Perspective from **Franklin Templeton Digital Assets**

Revisiting El Salvador's Adoption of Bitcoin

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On September 7th, 2021, El Salvador made history as the first country to adopt Bitcoin as legal tender. Spearheaded by El Salvador's President Nayib Bukele, this initiative aimed to address the country's economic challenges, attract foreign investments, and foster innovation.

Motivations for Adopting Bitcoin

President Bukele saw Bitcoin as a tool to help the underbanked. With approximately 70% of the population lacking access to traditional banking services, Bitcoin offered an opportunity to bypass the limitations of conventional banks.[1] Beyond that Bukele hoped to diversify the economy beyond traditional sectors and to position El Salvador as a global leader in blockchain innovation.[2] By embracing Bitcoin and blockchain technology, the country aimed to attract digital asset-related businesses, investment, and talent, fostering a new digital economy that could drive innovation and economic growth beyond its existing industries.

Additionally, Bitcoin adoption aimed to reduce the country's dependency on the U.S. dollar. El Salvador adopted the U.S. dollar as its official currency in 2001, which limited the country's control over its monetary policy. By adopting the U.S. dollar, El Salvador fell under the influence of the U.S. Federal Reserve, meaning that when the country's economic cycle differed from that of the U.S., its ability to respond with independent monetary policy was constrained. Introducing Bitcoin as a secondary legal tender provided an opportunity to regain some sovereignty over its economy and to protect the nation from the risks associated with fluctuations in the U.S. dollar.

Implementation and Challenges

Although the motivations to accept BTC as legal tender were well intended, many implementation challenges presented themselves along the way. The implementation of Bitcoin as legal tender with the launch of the Chivo digital wallet was intended to enable Salvadorans to store, send, and receive Bitcoin, to encourage financial inclusion, and to foster technological development to benefit the national economy. The Chivo wallet would serve as a catalyst for technological innovation.

However, El Salvador faced challenges with the utilization of digital assets. One of the most prominent concerns was Bitcoin's inherent volatility. The bear market in 2022 saw Bitcoin's value drop from $69,000 to $16,000 over the year. This raised questions about the stability of the country's financial system since the government had accumulated Bitcoin as part of its reserve assets, exposing its economy to Bitcoin's price swings, adversely impacting the real purchasing power for citizens that opted into BTC denominated transactions.[3] Technical issues also affected the rollout of the Chivo wallet. These included glitches that temporarily shut down the platform, incidents of identity theft, and security breaches.

Despite the implementation issues, approximately 46% of the population downloaded the Chivo app within the first year, largely due to the mandatory adoption of Bitcoin.[4] Yet, actual usage remained limited. Of those who downloaded the platform, only about 20% of users, predominantly wealthier, educated, young men, remained active on the app.[5]

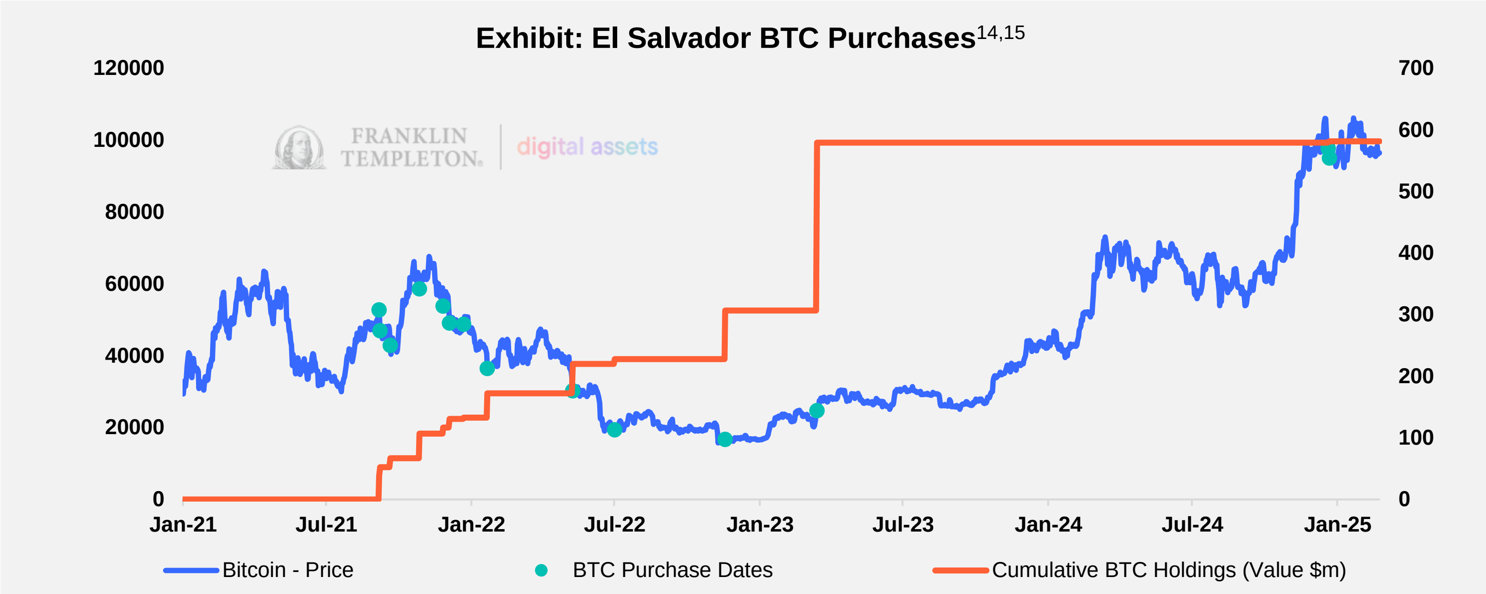
Expansion

Given the implementation challenges, the International Monetary Fund (IMF) expressed concerns that El Salvador's Bitcoin adoption could have destabilizing effects, fearing that Bitcoin's volatility might undermine public confidence in the country's monetary system and lead to financial instability. During negotiations for a $1.4 billion loan, the IMF delayed approval due to apprehensions about the country's Bitcoin policies. The loan was crucial for El Salvador as it would help reduce overall debt amid growing obligations, provide access to international capital markets to boost GDP, and lower borrowing costs, which could otherwise lead to financial distress.[6] In response to the criticism, El Salvador adjusted its Bitcoin policy. In January 2025, the government amended its policy, making Bitcoin acceptance for businesses voluntary rather than mandatory. This change helped to mitigate the fiscal risks associated with Bitcoin, which aligned with the IMF's recommendations, and it signals El Salvador's commitment to fiscal responsibility.[7]

Given the volatility of Bitcoin, El Salvador introduced stablecoins as a more predictable alternative for digital transactions. Stablecoins are pegged to a stable asset, like the U.S. dollar, and provide many of the benefits of digital assets without the price volatility of Bitcoin. To facilitate the use of stablecoins, El Salvador passed the Digital Asset Law in January 2023, offering tax exemptions for stablecoin issuers and users.[8] While data on stablecoin trade volume remains limited, stablecoin adoption by El Salvadorans with the registration of El Salvador's first regulated stablecoin, Alloy by Tether,[9] in 2024 and Tether's relocation to El Salvador on January 13, 2025, have signaled confidence in the country's digital asset-friendly environment.[10] The government's regulatory clarity, coupled with incentives for digital asset companies, created a robust ecosystem for stablecoins and other digital assets.

In addition to stablecoin adoption, El Salvador's strategy also included the introduction of Bitcoin-backed bonds, known as "Volcano Bonds." First proposed in November 2022 and passed in January 2023, these bonds were designed to pay down sovereign debt, fund the country, and build Bitcoin mining infrastructure.[11] While the Volcano Bonds have not come into fruition yet, the bonds, denominated in US dollars, offer a 6.5% annual yield over 10 years with a five-year lock-up period and a fast-track access to El Salvadoran citizenship for investors.[12] Furthermore, they would use hydrothermal energy from the Conchagua volcano, a renewable energy source, to power Bitcoin mining operations, reducing mining's environmental impact and supporting the country's sustainability goals.[13]

Additionally, El Salvador has consistently expanded its Bitcoin reserves, as seen in the exhibit, viewing capital appreciation as a way to fund debt repayment, infrastructure projects, and public services. With Bitcoin holdings estimated at $600 million—roughly 1.7% of the nation's approximately $34 billion GDP—the government aims to position El Salvador as a digital asset innovation hub while attracting global investors.[16]



Conclusion

El Salvador's embrace of Bitcoin and its expansion into stablecoins marked a transformative shift in the country's financial landscape. While Bitcoin adoption has faced volatility-related challenges, the government's proactive stance in implementing stablecoin-friendly regulations demonstrates a commitment to leveraging digital assets for economic stability and growth. Although the long-term effects remain uncertain, early indicators suggest positive trends in financial inclusion, investment attraction, and crime reduction.

El Salvador's experiment also serves as a case study for other nations exploring digital asset integration. Countries like the United States have seen growing discussions around Bitcoin strategic reserves, with policymakers and financial institutions evaluating its role as a hedge against inflation. Meanwhile, nations with high inflation or limited access to traditional banking may look to El Salvador's model as they consider adopting Bitcoin or stablecoins to enhance financial inclusion and economic sovereignty.

Sources:

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6. Source: "IMF Reaches Staff-Level Agreement with El Salvador on an Extended Fund Facility Arrangement." IMF. December 18, 2024.
7. Source: "Lawmakers in El Salvador Rush New Bitcoin Reform After IMF Deal." Reuters. January 29, 2025.
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12. Source: Ibid
13. Source: Ibid
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16. Source: "El Salvador GDP per capita." The World Bank.

Glossary:

Legal tender: A currency that must be accepted for payment of debts and obligations as defined by a government
Chivo Digital Wallet: A government-backed digital wallet introduced in El Salvador to facilitate Bitcoin transactions.
International Monetary Fund (IMF): Supranational organization that provides monetary, economic, social, and political support for countries
Stablecoins: A type of digital asset that is pegged to another asset, such as the US dollar
Alloy by Tether: A crypto platform that enables the creation of synthetic digital assets. It is tied to the price of the Tether Gold stablecoin, which is a stablecoin backed by gold.
Strategic Reserve: A stockpile of resources intended for use during economic or financial crises. A Bitcoin strategic reserve is a stockpile of Bitcoin.

WHAT ARE THE RISKS?

All investments involve risk, including the loss of principal.

Digital assets are subject to risks relating to immature and rapidly developing technology, security vulnerabilities of this technology, (such as theft, loss, or destruction of cryptographic keys), conflicting intellectual property claims, credit risk of digital asset exchanges, regulatory uncertainty, high volatility in their value/price, unclear acceptance by users and global marketplaces, and manipulation or fraud. Portfolio managers, service providers to the portfolios and other market participants increasingly depend on complex information technology and communications systems to conduct business functions. These systems are subject to a number of different threats or risks that could adversely affect the portfolio and their investors, despite the efforts of the portfolio managers and service providers to adopt technologies, processes and practices intended to mitigate these risks and protect the security of their computer systems, software, networks and other technology assets, as well as the confidentiality, integrity and availability of information belonging to the portfolios and their investors.

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