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Literature Search: Issuance of New National Currencies

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United States Agency for International Development
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<u>Literature Search: Issuance of New National Currencies</u>

I. <u>Former Soviet Union</u>

Abrams, Richard K ; Cortes-Douglas, Hernan; "Introduction of a New National Currency: Policy, Institutional, and Technical Issues", IMF Working Paper No. 93/49, June 1, 1993.

<u>Abstract</u>: In the last few years, a number of countries in the former Soviet Union and Eastern Europe have become independent or have regained their independence. Many have chosen to issue their own currencies, and more are likely to do so. Drawing on these and earlier experiences this paper summarizes the main policy and institutional arrangements necessary for the introduction of a new currency and discusses the key features of, and procedures for, the conversion.

The paper is designed as a working document for those involved with currency reforms to help ensure that all the necessary steps are taken before, during, and immediately after a new currency is introduced. It focuses on issues directly related to the introduction of a new currency. In many areas, checklists present the steps that must be taken and the most reasonable options. Other related issues, for example, supporting financial sector legislation, will arise whether or not a country remains in a wider currency area.

First, the paper discusses the main macroeconomic and operational measures required to prepare for the orderly transition to the new currency, including decisions regarding the choice of exchange regime, the issuance of coupons, and the costs and benefits of currency reforms. The next section covers issues relating to the production of the new currency bank notes. Next, the main features and terms of the conversion are discussed, as well as certain special issues, such as speculative inflows and the treatment of banks' customers and old currency contracts. The last section covers the operation of the foreign exchange market and maintenance of exchange rate stability in the period immediately following the introduction of the new currency. An appendix covers the technical aspects of currency handling, accounting, and management.

Hansson, Ardo, "The Estonian Kroon: Experiences of the first Year," in <u>The Economics of New Currencies</u>, Centre for Economic Policy Research (CEPR), Chapter 4, 1993.

<u>Abstract</u>: This paper/presentation describes how the kroon was introduced with a one-off exchange for roubles and then pegged by law at a fixed rate to the Deutschmark. There was a steep GDP decline and inflation fell more slowly than expected, but nevertheless the post-reform macroeconomic policy was an overall success in its achievement of stability and convertibility. There is already a resurgence of economic activity, but certain conditions specific to Estonia (i.e. large gold reserves, small size, and balanced budget) imply that only a few republics of the FSU can copy its example.

Melliss, Chris L,; Cornelius, Mark, "New Currencies in the Former Soviet Union: A Recipe for Hyperinflation or the Path to Price Stability", ***Bank of England working paper,*** **no. 26, 1994.**

Abstract: This paper describes the break-up of the rouble zone after the collapse of the Soviet Union in December 1991 and the opportunities and risks involved in establishing separate currencies in the new republics of the FSU. Fundamental disagreements about the desirable pace of economic reform, together with the need for radical changes in the pattern of economic activity, greatly weakened the case for retention of a single currency. Also, by mid-1993, the reformers in Russia had realized that continued use of the rouble by the republics weakened the authorities' ability to control monetary developments. The introduction of new currencies in countries lacking experience of economic policy making is bound to be a messy and uncertain process. This paper discusses the policy choices involved, in particular the appropriate exchange rate regime and the possible role for a currency board as a way of giving monetary policy credibility at an early stage in the transition. It concludes that bringing the fiscal position under control should be the first aim of policy for these countries. In the absence of bond markets deficits will tend to be money financed and the choice of exchange rate regime, by itself, is probably of second-order importance. The paper concludes with seven case studies, including the Baltic States and Ukraine. When the paper was written, some republics had inflation rates of 25% a month or more, and there seemed little prospect of a rapid fall. In fact performance has generally been rather better than then seemed likely. The main reasons for this seem to have been the absence of a 'flight-from-money' typical of Latin-American hyperinflation. Fiscal deficits have been kept under reasonable control, probably as a result of external pressure.

Miller, Marcus, "The Break-up of the Rouble Zone and Prospects for a New Ukrainian Currency: A Monetary Analysis", in The Economics of New Currencies, Centre for Economic Policy Research (CEPR), 1993.

Abstract: This paper/presentation describes how Russia's loss of control over rouble zone monetary policy led other republics to issue their own currencies. The 'free rider' problem which arises as each republic seeks 'local' benefits of deficit spending requires centralized fiscal control or a new currency in each republic. Focusing on the latter case, a monetary model of the linkages among deficits, money creation and inflation is described. This model is used to consider how the republics' current and expected deficits determine their inflation and exchange rates. This approach points to the close link between monetary and fiscal policies; introducing a new currency will only succeed if fiscal deficits are reduced.

Olding-Smee, John; Pastor, Gonzalo, "The IMF and the Ruble Area, 1991-1993", Symposium: IMF and the Ruble Zone, Comparative Economic Studies, volume XLIV, no. 4 Winter 2002.

Abstract: This paper summarizes the IMF advice on the ruble area as it was presented to the national authorities in Russia, the Baltic countries, and other states of the former

Soviet Union in 1991-1993. In the course of doing so, the paper corrects some misperceptions that have arisen about the IMF's role. The evidence presented in the paper suggests that: (i) the balance of arguments on the ruble area (and national currencies) changed over time, and hence so did the IMF's advice, and (ii) from the beginning, the IMF staff concentrated on pointing out the pros and cons of alternative monetary arrangements, without strongly advocating a particular one, emphasizing that it was the authorities' decision to stay in or leave the ruble area. Fund advice on how to introduce national currencies was made readily available to the various national authorities as early as January 1992.

Repse, Einars, "Be Ready to be Blamed for Everything: How Latvia Introduced its Currency", *speech transcript* appearing in: Finance and Development, vol. 30, no. 4, pg. 28, December 1993.

<u>Excerpt</u>: "A new currency must be loved and trusted. Inspiring that love and trust--difficult to achieve, and very easy to destroy--requires that a central bank have full control over monetary decisions in order to build credibility and confidence in the monetary system. With that idea in mind, my 'short guide to introducing a currency' would include th[e following] set of 'model recommendations':

- liberalize your markets (foreign exchange and others);
- set up an independent central bank;
- introduce your currency;
- adjust your financial system to market principles;
- introduce floating exchange rates;
- follow a tight or extremely tight monetary policy; and
- be ready to be blamed for everything."

Repse, Einars, "The Experience with the Latvian Rouble and the Lats", in <u>The Economics of New Currencies</u>, Centre for Economic Policy Research (CEPR), 1993.

<u>Abstract</u>: This paper/presentation focuses on the reform of the banking system and the introduction and stabilization of a new currency. The Latvian rouble was introduced to cope with a shortage of Russian rouble banknotes, and it also brought greater independence from the Russian authorities. The Latvian rouble was first stabilized and then gradually replaced with the sovereign currency, the Lats, and both now coexist. This paper stresses that the introduction of the Lats was not a separate currency reform, but rather a simple substitution for banknotes denominated in Latvian roubles. A discussion section follows the main body of the text. The discussion focused on the lack of clear rules in the Bank of Latvia's monetary policy. Michael Bruno emphasized that a strategy of targeting reserve money could prove too tight if there is a strong substitution from foreign exchange deposits into the national currency. In subsequent discussion Peter Bofinger asked why the Bank of Latvia had allowed a nominal appreciation of the Latvian rouble vis-à-vis the Deutschmark. Repse replied that a stable Deutschmark exchange rate would have resulted in higher Latvian inflation.

II. Bosnia

The Economist, "Building Bosnia on Banknotes", U.S. Edition, May 01, 1999.

III. East Timor

McLeod, Ross H.; "Which Currency For East Timor?" Pacific Economic Bulletin, vol. 15, no. 1, June 2000, pp. 113-118 (http://peb.anu.edu.au/pdf/PEB15-1mcleod.pdf).

Abstract: The temporary United Nations administration in East Timor has decided to use the US dollar as official currency *ad interim*. This may pre-empt the eventual decision as to the most appropriate currency for the new nation. It is argued that East Timor would certainly be better off using the US dollar than introducing its own national currency, because of the avoidable dangers and costs countries face if they have their own central banks. But there may be some advantages in using the Australian dollar rather than the US dollar or other possible candidates such as the Yen or Euro.

United Nations Transitional Administration in East Timor, "Explaining the New Currency of East Timor: Questions and Answers About Using the U.S. Dollar", February 2000 (http://www.un.org/peace/etimor/untaetPU/currency.pdf).

Valdivieso, Luis M.; Lopez-Mejia, Alejandro, "East Timor: Macroeconomic Management on the Road to Independence", Finance and Development, vol. 38, no. 1, March 2001.

Excerpt: "In November 1999, the IMF staff proposed a strategy that featured reviving the payment system, developing a basic fiscal framework, and providing a technical assistance program. The critical steps to be taken to revive the payment system were choosing the legal tender and establishing a monetary authority. After taking into account political and economic considerations, East Timor adopted the U.S. dollar as its only legal tender to help eliminate the distortions arising from the use of multiple currencies. The East Timorese leadership wished to eventually introduce a national currency, but the staff of the IMF, while receptive to these views, recommended that such a step be taken only once a financial market became functional in East Timor and sound financial policy and well-developed institutional and legal frameworks were in place. Initially, a monetary authority—the Central Payments Office—would be responsible for providing basic depository and payment services, mainly to the government, and facilitating the development of the foreign exchange and money markets by adopting internationally accepted bank licensing and supervisory procedures."

IV. Other Countries/Regions

Comite National de l'Euro, "Master Plan for the Introduction of Euro Banknotes and Coins", 2000, available at: (http://www.euro.gouv.fr/pieces_billets/html_ orienta_euro/resumegb.htm).

Abstract: All of the European countries that adopted the single currency will put euro banknotes and coins into circulation on January 1, 2002. The introduction of euro banknotes and coins in France will require the replacement of some 1.4 billion banknotes and between 7 and 10 billion French-franc coins. Under the existing European framework, it is up to each country to define procedures for introducing the new currency. The master plan presented in this document is the result of consultations with all of the players concerned, including the Banque de France, the French Overseas Department Note-Issuing Institution (IEDOM), credit institutions, the Post Office, merchants, consumers and security carriers. The master plan validated at the National Euro Council meeting on February 11th calls for three major steps in the introduction of euro coins and banknotes: (1) the preparation phase; (2) dual circulation of francs and euros; and (3) withdrawal of francs.

Cortes-Douglas, Hernan; Abrams, Richard K., "Introducing New National Currencies", Finance & Development, No. 4, Vol. 30, December, 1993.

Abstract: In recent years various countries have chosen to introduce their own permanent currencies; others have introduced provisional currencies, and many more are likely to follow suit soon. Countries typically introduce a separate currency not only because it is a symbol of national independence but because it gives them the authority to determine national monetary and exchange rate policies. Introducing a new currency is not easy. Monetary independence requires a degree of financial stability based on sound financial policies implemented at the time the new currency is introduced. Lack of adequate supporting policies may cost the new currency its credibility, which may be difficult and expensive to restore. This paper outlines the necessary steps prior to, during, and immediately after the introduction of a new currency.

Mencinger, Joze, "The Experience with the Tolar in Slovenia," in The Economics of New Currencies, Centre for Economic Policy Research (CEPR), Chapter 6, 1993.

Abstract: Yugoslavia's disintegration resulted from the federal government's failed stabilization policy. Independent monetary policy required the conversion of the dinar into the Slovenian tolar, which took place at a 1:1 rate to minimize technical problems and incentives to counterfeit the new notes. Slovenia possessed no foreign exchange reserves and therefore could not credibly peg the tolar to a stable currency or install a currency board; it therefore adopted a floating rate. Stringent central bank control of domestic credit caused foreign currency transactions to become the main channel of money creation. The independent central bank has been very successful so far in pursuing its monetary policy and reducing inflation.

V. General/Theoretical Literature

Abrams, Richard K., "The Design and Printing of Bank Notes: Considerations When Introducing a New Currency", IMF Working Paper WP/95/26-EA, March 1, 1995

Abstract: Planning for the new issue or replacement of a national currency has, for many countries, been made more difficult by the lack of consistent published information on the various aspects of this process. This paper attempts to ameliorate part of this problem by reviewing the main issues in designing, producing, and printing a new currency.

The paper discusses the problems that may arise when introducing or changing a national currency. Since many people view the currency as an important national symbol, design decisions may become emotional and contentious, resulting in long production delays. Yet the object of this exercise is usually to establish or restore confidence in the currency. Thus, the design selection process should minimize delays and seek to ensure that the currency is user friendly, durable, easily recognizable, and reasonably secure against counterfeiting. Key aspects of these design decisions are outlined, as are such issues as the initial value of the currency, the denominations to use, and the broadest considerations regarding the quantity of bank notes to print.

The paper also addresses the choice of who should print the currency. In the short run, it is often better to use a private printer, especially if the country lacks a bank note printing works. In the longer run, many countries may prefer to produce their own bank notes. However, the bank note printing industry appears competitive, partly because many countries have excess capacity at their bank note printing works.

Issues including the time involved in designing and printing bank notes, as well as the costs of producing various types of bank notes, are then outlined. The paper also argues that an educational campaign should be a prerequisite for introducing a new currency. While the primary objective should be to reduce the risk of counterfeiting, such a campaign will also help ensure that the currency gains immediate acceptance.

The paper reviews alternative steps that can be taken when there is inadequate time to produce new bank notes in an orderly manner. The favored alternatives include modifying the plates of the country that formerly printed the notes to print new bank notes and overprinting or affixing stamps to existing notes. However, each method may have its difficulties. The next best alternative is to print near-bank-note quality coupons. A country should avoid printing low-quality bank notes or hand stamping existing notes because of the risk of counterfeiting.