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Report

The financialization of recession response

Aaron Klein Thursday, January 5, 2023

Editor's Note:

This article was originally published in the Journal of Financial Crises by the Yale Program on Financial Stability on December 22, 2022.

Abstract

This paper analyzes economic policy responses to the COVID-19-induced recession, focusing on the American policy response. Despite widespread political distrust between the two parties sharing control of the government and the timing of the upcoming presidential election, America's political system was able to enact a massive policy response that reduced the severity of the recession. This political response happened faster than any automatic policy response would have, based on the delays in data reporting. The economic policies enacted continued America's trend toward financialization of fiscal policy. The Federal Reserve and America's private banking and financial systems were heavily relied upon to deliver general macroeconomic assistance to households and businesses, particularly small businesses. The immediate result was that households and businesses that have stronger ties to the financial system received greater economic support. Those with less strong ties to the financial system received aid more slowly and, in some instances, not at all. The long-term consequences of relying on the Federal Reserve to distribute recession assistance through the financial system blurs the lines between engaging in monetary and fiscal policy. This response is a continuation of the trend that began in America from the prior recession and appears likely to continue, potentially impacting the central bank's independence and raising concerns regarding the role of the Federal Reserve in society.

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