

## OUR TOP ISSUE

*Summer Holiday Edition.*

### FACEBOOK'S FAKE MONEY

**► If Facebook wanted to offer the world better, actually sound money, the choice is obvious: It would be a 100 per cent gold-backed Libra. But who knows: Maybe this will be the next step, initiated by Facebook, Amazon, or any other company because there sure is a vast market for sound money out there.**

Starting in 2020, Facebook wants to offer its customers a global high-tech currency and infrastructure.<sup>1</sup> The US IT giant says that this will provide many people around the world with easy and cost-effective access to the monetary and financial system. The new blockchain-based money is called "Libra". Technically, it is something akin to a *crypto-money-banknote* covered by a basket of official fiat currencies (such as US dollars, euros and the like). The heart of the Libra project is the "Libra Association" (LA). The non-governmental entity, based in Geneva, Switzerland, is supported by founding members such as eBay, Facebook, Mastercard, PayPal, Spotify, Uber, Visa as well as other renowned firms, and will be responsible for the operation and further development of Libra.

Libra will be created by participants depositing fiat currencies such as US dollars or euro with the LA, and the LA will then grant the depositors a corresponding Libra amount in a digital wallet, which can be used for payments via the Internet, smartphone, credit card or WhatsApp and messengers, i.e. Facebook's chat services. The chances of success seem to be pretty good for the Libra: Electronic payment is a world-wide mega-trend. People seem to have become increasingly open to new technological ways of making payments. And if money can be sent to and fro via social media, many potential customers will presumably like it very much.

Traditional banks have good reasons to worry. The Libra is about to siphon transactions out of bank accounts and put them into the LA's hands. Not the banks, but the LA will collect the fees and receives precious data on who pays what, when, and where. The banks will be left even more in the cold should customers begin to use the Libra for savings purposes as well. Because then banks would also lose the time and savings deposits with which they refinance their balance sheets at low costs. Or think of the credit business: The LA may at some point also provide its customers with short-term consumer loans – and thus put banks under even more competitive pressure.

In any case, from a customers' perspective it is a good thing if and when the competitive pressure in the banking business gains momentum; as is well known, competition stimulates the search for better products and lower prices, which benefits the customers. The now heightened competition from the fintech industry is undoubtedly quite a challenge for many banks. Not least be-

<sup>1</sup> The Libra White Paper can be found [here](#).

cause for decades state regulation has kept unwelcome outside competition from their backs, thereby, however, weakening their innovative strength. But our sympathies have to be first and foremost with the people demanding banking and financial services, not with the banks delivering them.

The critical question, however, is this: Is the Libra really good – or sound – money? Unfortunately, this question cannot be answered in the affirmative. The reason is this: The quality of the Libra depends on the quality of the underlying fiat currencies – and fiat currencies do not make for good money, as should be well known by now. Fiat currencies are inflationary; they enrich some at the expense of many others. The issuance of fiat currencies causes distortions in the credit markets, which provokes speculative bubbles and trigger booms and busts, and last but not least, fiat currencies lead the economies into over-indebtedness.

Against this backdrop, it becomes evident that the libra will suffer from all the economic and ethical deficiencies that come with its underlying fiat currencies. For instance, the Libra will be inflationary money to the extent that the US dollar, the euro, and all the other underlying fiat currencies are subject to inflationary measures by central banks, resulting in the Libra losing its purchasing power in step with the fiat currencies. In extreme cases, if the official currencies were to go under, the Libra would follow suit. The Libra is therefore not a real alternative to official fiat currencies, but rather a more straightforward and more cost-efficient way to use them.

The LA is supposed to keep the fiat monies paid-in by customers as a "reserve". This should make sure that the Libra can, at any given point in time, be exchanged back into national fiat currencies at its equivalent value. To this end, the LA wants to hold the reserve in fiat currencies-denominated bank deposits as well as in high-quality interest-bearing securities. To the extent that the LA decides to keep debt securities, the result would be a kind of "fractional reserve". In this case the Libra would even carry a payment default risk – which would strike if and when the LA could not, due to market stress, for example, exchange its bond holdings into fiat currencies at face value.

With the investment of the reserve, the LA hopes to earn interest income. But this is likely to be difficult. After all, central banks have slashed interest rates to extremely low levels, and there is no sign of a move away from this kind of monetary policy. Should monetary authorities impose negative interest rates on bank deposits, this would affect Libra holder directly: Because if the LA is then forced to pay for its bank deposits, the owners of the Libra will have to pay the bill. So anyone who thinks that the Libra might offer an escape from the bad fiat currencies is mistaken. The Libra is a fiat money clone; just as fiat currencies the Libra is fake money.

Unfortunately, the Libra project does not appear to be driven by the desire to provide the people in this world with better money. The fact that the Libra will be run on a private ("permissioned") blockchain does not change anything. The Libra is just the upshot of a rather smart entrepreneurial attempt to profit from the global market for payment services (and later perhaps also from the credit markets), and, of course, to collect as much precious transaction data as possible. If Facebook and the others wanted to offer the world better, actually sound money, the choice is obvious: It would be a 100 per cent gold-backed Libra. But who knows: Maybe this will be the next step, initiated by Facebook, Amazon, or any other company because there sure is a vast market for sound money out there.

### Articles in earlier issues of the *Degussa Market Report*

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E-Mail: [info@degussa-goldhandel.de](mailto:info@degussa-goldhandel.de), Internet: [www.degussa-goldhandel.de](http://www.degussa-goldhandel.de)

**Editor in chief:** Dr. Thorsten Polleit

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### Frankfurt Headquarters

Kettenhofweg 29 · 60325 Frankfurt  
Phone: 069-860 068 – 0 · [info@degussa-goldhandel.de](mailto:info@degussa-goldhandel.de)

### Retail buying and selling outlets in Germany:

**Augsburg** (shop & showroom): Maximiliansstraße 53 · 86150 Augsburg  
Phone: 0821-508667 – 0 · [augsburg@degussa-goldhandel.de](mailto:augsburg@degussa-goldhandel.de)

**Berlin** (shop & showroom): Fasanenstraße 70 · 10719 Berlin  
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**Hamburg** (shop & showroom): Ballindamm 5 · 20095 Hamburg  
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**Hanover** (shop & showroom): Theaterstraße 7 · 30159 Hanover  
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**Munich** (Old Gold Centre): Promenadeplatz 10 · 80333 Munich  
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**Nuremberg** (shop & showroom): Prinzregentenauer 7 · 90489 Nuremberg  
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### Retail buying and selling outlets around the world:

**Zurich** (shop & showroom): Bleicherweg 41 · 8002 Zurich  
Phone: 0041-44-40341 10 · [zuerich@degussa-goldhandel.ch](mailto:zuerich@degussa-goldhandel.ch)

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