

Thoughts on Libra

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Disclaimer: Views are those of the authors, not of the Federal Reserve Bank of Atlanta or the Federal Reserve System

Introduction

- Satoshi Nakamoto created bitcoin as an “Electronic Cash System”
- Wide adoption has not occurred – a major reason: price volatility



Introduction

- Bitcoin volatility still large in recent experience



- Intraday volatility also large (\$2,819.29 on June 27, 2019)

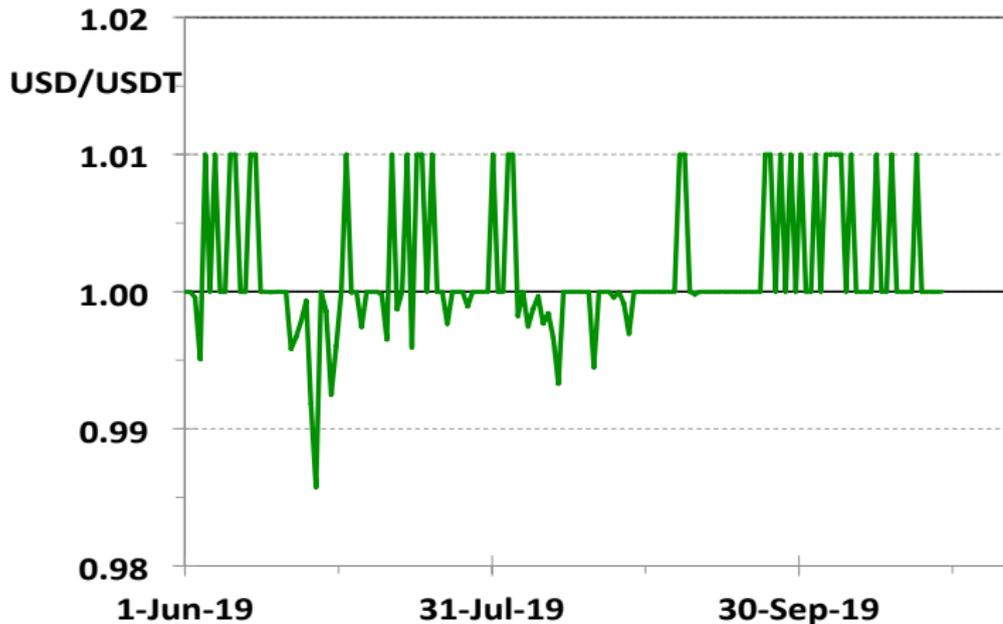
Introduction

- One proposed solution: **Stablecoin**

Native cryptocurrency intended to maintain $\approx 1:1$ exchange rate against a sovereign currency

Introduction

- Tether (USDT) is most widely used stablecoin pegged to USD



Introduction

- Recently Facebook has proposed setting up Libra, a multi-currency stablecoin

Native cryptocurrency intended to maintain 1:1 exchange rate against a weighted basket of sovereign currencies

- Has sparked great interest in the media and by policymakers
- Reason: Possibility Libra could be widely used
- Why not big concern with Tether?
 - Small only \approx \$4 billion in existence
 - Lack of on-line payments platform

Some History

- Introducing new **private** currencies is hard
- However, many instances when new private currencies arose even though sovereign currencies already in use
- Examples:
 - Stockholm Bank notes (Sweden 1660s)
 - Enskilda bank notes (Sweden 1830s - 1900)
 - State bank notes (U.S. 1780s - 1865)
- Common feature: New private currencies offered payments convenience over existing currencies
 - Stockholm Bank notes – copper standard
 - Enskilda bank notes – more convenient denominations than Riksbank notes
 - State bank notes – more convenient than specie for transactions

What about Libra?

- Deficiencies Libra could exploit
 - Current payment system in U.S. heavily bank dependent for P2P and not set up for digital asset transactions
 - Large number of unbanked in U.S. – mostly poor
 - USD not on digital ledgers like Ethereum, so not useful for
 - smart contracts
 - purchases of tokenized assets
- Potential advantages of Libra
 - Well-established global presence
 - Physical infrastructure and engineering support to quickly scale up
 - Would be on a blockchain
- Libra stable against a basket of foreign currencies is a side issue

Polymakers' Concerns

*“Libra and a digital wallet Colibra [sic] raised many concerns relating to privacy, trading risk, discrimination, opportunities for diverse owned financial firms, national security, **monetary policy**, and the **stability of the global financial system.**”*

Maxine Waters October 24, 2019

Issues for Monetary Policy

- Assume Libra purchased with sovereign currencies,
⇒ has no independent monetary policy
- As no new money created, may not seem an issue for domestic monetary policy
- However, if it widely replaces sovereign currencies in transactions, could affect countries' abilities to carry out monetary policy
 - The less a country's currency used, the less the effect of changing interest rates in terms of that currency
 - Could even affect countries whose currencies not in Libra's basket
 - Any country could become "Libra-ized"

Issues for Monetary Policy

- Assume Libra-based financial instruments, institutions and secondary markets arise (seems likely)
- Could affect ability to provide deposit insurance and act as LOLR
 - Reason: CB's cannot create new units of Libra

Issues for Regulation

- Libra-based financial instruments, institutions and secondary markets may pose threats to stability of domestic and global financial systems
 - Example: digital “bank runs” could happen
- May require micro and macro-prudential regulation to lessen threats

Conclusion

- Libra raises important issues for monetary and regulatory policies
- Should the response be one or more of:
 - CBDC or government-issued DC (China – DCEP)
 - Improved, less bank-oriented payments system
 - M-PESA (Kenya) on a wide scale?
 - Changes in structure of financial regulation
 - Ban on Libra
- That there is no good answer now shows need for more research – theory, data, history – to find best response to potential challenges were stablecoins to become widely adopted
- Libra is a wake-up call even if never actually launched