

Macro Roundup Article

Headline: [Fiscal Dominance and the Return of Zero-Interest Bank Reserve Requirements](#)

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Tweet: [@cwcalomiris](#) argues high American public debt levels and chronic deficits may lead toward an era of "fiscal dominance," in which the government forces banks to hold non-interest-bearing debt.

Summary: The essence of fiscal dominance is the need for the government to fund its deficits on the margin with non-interest-bearing debts. Inflation taxation has two components: expected and unexpected inflation taxation. Both are limited in their ability to fund real government expenditures. The expected component of inflation taxation (per period) is the product of the nominal interest rate and the inflation tax base, which consists of all non-interest bearing government debt. Unexpected inflation taxation occurs when the nominal value of outstanding government debt falls unexpectedly (thereby taxing government debtholders), and this component is also limited by the ability of government to surprise markets by creating unanticipated inflation. It is quite possible that a fiscal dominance episode in the US would result in not only the end of the policy of paying interest on reserves, but also a return to requiring banks to hold a large fraction of their deposit liabilities as zero-interest reserves. Related: [The Return of Quantitative Easing and Is a U.S. Debt Crisis Looming? Is it Even Possible?](#) and [The 2023 Long-Term Budget Outlook](#)

Primary Topic: Fiscal Deficits

Topics: Academic paper, Banking, Database, Fiscal Deficits, Fiscal Policy, Monetary Policy, Weekly

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