

As seen in



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Iraq's banks, currency in tatters

Rebuilding crushed financial system vital to nation's future

By Barbara Hagenbaugh

WASHINGTON — One of the most daunting tasks facing the architects of a new Iraqi economy is the creation of a new money and banking system.

Developing a financial system might be one of the biggest — and most difficult — economic projects in the world in recent decades. The currency must be stabilized, or a new one created, and the banking system must be rebuilt. The stakes are high. If the Iraqi monetary system doesn't get back on its feet, the entire economy likely would slide, making it an even bigger uphill climb to a post-Saddam society.

The old system is in shambles. Three currencies are circulating, including the dollar, which is gaining in popularity. Inflation is estimated to be running between 60% and 70% a year, maybe higher, and there's no system that remotely attempts to manage the money supply.

The central bank's role in the past few decades has been to print and distribute money. No one knows how much is in circulation, and figuring that out might be complicated by looting at the main headquarters of the central bank in Baghdad and damage done to a key outpost in Mosul.

Other basic economic data, such as on gross domestic product or government debt, are educated guesses or unknowns. What do they do?

"Start from scratch," says Raquib Zaman, finance professor at Ithaca College in New York. Zaman, who studies banking in the Middle East, says to expect "complete chaos" for a while because the transition from a government-controlled economy to a market economy will take time.

Officials from the United States are trying to keep the chaotic period to a minimum. Fourteen experts from the Treasury Department, including some who were on the ground in Afghanistan, are part of a 250-member team representing the U.S. in Iraq as part of the rebuilding effort.

The Treasury Department announced Friday that Michigan State University President Peter McPherson will lead the agency's team in Iraq. McPherson will act as the main liaison between U.S. officials and Iraqis put in place to rebuild the economy.

Officials from international institutions — including the International Monetary Fund and the World Bank — are expected in the country soon.

The United States and other

institutions will have to tread lightly and avoid being seen as dictating policy, or they will risk fostering mistrust and more economic instability.

"The impression shouldn't be left that Iraq is being exploited by foreigners," says Iraq-born Bassam Yousif, who left the country 20 years ago and now teaches economics at California State University, Fullerton. "There's a big risk of that."

Stabilizing the currency

The first step is to stabilize the nation's currency to stop crippling hyperinflation. Never an easy feat, it's more difficult in Iraq because three currencies are circulating:

- ◆ **Swiss dinar.** Called the Swiss dinar because it was designed in Switzerland, this currency was produced before the first Gulf War and has not been produced since. It's circulated in northern areas where the isolated Kurdish population resides. Because the amount of money is limited to what's already in circulation and it's not easy to counterfeit, it is considered a relatively stable currency, trading for about eight Swiss dinars to the dollar.

AS SEEN IN USA TODAY'S MONEY SECTION, APRIL 28, 2003

◆ **Saddam dinar.** The Saddam dinar features a portrait of Saddam Hussein, whose regime printed large amounts of the currency to finance military spending and lavish lifestyles, leading to sharp gains in inflation. The currency is also easy to counterfeit, leading to an even greater supply. The exchange of the Saddam dinar has fluctuated widely and currently trades for about 3,000 to the dollar.

◆ **Dollar.** As in other countries, the dollar has been in circulation in Iraq for years and has been an important part of commerce, particularly in the black market. But now it has become more popular.

Achmed Khalid, 30, recently traveled from Baghdad to Sulaymaniyah in the north with a car full of digital satellite receivers. He charged \$320 each and only accepted dollars. In one morning, he sold 10.

"The dollar is always the currency of choice whenever you have economic problems," says Sarkis Joseph Khoury, a Lebanese-born finance professor at the University of California, Riverside, who has consulted with Middle Eastern governments. Sixty percent of the more than \$650 billion of U.S. currency in circulation is estimated to be abroad, according to government data.

So far, Iraqis working on the docks, at oil wells and in the government are being paid in smaller-denominated U.S. bills. The U.S. government has shipped \$20 million in currency from the New York Fed — money that was taken out of Iraqi government officials' accounts frozen by the U.S. government, a U.S. official said.

All U.S. government officials interviewed for this story spoke on condition of anonymity.

The question for U.S. and Iraqi planners is what to do next:

◆ For the short term, some outside experts advocate a program in which Iraqis would bring in Saddam dinars to have them "stamped," to legitimize the currency, count how much is in circulation and perhaps most important, cover Saddam's portrait. Others say that would be too tedious.

◆ Some at Treasury argue Saddam dinars should be swapped for Swiss dinars as soon as possible. The company that printed the Swiss dinars more than a decade ago still has the printing plates in London and is ready to go into production, U.S. officials say.

The Swiss dinars could either be used on a temporary basis, until a new currency is created, or permanently.

◆ Others say both methods are too complex, and officials should let current money circulate until a new currency is developed. U.S. officials stressed Iraqis — not outsiders — would choose the new currency.

"People see money on a daily basis," says Rubar Sandi,

president of the U.S.-Iraq Business Council and a native Iraqi. A new currency "will give people a sense of a new beginning. Everything is fresh."

Rebuilding banking

The introduction of a stable currency will set a solid foundation for the long-term health of the Iraqi economy. Once the new currency is in place, which experts say could take less than a year, the banking sector will need to be restructured to develop a competitive system that will promote lending and commercial activity with strong government oversight. That's a task that could make creating a currency look easy.

The old Iraqi banking system was mostly nationally run. The new Iraqi government, with technical support from the United States and others, will have to create strong banking laws to establish rules, oversight and penalties.

In Iraq, all this will need to be done in the context of the country's culture. Islamic beliefs reject the notion of charging or granting interest — a main foundation of commercial banking systems around the world. But Islamic banks and commercial banks both operate in many Middle Eastern countries, and some Islamic banks find ways to charge interest through other means.

The Treasury Department last year had an "Islamic Banking 101" class and the issue is not being seen as an impediment to building up the banking sector, a U.S. official said.

The goal in Iraq will be not only to encourage entrepreneurs to establish banks but to prove to international banks that the country is an attractive place to do business.

Yousif, the Iraqi native now teaching economics in California, says the government will likely need to continue to have a heavy hand in banking for years.

"These are very, very risky activities," says Yousif, who left Iraq two decades ago at age 14 and has never returned. "It's going to need a lot of government support before you have a well-developed, functioning financial market where a private investor would be willing to lend."

Not the first time

This won't be the first time the United States assists a country in redeveloping an economic system. After World War II, U.S. and German officials devised a plan to introduce a new currency. To help fuel the economy, Germans were given 40 new Deutsche marks, equivalent to more than \$90

AS SEEN IN USA TODAY'S MONEY SECTION, APRIL 28, 2003

in current dollars.

There has been no discussion about a similar move in Iraq.

Although Iraq has a very different, and much bigger, economy, some important lessons can be learned about establishing currency and banking systems from the rebuilding of Afghanistan.

Inflation was rampant when the U.S. entered Afghanistan in 2001. Currency had been printed in large volumes, not just by the government but by warlords seeking to finance military operations. The currency, called the afghani, was easy to counterfeit.

The afghani lost 99.9% of its value in three decades, bringing the exchange rate to about 40,000 afghanis to the dollar. Consumers had to bring buckets of currency to buy small sacks of groceries.

But soon after the United States entered Afghanistan, confidence in the future of the economy rose, leading to a strengthening of the currency. Dollars also circulated.

On Oct. 7, 2002, a year after the first U.S. bombs fell on Afghanistan, a new afghani was introduced that knocked

three zeros from the previous currency and included several anti-counterfeiting measures, including watermarks. Afghanis were given a limited amount of time to exchange their currency.

Paul Davies, a senior consultant at the Adam Smith Institute in London who has been actively involved in Afghanistan, calls the new currency a success, noting there have been no major reports of counterfeiting, and it has been stable, although implementation was not a smooth process.

Iraq might have it easier. The population is better educated than Afghanistan's, and the near-term potential for the economy is likely higher. A wealth of untapped oil puts Iraq in a better place.

"There is much greater human capacity in Iraq than Afghanistan," says Peter Young, director of the Adam Smith Institute. "Perhaps people will be willing to come back more readily from overseas because there is more of an economy there."

Contributing: Donna Leinwand from Iraq

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Iraq's banks, currency in tatters, 1-2B

APPLICATIONS: *problem solving, economics, research, group work*

DISCUSSION: Before reading the article, define the following words: currency, inflation, gross domestic product, market economy. Who will be rebuilding Iraq's financial system? What is the first step in the process? Why do you think printing large amounts of money can lead to inflation? Why does business leader Rubar Sandi favor creating a new Iraqi currency? How will Islamic principles impact the development of a commercial banking system in Iraq? What central system manages the U.S.'s money supply? How does the U.S. thwart counterfeiters? Have multiple currencies ever circulated in the U.S.?

ACTIVITY: Imagine that you were going to teach recent immigrants about U.S. banking. In small groups, research and identify the topics you would cover in six, one-hour classes. Develop an outline for each lesson.

CURRENCY CONNECTION: What U.S. agency is responsible for designing currency? What U.S. agency is responsible for replacing currency? Why do you think the \$20 bill is being redesigned?

NATIONAL STANDARDS

NSS-EC.5-8.10 MARKET INSTITUTIONS

(Students) understand banks and other financial institutions channel funds from savers to borrowers and investors. (NCEE)

NSS-EC.5-8.11 MONEY

(Students) understand 1.) the basic money supply in the United States consists of currency, coins, and checking account deposits; 2.) in many economies, when banks make loans, the money supply increases; when loans are paid off, the money supply decreases. (NCEE)

The New Color of Money Challenge

The USA TODAY Charitable Foundation supports the Federal Reserve System and Department of Treasury's campaign to raise awareness of the newly redesigned \$20 note and U.S. currency among students, teachers and parents.



Q: Each new bill is 6.14 inches long. If the bills were laid end to end, how long would a line of 37 million notes stretch?

For more information about The New Color of Money and available materials and resources:

■ www.moneyfactory.com/newmoney ■ www.FederalReserveEducation.org ■ www.usatodayfoundation.org

A: It would be 227,180,000 inches long, about 18,931,667 feet long or about 3,585 miles long.

COMPLIMENTARY EDUCATIONAL RESOURCES

On October 9, 2003, the United States government will be issuing currency with new designs and security features beginning with the \$20 note. The new \$20 design retains three of the most important, easy-to-check security features that were first introduced in the 1990s: a watermark, security thread and color-shifting ink.

As part of a national campaign to raise awareness about the newly redesigned currency, the U.S. government is making educational materials available to teachers. These materials, correlated to national educational standards, aim to teach students about our nation's currency. The program, part of a broader initiative supported by education, civic and volunteer organizations, includes a range of interactive educational activities:

► **Interactive CD-ROM** – Educational activities related to the history, security features and production process of the newly redesigned currency.

► **Classroom Activity Poster** – Information on the newly redesigned currency and activities that drive students to the web and interactive CD-ROM.

► **USA TODAY Educational Lessons** – Daily and weekly activities challenging students on current events related to financial literacy and the newly redesigned currency.

► **Currency Puzzle Challenge** – Students are to find pieces in three issues of USA TODAY, assemble them, and complete the related activities.

All of these educational materials are available free to teachers online at www.moneyfactory.com/newmoney and www.usatodayfoundation.org. For more information, email: education@usatoday.com or contact Katie Mee at 202-530-4518.