

Reflections

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10 questions & answers about Facebook's Libra cryptocurrency

Those who follow cryptocurrencies have no doubt noticed that Bitcoin and other cryptocurrencies have recovered significantly this year. But the cryptocurrency that made the biggest headlines this summer is one that actually doesn't even exist yet. I am of course referring to Facebook's Libra, or "the Zuckbuck" as its harshest critics call it. In this analysis I will look closer at Libra: its potential and risks, and what obstacles it must surmount to become a reality. It is clear that if Libra makes it out of the starting blocks next year, it has the potential to radically change how we view currencies – transforming them from a government monopoly to a global means of payment controlled by the private sector. Despite its great promise, like all revolutionary changes Libra poses risks and faces strong opposition.



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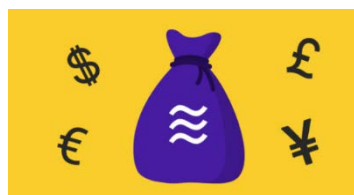
1. What is Libra?

Libra is a new cryptocurrency that is now being created by the social media giant Facebook and various other tech companies. Their relatively optimistic timetable is to have Libra ready for launch during the first half of 2020. It will consist of three parts:

- **The Libra currency** itself, which users will be able to send instantly to other users worldwide at low cost and without having to be bank customers. The currency will also support smart contractⁱ solutions.
- **A digital wallet** where users store their Libras, and with which they can interact with other Libra users in the network. *Calibra* is the name of Facebook's own digital wallet, but in the future there will be numerous such wallets created by different companies, with the same functions.
- **The Libra Association** is a group of organisations that will govern the Libra network and guarantee that it is secure and operates as intended. Aside from Facebook, companies like Visa, Mastercard, Uber, Paypal and Spotify have become members. The Libra Association will be located in Switzerland and consist of 100 companies and non-profit organisations.

2. How will the value of Libra be determined?

Just like Bitcoin, Libra will be a cryptocurrency based on blockchain technology, but several things will distinguish it from ordinary cryptocurrencies. One big different between Bitcoin and Libra is how the value of the currency is decided. While the value of Bitcoin is determined entirely by supply and demand – and may thus fluctuate dramatically over time – Libra is a "stablecoin" whose value is completely independent of supply and demand. The value of Libra will instead be pegged 1:1 to a reserve (or basket) of ordinary currencies. This reserve will consist mainly of US dollars, but will also include euros, Japanese yen, British pounds and Swiss francs. The way it will work is that if someone buys Libra and pays for it with ordinary money, that money will be added to the reserve. The money in the reserve will be deposited in various banks around the world or invested in



safe government securities. This structure is largely identical with a currency board system, for example the system used in Hong Kong to guarantee that the value of a Hong Kong dollar is stable

against the US dollar. There are examples of other cryptocurrencies that have similar structures.ⁱⁱ The assets in the Libra reserve will always cover the value of all outstanding Libra and thereby guarantee a stable value. Regardless of whether the supply of Libra increases or decreases sharply, this will not affect the exchange rate, but only the size of the Libra reserve. The reason this structure was chosen is that Libra is exclusively intended to serve as a means of payment and that it is extremely important that the value of the currency is stable over timeⁱⁱⁱ. Because of the dramatic fluctuations in the price of Bitcoin, that cryptocurrency is hardly used as a means of payment today, but is instead mainly regarded as a financial investment. Since Libra will be a stablecoin and not generate any other return in the form of interest, it will also be pointless as an investment, except perhaps for those living in countries with notoriously unstable local currencies, like Venezuela.

3. Who will control Libra?

Bitcoin and most other cryptocurrencies are open networks, where anyone who wishes can choose to join the network by starting to "mine". This gives them influence over the network in proportion to the computer power they deliver. But Libra's network will be closed – at least initially. This means that in order to participate and verify transactions in the network, it is necessary to be a member of the Libra Association or to have received its approval. The real power to control the overall development of the Libra network, both concerning technical issues and policy issues, will rest with the Libra Association.

When Libra starts, the intention is that the Libra Association will consist of 100 independent companies and non-profit organisations. Since each member – including Facebook – will have only one vote, no single member will be able to control the network. We can thus say that even though the Libra network will be controlled by a central organisation, decision making will still be decentralised since the organisation will consist of 100 independent members. Yet there is reason to be a little sceptical about this description since Facebook, as Libra's founder, will have a disproportionately large influence over what companies and organisations will be offered membership. This suggests that ultimately, Facebook will pull the strings more than anyone else.



Although many large companies have joined the Libra project, the other FAANG companies are missing. Apple, Amazon, Netflix and Google are all conspicuously absent. But we must assume that they are following how Libra is progressing with great interest. If Libra launches successfully, the other FAANG companies will probably have to try jumping on to the Libra train or create their own cryptocurrencies. In either case, the outcome will be that

cryptocurrencies will become a natural element of everyday life for billions of people.

4. What do politicians and central banks say about Libra?

It is no exaggeration to say that the Libra project has scared politicians and central banks. The US Congress has already held two hearings about Libra, and members were clearly suspicious and concerned about the project. The Chair of the House Committee on Financial Services, Democratic representative Maxine Waters, ended her committee's hearing on Libra by saying:



"When I first saw the White Paper unveiled, I almost went into a state of shock. I couldn't believe what I was seeing."

Maxine Waters, July 17, 2019

The authorities have never liked cryptocurrencies, but they have learned to live with them since – in their present-day form – they have not posed any acute threat to ordinary currencies. Libra is something entirely different. Libra's potential to reshape the global payments system and seriously compete with ordinary currencies have made governments and central banks sceptical of the project. The heads of the US Federal Reserve, the European Central Bank, the Bank of England as well as representatives the G7 countries have all expressed strong concerns that Libra might not be regulated in the same way as the rest of the financial system. Another circumstance that American politicians don't like is that the Libra Association will have its headquarter in Switzerland, not in the United States, which many people suspect is a way of avoiding being monitored by US authorities.

5. Can Libra spell the end of ordinary currencies?

What today's cryptocurrencies are missing, more than anything else, is users. This is also where Libra's great potential lies. Taken together, the global companies behind Libra have several billion users located worldwide and more money to invest in developing



and marketing than anyone else, including large countries and governments. Bitcoin has needed 10 years to get from zero to nearly 10 million users around the

world. It is mind-boggling that overnight, Facebook could offer Libra as a technologically superior global means of payment to all of its 2.7 billion users. If Libra were allowed to develop freely, there are many indications that in a relatively short time it could put various smaller weak national currencies out of business. Even if Libra is meant to serve as a means of payment for our everyday online purchases, there is nothing to prevent it from becoming much more widespread and from being used for everything from paying salaries to granting loans. Facebook and its digital wallet company Calibra have clearly stated that they will only offer payment intermediation, not banking services, since the latter are subject to much more complex and extensive regulations. But obviously this will not prevent people from collaborating with existing banks and, via these, offering Libra-denominated banking services in the same way that banks today already offer them in numerous other currencies. Countries that are politically unstable and lack a well-functioning financial infrastructure of their own could see their own currencies being crushed by Libra, which might function independently of a country's own payments system.

6. Can Libra make it impossible to pursue monetary policy?

If Libra proves very successful, one consequence is that it would undermine the ability of central banks to pursue monetary policy. But for this to happen, virtually the entire economy would have to transition to using Libra. In other words, we would have to buy groceries and clothing in Libra, borrow money to buy houses and flats in Libra, receive our salary in Libra and pay our taxes in Libra. Using Sweden as an example in such a world, a hike or cut in the Riksbank's key interest rate would have no effect since the interest rates on Swedish mortgages would not be related to the Riksbank repo rate, but to the cost of borrowing the mix of currencies that make up the Libra reserve. In such a world, the Fed would be very influential since more than half the Libra reserve would consist of dollars, whose interest rate the Fed decides. The difference is that the Fed's interest rate changes would no longer affect only US households, but all households in the world that have borrowed in Libra. This scenario would be very unfortunate, since there are major economic advantages if countries in different cyclical phases can have different interest rates and that, over time, their currencies can move up and down in relation to each other and thereby smooth out differences. So expect regulators, central banks and governments to do what is necessary to prevent Libra from becoming so widespread that it threatens to take over national economies.

7. How regulated will Libra be?

Regulations will play a major role in the Libra project and are undoubtedly the biggest threat to its becoming a reality at all. Issues related to KYC and AML^{iv} as well as the stability of the financial system must be resolved, but there are also uncertainties about consumer protection and how the technical security of the Libra network can be guaranteed 24/7. Facebook and the rest of the Libra Association seem to have a mixed view

of regulation. On the one hand, they are fully aware that regulations will limit the potential of the project. Yet regulations will also help make the Libra project trustworthy to ordinary people. Most governments and central banks have already realised that they cannot stop cryptocurrencies from playing a role in the global financial system. The regulations that will control Libra can perhaps become a model for how to regulate the rest of the crypto market. Libra could thus become the first example of public authorities letting a cryptocurrency serve a broad public while maintaining fairly extensive control over it. In any case, it is quite clear that if Libra becomes a reality, it will be thoroughly monitored and regulated by the authorities in a number of countries. Regulations will probably also be used to prevent Libra from taking up too much space in the economy.

8. Can national electronic currencies compete with Libra?



Another possibility is that Libra will speed up the development of official “e-currencies”, which several central banks are looking at today. The Swedish e-krona is one example of such a project. Central banks in various other countries have also begun to design their own e-currencies. These could offer technical functions similar to Libra, but like traditional currencies they would be entirely controlled by governments and central banks. But there are a number of challenges to central banks that make it unlikely that they can deliver competitive alternatives to Libra.

- Central banks lack the technical know-how that Facebook and other tech companies have in order to develop cryptocurrencies and the innovations they require.
- Central banks do not have the network required to reach customers. Facebook, in contrast, has daily direct contact with 2.7 billion customers, largely via smartphones.
- Central banks cannot make their e-currencies global. They will only be digital versions of their national currencies, and thus they will not be able to provide international payments.
- Central banks will not be able to develop their e-currencies as rapidly as the companies behind Libra.

9. What risks are associated with Libra?

Aside from risks related to money laundering, terror financing and financial stability, many people are critical because Libra will give tech companies even greater scrutiny and power over our lives. Although Facebook’s Calibra wallet will be a free-standing

company and the two companies have issued assurances that no information about customers will be shared between them, it is difficult for Facebook to shake off suspicions, given its questionable behaviour in recent years. Another concern is that the Libra Association will have the power to exclude people from its network in the same way that Facebook today assumes the right to exclude undesired people and companies from its social platforms. This power could also be used against small countries if Libra becomes widespread. Imagine a scenario of a small country depending on capital inflows from its citizens who work abroad and send money home every month in Libra. If the Libra Association controls the payment system, it is not hard to see how much political power this will give it.

Some people also believe that the Libra reserve system is risky in itself. First there is a risk that in the future, the Libra Association will be tempted to issue more Libra than it has backing for in the

reserve. Second, the assets in the reserve might be mismanaged or embezzled. These risks will probably be manageable, since the administration of the reserve and its strict connection to the Libra supply will probably be one of the areas that will be most strictly regulated and monitored by the authorities.

One major concern of many American politicians is Libra’s potential to change the existing global economic system, where the dollar has been the sun around which all other currencies have revolved in the post-war period. The dollar has long been the self-evident currency for global trade. Nine out of 10 international transactions now take place in dollars. The risk that Libra might seriously threaten the role of the dollar should neither be underestimated nor exaggerated. In order for Libra to be able to challenge the dollar as a global reserve currency, it is not enough that it moves into people’s wallets. It must also occupy an equally large space in the global banking system. The path to such a situation is long, winding and full of obstacles. The US will do everything it can to preserve the status of the dollar and will not hesitate to use regulations and other means at its disposal. Although many countries question the dominance of the dollar and both the EU and China are deeply dissatisfied with how the US uses the dollar to entrench its economic and political power, the alternative of instead handing that power to a group of US tech companies seems even worse. You can find more about the dollar’s future as a global reserve currency [here](#).

10. Who are the winners and losers from Libra?

Facebook maintains that the big winners from Libra will be ordinary people around the world, who will gain the opportunity to easily and cheaply send money anywhere. The 1.7 billion or so poor people who have no bank account (and are thus shut out of the global financial system) will find Libra especially beneficial.^v



It is less clear how the companies behind Libra intend to make money. Facebook’s official version is that it hopes it can make money because Libra will help direct more sales to all the small businesses found on its platform and that this, in turn, might lead to higher advertising revenue for Facebook. The Libra system itself will also make some money from the returns that the Libra reserve is expected to earn over time and from the fees charged when customers buy, sell or send Libra. The returns on the reserve will go towards covering the costs of operating the Libra network, and to the extent there is any surplus it will be allocated among Libra Association members as a return on the investments they have made. If the Libra becomes a success this could amount to substantial revenues. Among the losers from Libra will be central banks, which will see their currency monopolies eroded, reducing their influence even if their ability to pursue monetary policy is protected via regulations. Banks will also be losers when it comes to delivering payment intermediation services. If a small European importer can pay its supplier in China directly in Libra and the physical delivery of goods can be secured with the help of a smart contract built into Libra, it will be difficult for today’s system to compete in terms of price. In a broader perspective, it is not equally certain that banks will be losers, since Libra might pave the way for new banking services in the future.

ⁱ Smart contracts can be built into certain cryptocurrencies, for example making it possible for a transfer to be made only after a given condition is fulfilled.

ⁱⁱ The cryptocurrency Tether is an example of a stablecoin; its value is pegged 1:1 against the USD.

ⁱⁱⁱ The value of Libra will be completely stable against the basket of currencies in the reserve, but not against any individual currency.

^{iv} KYC = know your customer), AML = anti money laundering.

^v Libra Association, *An Introduction to Libra*, White Paper, 2019.