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Libra or Zuck-Coin? Risks and Opportunities of Facebook's Cryptocurrency

by Nicola Bilotta and Franco Passacantando

From a prophecy limited to the specialised press, technology firms venturing into the financial services domain is now a reality. Major technological companies (Big Techs)[1] have recently launched their own banking services and developed several partnerships with established banks.

Building on data accumulation, a large and pre-existing customer base and sophisticated technology, Big Techs have effectively penetrated the payment, money management, insurance and lending segments of the banking supply chain.[2]

Yet, so far none of these developments could have the disrupting effect of Libra, Facebook's cryptocurrency project that is due to become operational by 2020. Libra is designed to reach a critical scale very quickly, producing both opportunities and risks for international financial markets.

When it launched the Libra project on 18 June, Facebook proclaimed its goal was to enable a simple global currency and financial infrastructure that could empower billions of people.

The first objective is to boost financial inclusion for the 1.5 billion people worldwide who are unbanked despite owning a smartphone or having Internet access. The second goal is to introduce a cheaper, instant and frictionless mobile payment transactions in advanced economy markets.

Libra is technically a stable currency rather than a cryptocurrency, as its value is backed by a basket of low-volatile currencies and stable financial

[1] Like Apple, Amazon, Google and Alibaba.

[2] Too have a more detailed description of Tech giants' activities in banking, see Nicola Bilotta and Simone Romano (eds), *The Rise of Tech Giants. A Game Changer in Global Finance and Politics*, Bern, Peter Lang, 2019 (forthcoming).

Nicola Bilotta is researcher at the Istituto Affari Internazionali (IAI). Franco Passacantando is Scientific Advisor at IAI.

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assets, preventing wide fluctuations. Nevertheless, as the value of the Libra will fluctuate as a result of foreign exchange market shifts, it will still be subject to some variability.

Libra's first challenge will be to build trust among market participants. Local merchants and vendors will need to accept payments in a currency whose value can fluctuate against local currencies, which will still be used for most transactions and for paying taxes.

Facebook is also working on developing the Libra blockchain, the structure underpinning Libra's currency. The Libra blockchain will verify and record the exchange of value among users. At the beginning, it will be a so-called "permissioned" blockchain, access to which will be restricted and run by selected players. Yet, within five years, it set to become an open-source and fully decentralised blockchain system.

Facebook does not own the Libra currency or the Libra blockchain. The Libra project will be governed by the Libra Association, an independent no-profit entity, which includes 28 partners – including the payment networks Visa, Mastercard and PayPal; technological companies like Uber and Ebay; or smaller blockchain companies and crypto-focused investors.

To become a member of the network, applicants are required to invest 10 million US dollars – yet, it is presently unclear if all partners have already paid the fee or simply committed to do so. Each member will have one vote on the governing council and will gain dividends on the interest – proportionate to their investment – from the Libra reserve.

Opening up Libra's governance to a network of partners is a clever business strategy. Facebook will delegate any regulatory and security issues related to Libra's management to a third-party entity. Furthermore, it encourages users to not perceive Libra as an asset owned by Facebook, mitigating public mistrust.

Despite involving big and relevant players, no established bank is part of the network. Analysts have noted that Facebook tried unsuccessfully to convince the biggest US banks to participate. It is no surprise that none of the other largest Big Techs are included in the network, having themselves developed their own payment solutions.

As any other cryptocurrency, customers will need a digital wallet. Here, Facebook is exploiting the first mover advantage by creating Calibra, a digital wallet integrated to Facebook Messenger and WhatsApp.

Calibra is designed to capture three main payment activities. First, send remittance payments internationally to family members. Second, transfer money between friends and, lastly, make online and offline payments to retail merchants or among commercial counterparts. In this respect, Calibra is seeking to penetrate the international payment market but also to become a medium of exchange for the day-to-day activities of individuals.

Of course, any developer will be able to launch its own Libra digital wallet.

Yet, the data-network effects will likely consolidate Calibra's advantageous market power. Once a captive ecosystem is built, competitors will find high barriers to enter the market.

Payment solutions offered by Big Techs have two main business models. In the first, customers use an existing third-party infrastructure to process and settle payments. For example, Google Pay or Apple Pay rely on credit card or retail payment systems. In the second model, Big Techs develop their own system to process and settle payments – like Alipay and M-Pesa. Yet, in both cases, Big Techs depend directly or indirectly on banks.

This is not the case with Libra which would be totally independent from the traditional payment infrastructure, generating benefits and risks.

On the one hand, Libra could reduce the costs of transferring money, with great advantages especially for micro-transactions and remittances which currently have high transaction costs.

On the other, there are serious concerns on financial stability, anti-money laundering and privacy. As Mark Carney, Governor of the Bank of England, commented, the Libra will be discussed with an "open mind" but not an "open door".[3]

Facebook has promised that data from Calibra's transactions will be not used for advertising purposes and will be kept separated from Facebook's data aggregation mechanisms. Yet, it is not clear how this separation will be enforced.

If users integrate Calibra with their Messenger and WhatsApp accounts, Facebook will be able to track basic information – like with whom or at which shop users have started an interaction. Wired has also noticed that Calibra's user agreement allows Facebook to aggregate data from its digital wallet "to facilitate and improve the Calibra product experience [and] market Calibra products and services".[4]

At this stage of Libra's development, there are many open questions that require in depth analysis and reflection.

The first set of questions relate to privacy and anti-money laundering rules. Facebook claims the Libra blockchain will record any transaction, making this data accessible via a pseudonymous key. However, it remains to be seen how efficiently authorities could enter the system and implement tracking services to link a user's identity with a transaction, mitigating the risks of misbehaviour and moral hazard by users.

As any other financial intermediary, a Libra digital wallet will need to obtain verification details through an online procedure. Yet, to have a tight verification process – matching registered users with real identities

[3] Joumanna Bercetche, "Bank of England Keeps an 'Open Mind' on Facebook's Cryptocurrency Libra", in *CNBC*, 21 June 2019, https://cnb.cx/2WU2juR.

[4] Steven Levy and Gregory Barber, "The Ambitious Plan Behind Facebook's Cryptocurrency Libra", in *Wired*, 18 June 2019, https://www.wired.com/story/ambitious-plan-behind-facebooks-cryptocurrency-libra.

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–, the Libra network will need procedures that traditionally slowdown transactions times. Otherwise, Libra risks making the enforcement of anti-money laundering rules much harder.

In addition, as Libra will be a stable currency, users in emerging markets could switch from their local currencies to Libra, threatening the ability of those governments to control national monetary supply. This concern could be amplified if Libra is extremely successful. Thus, a network of private entities could partially demote the power of nation states as Libra would offer people an alternative to their local currency.

It also remains to be seen how such a currency could be managed at times of crises affecting one of the components of the basket. Changes in the composition of the basket of currencies and bonds would send a dangerous signal to the market and amplify the run out of certain currencies or assets.

Such a responsibility could in no way be taken by a private association.

In its White Paper, the Libra Association stated that "We believe that people have an inherent right to control the fruit of their legal labor".[5] Facebook should better explain what this political message means: who is preventing people from controlling the "fruits of labour"? Is this an allusion to tax authorities?

More clarity is needed also on Libra's governance, such as, which jurisdiction will control the compliance of Libra's activities? Under what regulatory framework will Libra operate?

Financial technology transformations bear benefits but also risks. Among the new players, Big Techs, given their size and customer reach, have the potential to rapidly reach a critical scale, requiring a prompt response from regulators.

While national and international authorities should not resist innovation, they should coordinate their efforts to better respond to Big Tech's entry in banking, maximizing the benefits while limiting the risks.

To properly frame Libra's long-term effects on the economy, the policy response should consider not only the financial regulatory and macroeconomic perspectives but also competition and data privacy considerations.

The Libra project poses far reaching questions regarding its impact on the ability of the authorities to manage the money supply, on the international reserves regime and on the trade-off between financial stability and banking efficiency. The Libra cryptocurrency will need to be blended with financial regulations, not become an instrument to circumvent them.

Libra has the potential to disrupt financial markets. Its long-term impact, however, is far from certain.

2 July 2019

[5] Libra Association, *Libra White Paper. An Introduction to Libra*, June 2019, p. 2, https://libra.org/en-US/?p=179.

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Via Angelo Brunetti, 9 - I-00186 Rome, Italy
T +39 06 3224360
F + 39 06 3224363
iai@iai.it
www.iai.it

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