

Appendix 8

Descriptions of Currency Exchange Operations and Foreign Exchange Auctions

Currency Exchange Operation of 2002-03

A steering committee for currency exchange operation was formed of senior officials from DAB and MOF, assisted by international experts from IMF, USAID, the Bundesbank, and the UN. The first stage of the operation included the ordering, printing and delivery of the new bank notes. DAB contracted the printing of the new currency in denominations of Af1, 2, 5, 10, 20, 50, 100, 500, and 1,000 to two reputable bank note printers in Germany and Sweden, building upon the work that had already been done for the Taliban regime. The new notes included several advanced security features to deter future counterfeiting. The authorities only had a crude estimate of the existing amount of old notes in circulation. Including the various counterfeits, the face value of the old afghanis in circulation was initially estimated at about Af16 trillion. For political reasons, it was decided that two types of unofficial notes would be eligible for conversion, but at a 50 percent discount. Taking this discount into account, the total value of old afghanis to be exchanged was estimated at about Af13 trillion. To avoid running out of new bank notes, fatally undermining the public's confidence, the authorities ordered a total value of the new notes of Af27.9 billion, equivalent to almost 800 million notes, weighing about 500 tons.

DAB had 89 branches, but most did not meet even the most basic requirements in terms of secure vaults and office space. With assistance from international donors, DAB urgently set out to refurbish or construct a minimum of one currency distribution facility in each of the seven major regions: Kabul, Kunduz, Mazar-i-Sharif, Herat, Kandahar, Jalalabad, and Gardez. A total of 47 exchange points were established. Some 2,500 local staff were selected to carry out the operation and paid considerably more than the \$30 to \$40 a month that a bank employee would normally earn. The UN and USAID provided international observers to oversee the process, notably the destruction of the old notes. The most efficient and certain way of destroying old notes proved to be incineration. Difficulties in transportation and security meant that the best approach was to incinerate the notes locally. The construction of ovens was relatively

simple and inexpensive. Also, ovens did not require electricity, which was lacking in many exchange points. Transportation was another obstacle. Ground transport for the more distant locations was ruled out for security reasons. The bulk of air transport needs was met by two helicopters and one airplane, an Antonov 32, provided by USAID. The Afghan Air Force also provided some assistance in terms of aircraft crews. The DAB governor and deputy governors of DAB visited provincial governors and local commanders in the provinces to ensure their cooperation.

With large parts of the population illiterate and hardly anyone owning a television, the campaign relied mainly on radio broadcasts and dissemination by word of mouth, through speeches, village meetings, etc. Also, a large number of posters were distributed, depicting the new notes and specifying their main security features. During the first two weeks of the exchange period, only the money changers would be allowed to exchange their old notes. In this way, DAB aimed to collect large volumes of old notes early on. In order to be able to handle the large volumes, a sampling procedure was agreed with the money changers, whereby only 10 percent of the total amount presented was verified to make sure that the count was correct, the denominations were correct, and the notes were indeed eligible for exchange. If the sample count was found, for example, to be 2 percent incorrect, this proportion would be discounted from the entire amount that a money changer was presenting. In November, uncertainty grew among the general public whether everyone would be able to convert their old notes for new ones on time. As a result, the exchange rate started to depreciate sharply. To ease the anxiety, DAB announced in mid-November that the conversion period would be extended by one month to January 2, 2003, and following this announcement the exchange rate quickly returned to levels close to those at the start of the exchange (IMF, September 2003, pp.100-101).

Foreign Exchange Auctions

DAB established foreign exchange auctions starting in May 2002. They are open to all licensed money changers. Initially, only the larger money changers participated, but by the first half of 2003, the number of participants was in the range of 50–80, with a few changers in the provinces also participating. DAB has progressively taken measures to improve the transparency and operation of the auctions, including public announcements in advance in local newspapers and on radio, announcement of successful bids in the presence of the participants,

and a clear explanation of auction procedures and any changes to be introduced at the outset of auctions.

The modalities of the auction have evolved over time. Since November 2002, sealed advance bids have been used as the starting point by the auctioneer (the governor or deputy governor of DAB) to offer a sell price for US dollars to participants in an auction session to which all bidders are invited. The auction closes when the auctioneer and participants agree on a mutually acceptable single clearing exchange rate. The auctioneer, however reserves the right not to sell. The amounts of US dollars requested in the sealed bids of the participants who finally agree to buy US dollars at the agreed exchange rate usually exceed the amount on offer. Therefore, to avoid any cornering of the market, broadly equal amounts of US dollars are awarded to each successful bidder, with the highest receiving a larger amount.

The amounts auctioned are linked to the overall monetary program. Auctions have been held on a fairly regular basis at 1–2 week intervals. By the end of the first quarter of 2003/04, 50 auctions had been held. The amounts sold per auction were on average about \$2 million for the first six months and since then have been in the range of \$5–10 million. The amounts and timing of the auctions have reflected the rate of monetary expansion, driven by the pace of government spending, and the size of movements in the exchange rate. In 2002/03, a total of \$135.4 million (Af6.2 billion) was sold through the auctions, and in the first quarter of 2003/04, \$34.5 million (Af1.7 billion) was sold (IMF September 2003, p.108).