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Consequences of Adopting Cryptocurrency as a Legal Tender with Reference to El Salvador

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***Abstract*: The objective of this research paper is to study about the various implications a nation has to face if they adopt any cryptocurrency as a legal tender and a form of currency in the economy and the case study of El Salvador when they adopted bitcoin as a legal tender. The president has said that the problem of high transaction fees when people send money to El Salvador from abroad which accounts for 20% of the nation's GDP will be solved by this move. The government also wanted to get rid of the UD dollar and excessive United States government control over the country's economy. Usage of bitcoin also has some other benefits such as no banking fees on bitcoin transactions, low transaction fees on international bitcoin payments, transactions are mobile and secure as they are equipped with blockchain technology and transaction are not required approval from authority or an external source unless the transaction is international. Cryptocurrency is also facilitating transactions for various crimes. Bitcoin mining also poses a huge environmental hazard as a lot of electricity is used in the process.**

***Keywords*: Cryptocurrency, Bitcoin, El Salvador.**

1. Introduction

El Salvador became the first nation to accept Bitcoin as legal cash on September 7, 2021, enabling its usage in any transaction, from paying for a coffee to filing taxes. Since it was one of the first actions taken by a sovereign government to formally recognise bitcoin as legal tender and there was a growing need for clarity regarding the implications of these new currencies and the technologies that power them, the decision was largely applauded by the global bitcoin community. El Salvador became the first country in the world to recognize bitcoin as legal cash, despite the fact that many regulatory bodies, tax officials, and central banks around the globe are still attempting to comprehend the nature and meaning of digital currencies.

The biggest economic issue facing El Salvador is that 20% of the GDP is made up of nationals sending money home from abroad, but they incur enormous transaction charges and 70% of the population lacks a bank account. In light of the fact that bitcoin enables quick, inexpensive international payments and doesn't require banks, El Salvador's President, Nayib Bukele, expects that the adoption of bitcoin as legal cash will address the nation's most pressing economic issue. Therefore, the adoption of bitcoin will benefit their economy since their GDP may rise.

Since 2001, El Salvador has accepted the US dollar as legal tender for all domestic transactions. The colon was the national currency at the time, and the dollar was permitted to circulate freely alongside it at a set exchange rate under the administration of President Francisco Flores. The argument put out by proponents of the dollar was that the predicted advantages of macroeconomic stability would offset El Salvador's loss of economic sovereignty, monetary independence, and even seigniorage—the distinction between the cost of minting coins and banknotes and their face value. But when purchasing power abruptly collapsed, the economy became even more dependent on remittances, which over the previous two decades had typically represented 20% of gross domestic product annually.

The president of El Salvador Nayib Bukele has also said that financial inclusion will take place. A quarter of the people of El Salvador live below the poverty line. This move will help people get jobs and they will be included in the formal economy and financial system. Close to 70% of the people of El Salvador are unemployed and depend on informal economy. In the recent years, bitcoin has gained so much popularity that El Salvador expects the investments made in the country to increase.

Along with all the above-mentioned economic benefits, there are also other benefits of using bitcoin which the El Salvador government must have taken into consideration while adopting bitcoin as a legal tender and an official currency such as no banking fees on bitcoin transactions, low transaction fees on international bitcoin payments, transactions are mobile and secure as they are equipped with blockchain technology.

Transactions made with bitcoin are also pseudonymous. It implies that they are not entirely anonymous and that only a blockchain address may be used to identify a transaction. It's also crucial to understand that Bitcoin only uses peer-to-peer transactions for its payment system. It implies that users can send and receive money from and to anyone on the network in any country. Unless they are receiving or transmitting bitcoin from a regulated exchange or institution, the parties to a transaction do not need permission from a higher authority or an outside source.

2. Consequences of Adopting Cryptocurrency as a Legal Tender

The market for bitcoin, the most popular cryptocurrency in

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the world, is often seen as a game of winners and losers played out between hedge funds, novice investors, nerds, and criminals. The tremendous danger associated with an anonymous digital currency that is very volatile is better left to people who are knowledgeable about the game or who don't care because they can reduce the risk or absorb any losses.

The dollar is not nearly as volatile as bitcoin. It's worth fluctuated between $32,462 and $40,993 between June 8 and June 15, while between May 15 and June 15 it varied between $34,259 and $49,304. Bitcoin is an inappropriate tool for macroeconomic stabilization because of its extreme oscillations and the fact that they are solely driven by the market, leaving no room for policymakers to control the swings.

El Salvador has been asked by the International Monetary Fund (IMF) to change its mind on making Bitcoin legal tender. Fears that the decision will cause instability and inflation in the impoverished Latin American nation sparked widespread demonstrations. The IMF has cautioned President Nayib Bukele about the dangers that cryptocurrencies pose to the nation, highlighting the fact that obtaining a loan from the organization would be challenging. Bitcoin's price can fluctuate a lot, and during the past year, it has climbed and fallen sharply. On January 25, 2022, bitcoin was trading at over $37,000, having dropped by approximately half from the high of $67,734 reached in November 2021.

A single coin cost roughly $10,000 in September 2020, to a high of $63,000 in April 2021, then dropped to $30,000 in July 2021. This volatility is expected given that cryptocurrencies are not backed by reserves or by the goodwill of any reputable organizations, such governments, private banks, or other reputable businesses. And those with modest incomes, who may poorly afford to withstand price swings as great as 30% in a single day, should avoid holding or trading in such an unstable asset.

Only 4.8% of the 1,281 respondents to a poll conducted by the Central American University (UCA) understood what Bitcoin was and how it was utilized. Over 68% of those surveyed expressed opposition to utilizing cryptocurrencies as legal cash. Less than 10% of transactions are made in bitcoin, according to business owners, and the majority of consumers are afraid of their currency collapsing. Recent demonstrations in the nation's capital, San Salvador, have shown a lack of trust among the populace, who believe the policy is a diversion from the government's contentious control. Additionally, the international markets lack enthusiasm.

Cryptocurrencies do seem to fulfil one purpose, which is to make unlawful transactions easier. It goes without saying that this is not a use that ought to be promoted. As the blockchain alters the nature of financial investigations, the rise of cryptocurrency crime is a significant problem for law enforcement organizations. The names of transaction creators are still unknown, despite the fact that all transactions made on the blockchain are preserved on the public record and available for scrutiny by anybody. Because of this, criminals utilize cryptocurrencies for crimes like money laundering, fraud, drug trafficking, child exploitation, trading on dark markets, cybercrime, and funding terrorism.

The amount of electricity used to mine bitcoins has increased to an all-time high. As knowledge of climate change and global warming has grown, so have the environmental concerns around bitcoin mining. Because bitcoin miners utilise massive, sophisticated equipment to validate transactions, mining requires a significant amount of electricity. Bitcoin mining uses more electricity than Malaysia, Sweden, or Argentina do in a year (more than 120 terawatt hours). China is home to 65% of the world's bitcoin mining operations, yet the country gets the majority of its electricity from non-renewable sources, namely coal, whose burning significantly contributes to climate change and global warming.

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