Photoillustration of the new Turkmen 10 manat banknote picturing prominent national poet Magtymguly Pyragy.

# New Money

*Åke Lönnberg*

**Introducing a new currency is a complex process—one that Turkmenistan completed successfully**

A popular destination for visitors to the IMF's Washington, D.C., headquarters has long been a 40-foot-long display of each member country's currency.

Most countries have their own currency, which is an important part of their national identity, though some belong to a monetary union and share a common currency with the union's members; others use that of another, often larger, country.

On occasion, a country must introduce a new currency. Turkmenistan, the former Soviet republic in central Asia, decided in 2008 to undertake a currency reform.

A major gap between the official exchange rate and the informal or market rate meant that Turkmenistan's price system had become complex and inefficient. This, in turn, created complexities in accounting and statistical reporting. So the government decided to introduce a new currency before launching market-oriented reforms. Currency reform was regarded as the foundation for further strengthening the macroeconomic framework, particularly monetary transmission: the more the population relies on the local currency rather than U.S. dollars, the more control the government has over macroeconomic policy.

The total and orderly overhaul of Turkmenistan's currency system in 2008–09 in many respects serves as a model for other countries.

## Big decisions

The introduction of a new currency is not undertaken lightly. The motivation could be hyperinflation, exchange rate collapse, massive counterfeiting of the existing currency, or even war. Or it could be an intentional change—for example joining a monetary union, such as the European Monetary Union.

Changing a national currency is a highly political decision. Sometimes the existing currency does not meet the economy's needs. The typical economy in need of currency reform is cash based and highly dollarized, with multiple currencies circulating at the same time.

The single most important price in any economy is the price of its currency vis-à-vis other currencies. Countries that assign non-market-based exchange rates for different goods or services—or for imports versus exports—tend to have significant distortions in their economy. Over time, this usually leads to slower growth overall. Eventually, the general public, the business community, and politicians may start pressing for currency reform and the introduction of a new currency.

Currency reforms are typically complex and risky: global experience confirms that a successful outcome is never guaranteed. The main ingredient in the successful introduction of a new currency is a strong commitment by the central bank together with the government to take the steps needed to ensure that the new currency is perceived as stable by companies, the general public, and the international community.

Introduction of a new currency comprises four phases. First, the necessary *preconditions*—sound macroeconomic policies and strong financial sector legislation—should ideally be in place or under way. Next, careful *preparation* is required, setting up the policies and processes behind the reform and drafting a detailed budget for the entire currency reform (including the cost of printing and minting the new cash currency). Then comes *production* of the new currency, and finally the most challenging phase: *implementation*.

## Setting the stage

A government facing currency reform often has limited ability to pursue macroeconomic policy. If the country is suffering from hyperinflation, its macroeconomic policies to date by definition were unsound. In some cases, a currency reform must be implemented despite a difficult macroeconomic situation. Currency reform alone is unlikely to resolve such problems and will yield its benefits only if underpinned by fiscal and monetary action. But psychologically, introducing a new currency can itself facilitate the stabilization of an economy. It is sometimes combined with exchange rate unification—to eliminate the complications of both an official exchange rate and unofficial market rate.

Turkmenistan was able to achieve favorable macroeconomic conditions before it implemented exchange rate unification and currency redenomination. During 2006–07, the economy was growing more than 11 percent a year, inflation was in single digits, and fiscal and external balances were strong.

A currency reform must be supported by financial sector legislation. Existing legislation—including the law establishing the central bank and regulation of banks and other financial institutions—should be reviewed to ensure consistency with international best practices. A law and regulations on the specific currency reform are also necessary, and other legislation—for example, governing accounting and financial reporting—may require updating. This work can be supported by technical advice from the IMF and other countries' central banks. Such technical assistance includes initial general guidance as well as detailed recommendations based on currency reforms in other countries.

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In a crisis situation, the government has little, if any, control over the circulation of different currencies. For that reason, the economy tends to be highly dollarized—that is, many transactions are made with a foreign currency, often the U.S. dollar. Moving forward, the government should favor a currency regime that supports open trade and free markets—one that allows international competition and is not overly protectionist.

The central bank is the arm of the state responsible for introducing a new currency, but it is not necessarily in a position to do so. It may lack staff with relevant experience, or sufficient branches throughout the country from which to operate, or even the funds necessary to finance a reform. Strengthening the institutional capacity of the central bank and ensuring it has the resources needed are critical preconditions for currency reform.

Private banks also play a key role in currency reform. But the banking sector may be weak or, in some cases, virtually nonexistent. In some parts of the world, informal funds transfer systems such as *hawala* and *hundi* are more vibrant or have nationwide networks that surpass those of banks. In such cases, collaboration between the central bank and these payment system operators is critical to the success of the reform.

The central bank must assess the extent to which counterfeit banknotes circulate. Together with the ministry of finance and the commercial banks, it should formulate a strategy to avoid an increase in counterfeit currency during the critical implementation stages of the currency reform.

The central bank should prepare a budget for the entire currency reform early on and revise it as necessary over time. The IMF can offer technical advice on preparing such a budget.

Introducing a new national currency is a highly complex project, which requires a well-functioning accounting system. Throughout the various stages, tested systems must be in place for independent auditors to safeguard the integrity of the currency reform, by ensuring correct reporting and accounting of the currency exchange. Failure in this area is not only costly but also potentially devastating to the currency reform's reputation.

Important as all these preparations are, the success of a currency reform depends just as much on a successful public education campaign. The central bank needs to coordinate this campaign with other agencies, financial sector representatives, merchants, and the general public. A delicate balance must be struck between providing sufficient public information and the need for confidentiality to avoid releasing clues to counterfeiters that could be used to undermine the integrity of the new currency. The information campaign should encourage people to deposit their cash currency in accounts at banks. The campaign must make it clear that once the currency reform is initiated, account holders can withdraw their money in the form of new banknotes. A second important point for the public education campaign is timely information on the stages of the currency reform to discourage a run on banks with temporary liquidity problems.

In Turkmenistan, the central bank conducted a proactive public communications strategy that began early in the currency reform. The terms of the redenomination were carefully defined and announced in advance. An awareness campaign was carried out throughout the country. Booklets, illustrating the new banknotes to be distributed, were published in national and local newspapers along with explanatory articles. In addition, pocket-size cards comparing the denomination of old and new manat were distributed to the public. And the Central Bank of Turkmenistan set up a phone hotline to answer questions from businesses and the public.

## Lights, camera, action

A new currency's name is a psychologically important decision for the government. One option is to emphasize continuity with the old currency by retaining the old name or adding "new" to it. Alternatively, the government may choose to underscore a break with the past by giving a completely new name to the currency to mark the start of a new monetary era.

In Turkmenistan, the government decided to keep the name "manat" for the redenominated currency. However, in line with an international convention among countries and central banks, the International Standards Organization changed the three-digit ISO 4217 code from TMM for the pre-2007 manat to TMT for the new Turkmen manat.

The banknote printer and the minter of coins should be selected competitively and in the international market. Even if domestic producers are available, they should be required to compete for the contract. It is not uncommon, by the way, for various banknote denominations to be produced by different international firms.

Turkmenistan's banknotes were printed by the British firm De La Rue, and the coins were minted by another U.K. company, the Royal Mint. De La Rue is now testing production of the banknotes from paper produced with local raw materials—Turkmen cotton, renowned since ancient times for its high quality.

Decisions on the artistic design of banknotes are almost always complex and time consuming. The design must be integrated with necessary security features: the higher the denomination, the more advanced security features are required. These often include watermarks, security threads, see-through registers, and hidden numerals. Decisions also need to be made on the size of banknotes—a uniform size as for U.S. banknotes or a different size for each denomination as for euro banknotes. Finally, the color scheme should be determined—again, uniform colors, like U.S. banknotes, or clearly different colors as for most other banknotes.

Hyperinflation and exchange rate collapse slash the value of a national currency, forcing the issuance of banknotes in ever higher denominations. In Yugoslavia in 1993, a banknote reached 500 billion dinars, and Zimbabwe's highest banknote issued was 100,000 trillion Zimbabwe dollars in 2008. In such situations, a redenomination of the currency is not only appropriate but also necessary. Redenominating a currency means administratively changing its face value. In itself, a redenomination makes no one richer or poorer. Technically most redenominations of currencies are undertaken by using factors of 10, 100, or 1,000 and simply moving the decimal point a certain number of steps to the left to establish a new value. Such a change is simple to explain to the general public and easy for companies to implement. It also represents a clear way of monitoring whether price gouging is taking place.

The first step in the Turkmen currency reform was to unify the exchange rate. In the past, because of a shortage of foreign exchange, there had been a dual exchange rate system made up of an official rate pegged at 5,200 manat per U.S. dollar and an informal parallel market rate of about 23,000 manat per U.S. dollar.

Later, the government devalued the official rate to 6,250 manat per dollar and introduced a commercial rate of 20,000 manat per dollar at which banks could trade freely with the public. The two markets were successfully unified on May 1, 2008—at the rate of 14,250 manat per dollar, a level consistent with the country's strong external position. Currency exchanges were located wherever customers might want to exchange dollars for manat, offering easy and official access at close to the informal rate, thus killing off demand for the informal market.

At the beginning of June 2008, the Turkmen government issued new foreign exchange regulations under which the Central Bank of Turkmenistan began providing banks and authorized currency changers ready access to foreign exchange, which in turn became available to the market-oriented private sector. Previously the central bank had been propping up the official, unrealistically low, exchange rate by restricting access to dollars. The provision of sufficient foreign exchange to an extensive network of exchange bureaus across the country eliminated the black market rate.

While unifying the exchange rate is important, the authorities must also modernize the national currency for a currency reform to be comprehensive. In Turkmenistan, the modernization entailed issuing a new family of banknotes that were smaller in size than the unnecessarily large old banknotes. It also included the reintroduction of coins. The Turkmen economy had been cash oriented for a long time, and the U.S. dollar was extremely popular. The weakness of the manat to the dollar, which required thousands of manat in an exchange conversion, was deemed unacceptable. One way to correct this was to redenominate the national currency.

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After the successful exchange rate unification, the authorities moved forward with the introduction of the new manat, revaluing the currency by a factor of 1 to 5,000. The pegged exchange rate of 14,250 manat per dollar resulted in an exchange rate of 2.85 new Turkmen manat to the dollar.

A presidential decree issued August 27, 2008, announced the introduction of the redenominated manat on January 1, 2009.

Even without redenomination, the denomination structure of a new cash currency is worth considering. Usually, lower denominations are eliminated and higher denominations added. There is generally a shift into coins from denominations that were previously issued in banknotes. Cultural and sociological preferences must be considered. For example, in some countries, such as Somalia and South Sudan, coins are not popular. In other countries, such as Germany, people want access to very high-denomination banknotes. A rule of thumb often applied in developing economies is to set the highest denomination of the national currency no lower than the equivalent of 20 dollars.

## Money in hand

Turkmenistan issued six new banknote denominations on January 1, 2009: 1, 5, 10, 20, 50, and 100 new manat. This was a major expansion of the upper denominations—the previously highest denomination, 10,000 old manat, now corresponded to a mere 2 new manat. The six newly issued banknotes each differed in size and were all shorter and narrower than previous banknotes. The design of the front of the banknotes presented prominent historic Turkmen personalities. The reverse side, as in the past, portrayed new key buildings and monuments of modern Ashgabat, the Turkmen capital.

In parallel, new coins were issued in the following denominations: 1, 2, 5, 10, 20, and 50 tenge; and the following year, two more coins were circulated with 1 manat and 2 manat denominations. This represented a de facto reintroduction of coins after high inflation and intense exchange rate pressure had rendered the previously issued coins valueless.

Once the design and denominations of a new currency are selected, the central bank must decide how much to produce, based on research on the demand for money in general and on various cash currency denominations in particular. Data on past orders of banknotes and coins should give reasonable estimates, which must be assessed in light of recent changes in public demand for the currency compared with other currencies. Technical advice is available from international banknote printing firms such as De La Rue and Giesecke & Devrient, and for coin denominations from mints such as the Royal Mint.

The next phase of currency reform is the conversion from old cash currency to new. The authorities must decide—at first privately—when the currency exchange will begin, when it will end, and whether or not to cap, in absolute terms, the amount to be exchanged. Then, decisions on the announcement of and publicity for the currency exchange must be made. Other essential decisions include the conversion rate and how financial assets, resident/nonresident accounts, and existing currency contracts will be treated in the currency exchange.

In addition to the guidance of the central bank and the ministry of finance, the views of the ministries of justice, commerce, and defense; the police force; the chamber of commerce; bank representatives and representatives of the informal payment system (if it plays an important role in the country); the general public; nongovernmental organizations; and key media outlets should be considered.

The key stakeholders, under the leadership of the central bank, should develop a detailed plan for distribution of the new currency. They must identify exchange points (places where the public can exchange the old money for new and where cash currency can be stored temporarily); establish facilities for more permanent storage of currency, such as vaults and strongboxes; and address various logistic issues, including exchange point staffing.

In its plan for the currency reform, the central bank must decide how to handle the soon obsolete cash currency. Old banknotes that have been exchanged for new currency should be immediately invalidated via ink markings or holes drilled in the currency. After a second counting, the then invalidated banknotes should be destroyed by shredding or burning. Routines should also be established for the collection and transportation of old coins, which may be sold by the central bank for scrap metal and ultimately melted down.

In line with common international practices, the Turkmen central bank allowed the two sets of banknotes to be circulated during 2009. By 2010, all banks were expected to exchange the old currency for new manat. And after that, the old currency was demonetized and retained only numismatic value.

The IMF's currency display was recently dismantled to allow for repairs to the building. If and when the display is restored and updated, there will be several new currencies for visitors to view, including the new Turkmen manat. ■

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