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
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
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
“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