



Finance Watch

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Libra: Heads I win – tails you lose

Ten reasons why Facebook's Libra is a bad idea



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Ten reasons why Facebook's Libra is a bad idea

On 18 June 2019, social media giant Facebook unveiled plans to create a new global “digital currency” to be called Libra, and an associated payment system. In this initial assessment, Finance Watch concludes that Libra is a bad idea – for its users, for the stability of our financial system, and last but not least for our democracy.

1 Libra is not a currency: it is a payment token controlled by a handful of global corporations

Libra is a **private payment token** (also known as an “exchange token”) and hence no different from more than 2,000 other “cybercoins” that are already on the market.¹

Bona-fide currencies fulfil three distinct functions:

- they act as units of account for goods and services to be priced in a standardised, comparable way;
- they act as legal tender, i.e. all businesses and individuals within a certain territory, usually a nation state, are obliged to accept it as a means of payment in exchange for goods and services; and
- they act as a store of value, allowing their users to make savings, which they can spend at some point in the future.

Payment tokens do not fulfil these requirements.² With very few exceptions, primarily Bitcoin, they are not used by businesses to price and trade their goods and services, nor are they widely accepted as a means of payment. They do not lend themselves as a store of value – to the contrary: payment tokens have been the subject of intense speculative investment and their value has been fluctuating wildly. If volatility is a measure of risk the volatility of Bitcoin since its launch has consistently exceeded all other asset classes, including gold, oil and property.³

Libra differs from existing payment tokens only in that it is **controlled by a consortium of very large global corporations, the so-called Libra Association**. The consortium comprises some of the largest global non-bank payment processors, such as Visa, MasterCard and PayPal. Libra could enable them to replace the existing oligopoly of central banks and commercial banks in payment services with a private oligopoly of their own. The launch of the Libra token is, in this context, merely a way of shifting the global flow of payments towards a single unit of account that they control.

1 *CoinMarketCap*, 01 July 2019, available at: <https://coinmarketcap.com/all/views/all/>

2 *cf. Financial Conduct Authority*, Guidance on Cryptoassets (CP 19/3), January 2019, pg. 9; available at: <https://www.fca.org.uk/publication/consultation/cp19-03.pdf>

3 *Fitzgerald, Maggie / Rooney, Kate*, Bitcoin plunges \$3,000 in less than 24 hours, showing its volatility once again, CNBC Online, 27 June 2019; available at: <https://www.cnbc.com/2019/06/27/bitcoin-shows-its-volatility-again-plunges-1500-in-less-than-24-hours-after-exchange-outage.html>

2 Libra is not a real “crypto-currency”: it is closed and centralised

Most people’s understanding of “crypto-currencies” is based on the original concept of the Bitcoin⁴: a decentralised, peer-to-peer virtual currency, based on open-source code where ledgers comprising the inventory of coins, and their transaction history (the blockchain), are distributed to thousands of independent nodes which are, in turn, reconciled, automatically, continuously and without human interference, by a mathematics-based reconciliation (consensus) mechanism.

Libra is not a crypto-currency like Bitcoin: its coin is not created through a mathematical computation process (“mining”) but through the exchange of official (fiat) currency against a digital payment token created by a number of authorised servers, which are operated by the Libra Association. It is not a peer-to-peer system and not, strictly speaking, a distributed system either: Libra uses a closed (‘permissioned’) blockchain where its ledgers are held only on Libra Association’s authorised servers. Whatever benefits Bitcoin and other “real” crypto-currencies promised, ranging from better resilience to tampering and cyber-crime to visions of a global peer-to-peer network that would, over time render banks and public institutions obsolete – the design of Libra will not meet any of them. Consider instead a gift token, issued by your favourite shop, which can be redeemed only where it has been issued. Except that for Libra, you have to pay.

3 Libra is a privately issued financial asset: its users could lose their money

Official (fiat) currencies are backed, explicitly or implicitly, by the “**full faith and credit**” of the issuing government. Central banks also hold reserves, usually in the form of gold and foreign exchange denominated in a number of so-called “reserve” currencies, such as the U.S. Dollar and the Euro. Over and above the backing of the central bank, official currencies are also generally seen as carrying a pledge from the issuing government over its assets – even if this is controversial and rarely enforceable in practice. In principle, though, the issuing state bears an unlimited liability for the money and financial debt it issues.⁵ This does not mean that countries do not default – there is plenty of precedent. But all these precedents show that countries that default cannot simply walk away from their obligations: a sovereign default is very painful for the country and its population and has lasting effects – governments therefore have a strong interest in avoiding it.

Libra, by contrast, is a **limited-liability** corporate venture set up in Switzerland by a loose association of large, mostly U.S.-based limited-liability companies. Their financial exposure to Libra is limited to their initial contribution to the reserve but there is, as of now, no formal obligation on them to support the value of the currency and maintain the fixed exchange rate. In the event of a global crisis it would be for Libra’s backers to decide whether they stand by their “currency” and defend the peg or walk away and leave investors (aka “users”) to count their losses. What is a matter of existential importance to users – whether the money in their accounts could lose its value – would be reduced to a commercial decision for Facebook and its supporters: if the financial risk to them outweighs the potential benefits they could, in principle, let Libra fall and move on – true to the motto of Facebook’s founders: “*move fast and break things*”.

4 Nakamoto, Satoshi (pseudon.), Bitcoin: A Peer-to-Peer Electronic Cash System, October 2008; available at: <https://bitcoin.org/bitcoin.pdf>

5 The principal factor behind the fragility of the “fractional reserve banking” model, which allows commercial banks to create money by issuing credit

4 Libra as a collective investment vehicle could escape global regulation

Libra is billed as a “**stablecoin**”, i.e. a payment token that is pegged at a fixed rate of exchange against a basket of official (fiat) currencies. The value of the token is backed by a reserve of financial assets that mirror the composition of the currency basket. This reserve would be funded by initial contributions of the founders, i.e. corporate members of the Libra Association and the payments made by Libra users, i.e. members of the public – in official (fiat) currency – to acquire Libra tokens. According to the Libra White Paper, the reserve would be invested in “*low-volatility assets, including bank deposits and [short-dated] government securities in currencies from stable and reputable central banks*”. “*The reserve will be held by a geographically distributed network of custodians with investment-grade credit rating to limit counterparty risk.*”

Although its labelling and stated objectives are different, the design of the Libra reserve effectively amounts to what is widely known as a “**money market fund**” – a collective investment vehicle that holds deposits and liquid, short-term government debt. Money market funds gained some notoriety in the last financial crisis – they were held responsible by many experts for the chain-reaction that started in the summer of 2007 in the U.S. and ended up triggering a global crisis.⁶ With this experience in mind, legislators the world over have since moved – more or less successfully – to introduce new rules. So far, however, regulators have not conclusively decided whether Libra would be regulated as a fund and Libra Association as a fund manager. In the absence of adequate regulation at a global scale it would be very difficult to monitor that adequate – and sufficiently liquid – reserves are held at all times and that Libra Association, and its “*distributed network of custodians*” would be capable, if needed, of reacting to a crisis, e.g. by providing liquidity and stabilising the value of the instrument. The Libra White Paper and the Libra Reserve Paper do not specify which financial institutions would act as custodians and which regulatory framework they would have to comply with.

5 The value of Libra may not be stable at all

The past holds many instructive lessons on how difficult it is even for some of the world’s largest central banks to defend a fixed exchange rate in times of crisis.⁷ Foreign exchange is the single largest and most liquid global asset category. Every day, some USD 5 trillion change hands on the foreign exchange markets. Even traditional, large and liquid foreign exchange markets with relatively tight regulation and thousands of professional participants are notoriously volatile, prone to overshooting and vulnerable to manipulation.

Libra would be launched as a new financial asset, readily accessible to large numbers of retail investors as well as to professional market players. It would be traded, according to the Libra White Paper, on “*a competitive network of exchanges buying and selling Libra*”. It is not clear at this stage how these exchanges would be run, by whom they would be supervised. At its inception, it may attract a large influx of money, which could soon test the capacity of these exchanges, and of the blockchain infrastructure, to maintain accurate, timely and transparent pricing and to settle transactions fast and reliably. As in the existing currency markets, the concentration of trading activity in the hands of a small group of institutional players could create the same old problems we have seen in the traditional markets, including exchange rate manipulation and insider trading.⁸

6 U.S. *Financial Crisis Inquiry Commission*, The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States, U.S. Government Printing Office (2011); pgs. 27-37 and 253-255; available at: <https://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf>

7 e.g. “Black Wednesday” (16 September 1992) when the U.K. was forced out of the European Exchange Rate Mechanism (ERM)

8 For an illustrative overview of recent fines and penalties against financial institutions for rigging the foreign-exchange markets, among others, see *Finance Watch*, Ten Years After: The Pit and the Pendulum, 15 September 2018, pgs. 32-33; available at: <https://www.finance-watch.org/publication/10yearsafter-back-to-business-as-usual-an-assessment-of-the-post-crisis-financial-regulation-in-europe/>

6 Libra could increase systemic risk in financial markets

If Libra were to grow to become a global payment system, as its sponsors expect, it would also become a source of systemic risk – even more so if its key components were left to operate in a regulatory “grey zone”. As mentioned before, the issuer of Libra, the Libra Association, and its “*distributed network of custodians*” would be responsible for maintaining the reserve at the required level at all times. Any doubts as to the adequacy of the reserve would likely trigger speculative attacks and have to be reviewed independently and audited on a regular basis. Initially, the risk of inadequate reserves could undermine the value of Libra, exposing its investors to losses. Further down the line, however, that risk may turn against the currencies that Libra is pegged against: once the Libra market is large and liquid enough vis à vis some of the reference currencies it may itself become an instrument for investors to speculate against them. If that scenario came to pass central banks would have to use their reserves, i.e. their citizens’ funds, to stabilise their own currency.

In addition to the solvency risk of the reserve Libra could also add to the liquidity dimension of systemic risk. According to the Libra operating model, interest income on the reserve is to be used by Libra Association members to cover their operating costs (and, perhaps, generate a handsome profit, too⁹). Libra Association would therefore have an interest in maximising returns on the reserve by investing as much of it as possible in higher-yielding assets – which tend to have longer maturities and are therefore less liquid. When confronted with mass redemptions of Libra, e.g. in a crisis, Libra’s “*distributed network of custodians*” could turn into forced sellers and destabilise the markets for these assets.

7 Libra may become a private “fiat” currency

Contrary to its billing as a “stablecoin”, maintaining a fixed rate of exchange to the official currency basket may not even be the objective of Libra’s sponsors in the long run. In fact, giving up the peg may well be the very point of the exercise. According to the White Paper, the reserve, and the fixed exchange rate of Libra to its underlying currency basket, are meant to “*help instill trust in a new currency and gain widespread adoption during its infancy*”, “*similar to how other currencies were introduced in the past*”.¹⁰ The expectation seems to be, implicitly, that this peg might be abandoned at some point when Libra has grown out of its infancy so that Libra becomes a fully-fledged, privately controlled fiat currency in its own right. Given the potential size and ambitions of Libra the temptation for its sponsors to abandon the peg at some point – and to capture all the benefits of seigniorage¹¹ would be huge.

Why citizens in Europe and elsewhere would have an interest to surrender this hard-won, and still imperfect, ownership of their currency to a group of unaccountable global corporations is anybody’s guess: it has taken centuries for the people of Europe to wrest control of the currency away from royal families and their bankers and hand it to democratically controlled governments and their agencies. For all their shortcomings, central banks such as the ECB or the Bank of England, and national Ministries of Finance are subject to some degree, at least, of public scrutiny and democratic accountability.

9 Mackintosh, James, Facebook’s Libra Is a License to Print Money, Wall Street Journal, 23 June 2019; available at: <https://www.wsj.com/articles/facebooks-libra-is-a-license-to-print-money-11561282380>

10 Libra Association, Libra White Paper, June 2019, pg. 7

11 Seigniorage is generally defined as the difference between the face value of money and the cost to produce it. As long as a fixed peg is maintained each unit would have to be backed up with the equivalent amount of ‘reserve’ assets, leaving no profit. If the peg is abandoned, the issuer would be able to generate a profit margin on each unit.

8 Libra is not designed “to empower billions”

The Libra White Paper sets out its stall as a revolutionary new initiative for financial inclusion. It points out that large swaths of the world’s population — 1.7 billion adults globally — remain outside of the financial system with no access to a traditional bank. Libra, it says, would allow many more people to have access to financial services and to cheap capital.

But the claim that Libra is aimed at bringing digital payments to large swaths of the unbanked, developing world is untenable, for purely practical reasons. To handle Libra, users need a smartphone, which, apart from the initial outlay for the hardware also requires mobile data coverage and a level of technological sophistication. This makes it rather less compelling than existing simpler and cheaper alternatives, such as M-Pesa, which require only a feature phone and basic connectivity. Moreover, Libra would expose financially unsophisticated users to exchange rate risk (by way of its reference basket) even if they have no need at all for a global (crypto)currency because the goods they trade and payments they make are denominated in their own domestic currency. Short of replacing these national currencies, it is difficult to see a compelling case for the rural population of developing countries adopting Libra.

9 Libra further concentrates power in the hands of digital oligopolists

Finance Watch has long criticised the traditional banking systems for its shortcomings – in particular its high degree of concentration that vests so much power in the very largest banks, making them “too big to fail”, and the nearly unlimited amount of leverage that enables banks to issue way too much credit based on way too little capital. But handing even more economic power to yet another, different set of even fewer private actors is not the solution.

The large digital platform companies, Facebook and a few others, have demonstrated, time and again, that they, too, are oligopolists determined to press home their advantage. Tellingly, the Libra Association comprises some of the largest global non-bank payment processors – Visa, MasterCard, PayPal – but no established financial institutions or public bodies that deal, for instance, with development and financial inclusion. The composition of this consortium makes the risk of this undertaking quite clear: facilitating a landgrab by a coalition of large companies hoping to unseat the existing oligopoly of banks.

It is well known by now that digital platform companies, such as Facebook, are systematically harvesting the personal data of their customers, and these data have ended up being misused by parties with scant regard for privacy and legal constraints.¹² Handing over citizens’ private financial data to the same handful of digital oligopolists is hardly going to redress the balance. To the contrary: well-documented issues, such as adverse selection and prediction bias, could well end up cementing social and financial faultlines in the same way as the echo chambers and filter bubbles of social media have done. The emergence of Libra imparts even greater urgency to policymakers’ and regulators’ ongoing efforts to adapt consumer protection in financial services to the realities of the digital era.

¹² e.g. European Parliament, Resolution 2018/2855 (RSP) on the Use of Facebook Users’ Data by Cambridge Analytica and the Impact on Data Protection, 25 October 2018; available at: http://www.europarl.europa.eu/doceo/document/TA-8-2018-0433_EN.html

10 Libra could become yet another channel for “dirty money”

Cryptocurrencies, such as Bitcoin, have been linked increasingly to illicit activities. Cybercrime often involves payments to be made in cryptocurrency. In the real world, cryptocurrencies have become a channel for money laundering. Whereas the blockchain has improved traceability, encryption and the holding of cryptocurrency in (pseudonymous) digital wallets guarantee anonymity. In recent years, global lawmakers and regulators have made slow, hard-fought progress against the global flow of dirty money. New laws were passed, non-compliant jurisdictions named and shamed and billions worth of fines imposed on banks. Much remains to be done but the traditional financial sector has been put on notice and is under pressure to cooperate. Success in the digital world has been even patchier so far.

There is a real risk that Libra, if it is successful and achieves global coverage, may soon attract unwanted custom from the wrong sort of users. This would not only set back regulators' efforts to rein in the global flows of money that underpin criminal activities. As we have seen with Bitcoin, the potential commercial and reputational damage to Libra and its sponsors from this could be substantial.

As long as the concerns outlined above are not convincingly addressed by national, regional and global regulation – supervised through effective global governance mechanisms – Finance Watch demands policymakers to immediately stop the introduction of Libra.

About Finance Watch

Finance Watch is an independently funded public interest association dedicated to making finance work for the good of society. Its mission is to strengthen the voice of society in the reform of the financial system by conducting advocacy and presenting public interest arguments to lawmakers and the public. Finance Watch's members include consumer groups, housing associations, trade unions, NGOs, financial experts, academics and other civil society groups that collectively represent a large number of European citizens. Finance Watch's founding principles state that finance is essential for society in bringing capital to productive use in a transparent and sustainable manner, but that the legitimate pursuit of private interests by the financial industry should not be conducted to the detriment of society. For further information, see www.finance-watch.org



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