Facebook's Libra: A Global Monetary System Governed by Private Corporations?

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Perhaps the clearest, most recent statement on the introduction of a monetary system outside the remit of national governments is the one made by Judy Shelton, one of Donald Trump's nominees for governor of the Federal Reserve Board, in a policy paper published by Cato Institute in 2018 when she stated: "If the appeal of cryptocurrencies is their capacity to provide a common currency, and to maintain a uniform value for every issued unit, we need only consult historical experience to ascertain that these same qualities were achieved through the classical international gold standard without sacrificing the sovereignty of individual nations…A modern version of this approach—one that permits the issuance of virtual currencies in tandem with government-issued currencies, adapting legal tender laws to permit healthy currency competition—should be put forward." It would appear that "…a modern version of [the classical international gold standard] approach—one that permits the issuance of virtual currencies in tandem with government-issued currencies…" is exactly what Facebook had in mind in its white paper proposing the Libra Global Coin. Why? Primarily as it attempts to address the drawbacks of bitcoin and other cryptocurrencies whose history of wild fluctuations meant that, although they were able to be used as a medium of exchange, they could not be used as a store of value or a unit of account. They, therefore, could not fulfil all the characteristics of money. Nonetheless, for Facebook Libra Global Coin to be that kind of monetary system which is driven by private corporations, it would need to surmount several hurdles. One of its greatest hurdles would be achieving a coordinated global approach that is needed to tackle most of the risks this new currency poses.

Facebook proposes two assets namely: the Libra Global Coin and the Libra Investment Token. The Libra Global Coin, which is most spoken about and which is proposed to be the currency used globally, has been described as a retail token and a payment tool that will facilitate money transfers to anyone in the Facebook/Whatsapp/Instagram network. Users would be able to buy Global Coins by depositing fiat currency with the Libra Association. They would also be able to transfer Global Coins over the network, and the recipient would be able to redeem those Coins for an equivalent amount of fiat currency or hold it for further use. To ensure the Libra Global Coin has a stable value, unlike the bitcoin and other cryptocurrencies, the Libra Association indicates that the proceeds from the sale of the Libra Coins would be invested in a range of short-term, interest bearing assets in major currencies such as GBP, EUR, USD, and JPY.

The Libra Investment Token will also be issued by the Libra Association to partners who invest in the Association. These tokens are currently issued to the 27 Libra Association partners who have each invested a minimum of $10 Million for a vote in the Libra Association. The plan is to increase the number of partners to approximately 100 when Libra launches. As consumers purchase Libra, the proceeds of purchase would be invested in short-term assets to generate income which would pay off the Libra Association's expenses and the rest shared equally among the partners. This, of course, promises to be a quite profitable venture given Facebook's existing customer base of 2.4 billion Facebooks users. Though an ingenious idea, devising a robust global regime that addresses significant issues raised by the Libra Global Coin is where the challenges lie.

Financial stability implications

The Libra Global Coin could carry a systemic risk if the Libra Association is unable to maintain the one on one reserve requirement stated in the white paper due, for example, to a depreciation in the market value of assets backing the currency. Since the Libra Association plans to expand to about 100 corporate partners capable of investing $10 Million dollars, this suggests that the corporate partners would be quite dominant global businesses which may require the use of the Libra Global Coin as the payment method for the goods and services they provide. The sheer scale of the potential usability of the Libra Global Coin from this type of scenario indicates that the coin could very quickly have systemic implications should its value drop. It also indicates that the Libra Association could very quickly become a systemically important financial institution (SIFI) – that is, a financial institution whose failure might trigger a financial crisis and is also known as 'too big to fail'.

The Libra Association in this respect could be deemed as performing 'bank-like' functions, taking 'deposits' – if the funds used to purchase the coins are classed as deposits and if libra users are deemed as depositing money with the Libra Association. Also, if the Libra Association is deemed as lending on the money in the form of short-term debt instruments with interest accruing used to pay expenses and dividends to its shareholders, this would be similar to typical bank-like functions. So, although the Libra Association is not a bank by definition[1], its functions and the implications of its failures could be deemed as sharing similarities with banks. This, as such, begs the question of whether the Libra Association should be made to comply with international capital requirement standards applicable to banks as set out in Basel III.

Monetary policy implications

Also, for countries where the Libra Global Coin would have more widespread use than local currency, such as those in jurisdictions with weak currencies including – some parts of sub-Saharan Africa and Latin America – national central banks are likely to lose their ability to conduct monetary policy, further weakening their ability to introduce the necessary economic policies to stimulate their economies in times of economic distress[2]. This could potentially affect their ability to service their sovereign debt, as well as secure future financing on the international financial market. So, due to its potential to displace national currencies, it would be imperative that there is an international oversight regime in place to monitor the operation of the Global coin were it to launch. This oversight regime could take the form of a global public-private partnership, one that involves an arrangement with the Libra Association and the Financial Stability Board (comprising ministries of finance, central banks, and regulatory authorities from G20 jurisdictions); a group of monetary authorities from developing countries where Libra is likely to have widespread use such as Indonesia, Mexico, Nigeria and Pakistan; and international organisations and financial standards setters such as the IMF and Basel Committee on Banking Supervision. This is likely to give Facebook Libra Project more legitimacy.

Money laundering implications

The Libra coin also raises significant money laundering implications. The reason for this is that although Facebook assures that its Calibra wallet – the main platform through which Facebook, Whatsapp and Instagram users would be able to purchase the Libra coin – would comply with Anti-money Laundering, Know Your Customer (AML/KYC) requirements, as set out under the Financial Actions Task Force (FATF) Recommendations, other wallet providers located in jurisdictions with weak financial regulations and who would be able to facilitate the sale and purchase of Libra, may not. This could result in regulatory arbitrage which then makes money laundering and terrorism financing a risk of the Libra coin. To mitigate this risk, there would need to be a well-coordinated consensus as to AML/KYC standards to be adopted amongst all states where the Libra coin would be used. As things currently stand, this would be a challenge. Even in advanced economies with strong financial regulatory regimes, money laundering is a challenge as seen in recent times.

Global digital Identity requirement

Closely linked to the money laundering drawback is the issue of digital identity – which the white paper attempts to address. As the Libra Global Coin would be purchased through the Calibra wallet and other wallet providers, purchasers would need to have a digital identity. Although Facebook is making progress in adopting technology such as facial recognition, physical ID card scanning and mobile biometrics to verify customer IDs, in preparation of its

Calibra wallet, this does not guarantee the effective identification of persons wanting to sign up to Calibra. Why? For the verification of IDs to be effective, national authorities would need to authenticate the identification documents (such as passports or national IDs) to be used by Facebook Calibra or any other wallet providers at the point where they sign up to the wallets. This is so as even with all the technology facilitating identity checking, a user may be able to acquire a fake ID which could be linked to their facial recognition and mobile biometrics. Without countries' authentication of the ID of their citizens signed up to use Libra, the operation of all such technology could be pointless. As such, governments all over the world would need to be supportive of this project. This is not the case at the moment, with the China, France, Germany and the US clearly opposing it. Added to this is the fact that in parts of the world where Facebook claims that the Libra coin would be designed to engender financial inclusion, those who require financial inclusion the most are hardly able to afford a fake ID or a genuine national authenticated one – thus questioning the extent to which the operation of the Global Coin could possibly facilitate financial inclusion.

Securities regulations implications for the Libra Investment Token and the Libra Reserve

As Libra's success would depend on the success of the Libra Reserve and the Libra Investment Token – the two critical infrastructures that are the bedrock of the whole project – it is necessary to define their status. This would be especially useful to know which regulatory regime should apply to them.

Whilst the status of the Libra Investment Token is a security that partners receive for their investment in the Libra Association, the status of the Libra Reserve – comprising a basket of currencies, government securities, and bonds and managed by the Libra Association – is less clear. As the Libra Reserve exhibits characteristics of an Exchange Traded Fund (ETF) (which is a basket of securities that is traded on an exchange) and a mutual fund (as it is made up of a pool of money collected from investors to invest in securities such as bonds and other assets), it is likely to be subject to securities regulation. If, however, the Reserve is neither classified as an ETF or a mutual fund by regulators, a separate category of asset class is likely to be created for it. If both the Libra Investment Token and the Libra Reserve are deemed as securities, then they would need to be subject to securities regulations of the licensing authority and would also need to be compliant with international standards set out by the International Organisation for Securities Commissions (IOSCO) as outlined, for example, in the IOSCO Principles. However, the choice of the location of the Libra Association in Switzerland, appears to be a strategic one as Switzerland is known to have more relaxed financial regulatory regimes in comparison to most advanced markets. Switzerland has also set itself out as a cryptocurrency hub that welcomes cryptocurrency businesses. This, of course, makes it a favourable location for the Facebook Libra Project.

Conclusion

From the above analysis, a great deal of international acceptance and cooperation would be required for the Libra Global Coin to operate without jeopardizing international financial and monetary stability. This level of international cooperation tilts more towards having one global policy and regulatory regime for the operation of the Libra Global Coin. As it is difficult to see how this can be achieved before the projected 2020 launch, it is not likely that we would see a monetary system driven by private companies anytime soon. If Facebook proceeds, what we would see instead is a fragmented and risky use of the Global Coin – with its acceptance in some jurisdictions and prohibition in others. Whilst the system would still be functional, it would by no means be comparable to the "…modern version of [the classical international gold standard] approach…" referred to by Judy Shelton. What perhaps might work in the medium term, is the suggestion by Mark Carney, Bank of England governor, in a speech in August 2019 of a new "synthetic" currency, "perhaps [provided] through a network of central bank digital currencies" as opposed to one driven by private corporations like Facebook. This "synthetic currency" could be more feasible an idea for a global currency to be used in international transactions. Although not driven by private companies, this type of currency, it would appear, would be more akin to what constitutes the "…modern version of [the classical international gold standard approach]…" referred to by Judy Shelton.

Notes

[1] The Libra Association's organisational form is unclear. Although the Libra Association describes itself as a 'not-for-

profit' organisation (white paper, p.3), it refers to the distribution of Libra as an 'incentive' to Founding members (white paper, p8). This was raised in the US House Committee on Financial Services and is an issue that would need to be clarified by the Libra Association with law makers / regulators.

[2] This is not a view that has been widely published by countries in these regions but is a genuine concern, particularly for African countries.

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