Can a New Currency End Tehran's Economic Woes?

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Faced with surging inflation and a falling national currency due to harsh U.S. sanctions that were reimposed after the United States unilaterally withdrew from the nuclear deal with world powers in May, Iran is planning to remove four zeros from the rial, taking its current official exchange rate with the U.S. dollar from 42,000 to the more palatable 4.2. The official rate is meaningless on the street, however; in reality, the value of the rial is far less

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—this week, it was trading at 120,000 to the dollar on the black market.

For years, Iran has been operating two exchange rates, one for crucial imports and one for everything else. (Even more rates have emerged in recent months on the back of a currency crisis.) If implemented carefully and as part of wider financial reforms, redenomination would be a positive move but hardly an answer for all the country's intertwined economic woes.

In an Instagram post on Jan. 6, Abdolnaser Hemmati, the governor of the Central Bank of Iran (CBI), announced that during a meeting with members of parliament on the same day, he notified them that the regulator has officially submitted a redenomination bill to the government for review. The bill aims to slash four zeros off the rial, after which each 10,000 rials will be equal to 1 toman—the unit that currently equals 10 rials and has been used in daily transactions and trade by Iranians for decades.

Hemmati also explained that the legal and technical requirements—including passing the bill through government and parliament and recalling old banknotes and printing new ones—mean that fully replacing the national currency will take roughly two years. He said while redenomination will run alongside articles of bank reform currently being reviewed by members of parliament in the meantime, implementing the finalized plan and introducing new banknotes will come after.

The rial has been Iran's official currency since 1932. The toman was the national currency during the Qajar dynasty (1785-1925) and the first few years of the Pahlavi dynasty (1925-1979).

Neither are Persian words, with rial and toman having Spanish-Portuguese and Turko-Mongol origins, respectively.

The redenomination proposal comes just over two years after a previous attempt on a smaller scale. In early December 2016, President Hassan Rouhani's cabinet approved a measure aimed at removing one zero from the national currency, effectively introducing the toman as the new official unit. Officials emphasized that it was not an attempt at redenomination but merely an initiative aimed at easing day-to-day transactions. It was criticized as a costly and insufficient move, so the initiative remained in a state of limbo and was ultimately rejected by lawmakers in September 2018.

So now the CBI has come up with a more substantial effort that could be worth the cost. But this is not the first time Iran has considered currency redenomination and a quick look at its modern history shows why.

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, CBI data show. Iranian authorities considered currency redenomination in 1994, when a 49 percent inflation rate was stoking fears of hyperinflation. The second attempt came in 2008 in an era defined by the controversial policies of hard-line President Mahmoud Ahmadinejad and multilateral sanctions put in place in response to the country's nuclear ambitions. In 2010, Ahmadinejad announced plans to lop off three zeros.

Both plans were halted due to the many uncertainties that stopped officials from reaching an agreement on how to implement them. When Rouhani's central promise of curbing inflation was delivered in 2016, it was the first time in 26 years that inflation was brought down to single digits.

A decade after Ahmadinejad's botched redenomination, the plan has resurfaced. But this time things are different on multiple levels. For one, currency devaluation caused mainly by galloping inflation has continued unabated. A major reason behind this is a lack of independence on the part of central banks that for the most part have had to act as mere executors of monetary policies devised by governments.

Most infamously, the populist Ahmadinejad used the central bank and government budgets to organize cash handouts and a controversial cheap housingmegaproject, both of which remain unfinished today and represent thorns on the side of the Rouhani administration and Iran's economic growth.

At the time of the Islamic Revolution, each U.S. dollar fetched about 70 rials on the open market. When Ahmadinejad announced his redenomination plan, each greenback was traded for about 10,000 rials, a rate that stood at more than 35,000 rials by the time his presidency ended.

Still, thanks to reimposed U.S. sanctions and local mismanagement, many Iranians surely yearn for that rate today. Like Ahmadinejad, Rouhani's central bank managed to stabilize foreign exchange rates roughly at their previous levels during his first tenure. But a vastly different picture has emerged since Rouhani began his second term in office in August 2017 and Donald Trump came to power in the United States.

The rial hit an all-time low of 190,000 rials on the black market shortly after the Rouhani-Trump showdown at the United Nations General Assembly in late September 2018, forming a currency crisis. It has since regained some lost ground on the back of the central bank's intervention and is now traded at around 120,000 to the dollar.

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, allegedly to prevent further confusion emanating from a discrepancy with figures published by the Statistical Center of Iran. Estimates say inflation now stands at higher than 35 percent, compared with below 10 percent a year ago.

But in addition to the currency crisis and inflation, the local political landscape is also different this time. There is much more cooperation between Rouhani's administration and parliament in terms of reaching economic solutions. For months, parliament's economic commission has been reviewing and gradually passing bank reforms that promise to deliver the biggest changes to Iran's banking system in decades— including granting the CBI more independence.

Therefore, the currency redenomination bill could become a good addition to much larger banking and monetary reforms that are the product of active cooperation between the government and parliament. But to become law, it would still need to be approved by the powerful Guardian Council after receiving the approval of parliament. The council's clerics have raised no objections to redenomination so far, and there is a consensus on all levels of the establishment that the banking system is in dire need of reforms.

Also promising is the fact that officials are seemingly aware of the benefits and limitations of currency redenomination. After a cabinet meeting on Jan. 9, CBI Gov. Hemmati told reporters that the central bank does not expect too much from redenomination. "We're not saying it will have an impact on economic growth and inflation. We know it's a cosmetic move. … We're doing it to facilitate payments and save on printing costs," he said. This shows officials view it only as a component of much larger, necessary reforms.

The Iranian government doesn't need to look far to see that if implemented as part of wider financial reforms, especially in the beleaguered banking system, redenomination could be helpful in several aspects.

In 2005, neighboring Turkey took six zeros off its currency and redenominated the lira in response to an inflation rate of higher than 50 percent. The move was relatively successful because it was implemented in tandem with wider reforms. But Turkey's 2018 currency crisis proved immensely challenging and again decreased confidence in the lira mostly due to a problematic banking system. Turkey's central bank gained independence in 2001 in the aftermath of an economic crisis, but that hasn't meant it has been fully free of government meddling.

Slashing four zeros before the end of the Rouhani administration—when there is hope that the overall Iranian economy will also be more stable in a post-Trump world—could indeed decrease spending in several areas. The most obvious is money printing.

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Annual money supply growth has now been decreased to around 20 percent on the back of unanimous warnings—even from Supreme Leader Ayatollah Ali Khamenei, who called the liquidity volume "mindboggling"—to prevent another budding crisis. Still, Iran's total money supply was close to a whopping 17 quadrillion rials at the end of the seventh month of the current Iranian year on Oct. 22, according to the latest CBI figures.

Furthermore, if the redenomination bill is passed into law, all monetary regulations and auditing books will also be changed to facilitate transactions. That will make accounting and auditing processes much easier. Finally, the rial's nominal exchange rate will benefit from simplicity. Smaller numbers make transactions much easier for businesspeople and the general public to calculate.

While redenomination won't actually strengthen the rial or boost public purchasing power as a stand-alone measure, it could have a positive psychological impact on the people. They are increasingly dissatisfied with the fact that a single U.S. dollar fetches tens of thousands of their national currency.

But authorities also need to recognize that the initial positive psychological impact of currency redenomination will be short-lived, and could be quickly reversed, if high inflation persists. The general public, especially a hammered middle class, knows that taking a few zeros off the rial won't do anything to lift their deteriorating prospects by itself.

The fact that the government does not view redenomination as a silver-bullet solution for high inflation and a weak currency is promising. Especially since history has shown what price people have had to pay for their leaders' lack of policy foresight.

Venezuela cut five zeros off its national currency last August in a move socialist President Nicolás Maduro said would turn the faltering economy around. It came as little surprise that it did nothing to curb the country's hyperinflation that the International Monetary Fund says will reach 10 million percent in 2019.

Worst yet, Zimbabwe slashed 12 zeros off its currency at the height of an economic crisis in 2009. Dealing with an astronomical inflation rate that was estimated at 89.7 sextillion percent by the Cato Institute meant that the move was an absolute failure. Zimbabwe was forced to ditch its currency altogether in 2009 and opt for the U.S. dollar, South African rand, and a basket of other currencies. Bond notes pegged to the dollar were introduced in 2016 as legal tender, but the Zimbabwean government may scrap them as well.

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—authorities are well-aware that Iranians' patience for economic hardship fueled by corruption and mismanagement is already running thin. But those countries, still plagued by instability today, should serve as cautionary tales.

To ensure a smooth transition process and to prevent a rebound that would force another redenomination and massive implementation costs a decade down the line, Iran's government and parliament need to reach a united vision. They need to aim for macroeconomic stability through local reforms on the national scale and weather the sanctions storm by working with foreign partners to keep the nuclear deal alive and buoy trade. Only after achieving those things can they take four zeros off the rial and rebuild public trust in a reinvented national currency.