice I don't think that this would be likely.

¹ Ibid., p.1, Article 2.

The fund has made short and medium term loans. The longest term so far has been for five years. The interest has been 6 percent per annum. The fund has loaned out all of its paid in capital. 98 percent of the loans were made to three companies. Up until 1959 the fund had been able to collect 16.7 percent of the interest due to it and only about 19.7 percent of the principal that fall due during this period.⁽¹⁾

Table 19 shows the total amount of loans granted to the industrial concerns.

3- The Annual Balance Sheet: The financial year of the fund is the solar year. Like all the other banks, the books of the fund are closed on March 20 and the annual statements are prepared accordingly.

Table 20 shows a copy of the latest balance sheet issued by the Fund.

The net profit of the Fund, after taxes is distributed as follows:⁽²⁾

- Every year a minimum of 40 percent of the net profit is to be carried over to the surplus account, and this shall continue until the balance of this equals the paid in capital which shall be considered for this purpose as 600 million Afghanis.

- Two percent of the net profit is to be carried over to a special account for the benefit (such as, health insurance, providing

¹The annual report of the Industrial Credit Fund. 1960 + Secretariate of the Credit Board. 1960

²Ibid., p.8 Article 21.

TABLE 19LOANS GRANTED BY THE INDUSTRIAL CREDIT FUND
BETWEEN THE YEAR 1956-57-1959-60(In Afghanis)⁺

<u>Y E A R S</u>	<u>AMOUNT GRANTED</u>
1956-57	116.908.000.00
1957-58	7.318.778.88
1958-59	1.200,000.00
1959-60	.300.000.00

⁺ Secretariate of the Credit Board. 1960

BALANCE SHEET FOR THE INDUSTRIAL CREDIT FUND 1958-59

(In Afghani)

<u>ASSETS: (1)</u>		
1. CASH		
A. <u>IN AFGHANIS</u>		
Credit Balance with Central Bank		
Bank Notes		
Coins		
B. <u>IN FOREIGN CURRENCY</u>		
With Central Bank		
In Banks (Funds) F111		
2. CREDIT ACCOUNT IN OTHER BANKS		
A. DEMAND		
<u>IN AFGHANIS</u>		147.254.26
<u>IN FOREIGN CURRENCIES</u>		
B. TIME		
<u>IN AFGHANIS</u>		
<u>IN FOREIGN CURRENCIES</u>		
		<u>1958-1959</u>

147.254.26

147.254.26

TABLE 20 (cont'd)

1958-1959

ASSETS: (2)

3. LOANS

A. IN AFGHANIS

Government

Government Enterprises

Mixed Enterprises

Municipalities

Private Enterprises

Other Banks.

Individuals

B. IN FOREIGN CURRENCIES

4. INVESTMENTS;

A. Securities

B. Participation

5. BUILDINGS

6. EQUIPMENT

7. OTHERS

118,992,874.95

1.00

106,571.51

GRAND TOTAL

Afghanis:

119,246,701.72

TABLE 20 (cont'd)1958-1959ASSETS: (2)

3. LOANS

A. IN AFGHANIS

118,992,874.95

Government

Government Enterprises

5,194,634.36

Mixed Enterprises

104,617,834.16

Municipalities

Private Enterprises

8,272,179.51

Other Banks.

Individuals

908,226.92

B. IN FOREIGN CURRENCIES

4. INVESTMENTS;

A. Securities

B. Participation

5. BUILDINGS

6. EQUIPMENT

1.00

7. OTHERS

106,571.51

GRAND TOTAL

Afghanis:

119,246,701.72

TABLE 20 (cont'd)

LIABILITIES: (1)

1958-1959

144 (d)

1. DEPOSITS:

A. DEMAND

IN AFGHANIS

1,686,255.18

Government

313.50

Government Enterprises

82,101.95

Mixed Enterprises

Municipalities

Private Enterprises

1,603,839.73

Other Banks

Individuals

IN FOREIGN CURRENCIES

B. TIME

IN AFGHANIS

1,076,461.43

Government

1,076,461.43

Government Enterprises

Mixed Enterprises

Private Enterprises

Other Banks

IN FOREIGN CURRENCIES

Table 20 (cont'd)1958-1959LIABILITIES: (2)

2. ADVANCE & CREDIT TO THE FUND

IN AFGHANIS

Government

Government Enterprises

Mixed Enterprises

Municipalities

Private Enterprises

The Central Bank

Other Banks

In Foreign Currencies

3. CAPITAL

4. RESERVES

5. UNDISBURSED PROFIT

6. OTHER LIABILITIES

GRAND TOTAL:

Afghanis:

119,246,701.72

108,895,000.00

1,069,226.48

6,350,879.77

168,878.86

SOURCE: Secretariate, Credit Board Industrial Credit Fund, Kabul, 1960

recreation facilities, pension and the like) of the officers and employees of the fund. This is over and above the bonus given to the officers and employees of the fund.

- The remainder is to be distributed as dividends to the shareholders.

C. THE SHORTCOMINGS OF THE FUND

From the above description it seems that the fund is a new born child. With its present set-up, and meager financial resources, it appears that it is not able to help and finance the needs of existing and potential industries. The fund seems to have neither the resources, nor the experience necessary for the financing of industry on a large scale. Unless an efficient and financially strong industrial development organization is established, the new industrial concerns may be seriously handicapped by the lack of necessary equipment, skills and working capital.

D. PROSPECTS FOR AN INDUSTRIAL DEVELOPMENT BANK

For some years the Afghan Government, recognizing the great need for satisfying the growing demands of the people for a higher standard of living, has been expending substantial funds to provide public facilities and services which will generally increase the output of the entire country. Its huge investments include transportation, communication, education and training, health, surveys of natural resources, development of strategic manpower, community

services, power development, irrigation and similar services. It is understood by the government of Afghanistan that these investments may not produce identifiable revenues, but they will lay the foundation for the desired increase in per capita income. The concentration by the government on these important investments is providing the foundation and environment in which revenue producing investments will flourish. The completion of these public-services projects which are under way or which are to be initiated in the near future, is necessary in order to increase the capacity of the country to absorb substantial private industrial investment.

A shortage of private capital for industrial investment is believed to be the characteristic of the underdeveloped countries. Despite the shortage, some capital really does exist in the form of private savings, but an effective mechanism for channeling these savings, however small, into industry is lacking. Governments do engage directly in industrial enterprises and also encourage the productive investment of private savings. But experiences indicate that a sound and specialized credit institution such as a development bank which is independent of the government machinery, which functions on a business basis and which is able to prudently allocate its funds, seems, normally to be more effective in stimulating new investments in and by the private sector than the direct action by the government itself. To provide industrial finance and, by various means, to draw more private capital into productive use are, in the opinion of the writer, the basic purposes for which development banks are being created in the underdeveloped areas of the world.

CHAPTER IX

"MORTGAGE AND REAL ESTATE BANK"

A. OBJECTIVES OF THE BANK

The Mortgage and Real Estate Bank was originally established as a Real Estate Credit Fund within the frame work of the Central Bank in the year 1948. It had an initial capital of Afghanis 30 millions. Only recently it received governmental subvention in its activity in the credit market which has in fact given it a new status.

In 1954 it was established as a Mortgage and Real Estate Bank under the form of a joint stock company.

Among the designated purposes of this bank are the promotion of house building and the establishment of companies supplying building materials, the financing of hotel construction and the financing of low cost community housing projects.

Since the initial capital was not adequate to meet the demand for construction purposes, an increase of its capital to Afghans 60 millions was arranged with the Central Bank in 1955-56. This is the second largest single participation of the government in any branch. ⁽¹⁾

This capital is divided into 10,000 shares of Afghans 5000 each and 20,000 shares of Afghanis 500 each.

Da Afghanistan Bank subscribed to shares equal to Afghanis 30 million, Pension Fund to shares equal to Afghanis 20 million

¹As indicated, the largest contribution has been in the capital of the Industrial Credit Fund which is about one hundred million Afghanis.

and private individuals and enterprises have subscribed to the remaining 10 million Afghanis.⁽¹⁾

By mid 1955, the bank had lent about Afghanis 37 million to approximately 500 borrowers, mostly government employees, at 3 percent interest per annum.⁽²⁾

To have made this possible, the Central Bank had to extend a loan of Afghanis 24 million during the fiscal year 1954-55 at 2½ percent interest. This brought the total available funds of the Mortgage and Real Estate Bank to about 54 million Afghanis. However, its total outstanding loans by the end of the financial year 1958-59 was Afghanis 65,934,966.23.

The bank is supposed to receive annually an amount of Afghanis 5 millions from government taxes and Pension Fund. Being subject to the approval of the Council of Ministers, this amount has not yet been put at the disposal of the bank.

B. ORGANIZATION AND ADMINISTRATION

The bank is organized of and administered by the following bodies:

1. General Assembly of Shareholders.
2. The Supreme Council.

¹The Statutes of the Mortgage and Real Estate Bank, Article 3, p.3

²Annual Report of the Bank, 1955-56.

3. The Executive Committee.
4. The Supervisory Committee.

1- The General Assembly of Shareholders: In addition to the extraordinary meetings this assembly meets once every year and those who can cast at least one vote are allowed to attend the meeting. Shares equal to a minimum of Afghani 10.000 will entitle the holder to cast one vote.

The assembly has the following rights and duties:

- To examine the annual report of the Executive Committee;
- To approve the annual balance sheet and fix the amount of reserves to be set aside and dividends to be distributed;
- To elect the members of the Supreme Council and Supervisory Committee; and
- To examine the approved budget for annual expenditure.

2- The Supreme Council: The Supreme Council is composed of 3 permanent members; namely the Minister of Finance, the Minister of Public Works, who acts as the chairman of the council and the Governor of the Central Bank; and four other members who are elected by the General Assembly of Shareholders.

It is the duties of the Supreme Council to approve the annual expenditure budget prepared by the Executive Committee and to take decisions on the proposals of the President of the Bank.

Members of the council are not allowed to serve simultaneously as members of the Executive Committee. Nevertheless, the government has reserved for itself the right to appoint a member of the Supreme Council to carry out temporarily the duties of a member of the Executive Committee if one is absent.

The President of the bank is appointed on the proposal of the Minister of Finance, approved by the Council of Ministers under a Royal Decree.⁽¹⁾

- 3- The Executive Committee: The Executive Committee is composed of three members, the president and two assistants.

It has the right to: establish or dissolve branches and agencies; prepare the budget for annual expenditures; prepare the annual balance sheet, for the general meeting of the shareholders.⁽¹⁾

- 4- The Supervisory Committee: The Supervisory Committee is made up of five members and the president is appointed by the Minister of Finance who will also be acting as the government auditor.

This committee has no executive power. Any proposals and/or objections will have to be submitted in writing to the Supreme Council.

It is the duty of the Supervisory Committee however, to check the accounts of the bank and see to it that the operations of the bank are conducted in conformity with the existing laws, rules and regulations and resolutions passed, from time to time, by the General

¹ Articles of Association, Article 31, p.8

Assembly of Shareholders. Moreover, it must examine the annual balance sheet and express its opinions to be presented in the annual report to the General Assembly of Shareholders.⁽¹⁾

G. FUNCTIONS AND OPERATIONS

The main functions of the bank are as follows:

- 1- The extension of long as well as short term loans against the hypothecation of real estate and the security of the shares of stock of banks and other companies.
- 2- To participate in the establishment of companies supplying construction material.
- 3- To conduct all kinds of customary banking and real estate transactions.⁽²⁾

So far the bank has not been able to maintain and utilize customers' deposits. However, the bank began to grant short as well as long term credit since its establishment. It has an amount of outstanding loans of Afghanis 65.934.966.25 at the end of the financial year 1958-59.⁽³⁾

The interest charged on loans granted by the bank varies within a range of 3 to 12 percent per annum, depending on the purpose and

¹ Articles of Association, Article 42, p.10.

² Articles of Association, Article 2.

³ Annual report to the General Meeting of Shareholders. 1959.

maturity they are obtained.

- 1- Loans carrying a rate of interest of 3 percent per annum are extended to homeless government employees whose movable and immovable properties do not exceed an amount of Afghanis 10.000. The amount of this loan varies with the official rank of the borrower. It is extended for a maximum period of 27 years and is to be drawn out of the bank on several installments within a minimum period of two years. The level of this loan has dropped from a figure of Afghanis 1.369.839.77 in 1955 to Afghanis 34.500.00 at the end of the year 1958-59. The main reason for this decline has been the failure to collect the interest and part of the principal on loans due from the borrowers.
- 2- Loans carrying a rate of interest of 4 to 6 percent per annum are extended for a period of 25 years to the employees and shareholders of the bank itself. The level of this loan too has, for the same reason mentioned above, dropped from an amount of Afghanis 356.453.85 in 1955 to 81.700.00 in 1958-59.
- 3- "Construction Credit", which is extended for the construction of apartment houses, stores, movie theaters, hospitals and other such places, carries an interest rate of 8 percent per annum. This type of credit covers a maximum of 40 percent of the total cost of the project. The balance has to be raised by the borrower from other sources. This type of loan is usually extended for a period of 10 years against the security of the place. Such loans have increased from a total of Afghanis 357.500.00 in 1955 to Afghanis 2.220.200.00 in 1958-59.

- 4- Loans extended for house repairing purposes against the security of shares of stock of any prospering business concern. The loan extended equals a certain percentage of the market value of these shares. It is usually between 30 and 40 percent of market value. Such loans are for one year and carry an eight percent interest rate. The level of this kind of loan has also increased by Afghanis 326.600.00 in 1958-59 over that of 1955.
- 5- By declaring its willingness to finance all the construction of the building, the Mortgage and Real Estate bank charges a 12 percent interest on such loans. It is usually extended for a period of three years.

All borrowers can have current account facilities. However, no overdraft practice is permitted. Loans falling under categories 4 and 5 can be obtained in one installment. There is no control over the proper usage of these latter two types of loans. The use of the first three types of loans must be closely supervised by the credit department of the bank. As it is the case with other banks, the Mortgage and Real Estate Bank too suffers from the lack of a competent staff of experts who could appraise properly the character of the borrowers, the property pledged against the loan obtained and supervise the usage of the loan granted thereto. As a result the borrowers have failed to duly meet their commitments. As it is revealed from the annual reports of the Executive Committee of the bank for the year 1958-59, a total of Afghanis 33.753.404.22 has been outstanding as collectible loans and interest overdue from private individuals and Kabul Municipality. With the relatively small capital, the procrastination of these loans has weakened the activity of the bank

to extend more short, medium and long term loans to a greater number of people.

Having no alternative the bank itself showed interest in building apartment houses for rent and sale to the homeless individuals and families, (mostly, government employees). However, due to inadequacy of sufficient funds they have been able to build up only 64 houses and a limited number of stores.⁽¹⁾ The bank also undertook, on a commission basis, to construct buildings for use by the government monopolies in Kabul, customs offices and warehouses in Torkham, (Ningachar province), and the Ningachar Hotel in Jelalabad. The commissions expected from these operations have not yet been completely paid to the bank.

The Mortgage and Real Estate Bank is not entitled to engage in pure commercial banking activities such as the purchase and sale of bills, treasury notes and the like. It has been authorised⁽²⁾ to invest in the capital of companies that tend to promote the construction of houses, stores and public buildings. It has thus participated in the capital of the Hotels Company and Eastern Wood Cooperative Afghanis 2.000.000.00 and Afghanis 200.000.00 respectively. However the returns expected from these investment items have not been transferred to the bank yet.

D. BRANCHES AND THEIR OPERATIONS:

The Mortgage and Real Estate Bank has one branch office in the Ningarhar Province. With the cooperation of the Hotels Company, this

¹ Annual Report to the General Assembly of Shareholders, p.12 Kabul, 1957-58

² P. Cit. P.2 article 3

branch has succeeded to construct the Ningarhar Province's Hotel and Municipality Buildings. The failure of opening and operating branches in other parts of the country can not only be attributed to the lack of a competent banking staff but to the inadequacy of financial resources as well.

E. THE ANNUAL BALANCE SHEET OF THE BANK

The business year of the bank commences on the first of Hamal (March 21) to the end of Hout of the solar year. All accounts and books of the bank are closed and an annual financial statement is issued.

Table 21, shows the latest copy of the annual balance sheet of the bank for the year 1957-58 and 1958-59.

After paying the required company taxes, 40 percent of the annual net profit have to be carried to the reserves account until it equals the paid up capital of the bank. A two percent of the net profit is to be set aside as a bonus for the officers and employees of the bank. The balance of the net profit is prorated among the shareholders.

Since the bank is suffering from a shortage of funds no dividends are distributed and the amount of net profit after taxes is carried over to the reserves account.

A COMPARATIVE BALANCE SHEET OF THE MORTGAGE & REAL ESTATE BANK
FOR THE YEARS 1957-58-1958-59 in Afghanistan

<u>ASSETS: (1)</u>	<u>1957-58</u>	<u>1958-59</u>
1. CASH		
A. <u>IN AFGHANIS</u>	4,030,602.01	4,134,780.63
Credit Balance with Central Bank	4,030,602.01	4,134,780.63
Bank Notes	--	--
Coins	--	--
B. <u>IN FOREIGN CURRENCIES</u>	1,919,013.27	1,916,667.84
With Central Bank	1,919,013.27	1,916,667.84
In Bank's Till	--	--
2. CREDIT ACCOUNT IN OTHER BANKS.		
A. DEMAND	409,751.31	316,118.40
In Afghanis	409,751.31	316,118.40
In Foreign Currencies	--	--
B. TIME	--	--
In Afghanis	--	--
In Foreign Currencies	--	--

TABLE 21 (cont'd)

1957-58

155(b)
1958-59

ASSETS: (2)

3. LOANS

In Afghans:

Government

Government Enterprises

Mixed Enterprises

Municipalities

Private Enterprises

Other Banks

Individuals

In Foreign Currencies

4. INVESTMENTS

A. SECURITIES

B. PARTICIPATIONS

Government Enterprises

Mixed Enterprises

Private Enterprises

Other Banks

74,362,362.84

65,934,966.23

74,362,362.84

61,082,124.35

2,214,026.40

2,214,027.40

2,214,026.40

214,027.40

Cont'd

TABLE 21 (cont'd)

		<u>1957-58</u>	<u>1958-59</u>
<u>ASSETS: (3)</u>			
5. BUILDING.	---	12,735,141.70 *	12,413,480.51
6. EQUIPMENT	---	---	1.00
7. OTHERS	---	8,073,671.62	20,249,094.23

	GRAND TOTAL:	Afghanis.	103,744,570.15	Afghanis.	107,179,136.24

* This total includes that of equipment.

SOURCE: Accounting Department, Mortgage & Real Estate Bank. 1960

Cont'd...

TABLE 21 (cont'd)1957-581958-59LIABILITIES: (1)

1. DEPOSITS

100.00

A. DEMAND

IN AFGHANIS

Government

Government Enterprises

Mixed Enterprises

Municipalities

Private Enterprises

Other Banks

Individuals

100.00

IN FOREIGN CURRENCIES

Government & Government Enterprises

Mixed Enterprises

Municipalities

Private Enterprises

Other Banks

Individuals.

TABLE 21 (cont'd)

LIABILITIES: (2)

B. TIME, Deposits

1957-58

1958-59

IN AFGHANIS:

Government Enterprises	---	100.00	---	---
Mixed Enterprises	---	---	---	---
Municipalities	---	---	---	---
Private Enterprises	---	---	---	---
Other Banks.	---	---	---	---
Individuals	100.00	---	---	---

IN FOREIGN CURRENCIES

2. ADVANCE & CREDIT TO THE BANK

IN AFGHANIS

Government	---	15,902,988.28	---	8,738,188.73
Government Enterprises	41,217.47*	---	---	---
Mixed Enterprises	---	---	---	---
Municipalities	---	---	---	---
The Central Bank	---	---	---	---
Individuals	15,861,770.81	---	---	---
<u>IN FOREIGN CURRENCIES</u>	---	---	---	---

* This total includes that of municipalities.

TABLE 21 (Cont'd)

	<u>1957-58</u>	<u>1958-59</u>
<u>LIABILITIES: (3)</u>		
3. CAPITAL	60,965,700.00	60,965,700.00
4. RESERVES	23,181,777.65**	13,270,275.04
5. UNDISTRIBUTED PROFITS.	3,694,004.22	3,055,566.90
6. OTHER LIABILITIES	--	21,149,305.57†

GRAND TOTAL: Afghanis. 103,744,570.15

107,179,136.24

** This item includes pension fund = Afghanis 8,747,177.23 & contingent fund = Afghanis 7,863,109.46

† This item is composed of contingent fund = Afghanis 7,863,109.46 & advances to the bank = Afs. 13,286,196.11

SOURCE: Accounting Department, Mortgage & Real Estate Bank, 1960

CHAPTER X

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS:

I - AGRICULTURAL CREDIT: Due to the significant role that agriculture plays in the economy of Afghanistan and the growing financial needs of this sector, it is appropriate to give it the first consideration in the conclusion of this paper.

Afghanistan is a predominantly agricultural country with an area of about 270,000 square kilometers and a population estimated at about 1,3310,000 people. In 1959 the national income was 31,000,000,000 Afghanis. Almost 75 percent of the population earn their living from agriculture. This sector of the economy is highly unorganized and is characterized by the predominance of one-man ventures, where every peasant is supposed to rely on his own resources for his operations. The farming is conducted on a poor soil with simple implements, inefficient methods of farming, and inadequate financial resources. As a result, the per capita production in this sector is extremely low by western standards. Although the expenditure in the First Five Year Plan on roads, irrigation projects, improvement of seeds and other such exploits have increased the share of this sector in the national income to more than 72percent, yet, the basic financial needs of the farmers are still not met.

With the underdeveloped nature of its industry Afghanistan's economic development depends primarily on the wise exploitation of the country's agricultural resources. This is so because not only for many years to come the great majority of the people will depend upon their crops and livestock for their livelihood, but without its substantial

agricultural exports Afghanistan cannot obtain the foreign exchanges to pay for its imports of capital goods for development. Current industrialization plans are almost entirely based on agricultural products, such as wool, cotton, sugar and skins.

There are many reasons why an appreciable expansion in agricultural and livestock production is becoming increasingly urgent and vital. The Afghan population is growing as a result of the various measures taken in the fields of preventive and curative medicine. The wants of the common man are no doubt rising also. The industrial development of the community is proceeding at a much faster rate than earlier and the new factories are demanding a greater quantity and variety of agricultural raw materials. Generally the overall rising tempo of economic development since the adoption of the First Five Year Economic Plan requires continually increasing amounts of foreign exchange that is derived almost entirely from the sale of agriculture and livestock products.

In order to increase productivity and yields, many basic problems have to be solved. Shortages of capital and lack of technical know-how must be tackled. Most individual farmers and animal breeders lack the necessary working capital. The majority of them use primitive tools and very few of them can afford to use modern equipment and machinery. Chemical fertilisers are very seldom used. Although organic materials are used instead, these are frequently not scientifically applied. Most farmers and livestock breeders are apparently reluctant to abandon the primitive techniques and follow wasteful and old fashioned

traditional practices even if modern equipment is at hand. A large number of crops and animals still suffer from pests and diseases.

Due to the increasing need for agricultural credit an agricultural bank was established by the government. The credit program of this bank did not prove to be successful. The bank has encountered difficulties in collecting the already extended loans so as to be able to meet the demand of other borrowers.

Since the bank is not capable of expanding its capital by selling its shares, the government can increase its share in the capital of the bank. Moreover, through the help of the Ministry of Agriculture and the Central Bank an agricultural credit program can be set up through which funds will be supplied to the farmers and their associations. Such a program will have to be consistent with the general government economic plan. This agricultural credit program, which would gradually replace the use of loans from private money lenders, can make a great contribution to improve the economic lot of the rural people. Branches of the agricultural bank have to be established in almost all provinces and cities of the country. The loan will be made by the agricultural bank through the managers of its branches who will be given major responsibility in the approval and handling of loans.

Ordinarily, it is desirable to organize such an agricultural credit system on a cooperative basis with loans made through farmers cooperative associations, but under the conditions presently prevailing in Afghanistan it does not seem possible to organize agricultural credit on a cooperative basis. Aside from the lack of a cooperative law in the

country, the farmers' lack of experience and ability in leadership necessary for successful cooperative associations make the establishment of cooperative credit system somehow not practical.

However, it should be understood that the long-term objective will be to organize a credit program on a cooperative basis with loans made through the farmers' cooperative credit associations or through the farmers' multi-purpose cooperative associations. The cooperative approach has the distinct advantage of having farmers assume responsibility for approving loans in their home communities and their judgement will be a means of keeping the loans on a constructive and sound basis for improvement of farming. Under this approach the farmers would contribute some capital to the cooperative association. These associations may try, among other things, to stabilize the prices of agricultural produce by buying and selling and exporting when the situation permits.

Loans made to farmers should be of short-term and intermediate-term nature. The maximum period of loan should be something like five years. However, for long-term needs these intermediate-term loans may be made subject to renewal if the terms of the loan agreement are complied with. Capital is scarce in Afghanistan and the relatively small amount of capital which is available to the bank should be used for purposes such as improved seeds, fertilisers, spray materials, simple tools and the like, which result in greater productivity. When the loans for supplies and other purposes are obtained, they may not always be advanced in cash. If the loan is paid to the farmer in cash

he may squander the money on consumption and for other purposes that were not envisaged in the loan arrangement. Therefore, the branch of the agricultural bank or the cooperative association should consider extending loans in kind or pay the dealer directly in cases where supplies are bought from a dealer by the borrower. Close supervision of the use of loaned funds will be necessary.

Before approving a loan the management of the branch of the bank or the management of a cooperative in the area should, in addition to conducting a careful study of the application, appoint a loan officer to visit the farm of the applicant and make a report. The applicant's plans should be examined and an estimate made of the net farm earnings to determine how and when the interest and the loan can be repaid. Since the bank or any cooperative association will have to handle supplies as well as cash for the farmers, it should have two departments, one for supplying commodity and the other for dealing in cash loans.

Since capital is scarce and interest rates are normally high in Afghanistan, the principle to be followed in determining the rates on loans by the banks and cooperative associations would be to give the farmers as low an interest rate as possible. But, at the same time keep the interest rates at a level which would enable the bank to pay the operating expenses of the loan program and build up some resources to meet losses on loans.

Although such a credit program is likely to contribute to the development and improvement of agriculture and increase productivity both per man hour and per acre, yet, while increasing production per man

hour and per acre, it is equally important to see to it that the total estimated demand will have to be sufficient to absorb the resulting increased production. Such an agricultural credit program has to be carefully studied by Da Afghanistan Bank and coordinated with other projects so as to maintain a balanced and sustained economic progress.

II - INDUSTRIAL CREDIT: There has recently been a perceptible change in outlook regarding the importance and place of industry in the Afghan economy. While agriculture is still the most important sector of the Afghan economy, industry holds the next position. It is becoming increasingly clear that under the present circumstances a more rapid development of industry is both feasible and necessary. The standard of living of the Afghans is rising gradually. At the same time large-scale development plans have been embarked upon which require large amounts of foreign exchange. It is no longer possible to satisfy the requirements of these development plans and simultaneously meet the increasing demand for both productive and consumptive imports from abroad. Hence, it is imperative to try to produce locally an increasing number of these requirements in order to reduce the pressure on the balance of payments without curtailing the pace of economic development.

In common with most other underdeveloped countries, Afghanistan suffers from a shortage of capital. Lack of capital is mainly due to the relatively low rate of savings which in turn derives mainly from the prevailing low income level. This scarcity is particularly felt in the industrial field because people generally do not favor investment in industry.⁽¹⁾

¹From an interview with the Director General of the Industrial Credit Fund, Kabul, 1960.

The desire for quick profits induces the people to invest in more familiar fields such as land, trade, buildings and means of transportation, (motor vehicles). Unfamiliarity with industry and its potential high profit yields, and uncertainty about the future are basic reasons for this prevalent attitude in the private sector. Many basic industrial projects such as power generation, coal mining, petroleum and cement have obtained their capital from the public sector. In some cases such as textile, china ware and sugar, where private capital has been available in apparently adequate amounts the government has welcomed the opportunity of confining its role to guidance and encouragement. Although it is expected that more and more private capital must come forward from the private sector, the plans of many private individuals are hampered by the lack of adequate term-credit facilities. Many investors have to depend on their own resources or borrow from private money lenders at very high interest rates. The resources, both financial and human, of the existing Industrial Credit Fund are not adequate to enable it to meet the needs of numerous small and medium sized industrial firms.

As a primary step the existing Industrial Credit Fund could borrow, with the guarantee of the government, from abroad on a long-term basis at a low rate of approximately 5 to 6 percent per annum. In such circumstances not only capital will be supplied to the needy industrialists but will also help to solve the problem of the shortage

of competent management. In most cases where foreign capital is forthcoming for participation with Afghan capital the foreign investor would demand a share in the management. But under the Foreign Investment Law, these foreign partners are required to train Afghans to take over almost all managerial and supervisory posts in due time.

It is advisable that with the expansion of the capital of the existing Credit Fund, considerations should also be given to its promotion into an industrial development bank. With substantial financial and human resources, this organization will be capable of supplying a great number of existing and potential industrialists with easy credit and technical know-how for the attainment of a higher productivity to meet local demand and seek a share in foreign markets.

III - REAL ESTATE CREDIT : Due to the safety and profitability of real estate investments, substantial capital have been invested in this sector lately, yet a great number of city dwellers are still homeless and incapable of financing the construction of houses for private use. A mortgage and real estate bank was established in 1957 with government participation in its capital to help the situation. This bank has loaned-up and invested practically all its paid-in capital for long periods. It has not been able to attract deposits so as to improve its loan capacity. In the beginning the bank tied-up all its paid-up capital in unsound and in some cases quite doubtful transactions. Here too the writer believes that the bank must try to carefully study the loan application and arrange a loan program under which people will receive loans in cash or supplies for building houses and above all make sure that the principal is promptly repaid with the interest.

To increase its resources it has to be able to sell its shares and attract deposits. To do that the bank must show signs of prudence and profit so as to attract buyers for its shares and that depositors are willing to deal with it.

IV - COMMERCIAL CREDIT, (FOREIGN TRADE): Foreign trade is the most developed sector of the Afghan national economy in comparison with agriculture, industry, real estate and transportation. Banking was first developed in response to the needs of trade. The first national bank was established mainly to assist exporters in meeting foreign exchange requirements. The increase in the volume of exports over the last seven years (for which figures are available) has been more than twofold, i.e. from 731 million Afghanis in 1951-52 to 1723 million Afghanis in 1959-60. This expansion was both in real as well as monetary terms, i.e. it reflects an increase in both volume and value. An increase in exports has taken place regularly in every year except for a drop of 6 percent in 1955-56 and 13 percent in 1958-59. The decline in these two-years was because of a transit blockade by Pakistan and of bad weather which adversely affected many agricultural crops, particularly cotton and wool.⁽¹⁾ The expansion in imports during these years surpassed that of exports causing an adverse balance of payments of - 86.2, -123.8 and - 810.1 million Afghanis during the years 1953-54, 1956-57 and 1958-59 respectively.

Since Bank-e-Millie was mainly concerned with the financing of industry, the increasing trend in the volume of trade, both internal

¹Economic Review of Afghanistan, Kabul 1960, p.197.

and external, necessitated the creation of Pashtany Tejaraty Bank, a second commercial bank. Here too the government had to participate - through the Central Bank - in the capital of this new bank.

There is no legislation governing the operations of all these banks, both commercial and specialized. The growing need of financing in the different sectors of the economy has gradually resulted in the formation of the present banking system. Since the government holds a large share of the capital of these banks it has a controlling vote in all their meetings. The presence of several ministers and the governor of the Central Bank in the Supreme Council of all the banks ensures that their policies are framed by these two bodies in a manner consistent with the governments' development plans.

The Central Bank has not yet been able to devote itself entirely to the central banking business. It still conducts some commercial and industrial banking activities, as well. These activities, as claimed,⁽¹⁾ are not conducted for profit purposes, but to establish a stable low rate of interest and make the existing, agricultural, industrial, real estate and commercial banks supply funds to the economy at lower cost than previously. This has created an atmosphere of lack of cooperation among the members of the banking system specially between Pashtany Tejaraty Bank and the Da Afghanistan Bank, as the farmer claims that:

¹See chapter four page (59)

- 1- Central banks in other countries do not lend directly to the public.
- 2- The Central Bank should lend first to commercial banks and they will in turn lend to the public.
- 3- If it wants to lend to the public the rate of interest should be a little higher than that of Pashtany Tejaraty Bank and that the Da Afghanistan Bank should advance to the commercial bank all the funds it requires and obviously make such advances at a lower rate of interest than that granted to the public, i.e. at about 6 or 7 percent. (1)

The writer believes that the first contention is not entirely in accord with the facts. Whereas central banks in many countries, notably, U.S. and a large number of European and Latin American countries do not deal directly with the public but only through the medium of the other banks, there are numerous, significant exceptions, the most prominent of which is the Bank of France, an institution which, in addition to being the central bank is also the largest commercial bank in the country. Other central banks which lend directly to the public are the Commonwealth Bank of Australia, the National Bank of Egypt and the Central Bank of Turkey. Since the central bank in a number of other countries do in fact make direct loans the second contention is based on an incorrect premise.

The central banks in many underdeveloped countries are expected by private and public sectors, to, in addition to central banking activities, undertake the financing of a number of development

¹From an interview with the President of the Pashtany Tejaraty Bank, Kabul, 1960.

projects in the fields of agriculture, industry, real estate and trade. This will at certain times increase the volume of currency in circulation. The central bank, ought to accept deposits. Because of the inadequacy of traditional central banking weapons, the central bank will have greater influence on both the supply of credit (and hence of money) as well as its allocation if it accepts deposit from the public.

The writer furthermore believes that banking institutions in Afghanistan no less than other socio-economic institutions, should be adopted to the special conditions of the country rather than copied wholly from other nations. Nevertheless, experience elsewhere certainly provide available suggestions which it would be wasteful to ignore.

At present, banking in Afghanistan is not a highly developed business as it is in more advanced countries and the need for specialization is correspondingly less. Banks can be expected to engage in various activities and consequently, there appears to be no reason why the Da Afghanistan Bank should not continue to make direct commercial loans provided it does not abuse its privileged position as the central bank, "which is the safeguarding of the stability of the monetary and credit system of the country."⁽¹⁾

Perhaps as the economy develops and the banking system matures it may at some time in the future become to the advantage of the country for the Da Afghanistan Bank to withdraw from making direct loans and concentrate on monetary policy.

¹S.N. SEN., OP.CIT., p.5

The third contention to the effect that if Da Afghanistan Bank does continue to lend directly to the public it should do so at a rate of interest higher than Pashtany Tejaraty Bank and that the loans made to Pashtany Tejaraty Bank should be at a rate below that made to the public, is not acceptable either. This would certainly be to the advantage of the Pashtany Tejaraty Bank. Such a procedure, if it is to be justified, should offer some advantages to the economy as a whole or to the prospects of development of the banking system, and not to the Pashtany Tejaraty Bank alone. If Pashtany Tejaraty Bank wishes to expand the volume of its loanable funds two courses are open to it:

- 1- The first is to attract more private deposits.
- 2- The second is to sell more shares to the public. In this connection government policy is of great importance because deposits are likely to increase significantly only if the public has confidence in the stable value of money.

Fear of inflation discourages people from keeping assets in the form of cash or bank deposits and encourages them to convert them into gold, commodity, real estate or foreign exchange holdings. If the government wishes to promote the development of a genuine banking system it is of prime importance that its general economic policy be one of stability not inflation so that it could inspire general confidence in the money.

In addition to increasing its loanable funds by attracting deposits, the Pashtany Tejaraty Bank can dispose of its remaining shares to the public and this depends on the success of the bank and the level

assess their credit-worthiness and separate the good risk from the poor ones. This is admittedly hard work, but is a necessary part of the banking business that Pashtany Tejaraty Bank must realize. It should build up a sound business consisting predominantly, as it is stipulated in its articles of association, of small loans, that is important and potentially productive field which Da Afghanistan Bank appears to have neither the facilities nor the inclination to enter.

Due to meager financial resources and incompetent personnel the banks have not yet been able to operate on a large scale over a wider area. The inadequacy of banking facilities in relation to the area and people of Afghanistan, therefore, leaves much to be wanted. In addition to an expected increase made - both by the government and private sector - in the capital and deposit accounts of the banks, the government must take the provisions to supply an adequate and highly skilled banking personnel. The commercial banks, agricultural and cottage industry bank and farmers cooperative associations and other such financial/organizations have to be encouraged by the government to extend their branches and offices to the smaller towns and villages. This will serve, among other things, to supply funds at lower cost and to establish a close relation between the interest rates and operations of the private money lenders and that of the organized sector of the money market.

The writer is of the opinion that a special banking legislation has to be enacted to maintain the soundness and solvency of the banking system and to protect the interest of the depositors and investors in cases of any disturbances.

The present form of banking organization in Afghanistan can be attributed to the presence of several factors. Banking like other business activities in Afghanistan is considered an ordinary commercial act and thus is subject to the Afghan Commercial Code. According to this code, banks are to be established as joint stock companies composed of a number of councils and committees, such as the Supreme Council, executive committee, supervisory committee and general assembly of shareholders. Since the members of the executive committee are appointed by the Supreme Council, these companies (including the banks) actually have a board of directors which is composed of a Supreme Council responsible for framing the major policies and an executive committee designed to execute these policies.

Since the government has declared to take an active part in the economic development of Afghanistan and holds a majority of the shares of stock of the banks, it has decided to place a number of ministers and the Governor of the Central Bank on the Supreme Council of each bank. This is primarily for purposes of formulating the policies of each bank. But to avoid any undesirable consequences, due to the possible political influence on the policies of these banks, the representation of these ministers, on the Supreme Council of each bank should be avoided. Instead the presidents of different departments of the ministries concerned should be required to attend, in an advisory capacity, the meetings of the Supreme Council of their appropriate bank. In addition to being permanent the representation of these officials is likely to keep-out political influence

and ensure an adequate supply of relevant technical information to the Governor of Da Afghanistan Bank in their particular fields. The Governor of the central bank will have to shoulder the responsibility of influencing and coordinating the policies of each bank to the best interest of the economy.

Since there are no certified public accountants, every company is required, as has been seen in previous chapters, to have a supervisory committee composed of three auditors, who in addition to supervising the overall operations are responsible to audit their accounts. The government must establish an institution so as to ensure an adequate supply of competent certified accountants.

V - CENTRAL BANKING OPERATIONS: Monetary policy in conjunction of course with fiscal policy and other appropriate measures, is the instrument normally employed to prevent undue expansion and contraction of credit facilities with their possible harmful results. An appropriate monetary policy should, therefore, be worked out between the Ministry of Finance and Da Afghanistan Bank, and the latter given the responsibility of enforcement and vested with the necessary powers.

Although quarter of a century old, Da Afghanistan Bank has not yet been able to employ the most common measures of monetary control. It has not arranged facilities for rediscounting practices. The needs of the banks have been satisfied by extension of loans, short and long terms. Due to a shortage of eligible trade bills and government security open market operations is not conceivable at present, either. The cash ratio is applicable to only two banks. Despite the fact that it has a strong position in the Supreme Council of the banks, Da Afghanistan Bank has found it difficult to convince them to pursue the general policy of the central bank.

The art of central banking has to be acquired not only to help the promotion of an organized and developed money and capital market, but to promise a sound economic progress as well. In this respect the Da Afghanistan Bank must employ the most effective weapons of monetary policy. To begin with rediscounting facilities should be provided for the banks to make use of them in case of need.

This practice will not only make the bank rate occupy a significant position in the market but will also provide a tool for regulating the quantity of money. In order to encourage the banks to get into the practice of rediscounting, at the beginning, the DaAfghanistan Bank has to charge lower interest rate on rediscounting than on outright loans to the banks. The level of interest rates must be conducive to a rapid growth in investment activity. The Da Afghanistan Bank must announce the eligibility rules for bills to be rediscounted. Such a rule can entail a single or differential rediscounting rates for different bills (commercial, agricultural etc.) to be discounted, so as to channel funds into different sectors of the economy. "Most central banks in underdeveloped countries not only announce a single discount rate for first-class trade bills which is called the official or standard bank rate, but the same or a different rate for agricultural bills as well".⁽¹⁾ Da Afghanistan Bank can also reserve the right to reject or attach strings to any bills discounted or rediscounted or any loans granted. Da Afghanistan Bank must make the banks - concerned - understand that the practice of rediscounting is not a sign of weakness. Since Da Afghanistan Bank is represented on the Supreme Council of the banks, it could easily convince and persuade their managers and get their cooperation in this respect. The eligibility rule and rediscounting practice will promote the creation of a bill market which is a prerequisite of an organized money market. This will at a later stage make the application of another instrument of monetary policy, ^{i.e.} open

¹DE KOCK, Central Banking, 3rd edition, London, 1954, p.166.

market operations, possible.

In order to create and develop a capital market it is possible for the Da Afghanistan Bank to open a separate department and, through it, announce to the banks and public that it is ready to act as an intermediary between sellers and buyers of bonds, shares and other securities and has to publish once or twice a week a list of the prices of these securities.⁽¹⁾ Such an office will later be promoted to an independent stock exchange. Since the existing shares and securities in Afghanistan are to bearer this will facilitate their transfer from one party to another. Excessive borrowings by the government from the central bank should be reduced. The government must be approached to resort to issue securities from time to time, so as to balance its revenues and expenditures and eliminate any possible inflationary pressure arising from huge public expenditures. "The means of improving the government securities market might be through a wider variety of issues which would provide better marketability and competitive interest rates with private issue, and through such special features as ready convertability to cash, acceptance of government securities at par for tax payments and other features."⁽²⁾ These securities could be marketed through the Da Afghanistan Bank. Moreover, the central bank should also be able to issue securities of its own and market them whenever monetary developments demand.⁽³⁾

¹CARL IVERSEN, A Report on Monetary Policy In Iraq, 1954, p.206.

²BENJAMIN HIGGINS AND W. MALENBAUM, Financing Economic Development, International Conciliation, No. 502, 334, (March, 1955).

³Lecture by Professor I.Y. Ashaur in B.A. 301, A.U.B. 1961.

A variable reserve ratio is to be considered at all times. Considering the priority schedule of the general development plan, Da Afghanistan Bank can maintain a minimum cash reserve ratio for each bank that can be changed from time to time.⁽¹⁾ In addition to the quantitative means of control the Da Afghanistan Bank, by being represented in the Supreme Council of the banks, must be in a position to maintain qualitative means of credit control as well.

Since Da Afghanistan Bank conducts both central and commercial banking activities, it is advisable that it should be organized of two separate departments, an "Issue Department" confined to central banking operations and a "Banking Department" designed to conduct commercial banking activities.

The governments' strong desire for rapid economic development should induce the Ministries of Finance, Commerce and Planning and the Governor of the central bank to review the present exchange system. Any further change, however, must preserve some of the desirable features of the present system. One of the desirable features is in the writer's opinion, the absence of any export or import restriction or currency discrimination so as to ensure freedom of trade.

There are, however, some aspects of the present exchange system that are recognized to be disadvantageous. Because of the multiplicity of the existing rate structure the true value of the Afghani is not clearly evident. The lack of stability in the existing rate

¹It will be recalled that the Agriculture and Real Estate Banks accept deposits, and the assumption here is that if and when a legal cash ratio is to be introduced, it will apply to all.

adds an unnecessary element of uncertainty in trading (export and import) and long-term foreign investment in Afghanistan. It is also true that the present system also conceal the true cost of foreign investment in terms of local currency. The uncertainty concerning the value of Afghani in terms of other currencies adds a further reason for the reluctance of foreign capitalists to invest in Afghanistan. Even local savings funds may be converted to other currencies and held in foreign lands in attempts to avoid the risks of exchange fluctuations, thus depriving the Afghan economy of urgently needed funds. The government has tried to increase the currency cover so as to inspire confidence in its "strength". Stability of the value of the currency, however, will certainly be a more relevant factor in developing confidence than the ratio of gold and silver in the note cover. In view of these considerations an exchange reform has to be introduced.

Under the new system, the present multiplicity of rates needs to be replaced ultimately if not immediately by a simplified rate structure, not to say a single rate.

If for the time being an official and a free market rates are allowed to exist side by side, some effort should be made to **keep** the spread between these rates as narrow as possible so as to lead to the adoption of a single rate. The spread at present in the buying and selling rates, which is intended to add to the government revenues and which is used by the government to promote incentives for exporters and importers of certain items could be maintained by using the terms "taxes" and "subsidies".

A high degree of flexibility could be achieved by increasing or decreasing these "taxes" or "subsidies" without complicating the structure of values of the Afghani in terms of foreign currencies. An institution such as Da Afghanistan Bank itself or a proposed Exchange Equalization Account, that will be working closely with the Ministry of Finance and Da Afghanistan Bank could be required to purchase and sell exchanges and Afghanis to achieve an all time reasonable stability in the value of Afghan currency. A certain percentage of export earnings will have to be carried over to the proposed - exchange equalization account to build up standing fund in order to meet shortages which might develop in the balance of payments in certain years.

As a concluding remark it could be argued that the need for a broad range of necessary skills is clearly felt in the entire Afghan Banking System. For, although, "it is a truism that the ultimate success a banking system is able to achieve is the result of the public confidence it has built up for itself. This in turn is dependent on the fundamental soundness of its working and of the principles followed."⁽¹⁾ However, in the long run, "the sound operation of banking system in any country can not be assured by means of legislation only. Its prudent performance depends upon the persons more than on any legal formula."⁽²⁾

¹BENJAMIN HAGGOT BECKHORT, Banking System, p.417, Columbia University press, N.Y. 1954.

²MIKDASHI, ZUHAYR, "The Monetary System of Lebanon." (unpublished Master's thesis, A.U.B. 1956), p.137.

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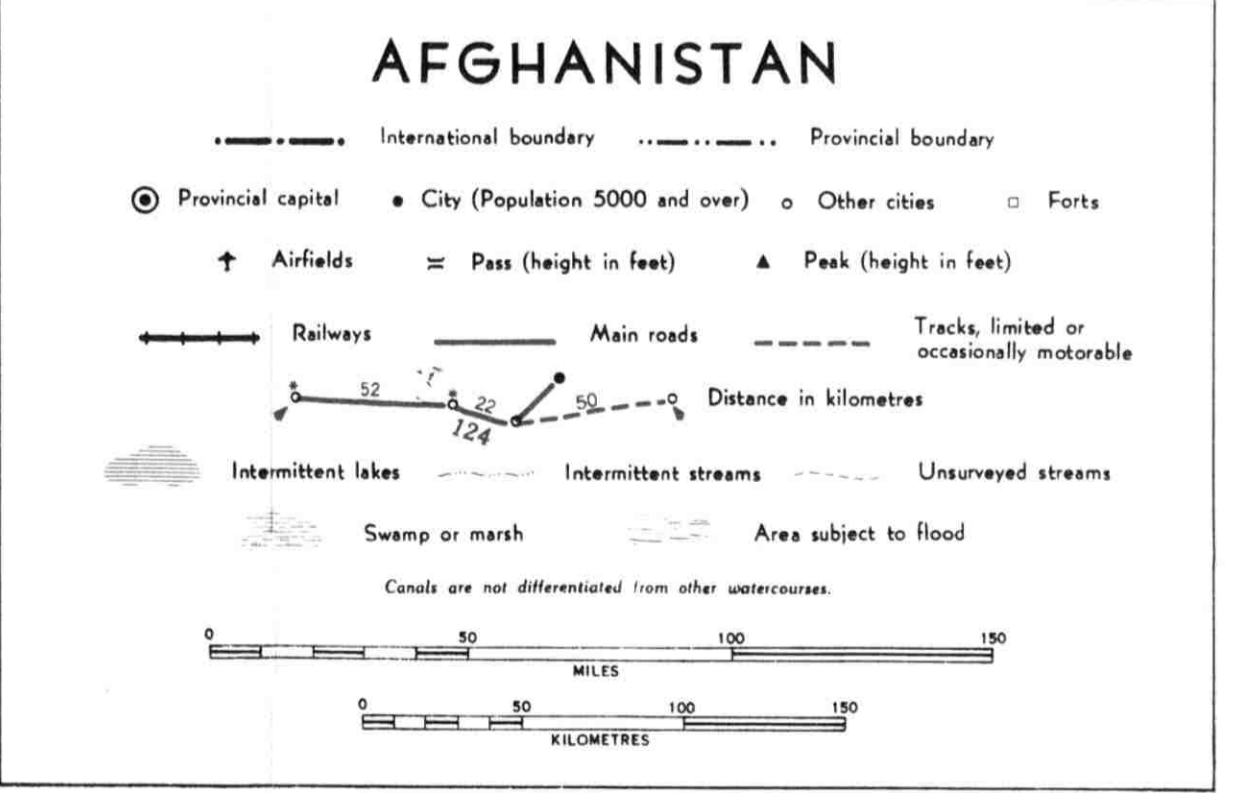
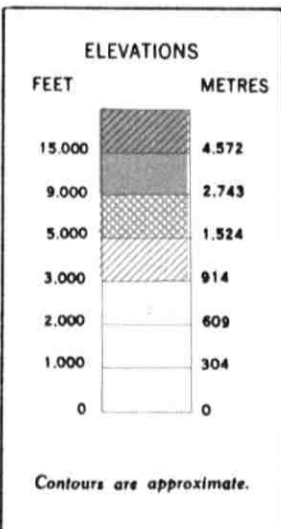
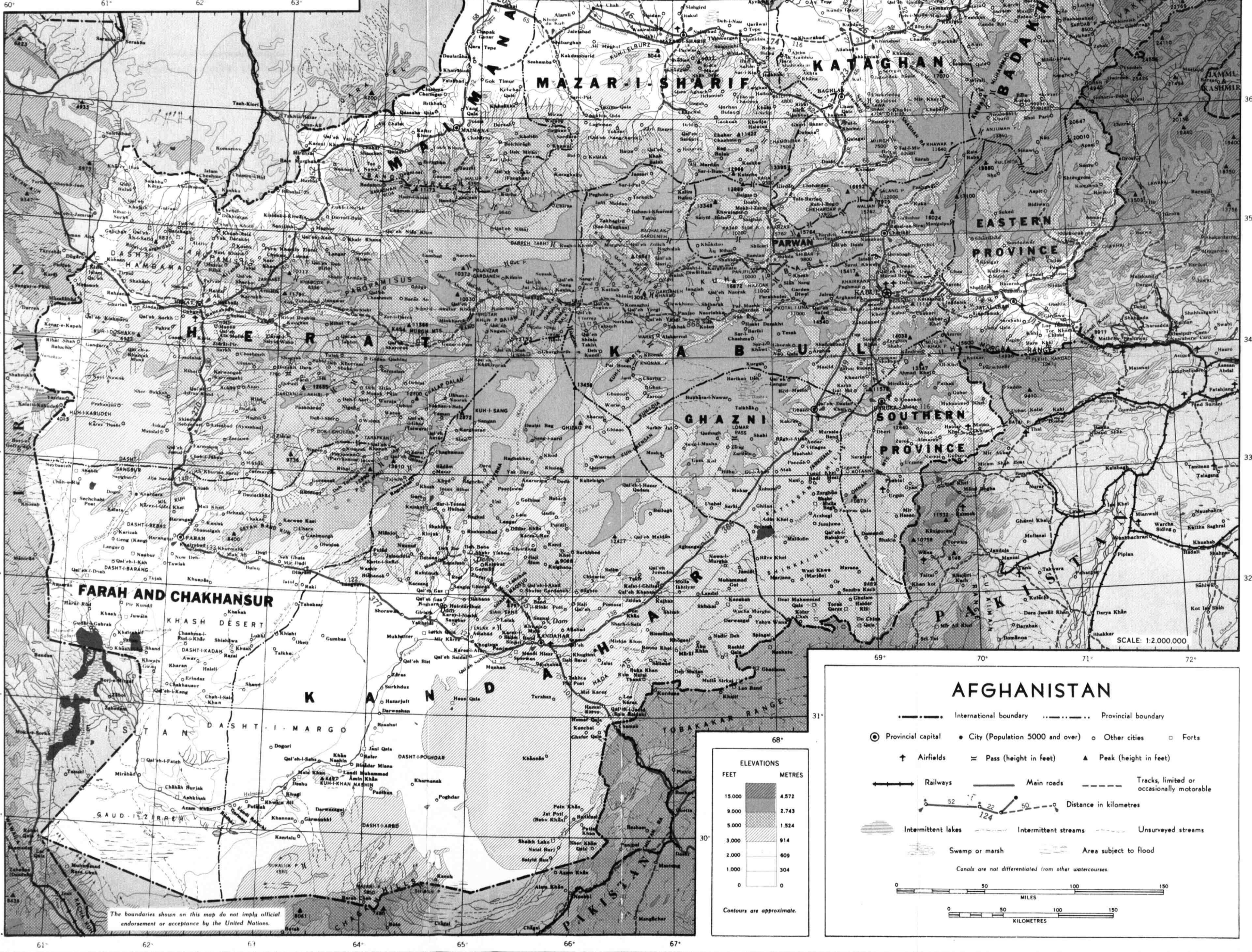
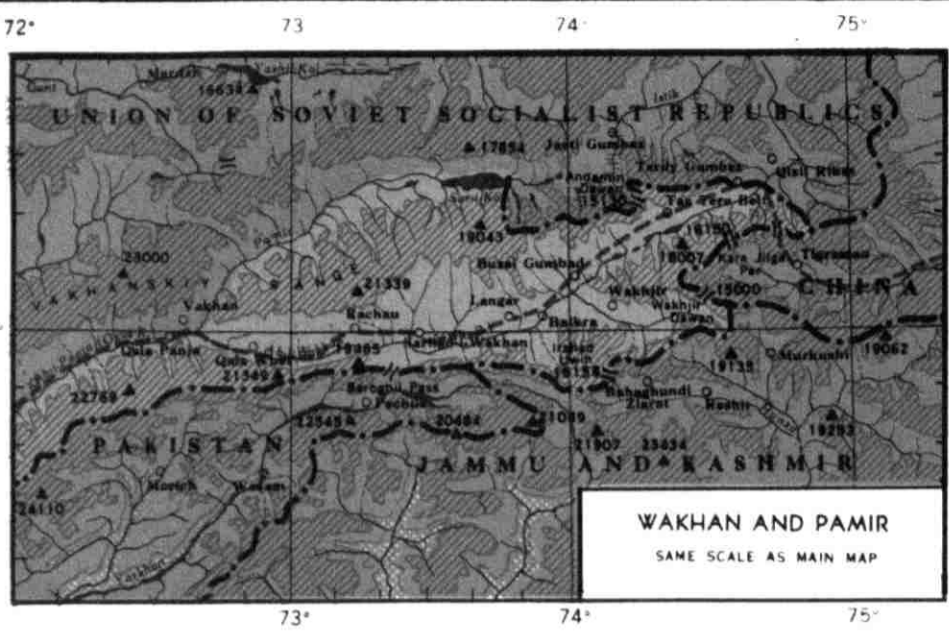
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5. MR. MOHAMMAD YACOB ATTAIE, Mortgage & Real Estate Bank, President.
6. MR. FAZL MOHAMMAD KHAIRZADEH, Bank-E-Millie, Afghan, Assistant President.
7. DR. HASSANAIN, IMF Advisor to the Afghan Government.



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