



# Did El Salvador just make Bitcoin into real money?

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El Salvador recently approved a law making Bitcoin — the world’s most popular of more than a thousand cryptocurrencies — a legal currency there as of September.

The reaction was immediate, although there was no agreement on the importance of the move. Nor was there much discussion of the important underlying issues of whether some combination of cryptocurrencies will challenge the U.S. dollar as the world's dominant reserve and trading currency or whether non-governmental digital currencies might eventually challenge government currencies.

The stakes could not be higher, and the cast of characters is head-spinning.

Since the 1940s, the dollar has been the foundation of international trade. All countries and their central banks must hold dollars to engage in trade, and the U.S. government has enjoyed unique controls over international trade such as its ability to impose severe sanctions on adversaries and enemies. Moreover, since the U.S. government controls the supply of dollars, it has the unique ability to run trade and other deficits by printing dollars. Anything that challenges this arrangement threatens fundamental features of America's stature.

Enter cryptocurrencies.

Unlike the Chinese Renminbi (RMB) or the EU's Euro, cryptocurrencies began as private sector inventions to facilitate payments by avoiding the time and cost of currency exchanges, banks, processing fees, credit card companies, etc. As a result, they are widely classified as "financial assets," not currencies, by many governments. Because they often involve large asset transfers on the internet, however, cryptocurrencies require extremely secure, internet-centric processes, the most popular of which is called blockchain.

So, blockchain-based, internet-centric, private cryptocurrencies have sprung up as both investments and as de facto currencies.

Enter governments.

For many governments — notably China — private sector cryptocurrencies present a threat to the very role of governments and worse, a threat that is controlled by businesses, most of which are American. There is, in this view, no role for businesses or individuals in creating money. Also, for these and many other governments, free-standing cryptocurrencies when used as an investment represent a fraud. Since most private sector cryptocurrencies are not backed by any government currency, they are — in this view — play money worth only what

a sinister seller or duped buyer will charge and pay. Nonetheless, freestanding cryptocurrencies, including the leading example Bitcoin, have caught on and are accepted as a form of payment by a growing number of businesses and as an investment by investors worldwide.

Enter big tech.

To offset the fact that many cryptocurrencies are not backed by governments or dollars, some tech businesses — notably Facebook, Uber, Spotify, etc. — have experimented with cryptocurrencies that are legally and explicitly backed by currencies/dollars, so there is no doubt that real cash is redeemable for the cryptocurrency: called “stablecoins.” Like free-standing cryptocurrencies, stablecoins bypass currency exchanges and bank fees, and they offer global, rapid, low-cost ways to make payments.

Enter Venezuela and Russia.

In order to bypass American economic sanctions, in 2018, (with reported support from Russia) the Venezuelan government introduced the Petro, which it described as a government stablecoin backed by Venezuelan petroleum, and it recognized the Petro as currency within Venezuela. Particularly — but not only — because the Petro is an effort to bypass U.S. sanctions, Venezuela’s experiment has been controversial. And almost certainly not a success, since it’s not clear that any country (except perhaps Russia and Iran) or any major businesses have yet to accept Petros as a currency. This probably has as much to do with the size and diversity of the Venezuelan economy as it does with active opposition from the U.S.

Enter China.

Everyday payments in China are not based on cash, credit cards or banks. They are primarily based on two Chinese, RMB-centric electronic payment systems: WeChat Pay and Ali Pay, which have 800 million and 520 million users. These encrypted, digital payment systems charge low fees and permit over a billion Chinese to transfer funds or pay for purchases in RMB with their smart phones. Because of the success of these digital wallets, the Chinese government has announced plans to issue a purely digital RMB (d-RMB.) The d-RMB is an online

version of RMB cash (with virtually no fees) that has been tested inside China. It is likely to be promoted by China as a new, global form of currency.

The d-RMB will almost certainly challenge the dollar as currency for international payments, with d-RMB holders free to convert their d-RMB into other currencies or spend them in China or in some other countries.

Enter El Salvador.

With a per capita GNP of around \$4,000, El Salvador is the smallest country in Central America, but it is the most densely populated. Since the end of its civil war in 1992 (which drove at least one million refugees to the U.S.) successive governments have pursued different development plans. These ranged from tourism to textiles to making the country's official currency the U.S. dollar. But nothing has been more important than the estimated \$4 billion in annual payments made by some 1-2 million El Salvadorans in the U.S. to some 360,000 households in El Salvador.

In 2019, Nayib Bukele, 37-year-old mayor of San Salvador, was elected president from the "New Ideas Party," which also captured a majority in the Congress. Although accused of authoritarian tendencies, his approach has partly centered on alleviating poverty through technology.

In June, Bukele proposed and Congress approved making Bitcoin their second currency because it would reduce fees paid by expatriates who send money home, free the country from exclusive American monetary control and attract technology investments. The first two are not disputed, although degrees are widely debated; and the risks completely separate. Regardless, El Salvador has now made Bitcoin an officially-recognized currency within that country.

Whether this is a major step in global acceptance of cryptocurrencies or another small distraction in a much larger economic, geopolitical and technological struggle probably depends on whether any other countries follow El Salvador in recognizing Bitcoin and, more importantly, what happens as governments led by China promote their own national digital currencies.

Either way, the United States needs to be paying attention.

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