

This essay will argue that private companies, such as the likes of Facebook, are not better placed than central banks to issue and maintain stable currencies and that while central banks should continue to exercise their sovereignty in issuance of currency, the need to move to digital currencies has proved to be pertinent.

What is Stability?

While there is no particular definition for financial stability, a popular understanding of it is the idea of gaining trust and “public confidence”.¹ Money is an “indispensable social convention”² that works when the public trusts in its stability and acceptability as well as retains confidence in the authorities backing it.³

Central banks are able to achieve said stability by being the ‘trusted’ sole issuer of money, controlling inflation (done by performing open market transactions that either inject or remove extra funds from the market) and acting as a regulatory authority of a country’s monetary policy.⁴

Libra vs Bitcoin?

Before engaging further, it is worth noting that the currencies being issued by private entities are significantly different compared to cryptocurrencies. A perfect

¹ Tommaso Padoa-Schioppa, ‘Central banks and financial stability: exploring a land in between’ (Second ECB Central Banking Conference, Frankfurt, October 2002), <<https://www.ecb.europa.eu/events/pdf/conferences/tps.pdf>> accessed 2 December 2020

² Yves Mersch, ‘Money and private currencies – reflections on Libra (ESCB Legal Conference, Frankfurt, 2 September 2019) <<https://www.bis.org/review/r190902a.pdf>> accessed 3 December 2020

³ Ibid

⁴ Reem Heakal, ‘What Central Banks Do’ (Investopedia, 9 May 2020) <<https://www.investopedia.com/articles/03/050703.asp>> accessed 2 December 2020

explanation for the growing popularity of the former may be offered by comparing Libra to Bitcoin, the most popular cryptocurrency yet.

Although advertised as a cryptocurrency, Libra is in-fact far from one.

Cryptocurrencies such as Bitcoin are based on a 'permissionless system'.⁵ This means it is an open, completely decentralized, peer-to-peer system where anyone can send money to anyone, by creating their own wallet and developers control the governance of the cryptocurrency.⁶ Furthermore, the value of a Bitcoin is not dependent on any single currency. Because it is treated as yet another investment, its value is determined by mere speculation. This combined with a lack of backing by a trusted authority, causes extreme volatility in cryptocurrencies, thereby making them less attractive.

Libra on the other hand while open and shares a vision towards decentralization, does not share the characteristic of volatility as does Bitcoin. According to its white paper, each Libra coin will be backed 1:1 by the Reserve, i.e., full backing.⁷ This means that for every Libra coin an amount equivalent to it will be held in the Libra Reserve in the form of cash, cash-equivalents or short-term government securities.⁸ Since every Libra coin is backed equivalently by the reserve, the value is said to remain stable, and hence appropriately referred to as a 'stablecoin'. Even so, Libra is

⁵ Elizabeth Lopatto, 'Libra, Explained' (The Verge, 26 June 2019)<<https://www.theverge.com/2019/6/26/18716326/facebook-libra-cryptocurrency-blockchain-irs-starbucks>>accessed 4 December 2019

⁶ 'Bitcoin vs Libra: Facebook's digital currency is not the same as Satoshi Nakamoto's cryptocurrency' (Business Today, 20 June 2019)<<https://www.businesstoday.in/technology/top-story/bitcoin-vs-libra-facebook-digital-currency-is-not-the-same-as-satoshi-nakamoto-cryptocurrency/story/357530.html>>accessed 4 December 2020

⁷ 'White Paper' (Diem Association, April 2020)<<https://www.diem.com/en-us/white-paper/>>accessed 3 December 2020

⁸ Ibid.

not like most stablecoins that are pegged to a single currency. Instead, Libra is pegged to a basket of “low volatility assets, including bank deposits and government securities” in multiple currencies.⁹

Since, Libra will be tied to fiat currencies (currencies not backed by physical assets but rely solely on ability of monetary authorities to ensure currency’s stability)¹⁰ like the US Dollar, that are for most part stable, it is more attractive than cryptocurrencies.

Challenges of private issuance of currency?

However, for all the safeguards Libra promises its users, private currencies continue to face challenges that threaten their stability.

Advocates for private currencies argue that central banks are monopolistic entities that are prone to be manipulated by the central government and as a result may be induced to serve the needs of a political party.¹¹ However, even if this were the case, such a situation may be overcome by calling for central bank’s independence. This solution strengthens public confidence and trust in the central bank as the issuer of currency by virtue of their public interest.

On the other hand, private organisations, especially the likes of Facebook, battle with lack of trust (which as explained above is intertwined with stability). This stems largely from their orientation towards profit maximization. The difficulty arises from

⁹ Ibid.

¹⁰ Gregory Claeys and Maria Demertzis, ‘The next generation of digital currencies: in search of stability’ (Bruegal Policy Contribution Issue #15, 2019) <<http://aei.pitt.edu/102352/>> accessed 5 December 2020

¹¹ C. Goodhart, ‘The Central Bank and the Financial System’ (1st edn, Macmillan Press Ltd 1995) x.

the conflict that private companies would face between maintaining a stable price for the currency vs profit-maximisation.¹² One way this may pan out is if companies artificially lower the value of their currencies, buy them back from investors and then re-sell them at higher older prices, thereby making a hefty profit.¹³

The other challenge in garnering trust, is the access and misuse of private data. Facebook is no stranger to this problem. The threat that Facebook will misuse personal financial and transactional data of its billions of users is not novel. The Cambridge Analytica scandal is the best-known example, where the firm misused data of over 50 million Facebook users to influence the US Presidential Elections of 2016.¹⁴ Facebook will have complete access to the private data that they will monetize as a profit-oriented institution.

The challenges with being “profit-oriented” may be well explained through an analysis of the Libra Association. The Libra Association is said to act as a central bank of sorts, because it would perform bank-like functions by acting as the regulatory authority for the stablecoin, even though it is not a bank by definition.¹⁵ To be a part of the Libra Association, corporations are required to make a \$10 Million dollar investment.¹⁶ This has several implications. Firstly, it suggests that majority of

¹² Claeys and Demertzis (n 10)

¹³ Konstantin Rabin, ‘Should private companies be able to create currency?’ (Finextra, 28 October 2019)<<https://www.finextra.com/blogposting/18067/should-private-companies-be-able-to-create-currency>>accessed 6 December 2020

¹⁴ Tatiana Koffman, ‘Facebook’s Libra White Paper is Now Live’ (Forbes, 18 June 2019)<<https://www.forbes.com/sites/tatianakoffman/2019/06/18/facebooks-libra-white-paper-is-now-live/?sh=2f05962d6e00>> accessed 3 December 2020

¹⁵ Iwa Salami, ‘Facebook’s Libra: A Global Monetary System Governed by Private Corporations?’ (E-International Relations, 8 October 2019)<<https://www.e-ir.info/2019/10/08/facebook-libra-a-global-monetary-system-governed-by-private-corporations/>>accessed 8 December 2020

¹⁶ Josh Constine, ‘Facebook announces Libra cryptocurrency: All you need to know’ (Techcrunch, 18 June 2019)

the members of the Association would be for-profit firms with 'dominant global businesses' that would mandate the use of Libra as a mode of payment for its goods and services.¹⁷ Furthermore, they will also decide which banks, payment processors and distribution agents to work with, thereby encouraging anti-competitive behaviour in the market. Should then the value of the stablecoin drop, this would have systemic implications on the stability of the currency.¹⁸ Additionally, members of the Libra Association enjoy limited liability, which increases fear as to whether they will operate in full faith and continue to hold the trust and confidence of those using Libra.¹⁹ A feature specific to the Libra project is that the seigniorage profits will go back to the association, and although Facebook alleges that such profits will be invested back into the project, there still persists the underlying risk that being for-profit firms, they have an incentive to maximise these profits, which would mean investing in riskier and less liquid assets to back their Libra coin or changing to partial backing.²⁰

CBDCs an answer?

Facebook's Libra, has undoubtedly been a wake-up call to central banks of the increasing move towards electronic forms of currency. Central Bank Digital Currencies (CBDCs) may be the solution.

¹⁷ Salami (n 15)

¹⁸ Ibid

¹⁹ Mersch (n 2)

²⁰ Claeys and Demertzis (n 10)

The obvious advantage with CBDCs is the direct access to central bank accounts²¹, where the public can hold legal tender in an institution which they ‘trust’. While this removes one of the biggest challenges facing private issuance of currency as discussed above, central banks may also suffer from conflict of interest, similar to Facebook, where issuing CBDCs and maximizing users would likely collide with maintaining financial stability.

A plausible solution to this would be “synthetic central bank digital currency (sCBDC)”²². This is when public and private institutions cooperate. Private companies with digital expertise can continue to issue stablecoins to businesses and households but will hold accounts at the central bank.²³ This solution would retain the role of the central bank in maintaining financial stability and ensure its sole focus in doing so. It would also avoid private companies swaying monetary policy and thereby threatening stability through their desire for maximization of profits.

Conclusion

Profit maximization allows private institutions to thrive. However, as long as they exist in tandem, private institutions will not truly cater to the public interest and confidence, thereby will not be able to ensure financial stability, a key ingredient for smooth economic functioning.

²¹ Antonio Fatas and Beatris Weder di Mauro, ‘Cryptocurrencies’ challenge to central banks’ (Vox EU, 14 May 2018)<<https://voxeu.org/article/cryptocurrencies-challenge-central-banks>>accessed 9 December 2020

²² Alexander Kriwoluzky and Chi Hyun Kim, ‘Public or Private? The Future of Money’ (Monetary Dialogue Papers, December 2019)<<https://www.europarl.europa.eu/cmsdata/207653/13.%20PE%20642.356%20DIW%20final%20publication-original.pdf>>accessed 8 December 2020

²³ Ibid.