

[The Fiscal Implications of Parallel Currencies](#)

CFM-DP2026-22

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The analysis of a macroeconomic policy is not complete without characterizing its fiscal implications. Many well-intended policies are never adopted because of the burden they put on the Treasury; many inferior policies are embraced because they bring in revenues in the short term. This paper investigates the fiscal implications of an alternative policy to manage the exchange rate and capital flows: an offshore currency. An advantage of this monetary tool relative to financial transaction taxes and macro-prudential policies is that it may be easier to implement and to adjust at high frequencies. This paper adds a further advantage: its fiscal footprint is small and changes little when policy moves the tool.

Our first result is that the fiscal footprint is approximately equal to the size of offshore deposits times a wedge that depends on the marginal liquidity cost of deposits. A policy that produces outcomes corresponding to a 1% financial transaction tax generates fiscal revenues of 0.15% of GDP. They mostly come from seigniorage collected from printing money, as opposed to liquidity revenues from lending to banks. Adopting an offshore currency as a tool in the Integrated Policy Framework would leave a small dent in the Treasury accounts.

Our second result is that the Laffer curve depends on two effects: the impact on the tax wedge created by the scarcity of money, and the impact on the exchange rate of an injection of money. Their relative size depends on the elasticity of the demand for deposits. For a reasonable calibration, we found that the Laffer curve is downward sloping around the steady state, so that fiscal revenues could be higher by cutting the offshore money supply. Policymakers tempted to use the offshore printing press for fiscal purposes would find that revenues would actually fall. Quantitatively, we found that the change in revenues is small, even for large variations in the money supply. Therefore, an offshore currency system would not pose a significant temptation to be used for financial repression.

Our third result is that the two components of revenues---seigniorage and liquidity---change significantly as money expands, since each has a different Laffer curve. Seigniorage dominates in the level of revenues, but liquidity drives the slope of the Laffer curve. As the supply of money changes, the incentives for banks to supply deposits change as well, and money multipliers vary.

Our fourth result is that the small and insensitive fiscal footprint is robust to the elasticity of deposit demand, to whether policy chooses to float or peg the exchange rate, and to the use of policies that affect money demand or money supply. All of these changes have a significant effect on the breakdown of revenues between their wedge and exchange-rate components, between seigniorage and liquidity, and between the incidence on domestic and on foreign depositors. Finally, the fiscal revenues scale approximately one-to-one with the demand for the offshore currency.

Combined, these results suggest that policies regarding parallel currencies can stay within the domain of the central bank, without requiring fiscal support or succumbing to fiscal dominance.