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The Myths and Realities of Redenomination: A Case Study of Sierra Leone

Mohamed Ibrahim Justice Ganawah

Lecturer, Department of Economics and Commerce, Faculty of Social Sciences and Law, Fourah Bay College, University of Sierra Leone, Sierra Leone

Corresponding Author: Mohamed Ibrahim Justice Ganawah

Abstract

The study aims to determine the impact of redenomination on the economy of Sierra Leone and also to explain believes and realities of redenomination process. The study utilizes secondary data that were obtained from World Bank reports, other articles and commentaries on redenomination. A qualitative analysis was utilized in the study.

This research paper, additionally examines the redenomination practices in several countries in the world, and the study have shown that the best time for redenomination is the beginning of economic growth or a radical restructuring of the economy after hyperinflation is

stopped. Redenomination will not be effective if it is not accompanied by economic growth, which means inflation control, GDP growth, a decrease in unemployment, balancing the country's balance of payments, etc.

The paper has further illustrated the need to strengthen monetary policy practices because of the special importance of the Central Bank in economic management and the diversity of stakeholders' expectations. The empirical findings of this study are glaringly consistent with the guidelines developed by the Central Banks' in rolling out the redenomination process.

Keywords: Redenomination, Economic Growth, Inflation, Devaluation, Money, Imbalance, Liquidation

1. Introduction

Redenomination is the recalibration of a country's currency, typically due to hyperinflation and currency devaluation, whereby an old currency is exchanged for a new one at a fixed rate. Simply put, extra zeros are removed. For instance, Le1000 = Le10, Le1000,000 = Le1000.

Redenomination means the liquidation of the old currency and the emergence of a new one, and the exchange rate of the new currency will depend solely on the effectiveness of the reforms. If the methods of dealing with hyperinflation are successful, the rate will increase.

Redenomination is often accompanied by a decrease in the money supply (withdrawal of money from circulation) in order to contain and prevent inflation. Therefore, we can say that redenomination is also an auxiliary step towards strengthening the national currency.

The best time for redenomination is the beginning of economic growth or a radical restructuring of the economy after hyperinflation is stopped. Redenomination will not be effective if it is not accompanied by economic growth, which means inflation control, GDP growth, a decrease in unemployment, balancing the country's balance of payments, etc.

A crucial factor determining the success of this event is awareness-raising among the population. When neglecting this need, the authorities will be faced with redenomination further aggravating the economic situation:

- The redenomination will only fuelled panic and demand for other safe-haven assets: foreign currency, essential goods, etc. Prices for these assets rose while real estate and expensive property fell.
- Money will be withdrawn from the banking system, effectively dehydrating the national economy. The situation will be aggravated by a series of bankruptcies with a sharp drop in the value of collateral.

2. Format of Redenomination

There is no single format of redenomination. In its free form, it can last for a fixed period of time (2-4 weeks) and not be controlled by the state. Prices are indicated in both currencies in the transition period. Even after the transition period, people will be able to change the old bills in banks for a long time (there have been cases where old bills were accepted in banks for

another 3 years after the redenomination). The fixed form provides two options:

- The state sets a limit on the amount of exchange per person. Exchange time is limited - an average of 3-14 days.
- The redenomination is a one-time even. From a certain date, new bills begin to operate, which could be obtained earlier by exchanging old ones, for example, in banks.

3. Factors Preceding Redenomination

There are basically two main factors that precede redenomination. These are:

- Imbalance in the national economy. Significant prevalence of imports over exports, unjustified growth of money supply not provided by production, budget deficit, growth of public debt and its maintenance costs, growth in unemployment, etc.
- Hyperinflation. The imbalance of the national economy leads to uncontrolled price increases. To support the population, the state resorts to issuing. The increase in the money supply creates a new round of demand, followed by a new increase in prices.

4. Objectives of Redenomination

The goals of redenomination are regarded as potential, since they are not always achieved. The major ones are:

- Moving capital out of the shadow: The population that stores money in national currency will be forced to exchange it in any way possible. History knows examples where, in order to detain the economy, stringent conditions for the exchange of money involving personal identification were introduced. For example, in Russia in 1993, two weeks were given for money exchange, the restriction was 100 thousand rubles per person, and the passport was stamped upon exchange. These measures are ineffective, because, instead of exchanging for a new currency, the population will invest shadow money in foreign currency, gold, and real estate. And such cash flows cannot be controlled.
- Simplification of calculations: Operating in amounts with no extra zeros is simpler and more convenient.
- Reduced issuing costs: large bills require the issue of change bills/coins, the cost of which sometimes turns out to be higher than face value.
- Eliminating high inflation rate: Redenomination of a country's currency might be done to curb inflation (the constant increase in general prices) or simply to change to a new currency. One of the upsides of this strategy is that it helps in reducing the amount of currency in circulation which may invariably reduce the level of inflation in the country.
- Economic stabilization: a redenominated Leone currency may help in easily converting the Leones with other major currencies, minimise the cost of producing and distributing the Leone in the long run, provides access to cleaner bank notes and the convenience of redrawing and carrying less cash around.
- Improving the currency's credibility

5. Status of the Sierra Leone Economy

The current status of the SL economy according to the World Bank (2021)^[4] is as follows:

“Sierra Leone's economy is projected to recover from the COVID-19 contraction with real GDP expected to rebound by 3.0 per cent in 2021, an upward revision of 0.8 percentage point relative to the 2020 forecast”.

Whilst this is a welcoming news, inflation remains a cankerworm eating into the livelihood of many citizens. For instance, our inflation rate for 2021 is at 13.4%, which is slightly higher than Ghana at 10%, Guinea at 10% and the Gambia at 6% (World Bank, 2021)^[4].

To counteract this, the Bank of Sierra Leone (BSL) has been trying several monetary policy tools. Monetary policy is aimed at controlling inflation and deflation; the former referring to the constant increase in general prices of goods and services caused by an increase in the amount of money in supply whereas the latter refers to a situation where there is less money in circulation.

One recent monetary policy tool that our central bank has proposed which has ignited mixed feelings among citizens is the redenomination of our currency.

6. Redenomination Dynamics

According to the Central Bank Governor Professor Kelfala M. Kallon “Our current currency is too big to fit into a wallet and we spend too much money printing oversized banknotes,” means there is need to redenominate the Leone. Primarily, the removal of the three zeros from the currency will not affect its value. A percentage decrease in the numbering of the banknote will lead to the same proportionate decrease in the general price system. It can be explained thus; let assumed that Miss Lunet present monthly earnings is Le20,000,000.00 and after the redenomination, her monthly income will stand at Le20,000.00. Now, the value of the Le20,000,000.00 before the redenomination will be equated by the SLL20,000.00 after the redenomination. The quantity of commodities/goods and services that the twenty million Leones can be sacrificed to obtain will be the same quantity of commodities/good and services the Le20,000.00 can obtain after the redenomination. Likewise, let's take a bag of FLOUR and a bag of CEMENT as food and non-food items; the current average price for both items are SLL400,000.00 and SLL100,000.00 respectively. After the redenomination, the average price for a bag of FLOUR and a bag of CEMENT will be Le400.00 and Le100.00. This system will apply to all goods and services across all businesses in the country.

Most importantly, currency redenomination at its best is more of a psychological game; for instance, with the redenomination: le14000 which is the current nominal exchange rate value for £1 will now be equal to le14. Thus, £1 will be equal to Le14 and not Le14,000. This is psychologically a great news to the average citizen. Also, the reduction in the number of zeros will help in improving the image of the country abroad.

However, whilst the nominal value of the currency will change as stated above, the real value will remain intact. Thus, the British Pound (£) or US Dollar for instance (\$) will still remain stronger against the Leones (Le), everything remaining constant (*ceteris paribus*). Redenomination does not simply have any impact on a country's exchange rate in

relation to other currencies.

In economics, the nominal value is measured in terms of cash/legal tender. The nominal value is the face value of money. It doesn't take into account things like inflation, thus painting a wrong picture.

The real value is, however, measured in terms of the actual amount of goods or services that your money can buy. It is an inflation-adjusted value and thus shows a realistic picture. It is the true market value of a country's currency.

Redenomination of a currency, therefore, only affects the nominal value (fake value) and not the real value of money.

7. Negative Consequences of Redenomination

The negative consequences of redenomination are mostly psychological in nature:

- Rounding prices up. While before the redenomination a product was worth 10,700 units, after it the new price of 10.7 will most likely be rounded to 11 units. However, in comparison with the previous inflation, such rounding is rather painless.
- The need to get used to new monetary units. The need to adapt to constant change is inevitable.
- Perception. When you are holding in your hands 1000 or more times less money, it may feel like you have been robbed. The feeling goes away quickly.

8. Dynamics of Redenomination in the World

- Weimar Republic. In the post-war years from 1919 to 1923, the German economy was at the bottom. The paper mark, which replaced the gold mark after August 1914, could not perform its functions well. The hyperinflation that followed the war was well described by Remarque in the novel *The Black Obelisk*. In 1923, the paper mark was replaced by the Reichsmark, which existed until 1948.
- Hungary. Hungarian hyperinflation and the subsequent redenomination in 1945-1946 became the highest in the entire history of the world financial system. The country's economy was destroyed by the war, prices doubled every 15 hours and it became impossible to control their turnover. The largest pengo bill at the time of redenomination was 1 sextillion (billion trillion or 10^{21}). On August 1, 1946, forint was introduced, the exchange rate was 4×10^{29} (400 octillion). In general, along with other measures, the reform was successful.
- Turkey. In 2005, the country redenominated at the rate of 1 million to one. It had no negative consequences, apart from price confusion.

There are also examples of unsuccessful monetary reforms in history when redenomination only aggravated the situation:

- Zimbabwe. The country was in the top 10 strongest redenomination's in the world twice. On August 1, 2008, 10 billion old dollars were exchanged for 1 new dollar. It took the country only 7 months to repeat the record: on February 2, 2009, the next redenomination was held at the rate of 1 trillion to one dollar. Inflation amounted to 231 million %, and in mid-2009, the national currency completely ceased to exist for 10 years. Recently, the government decided to return the Zimbabwean dollar again, but its rate remains unstable. NOTE: Zimbabwe went through numerous currency

redenominations in its attempts to contain inflation before formally abandoning the Zimbabwean dollar in 2015.

- Russia. The non-diversified oil export-oriented economy failed in 1997. The drop in oil prices, the Asian recession, and the decline in production were preceded by hyperinflation of more than 2,500% per year. In an effort to compensate for the budget deficit, the government resorted to the following methods:
 1. Unsecured emissions, which by 1997 led to a rapid increase in consumer prices.
 2. Issue of short-term government bonds. To cover debt and pay out profits, the state was forced to resort to issuing more and more securities, thereby building a classic pyramid. In early 1998, three zeros disappeared from ruble denominations. But this did not eliminate the structural problems of the economy, and in August of that year national bankruptcy followed. This partially solved the internal problems, albeit at the expense of investors. After the bankruptcy, the country's economy gradually went up, but the redenomination was an example of an unsuccessful economic policy.
- Venezuela. This example is described at the beginning of the review. As of autumn 2019, the country so far has not been able to get out of the long crisis. And most likely, the redenomination held in 2018 is not the last one.

In 2002, the Afghan government in response to the continuous decline of the value of their currency similarly knocked off three zeros from their currency, whilst Turkey removed six zeroes from their Lira in order to restore the credibility of their currency. Ghana and Zimbabwe respectively removed three and four zeroes from their currency with the aim of restoring the loss of confidence in their currencies by their citizens. To counter hyperinflation in their countries, Argentina, Peru and Brazil also redenominated their currencies.

Overall, over nineteen nations have used redenomination as a tool with some doing it more than once; Brazil redenominated 18 zeroes in 6 separate occasions, Israel knocked off 9 zeroes in 4 occasions, Russia removed 3 zeroes in 3 occasions and Peru 6 in 2 occasions. Thus, this is not a new phenomenon.

9. An In-depth Analysis of Redenomination Implementation Process in Sierra Leone

It is difficult to control inflation in a country like ours without constantly engaging the wider business community (formal and informal). Developing top-bottom policies that don't take into account the informal sector in particular which controls most of our economic activities might be just counter-productive.

Redenomination comes with associated costs like the printing of new notes and disposing of the old, money to be spent on public education, relevant software's and accounting record system and additional cost to the economy if inflation still persists.

Redenomination is likely to confuse the public; the majority of which are uneducated. It is likely that in this confused state, some citizens may now be thinking about quickly converting the Leone they presently hold into dollar and hoard ahead of the implementation date. Thus, there should

be a wide-reaching and marathon public education on the issue using different languages and media platforms including social media. Meanwhile, because it will take time for the public to assimilate the new change, we would have thought that the government would have done so at the very start of their term in office.

Also, our country is heavily dependent on imports. World Bank (2021) ^[4] indicates that “Sierra Leone had a total export of 205,368.28 in thousands of US\$ and total imports of 986,898.69 in thousands of US\$ leading to a negative trade balance of -781,530.40 in thousands of US\$. The trade growth is -9.80% compared to a world growth of 3.50%. Sierra Leone services export is 74,604,792.44 in BoP (Balance of Payment), current US\$ and services import is 429,978,320.20 in Bop, current US\$. Sierra Leone exports of goods and services as a percentage of GDP is 15.99% and imports of goods and services as a percentage of GDP is 37.53%.” In essence, we import far more than we export which leaves us in a very vulnerable position especially in terms of controlling the prices of basic commodities like rice, petrol, sugar, salt. When a country imports more than it exports, it loses control of pricing and its currency will continue to devalue. Prices are largely determined by the producers of the exporting countries which we have little or no control over.

To mitigate this, we will need to focus on building stronger unicorn businesses in agriculture, fisheries and mining for instance that can engage in the massive export of our local goods. In particular, the government needs to proactively identify and develop a minimum of 50 entrepreneurs who have the potential of developing Unicorn Businesses that will engage in the massive export of their products and/or services over the next 5 years.

The mandate can be given to the Small and Medium Enterprise Development Agency (SMEDA) in collaboration with the Sierra Leone Investment and Export Promotion Agency (SLIEPA). SMEDA will oversee the identification and personal/ business growth of these entrepreneurs whereas SLIEPA can help engage the key actors within the international market space to enable the smooth introduction of our local products and services.

The approximate cost of producing each entrepreneur (including training, seed capital etc) is US\$1m over five years. This amount is expected to be covered by key players like the banks and other financial institutions (in the form of loans to each start-up), government (in the form of subsidies and the creation of shared office spaces), non-governmental agencies (in the form of expert trainings and access to technology) etc.

There is a need to mobilise the selected entrepreneurs into core teams/clusters. This can be done by regions or towns and by using the Industry Classification Benchmark (ICB) which helps to segregate the macro economy into industrial clusters i.e., education, agriculture, health, fashion, food and beverage etc.

In a nutshell, the Regional Teams or clusters should have a strong flavour of Specialisation like in the US: Silicon Valley (Tech); Las Vegas (Entertainment); Dallas, Beverly Hills; Hollywood etc.

Similarly, we could have Bo (Agriculture), Freetown (Technology and Tourism), Kono (natural resources), Makeni (Farming), Bonthe (Fisheries) etc. This kind of structuring will not only help those regions to specialise in key economic activities but could also help to decentralise

our already currently centralised economic system.

The government needs to take series of actionable steps around the creation of a viable entrepreneurial ecosystem which makes it easier for anyone anywhere with little or no resources to start and effectively run their own business.

The government can specifically take the following actions: levy a lower tax rate or give tax holidays to start-ups, create an online platform that makes it easier to pay for and register a business within 24 hours, negotiate business partnership deals with neighbouring countries through SLIEPA to make it easier for our businesses to trade. It needs to also actively promote the concept of entrepreneurship as a primary not secondary source of our development.

We need to get the Central Bank to heavily invest in global assets primarily in stocks, bonds, digital assets like Bitcoins etc in conjunction with helping our banks in breeding our locally grown Multinational Enterprises (MNEs). Investment in global assets has the potential of strengthening our currency.

The Central bank of Japan for instance is actively involved in the purchase of global assets primarily in the form of stocks and bonds. This bold and unorthodox move by the central bank of Japan started is as a result of the tough deflationary condition the country was in, in 1989. They tried conventional monetary policy instruments but the condition deepened. This uncharted path helped stabilised Japan's economy. Bloomberg has described Japan as follows:

"Japan is to central banking what the old Bell Labs was to the global tech industry: a hotbed of ideas that get adopted by others. Going back to the late 1990s, it was forced to pioneer unorthodox methods to try to spur growth and restart the economy's credit machine. In doing so, it's shown other central banks that they have a broad array of options when they've already cut interest rates to zero."

According to a Yahoo Finance report “as of April 2019, Japan's central bank was a top ten shareholder of more than 50% of publicly traded companies”. Therefore, whilst we applaud the central bank for using every traditional monetary policy tool to stabilise the economy including the proposed redenomination of our currency, It will have to go beyond the usual by engaging the business community (formal and informal), help build strong unicorn companies/MNEs as well as investing in global assets to include stocks and digital assets like bitcoins.

Finally, and most importantly, for us as a country to get it right, the implementation of this instrument will involve a lot of patchwork and collaborative effort at all level. The system has to be strictly monitored, every minute, hour and day count until there is sanity in the economy. Bank of Sierra Leone, would first of all need somehow strong foreign currency reserve that they can use to augment any shortfall of USD in the system for the sake of importation; this could be done by auctioning of the USD to importers through Commercial Banks. Also, there must be strong monetary and fiscal control measures. The Bank of Sierra Leone, Ministry of Finance, Ministry of Trade and other related MDAs have to do all that is possible to maintain the price system and not to have a recourse for inflation.

10. Conclusion

Redenomination is only an auxiliary tool for improving the

economy, allowing to smooth out the effects of the crisis and hyperinflation. Its task is to restore confidence in the national currency, simplify settlements and take control of the shadow turnover. Central Bank Governor Kallon said that the new currency notes will reduce transaction costs as well as giving a “psychological boost to the citizens”. It is carried out in conjunction with a comprehensive program of economic growth. In itself, it can only aggravate the situation due to the panic of the population. It is practically impossible to make money on redenomination directly, but the changes in the country can lead to increased investor interest in the future. Nonetheless, it should be noted that redenomination isn’t necessarily a bad idea and that we are not the first country that would have adopted it. The effect of the currency redenomination will be felt on every one irrespective of your financial status or earning power. As its affect the income or liquid assets of the poor person so also on the average and the rich person.

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