

TIME

El Salvador Is Betting on Bitcoin to Rebrand the Country — and Strengthen the President's Grip

Ciara Nugent

October 1, 2021

When Roman Martinez was growing up in El Zonte, a small coastal village in El Salvador, the American Dream loomed large. Beyond the local fishing industry, which Martinez's parents worked in, there weren't a lot of opportunities. "Young people just wanted to leave, to go to the U.S.," he says. "But now we have a Salvadoran dream."

It's a dream about Bitcoin. Two years ago an anonymous American donor sent more than \$100,000 in the decentralized digital currency, or cryptocurrency, to an NGO that Martinez works for in El Zonte to pay for social programs. As the team began encouraging families and businesses to use Bitcoin, many of the town's residents, most of whom had never had a bank account, began saving their money in the currency, making gains as its value surged. Curious tourists flooded into the town and foreign businesses set up shop. The project gave El Zonte the nickname "Bitcoin beach," simultaneously a philanthropic endeavour and one of the world's largest experiments in cryptocurrency.

"People with little income, who didn't have access to a financial system, with \$5 worth of Bitcoin they can start building something that can be the legacy they leave to their children," Martinez says, over video call, wearing a black T-shirt emblazoned with Bitcoin's orange logo.

It was partly El Zonte's experiment that inspired El Salvador last month to become the first country in the world to adopt Bitcoin as legal tender—alongside the U.S. dollar, which El Salvador has used as its currency since 2001. The Bitcoin law, which came into force on Sept. 7, makes taxes payable in Bitcoin, obliges all businesses to accept it, and paves the way for the government to disburse subsidies in it. The government has built a network of 200 Bitcoin ATMs and a digital Bitcoin wallet app, called Chivo, through which it has distributed \$30 worth of Bitcoin to every Salvadoran citizen in a bid to kickstart the Bitcoin economy. Salvadoran President Nayib Bukele claims 2.1 million Salvadorans have used Chivo so far, in a country of 6 million people.

Bukele is touting Bitcoin as a way for Salvadorans to reduce the fees they pay to send and receive remittances—which make up 22% of El Salvador's GDP, mostly from the U.S.—and as a way for the 70% of Salvadorans who are unbanked to access financial services.

He's not alone in advocating for cryptocurrencies as a way for developing economies to bypass a global financial system in which access to services and investment are geared towards the world's richer countries and individuals. Crypto has achieved its highest penetration mostly in countries where banking systems are costly and complicated to use, or where local economies and currencies are unstable.

But critics say making Bitcoin—notoriously volatile and not subject to controls by any central bank—into legal tender is an unjustifiable gamble for El Salvador's already ailing economy. The \$200 million of taxpayer money congress has devoted to the project equates to 2.7% of the government's total budget for 2021, or almost three times the agriculture ministry's budget for the year. The uncertainty introduced by the Bitcoin policy has sent the price of government bonds tumbling, and halted negotiations for a deal with the International Monetary Fund (IMF) that the country is seeking to plug a \$1.5 billion hole in its public finances.

'The coolest dictator in the world'

For the President, a 40 year-old with the casual wardrobe and cheeky communication style of a tech entrepreneur, Bitcoin is about more than its immediate economic impact, though. It's a chance to rebrand El Salvador, from a country known primarily for gang violence and a sluggish economy that drives emigration to the U.S., to an independent, modern crypto pioneer. For young Salvadorans like Martinez, that means creating a Salvadoran dream. For the international community, it's a rebuke to a world order that casts El Salvador as the backyard to the U.S.—which Bukele has increasingly railed against since taking power in 2019. Instead, he casts El Salvador as an independent hub of innovation, aligned with the anti-establishment crypto community, members of which have flooded and celebrated the country in recent months and will return for a large crypto conference in November.

Envisioning the transformation he witnessed in El Zonte taking place across the country, Martinez is excited—despite doubts among the wider population. “We’re used to new things happening in the U.S. or Canada or Europe,” Martinez says. “Now we’ve changed the narrative about El Salvador and started moving forward.

But there’s another narrative unfolding in El Salvador. Since Bukele’s party, New Ideas, won a landslide victory at parliamentary elections in February, he has moved rapidly to undermine the structures of El Salvador’s democracy. In May, parliament voted to replace opposition-linked judges on the supreme court with Bukele allies, bringing all levers of power under his control. In September—a few days before the Bitcoin launch—the same court ruled that Bukele can run for a second term in 2024, in defiance of El Salvador’s constitution, triggering sanctions from the U.S. He has also stepped up attacks on the media, including launching criminal investigations into news organizations and kicking critical journalists out of the country.

Analysts say the Bitcoin experiment is part of Bukele’s proto-strongman trajectory. “He’s fallen in love with his own power and wants to nurture this cool millennial President image through this adventure into the Bitcoin world,” says Tiziano Breda, a Central America analyst at the International Crisis Group, a think tank.

It's working for him, largely. The Bitcoin law has sparked the first major protests of his presidency, with 8,000 people marching in San Salvador on Sept. 15— a significant number of people in a country where street protest is unusual. But the President's approval ratings still stand above 85%.

With that backing, Bukele is deeply dismissive of global concern about his leadership. On Sept 18, he changed his bio on Twitter to "Dictator of El Salvador," clearly trolling the international press. Then, a couple of days later he changed it again, to "The coolest dictator in the world."

El Salvador's rapid transformation

On the night that Bitcoin launched in El Salvador, Nelson Rauda, a reporter for independent newspaper *El Faro*, went to a party. At a sleek hotel bar next to an infinity pool overlooking the Pacific ocean in the department of La Libertad, crypto enthusiasts and internet celebrities from the U.S., including YouTuber Logan Paul, danced and let off fireworks to celebrate a major moment for the cryptocurrency. Some wore headdresses and carried orange signs featuring Bitcoin's white B logo. Almost everyone was speaking English. "The scenery, and the location was a beach in El Salvador, but it could have been anywhere else in the world," Rauda says. "[The crypto community] want to portray themselves as bringing a future and development to El Salvador through Bitcoin— a kind of white saviorism in that sense. But most of them are not interested in the country, just business."

Bukele's government welcomes their business. The President claims that if 1% of the world's Bitcoin were invested in El Salvador, it would raise GDP by 25%. He has offered permanent residency to anyone who spends three Bitcoin (currently around \$125,000). He has also highlighted the fact that, since Bitcoin is legal tender, rather than an investment asset, foreigners who move to El Salvador will not have to pay capital gains tax in the country on any profits made if the cryptocurrency's value increases. To that he adds, in English, "Great weather, world class surfing beaches, beach front properties for sale" as reasons that crypto entrepreneurs should move to El Salvador.

This pragmatic, salesman-like tone is something that Salvadorans appear to appreciate from their President. Though he served as mayor of the capital, San Salvador until 2018, Bukele ran for the

presidency in 2019 as a political outsider. He used his direct link with millions of followers on social media to pit himself against the right and leftwing parties that had ruled the country since its civil war in the 1980s. That conflict, in which the U.S. played a decisive role by funding opponents of leftist rebels, sowed the seeds of many of El Salvador's current problems: chronically low economic growth, weak institutions vulnerable to corruption, the world's worst rates of gang violence and one of the lowest rates of direct foreign investment in Central America. Bukele argued, convincingly, that the postwar governments had failed to meaningfully address those woes over three decades.

Since taking office, Bukele has projected an image of ruthless efficiency. In February 2020, he and a group of armed soldiers stormed into parliament in order to pressure lawmakers to pass his budget plan. He has slashed rates of gang violence, with the country's homicide rate falling from 51 per 100,000 in 2018 to 19 per 100,000 in 2020 (Experts debate whether this is a result of Bukele's security policy, gang trends independent of him, or a secretive quid pro quo deal he may have struck with gang leaders). He adopted a hardline response to COVID-19, ordering one of the world's most stringent lockdowns and giving security forces the right to put any rule-breakers in detention centers, a move human rights watchdogs say led to violent repression.

The unprecedented popularity Bukele has enjoyed has allowed him to move faster than Latin America observers expected to take anti-democratic steps, such as intervening in the judiciary, Breda says. "For many other sort of authoritarian governments in the region, it took years to do the things that Bukele has done in such a sweeping way. The pace is definitely surprising."

'Bitcoin is costing the country dearly'

Those who are most sceptical of Bukele—conservative economists—see his Bitcoin law as new packaging for an old move for populist authoritarian leaders in Latin America. The policy was labelled a "Bitcoin scam" in a *Wall Street Journal* op-ed.

"They're always trying to pull a rabbit out of a hat," says Steve Hanke, professor of applied economics at the Johns Hopkins University and director of the Troubled Currencies Project at the

libertarian think tank, the Cato Institute. “They say: ‘We’ve had all these financial problems because of all these irresponsible leaders we’ve had in the past. And now here I am riding a white horse and I’ve got some new gimmick that’s going to solve it all. It’s called Bitcoin.’”

Hanke helped advise the Salvadoran government on the country’s dollarization, when it adopted the U.S. dollar as its sole currency in 2001. From 1993 the Salvadoran colón had been pegged to the U.S. dollar on a fixed exchange rate, in a successful effort to keep previously rampant inflation under control. After eight years, the government opted to fully replace the colón with the dollar. That made the economy more stable and lowered the cost of borrowing, but limited Salvadoran governments’ freedom to spend money, particularly in times of financial crisis. Hanke and others have speculated that the Bitcoin move is a first step towards scrapping dollarization altogether and issuing a national digital currency. That would both enable looser public spending, and reduce the impact of U.S. sanctions.

But for local economists, the immediate concern is how Bitcoin could complicate El Salvador’s path out of a deep pandemic recession. “Public finances in El Salvador are on a knife edge. Public debt stands at close to 90% of GDP and the government needs to find almost \$1.5 billion to close the year and pay its obligations,” says Alvaro Trigueros Arguello, director of economic studies at FUSADES, a San Salvador-based development thinktank. Though El Salvador’s economy is growing—with the Central Bank saying Sept. 29 that GDP is on course to surge by 9% this year—Trigueros Arguello says this is mostly due to a temporary factors, including the reopening of businesses after COVID-19 restrictions and a surge in remittances after the disbursement of pandemic aid packages in the U.S.

The Bitcoin rollout has complicated El Salvador’s relationship with the IMF, from which it is seeking a \$1 billion assistance package. In June the fund denied a request by El Salvador to assist in its Bitcoin rollout. It cited the lack of transparency in cryptocurrencies, arguing that the difficulty of tracing who makes Bitcoin transactions has facilitated criminal activity elsewhere, as well as environmental concerns about widening the use of Bitcoin, which requires vast amount of energy to produce. Fears over the cryptocurrency’s impact on El Salvador’s macroeconomic stability have

stalled negotiations between El Salvador and the IMF, Trigueros Arguello says. “The government needs international credit and because of Bitcoin, it’s not getting it,” Trigueros Arguello says. “Bitcoin is costing the country dearly.”

The backdrop to El Salvador’s experiment hasn’t undermined the excitement for those who want crypto currencies to be more widely used. Bitcoin Twitter has filled with tweets celebrating how easy it is for Salvadorans to use the currency in places like Starbucks, and praising Bukele’s foresight. “I’m totally excited about what’s happening in El Salvador. [Particularly] the fact that it’s happening in Latin America,” says Cristóbal Pereira, CEO of Blockchain Summit LatAm, a regional conference covering the blockchain technology that underlies Bitcoin, which will host events at El Salvador’s own Bitcoin conference in November. “If people end up using it widely, there’s a good chance other countries and people will end up using it more too.”

It’s too early to tell if the buzz will be matched by the significant investments Bukele is hoping for. Analysts say businesses will likely wait and see how the bitcoin rollout affects El Salvador’s economic stability before striking any major deals.

Mike Petersen, an American who moved to El Zonte in 2005 and helped found the Bitcoin beach, says he’s received a “a huge flood of [enquiries from] businesses that want to set up shop here, because, for the first time they are realizing, hey, Salvador is a forward looking country.”

Those include companies in the Bitcoin space, such as exchanges and ATM networks, but also real estate developers, manufacturing companies and “some lighting and architectural companies that are now outsourcing, hiring architectural students here to do design and and put together bids for them. Because they can pay them in Bitcoin.”

Peterson says he doubts that concern about the political situation in El Salvador will have any impact on investors. “Elite media circles are the ones that are more focused on that. I think, in the business

climate, people are more pragmatic and practical about things. And they see that Bukele is extremely popular.”

What’s not necessarily popular, so far, is Bitcoin. Bukele claims that a third of Salvadorans are actively using Chivo, but it is unclear how many are only using the app to access the initial \$30 gift from the government. Media outlets in El Salvador reported long queues for the ATMs, where most people were converting their Bitcoin to take dollars home with them. In the first week of the rollout, one of the country’s largest banks told *The Financial Times* that the cryptocurrency accounted for fewer than 0.0001 % of its daily transactions. Rauda, the *El Faro* reporter, says he knows “no one” who’s using Bitcoin on a regular basis.

Teething troubles

The government gave itself just three months after parliament approved its Bitcoin law in June to introduce the currency, leading to a series of technical issues with the Chivo wallet app. Crypto bloggers reported cash taking days to show up in their Chivo accounts after being transferred by other users, bugs making the app unusable, and an initial inability to transfer any sum below \$5. Bukele, who took to Twitter throughout the launch to offer emoji-laden tech support messages, claimed most of the technical problems were resolved within a few days.

The bumpy rollout helped trigger a 10% fall in the value of Bitcoin against the day it became legal tender, and further falls since. On Sept. 20 Bukele said his government had “bought the dip” and acquired 150 more coins, bringing the country’s total holding to 700 (around \$22 million).

Chaotic rollouts of new government programs are not unique to El Salvador. But some in the Bitcoin community have concerns about the structure of the country’s experiment, beyond the initial hiccups.

Marc Falzon, a New Jersey-based Bitcoin YouTuber who visited San Salvador to document the rollout, says he became concerned about Salvadoran taxpayers footing the bill despite opposition to

the policy, and about Article 6 of the Bitcoin law, which says that all economic actors in the country must accept Bitcoin if they have the technical capacity to do so.

“Forcing people to accept a decentralized currency from a centralized authority ebbs away at the legitimacy of not just Bitcoin, but cryptocurrency in general,” he says.

Supporters of the project point out that Salvadorans don't have to keep their money in Bitcoin if they don't want to, with the government guaranteeing their ability to transfer them into U.S. dollars via its national development bank and a range of services allowing businesses to make that transfer automatically.

But Falzon says that the positive image of EL Salvador's rollout generated by Bitcoin influencers on Instagram and Twitter didn't reflect what he saw. In a health store near his hotel, for example, the shopkeeper said she couldn't afford to restock because so many Bitcoin payments made by customers had simply never shown up in her Chivo app account. “For people in the Bitcoin and crypto community, El Salvador is a ‘told you so moment,’ proof that this isn't just a fad. And I think that in that enthusiasm, we can lose sight of both the bigger picture—in how future countries may start to follow suit—and also of the individual experiences of the people that are in these countries.”

Some individuals are happy though. Martinez, the community activist who grew up in El Zonte, says the town's experience suggests hesitancy to use Bitcoin—and opposition to the Bitcoin law—will fade as Salvadorans become more used to the technology, and become widespread within a few years.

He's not concerned, he says, by how Bitcoin may play into Bukele's larger political project. “As an NGO, we're apolitical. We support anything that can make a better El Salvador. And I think we're walking towards a better future.”