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[Monetary financing does not produce miraculous fiscal multipliers]

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High levels of government debt raise the question to what extent the private sector will be willing to buy the additional government debt that would have to finance future fiscal stimuli. One alternative is to money-finance such stimuli by letting the central bank buy the additional government bonds and permanently keep these on the central bank balance sheet.

In this paper, I investigate the macroeconomic effectiveness of such money-financed fiscal stimuli when the monetary base consists of non-interest-paying money and interest-paying reserves. Paying interest on reserves allows the central bank to control the short-term policy rate and the size of the central bank balance sheet, which is in line with what major central banks have been doing since the Great Financial Crisis of 2007-08.

In the paper, I focus on the case where the return on central bank reserves is below that on government bonds. In that case, money-financing a fiscal stimulus reduces funding costs for the government (relative to a debt-financed stimulus). Despite reducing funding costs, however, I establish for several New Keynesian models a so-called `irrelevance result' in the sense that money-financed fiscal stimuli have zero macroeconomic impact with respect to debt-financed stimuli. Key to this result is i) that the central bank retains direct control of the policy rate when the stimulus is money-financed, and ii) that the interest rate at which households save only depends on the policy rate of the central bank. In that case, the consumption and savings decisions of households are unaffected by the way the stimulus is financed, and there will be no macroeconomic impact from a money-financed fiscal stimulus (relative to a debt-financed stimulus).

I also show that the 'irrelevance result' carries over for several variations and extensions, among which the two-tiered reserve system that is currently in place at the European Central Bank.

I end the paper by investigating an extension for which the irrelevance result is broken and money-financed fiscal stimuli become more effective than debt-financed stimuli. However, the quantitative difference between a money-financed fiscal stimulus and a debt-financed stimulus is only half the impact that is found in a model where the monetary base does not pay interest. Therefore, the quantitative impact from money-financing fiscal stimuli is likely to be limited in reality.