Game over for Libra? The G7 report lays down the rules

Today's G7 Report on 'global stablecoins' confirms authorities' concerns with Facebook's proposed digital currency Libra. We still see a way forward for Libra, but is Facebook willing to take that route?

Libra represents a breakthrough in digital currency thinking

Facebook may have underestimated the pushback it received on Libra, but the proposal has at least one major achievement: it has greatly accelerated the debate on digital currencies and has jolted authorities in thinking about the implications of global currencies for monetary policy and financial stability. This morning, the G7 published a report on 'global stablecoins', and while the report covers more than just Libra, it is clear that the workstream would not have existed, had Facebook not launched its proposals earlier this year.

The problems authorities see with global stablecoins are basically twofold: practical, and fundamental

The problems global authorities see with global stablecoins are basically twofold. Firstly, there are practical demands in the area of fighting money laundering, fraud, terrorism finance, but also, for example, with security, data protection and privacy. Any institution dealing with money should comply with such demands. Authorities have made clear that Libra has not yet fully provided satisfactory answers in these areas. But that may change in the future. The fact that a number of experienced payment processors have left the Association is not helping Libra here and could mean a further delay in its timetable. But Facebook has the financial power to buy external expertise where needed and should be able to address practical matters should it wish.

Fundamental issues pose a more existential threat to global stablecoins

Secondly, there are more fundamental issues to address. A stablecoin launched on a global scale, and denominated not in domestic currency but (as in the case of Libra) based on a basket of existing currencies, has profound implications for financial stability and monetary policy. When economies abandon their domestic currencies and move to global stablecoins, the ability of domestic central banks to set monetary policy is greatly reduced.

As we show elsewhere, countries are already faced with an "impossible trinity", meaning they cannot achieve free cross-border capital mobility, monetary policy autonomy and exchange rate management at the same time; countries have to choose two out of these three. Wide domestic adoption of a global stablecoin reduces this policy menu still further.

> *With a global stablecoin, there is no-one to call to discuss monetary policy consequences*

Capital mobility is enforced by the stablecoin, while monetary autonomy is restrained by the limited use of domestic currency by residents. A country then may be left with the option of trying to manage its exchange rate vis-à-vis the stablecoin, to retain some influence on competitiveness. That is not an attractive prospect for central banks. Even for those countries which are highly dependent on the dollar for trade and external financing, at least with the dollar they can phone the Fed and discuss implications of Fed policy for their economies. With a basket-based stablecoin, there is no-one to call.

Moreover, a global stablecoin held by many agents (say a modest share of Facebook's 2.4bn users), quickly becomes a systemic institution itself. Even if it does not set monetary policy itself, by its sheer size its buy and sell actions will have profound implications on financial markets. A "bank run" on such a stablecoin could have wide repercussions and might necessitate a bailout should confidence in the payments infrastructure deteriorate. Finally, global stablecoins will bolster the platforms they are traded on, adding to bigtech competition worries.

Read our article "Why the crypto debate is far from over" for more on this

The problems stablecoins pose, depend on their use case

So it is with good reason that authorities want to think through all the implications of a stablecoin, such as Libra, which has the potential to grow big very fast. G7 Working Group chairman Benoît Coeuré emphasised authorities do not want to ban stablecoins before it's clear how they would actually operate in reality. But at the same time, such coins should not jeopardise public policy goals, including monetary policy and financial stability.

The G7 poses high demands, but does leave some room for global stablecoins

The G7 report does provide an opening for Libra. It notes that the impact of a stablecoin is bigger when it is used as a store of value. The Libra association has emphasised that Libra is primarily intended for use in remittances, and to provide the unbanked with a digital means of exchange, and that it assumes people will move in and out of Libra quickly. If indeed Libra can credibly guarantee authorities that the coin will only be used as a means of exchange, that might provide a window to move discussions forward. The problem here is, is the Libra association able and willing to provide such guarantees? How will it force people to exchange their Libras for fiat currency? What if the Libra association decides that in a few years' time, it is useful as a store of value after all?

There might be an easy way out, but Libra appears unwilling to take it, for now

An obvious solution that would take away a lot of objections is to abandon the idea of a global stablecoin, and to instead issue €-Libra, $-Libra, etc. In this way, the locally denominated Libras would easily fit existing e-money regulations, and central banks would retain their current control on local currency. Abandoning the global denomination would also, in our view, not reduce the gains to be reaped from operating a single digital global infrastructure.

Blockchains such as Ethereum show that it is very easy to operate tokens representing different assets and currencies on a single ledger. So far, however, Libra appears unwilling to let go of the idea of a single currency. So long as Libra clings to that idea, we think it will face strong opposition from central banks. We look forward to seeing what Facebook's CEO. Mark Zuckerberg has to say on this at his Congressional hearing next week.

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