Facebook’s Cryptocurrency will be Transformative

Last week Facebook announced its proposal to launch a new cryptocurrency next year, named the Libra. While Bitcoin is also a cryptocurrency, Libra is very different and has extraordinary potential.

Bitcoin is a truly decentralised currency with no central administering organisation. Its supply is very tightly constrained, so its value varies wildly. The three indicia of money are that it is a medium of exchange, unit of account, and store of value. Bitcoin’s extreme volatility means it can only serve as a medium of exchange in instantaneous transactions, so it is currency, but not money.

Libra will be money. Its value will be tied to a basket of the world’s major government-issued currencies and every Libra issued will mean an equal amount of such currency, or highly liquid government bonds, have been placed on deposit with a reliable repository. Libra is a stablecoin. It will be the first with breathtaking reach and utility because far more people globally today have a Facebook account than a bank account.

It will not initially be fully decentralised as, while it will operate on a blockchain, the initial processing nodes will be the 28 members of the Libra Association, which include Visa, Mastercard, Spotify and Uber. Why Uber you ask? Because Uber pays over US$ 800 million annually in merchant charges on card payments. Expect to be paying for Uber rides here next year from your Facebook account. The plan is for full decentralisation to start in five years but this requires major technological advances – Bitcoin’s solution is far too slow and energy-intensive.

English regulators are harrumphing that they see no reason why Libra will succeed there with such good payment options available in Pounds Sterling. They are right and wrong. Right to suggest Libra’s usefulness will initially be limited in highly developed countries; and wrong to imply Libra won’t be a game changer, because some 1.7 billion people today lack access to the most basic financial services. Libra is mobile money in the Kenyan M-Pesa sense, on a global scale.

Commentators suggest Libra lacks the cash-in / cash-out functions provided in mobile money networks by small stores that typically sell phone airtime and mobile money services along with groceries and cigarettes. However, the cash-in function will likely come in government salary, welfare and transfer payments to citizens. Welfare payments are bedevilled by what is politely termed ‘leakage’ in countries where recipients are often illiterate and lack a bank account. Some Indian states were seeing up to 45% of welfare payments disappear in this way before India implemented its Aadhar system of digital identity that has seen hundreds of million people get a bank account. The cash-out function will follow as small business owners opt to receive Libra paid into their own Facebook account, in return for their goods or services, as has already happened in China with AliPay and WeChatPay.
Mark Zuckerberg has said that “In a lot of ways Facebook is more like a government than a traditional company”. Libra is his biggest step yet into the realm of the sovereign, for Facebook will collect the seigniorage – the financial benefit of issuing currency which usually accrues to a central bank – and here will be the interest paid on the cash on deposit or liquid government bonds.

One should expect a response from the world’s major central banks. If Libra begins to take off, expect issuance of the digital currencies that many major central banks have been piloting. However this game plays out, Libra is a game changer.

In our part of the world, Libra will be transformative. Costs of remittances from Australia to Pacific Island nations are among the highest in the world, with Pacific Islanders often having to pay 10% or more to transfer money home. Imagine working in the hot sun picking fruit in the Riverina to earn $500, only to lose $100 to send the amount to your family in Tonga or Samoa.

In poor countries Libra will totally change the financial services game. In all countries, regulators will require Facebook to conduct money laundering and terrorism financing checks on all Libra users. The Libra plan includes a global digital identity to meet these requirements. Once Facebook achieves this regulatory compliance, expect an expanded suite of financial services to follow.

The Australian banks are currently consumed by responding to the Hayne Royal Commission recommendations. They also provide a comprehensive array of easy-to-use financial services which has made life tough for FinTech start-ups here.

Meanwhile in China Ant Financial, the payments and financial services subsidiary of Alibaba, uses its vast store of data to make loans and in America two of the leading lenders to small businesses are Amazon and Square, a payments app. Ant, WeChat, Amazon and Square have better data than the banks – they have a real time feed on businesses’ income as it is paid to them by customers – so of course they are displacing banks as lenders.

Whoever has the best data and data analytics is best able to price credit and insurance. Historically in Australia that has been our banks. It is no longer. Facebook will initially take off as a financial services company in poorer countries, but right now our banks should be very afraid. Radically new strategic thinking is required. The only real question is whether our banks’ leaders are up to the challenge.

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