

Libra, the cryptocurrency of Facebook

Finance is a key sector for the economy. Therefore, any significant innovation in this field deserves to be analysed with caution, and its implications, well understood. This is what we seek to do in this article with the Libra project.

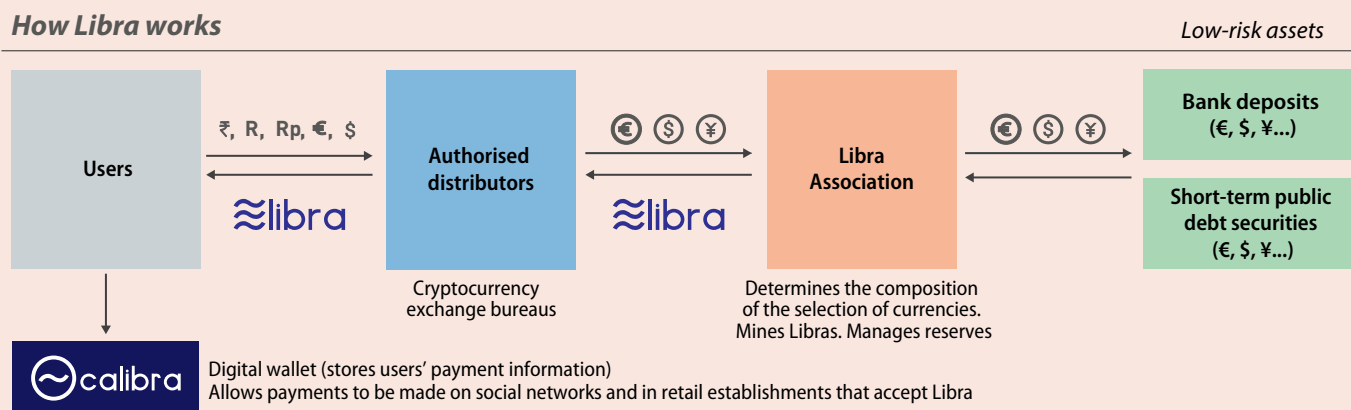
A brief history of cryptocurrencies: from Bitcoin to Libra

- Up until now, **cryptocurrencies have been considered more as speculative assets than as money itself**. The main reason is that their value has tended to be unstable and they have not demonstrated a clear advantage over existing alternatives. For all these reasons, they have not reached a critical mass of users.¹ This is largely because Bitcoin and other cryptocurrencies that have followed it are not backed by a government, meaning that their value as a means of payment resides in the expectation that other people will accept it as such. In addition, these cryptocurrencies do not adjust their supply according to their demand, causing even more volatility.² All this **limits their function as a store of value and unit of account**.
- In this context, stablecoins seek to minimise the volatility of cryptocurrencies**. To do this, the issuer of the stablecoin links its value to that of another more stable asset, such as fiat currencies (e.g. the dollar) or products (precious metals). **To date, however, stablecoin initiatives have had a limited user base**, since they are promoted by companies that are either new entrants facing high costs to promote the adoption of their product (Tether) or that target wholesale (JPM Coin). In addition, there are doubts over their scalability because, for now, it seems unlikely that the projects presented to date can process the number of transactions that are processed per second through conventional electronic means of payment.³

The Libra project

- Libra is presented as a **private, digital and global currency, and as an alternative means of payment based on blockchain technology**. In fact, Facebook has written its own blockchain code and has announced that the transactions will be verified between servers of the members of the Association⁴ (permissioned network) in order to speed up transaction processing times and serve millions of accounts,⁵ although the goal is for it to eventually do so in a decentralised manner.
- Libra has a high potential for adoption since its promoters have a large user base**. Specifically, Facebook has the biggest social network in the world, with over 2.4 billion active users. Furthermore, the other members of the Libra initiative are big players that are well established in the payments and mobile applications markets. In short, Libra has a potential scale that other initiatives lack.
- Libra is a stablecoin: its value will be linked to a selection of international currencies**. To support its value, the Association aims to maintain, in the form of reserves, deposits and investments denominated in major international currencies, such as the dollar and the euro, for an amount equivalent to the Libras it issues. The evolution of the value of Libra, therefore, should go hand in hand with the currencies that make up the selection. Those wishing to buy Libras will have to do so through authorised distributors (exchange bureaus and banks), which will be able to buy Libras from the Association in exchange for the aforementioned major currencies and sell them on to users in exchange for their local currency.

How Libra works



Source: CaixaBank Research.

- See the article «[What can we expect from cryptocurrencies?](#)» in the Dossier of the MR05/18.
- The supply is governed by predetermined rules that do not take into account the demand for them. For example, the Bitcoin protocol establishes that a circulating supply of 21 million units will be reached in 2040, at which point no more bitcoins will be mined.
- As a benchmark, VISA has the capacity to process over 65,000 transactions per second.
- Libra will be governed by an association of shareholder companies (for now made up of Facebook and another 26 companies).
- The validator nodes will at first be the founding members of the Libra Association, and a group of 100 validator nodes is expected to be able to process 1,000 transactions per second.

- **The Association will invest its reserves** in liquid and low-risk assets, such as bank deposits (denominated in stable currencies) and short-term government debt securities of countries with a good credit rating. It is anticipated that the performance of such assets will serve to cover operating costs and pay dividends to the founding members.
- **Libra aims to be an alternative payment vehicle and to reduce friction in international transactions.** A global stablecoin such as Libra, aimed at retail use, can make cross-border payments and transfers cheaper and easier to carry out by reducing transaction costs. Furthermore, it can reach users who do not currently have access to the financial system, by allowing them to store their money⁶ and execute transactions using their mobile phone. In fact, the project is also introduced as a tool to promote financial inclusion for the more than 1.5 billion people around the world who do not have access to a bank account.

Doubts over Libra

Various regulators and supervisors have expressed certain reservations that could hamper, or at least slow down, Libra's deployment:

- **Data management.** Potentially, the Association could have access to large amounts of its users' personal and financial data. Up until now, the Association has not specified how it will store and manage this information, nor what measures it will implement to ensure they remain properly protected.
- **Fight against illicit activities.** The traditional digital payments system is not anonymous, as transactions are processed and recorded by third parties (the bank of the buyer and of the seller, and the card company). All this helps to ensure compliance with regulatory requirements (such as customer's registration) in order to prevent money laundering and other illicit activities. In the case of Libra, on the other hand, as it is a cryptocurrency the exchange of money could presumably take place in a decentralised and anonymous manner. Therefore, it is not clear how compliance with these regulations will be ensured.
- **Risks of abuse of dominant position.** There is a fear that the promoters of Libra could use their current position, which is dominant in some cases, to encourage the use of Libra over other alternatives, which would represent a constraint on innovation.

Implications for financial stability

In addition to the considerations above, the size and scope of Facebook imply that Libra has the potential to become systemic. The widespread use of Libra **could have major implications for financial stability, some of which are summarised below:**

- **The stability of Libra is not guaranteed,** rather, it depends on the stability of the assets that back it and on the Association's commitment to keep the value of Libra stable. However, if Libra becomes systemic in its proportions, this commitment should be reinforced through appropriate regulation and supervision.
- **Libra could contribute to the generation of global episodes of financial instability.**⁷ The Association plans to invest the currencies it obtains from the sale of Libras in low-risk assets (bank deposits or sovereign bonds). If doubts over the cryptocurrency were to arise, for instance for security reasons, and there were a mass selloff, it is not clear whether the Association could meet this demand if a portion of the reserves are invested in assets that are subject to a certain liquidity risk. In addition, the pressure on banks balance sheets in which the Association is a depositor would inevitably increase.
- **Libra could increase economies' sensitivity to changes in investor sentiment.** Libra can facilitate international capital flows because it substantially reduces the transaction costs associated with cross-border transfers. This offers clear benefits, but it could also have significant implications for the financial stability of many emerging economies because, by boosting and facilitating capital flows, it could amplify capital outflows in the event of changes in investor sentiment and risk aversion.⁸
- **The widespread adoption of Libra in economies with less stable currencies (libraisation) could influence the monetary policy of their central banks.**⁹ Just as the dollar does today, Libra is a good candidate to replace the local currency as a store of value in economies with less stable currencies (where high inflation hinders this function). However, if residents can easily exchange their local currency for a set of stable currencies through Libra, they will take refuge in this asset at the slightest hint of problems in their economy. This could lead to significant episodes of depreciation of the local currency and make it difficult to maintain price stability.

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6. Together with Libra, Calibra will also be created. This is a digital wallet that will store users' payment information.

7. See S. Cecchetti and K. Schoenholtz (2019). «Libra: A Dramatic Call To Regulatory Action». VoxEU blog.

8. See M. Pettis (2019). «Facebook's Libra: Does the World Need Less Frictionless Money?», Carnegie Endowment for International Peace.

9. This already occurs with dollarisation: the tendency of residents to protect themselves from the volatility of their local currency with accounts and contracts denominated in dollars.