

The fiscal and monetary response to COVID-19: What the Great Depression has – and hasn't – taught us

George Selgin

Center for Monetary and Financial Alternatives, The Cato Institute, USA

Correspondence

Email: gselgin@cato.org

Abstract

Although some regard the New Deal of the 1930s as exemplifying an aggressive fiscal and monetary response to a severe economic crisis, the US fiscal and monetary policy responses to the COVID-19 crisis have actually been far more substantial – and, so far, much more effective in reviving aggregate spending. Although many fear that these responses, and the large-scale increase in bank reserves especially, must eventually cause unwanted inflation, the concurrent sharp decline in money's velocity has thus far more than offset any inflationary effects of money growth, while forward bond prices reflect a general belief that inflation will remain below 2 per cent for at least another decade. Notwithstanding the growth of the Fed's balance sheet, Fed authorities can always check inflation by sufficiently raising the interest return on bank reserves. Nonetheless, recent developments have heightened the risk of 'fiscal dominance' of monetary policy at some point in the future.

KEYWORDS

COVID-19, credit policy, fiscal stimulus, Great Depression, monetary policy, New Deal

JEL CLASSIFICATION

E5; E62; N1

1 | INTRODUCTION

The Great Depression remains ‘great’ in the particular sense of holding the record for severity that every downturn since has vied for, albeit in vain. It was therefore inevitable that the sharp downturn that followed the outbreak of the COVID-19 crisis in March 2020 would be compared to it. In April, Gita Gopinath, the IMF’s Chief Economist, said it was “very likely that this year the global economy will experience its worst recession since the Great Depression” – one “far worse” than the 2009 crisis (Rappeport & Smialek, 2020). And recently World Bank President David Malpass observed that the current crisis is itself “truly a depression, a catastrophic event” that continues “to add to the ranks of those in extreme poverty” (New One Entertainment, 2020).

Just as inevitably, some have looked to the 1930s, and to the US Roosevelt Administration’s New Deal especially, for ways to cope with, if not end, the present crisis. “For many Americans”, writes Harvard American Studies Professor Lizabeth Cohen, “the New Deal ... remains the standard for how the federal government should respond to a major national emergency. ... Many hope to replicate that achievement today.” But to do so, Professor Cohen says, “We need to know not just what [Roosevelt and his associates] did, but how they pulled it off” (Cohen, 2020).

Professor Cohen herself offers a very good, if brief, account of how the New Dealers ‘pulled off’ their programme. Here I wish to consider just *what* they did, and whether and how their successes and their failures might assist efforts to deal with today’s crisis.

2 | CRUCIAL DIFFERENCES

If we’re to make good use of the New Deal experience in formulating or revising policy responses to the current downturn, we must first recognise that, despite some similarities, today’s crisis is very different from the Great Depression. It follows that some policies that helped then may not be relevant today, whereas others may prove useful now that wouldn’t have been useful then.

One especially important difference between the Great Depression and the present downturn is that today’s crisis hasn’t involved a collapse of the financial system. Deposit insurance has ruled out 1930s-style bank runs, while the shoring up of bank capital ratios since 2008 has helped to reassure holders of uninsured or only partially insured deposits.

The banking system’s present strength has several important implications. Most obviously it means that we’ve been spared a dramatic collapse of money and credit of the sort that took place in the early 1930s. To be sure, *spending* has collapsed, both suddenly and much more severely than it did in 2008. Yet this collapse, which has mainly been a consequence of travel restrictions and lockdowns, has still been small compared with that of the 1930s (see Figure 1).

Furthermore, the recovery from the present downturn is already well under way, and (as the following figures show) proceeding at an encouraging pace, whereas recovery was slow both in the 1930s and after 2008, as is often the case when downturns are caused or accompanied by financial crises.¹

An important implication of these differences is that at least one set of New Deal policies, considered by many to among be its greatest triumphs, cannot be of any use to policymakers today. I refer to the national bank holiday and steps taken during it to end banking crises and get the banking system back on its feet. Those steps marked the end of the ‘Great Contraction’

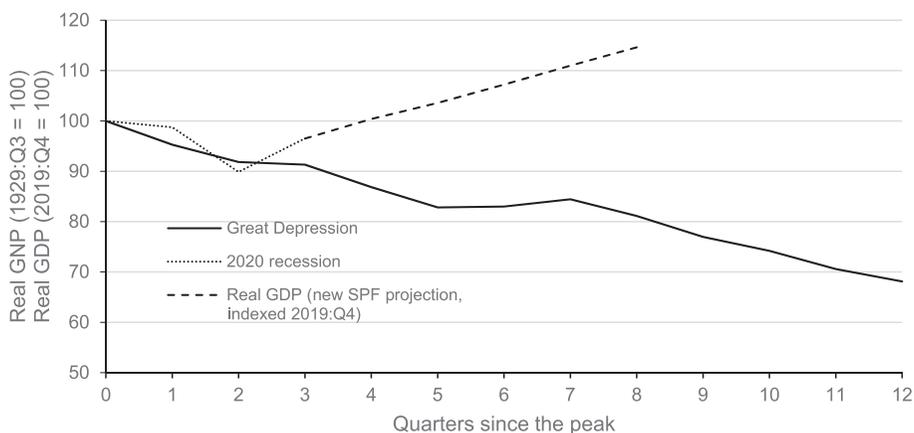


FIGURE 1 Downturn and recovery in the 1930s Great Depression and the 2020 recession

Note: SPF, Survey of Professional Forecasters

Source: Wheelock (2020)

that began in 1929, and the start of a process of recovery, albeit one that would suffer many setbacks (Selgin, 2020a).

For obvious reasons, President Roosevelt's decisions to suspend the gold standard, and, after an interval of 'dirty' floating, to officially devalue the dollar, which are also supposed by many to have assisted the recovery, can also have no analogues in today's world of irredeemable fiat money. Neither, for that matter, can the heavy gold inflows that occurred between 1933 and the outbreak of World War II. Yet those inflows, which were the result of European unrest rather than any New Deal measure, were the most important factor behind the post-1933 recovery (Selgin, 2020b).

Instead, for lessons we might fruitfully apply to today's saturation, we must look at other aspects of the New Deal, and especially at both New Deal fiscal policies and Federal Reserve credit policies. And lessons we shall find. Unfortunately, those lessons are mainly negative: if, as David Kennedy claims, "the Depression demonstrated the indispensable role of government ... when it comes to dealing with the kinds of crises we face now and that we faced in the 1930s" (De Witte, 2020), it did so mainly by showing what happens when the government *doesn't* take appropriate steps. We have, in other words, more to learn from the New Deals failures than from its successes.

3 | FISCAL STIMULUS

Many still suppose that the unprecedented growth in government spending, and deficit spending in particular, during the New Deal together played an important role in promoting whatever recovery took place prior to World War II. But while both total and debt-financed federal spending did indeed increase to record levels during the New Deal, their levels were not remarkably greater than those seen during the last years of the Hoover administration (1929–33); and in both cases the deficit grew to record levels not because either government had actually embraced deficit spending (though Roosevelt's finally did so starting in 1938), but despite concerted efforts to avoid them through higher tax rates, new taxes, or both.

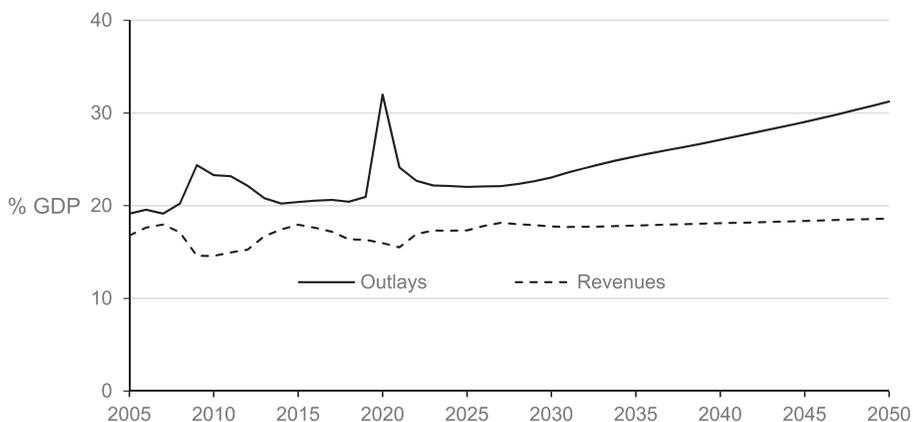


FIGURE 2 Total US government outlays and revenues, 2005–2050
 Source: Edwards (2020)

And while New Deal fiscal policy was indeed more expansionary than anything seen before then, as a share of GNP both total and deficit spending were very modest in comparison with recent pre-crisis levels, let alone current ones. Indeed, the scale of New Deal government spending was, according to Christina Romer (1992), Price Fishback (2010), and other economic historians, too small to have contributed to any substantial degree to the post-1933 recovery. Only the far greater outlays following the outbreak of World War II, which eventually raised government spending to over 44 per cent of GDP (a record still not surpassed), but which was not itself part of the New Deal’s recovery programme, can truly be said to have ended the depression.

Congress’s response to the present crisis has, in contrast, been both rapid and substantial. Whereas “it took ten years to raise federal outlays ... from 3 to 11 percent of 1929 GDP”, Fishback (2020) observes, by May 2020 the fiscal response to COVID-19 was already “several orders of magnitude larger than the New Deal response to the Great Depression”.

According to recent Congressional Budget Office projections, as reported by Chris Edwards (2020), the current spike in deficit-financed outlays (see Figure 2) will be followed by more modest but continually rising future deficits, owing mainly to the rising cost of servicing the debt (Figure 3), causing the publicly held share of federal debt to surpass its previous record of 106 per cent of GDP sometime in 2023, and to approach 200 per cent of GDP by 2050.

Although mandatory unemployment insurance was the main cause of the recent spikes in total and deficit spending, the Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020 also provided for a substantial increase in discretionary spending. Among other things, Fishback explains, that Act extended unemployment benefits to workers whose employers had not paid for their insurance, while adding \$600 to ordinary weekly payments – enough to avoid the normal 7 per cent decline in spending among the newly unemployed.² Finally, by providing for another \$3.7 trillion in emergency spending, including a trillion dollars to support state and local governments, Congress raised government spending to a share of GDP approaching that of World War II. In short, despite being divided, the government, having long since overcome its New Deal-era fear of deficit spending, was willing “to take steps that go far beyond what the New Deal government did in the 1930s” (Fishback, 2020).

Thanks in large part to this aggressive fiscal response, the *pace* of aggregate spending recovered relatively rapidly from its sharp decline between late January and mid-April. As

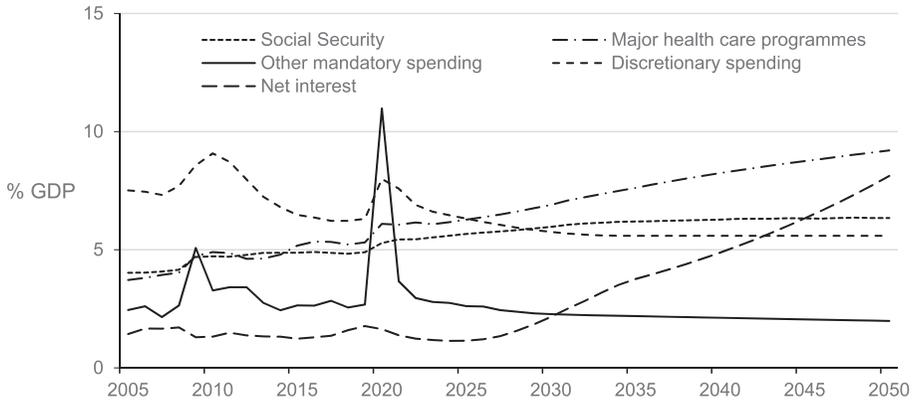


FIGURE 3 Breakdown of US government spending, 2005–2050
 Source: Edwards (2020)



FIGURE 4 Change in all consumer spending, 2020
 Source: Opportunity Insights Economic tracker (<https://tracktherecovery.org/>)

Figure 4 shows, by late September it had almost returned to its value a year before. However, that return still leaves the *level* of spending well below its former trend. Nor should the revival of total spending, so far as it goes, be allowed to obscure the dramatic change in its composition, which has left whole industries languishing even as it has invigorated others.

4 | RELIEF, RECOVERY, AND REFORM

Although the scale of the fiscal response to COVID-19 seems more reminiscent of that witnessed at the outbreak of World War II than of New Deal fiscal policy, today's fiscal response shares one important – and deleterious – feature with its 1930s counterpart, to wit, a tendency to conflate fiscal policies conducive to genuine recovery with policies that serve instead either



to provide temporary relief only or to implement reforms that, whatever their long-term merit, do little if anything to revive private market activity.

While President Roosevelt famously insisted upon distinguishing the ‘three R’s’ of Relief, Recovery, and Reform, the distinction has not always been adequately appreciated by later students of the New Deal. Some, for example, insist on gauging the pace of recovery during the 1930s using Michael Darby’s revised unemployment statistics (Darby, 1976), which include those working in the Works Progress Administration and other New Deal work-relief programmes among the employed, instead of conventional series that consider them ‘unemployed’. Although one may well complain that ‘unemployed’ is the wrong word to describe persons who were in fact working, if only for modest wages, the fact remains that the series that commits this terminological offence is also the more reliable indicator of the progress of recovery.

Some assessments of the CARES Act’s success likewise conflate its effectiveness as a source of temporary relief with its ability to promote lasting recovery. According to a recently published study (Ganong, Pascal, & Vavra, 2020), by August CARES Act relief recipients, having used up most of their emergency support, began to rein in their spending again, thereby exposing the US economy to a further downturn. “With savings dwindling and no further economic relief in sight”, the *Wall Street Journal* observes in reporting on the study, “nearly 11 million jobless workers may curb spending even further or fall behind on debt or rent payments” (Davidson, 2020). The same report has Peter Ganong, one of the study’s authors, observing more bluntly that “[t]he economy right now is essentially running – or not running – on the exhaust fumes of the CARES Act”. In other words, notwithstanding claims made by President Trump and some other Trump administration officials, the (partial) revival of spending since April, like the post-1933 decline in Darby’s New Deal unemployment measure, may reflect the extent of relief only, rather than the true extent of recovery.³ Only once the public’s fear of infection subsides and presently restricted activities are allowed to resume will a more complete disgorgement of savings accumulated by those whose livelihoods were not cut off by the crisis (Bird, 2020) provide the basis for a sustained recovery.

It is also the case that some actual New Deal programmes seemed to honour the distinction between relief, recovery, and reform more in the breach than the observance. This was especially true of the National Recovery Administration (NRA), which was based on the premise that reforms long sought by labour representatives on the one hand and businessmen on the other would also serve, if implemented, to spur recovery. For reasons very thoroughly set forth in a 1935 Brookings Institution study, that premise was tragically mistaken; and the NRA, instead of hastening recovery, impeded it until the Supreme Court, by declaring it unconstitutional, brought the ill-fated experiment to an end (Selgin, 2020c).

A similar confusion of the goals of reform and recovery has also limited the effectiveness of the government’s response to the COVID-19 crisis. It has done so, most obviously, by inspiring attempts to treat both the original CARES Act and negotiations concerning a second stimulus package as Trojan horses by which to introduce or expand government programmes that, whatever their other merits, are unlikely to help to either shorten the COVID-19 crisis or render it less painful. The \$25 million in CARES Act support earmarked for the Kennedy Center was an especially notorious (and successful) instance of such an attempt; but there have been many others, both Republican and Democratic (Waldman, 2020). Mostly unsuccessful attempts by clean-energy trade groups and environmentalists to include ‘green’ legislation in the CARES Act were an important cause of disagreements that delayed its passage (Brady, 2020). Similar attempts to smuggle (mostly progressive) reforms into a second stimulus package

(Boehm, 2020) in turn contributed to the gridlock that dashed any hope for its passage by the Trump administration (Kane, 2020; Schalteck, 2020).

5 | MONETARY POLICY

If the difference between New Deal and recent fiscal policy measures is great, that between the Fed's conduct during the New Deal and its recent conduct is even more pronounced. Indeed, it comes close to being a difference between doing nothing and doing (or trying to do) everything!

Thanks to Friedman and Schwartz (1963), the fact that the Fed failed to make adequate use of open-market security purchases to prevent a 'Great Contraction' of the US money stock between 1929 and March 1933 is now notorious – so much so that former Fed governor Ben Bernanke felt obliged, on the occasion of Friedman's 90th birthday on November 2002, to apologise on the Fed's behalf to him and Anna Schwartz, while promising that the Fed would never "do it again" (Bernanke, 2002). What is not so well appreciated is the Fed's almost entirely passive role throughout the remainder of the 1930s, when, as Figure 5 shows, the Fed's total security and commercial bill holdings remained almost constant. The Fed's balance sheet did grow, thereby allowing the money stock to grow as well; but that growth was fuelled almost entirely by gold imports over which the Fed itself exercised no control and for which neither it nor the US government deserved credit. Instead, their main cause was the increasing likelihood of war following Hitler's rise to power. Even President Roosevelt's official devaluation of dollar in January 1934 contributed much less to US money growth than it might have: although the devaluation meant an immediate increase in the nominal US gold stock, instead of adding to banks' reserves the proceeds from it were appropriated by the US Treasury, which used most of them to establish its Exchange Stabilization Fund.

True to Bernanke's word, both during his tenure and since the Fed has avoided a repetition of its performance during the 1930s – and how! In one month starting in mid-September 2008,

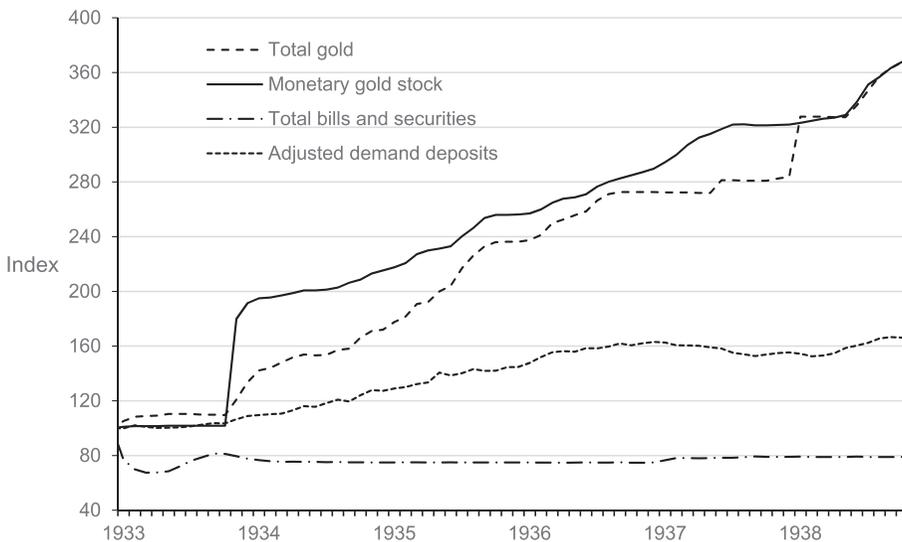


FIGURE 5 Federal Reserve's total security and commercial bill holdings, 1933–1939

Source: National Bureau of Economic Research

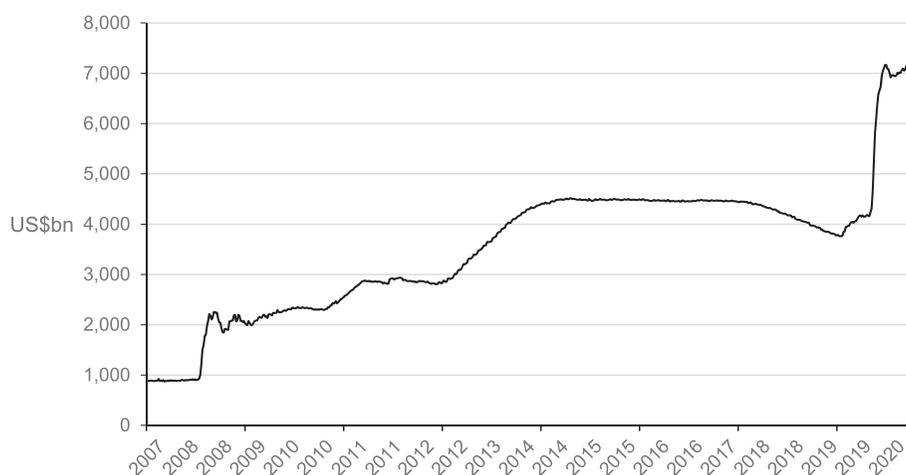


FIGURE 6 Federal Reserve's total assets (2007–2020) less elimination from consolidation (Wednesday level)
Source: Board of Governors of the Federal Reserve System

the Fed's assets doubled; by early 2015 three rounds of quantitative easing had doubled them again, to about \$4.1 trillion. The Fed's response to the current crisis has been even more dramatic: at the start of 2020 its assets were at roughly their level five years earlier (see Figure 6). They have since increased by another \$3 trillion, and for the time being the Fed remains committed to buying at least \$120 billion more each month.

While the impressive scale of the Fed's open-market purchases makes for a sharp contrast with the situation in the 1930s, low interest rates were a feature of both episodes. Those low rates discouraged Fed authorities from buying securities during the New Deal, and have limited the stimulus effect of their recent purchases. In March 1934, the New York Fed reduced its discount rate to 1.5 per cent – its lowest level since the Fed was established; in September 1937 it lowered it another 50 basis points, to just 1 per cent, where it remained until the start of 1948. Yet even those record-low discount rates were high compared to then-prevailing rates on Treasury securities. The rates for three-month Treasury bills are shown in Figure 7, from a 2010 article by Gerald Dwyer. As Dwyer (2010) explains,

With the exception of a brief period in 1937, interest rates on these securities never averaged as high as 25 basis points in any month from October 1934 to November 1941. Although interest rates on reserves were zero, interest rates on three-month Treasury bills were not far from zero.

As Figure 8 shows, between them, banks' desire to keep liquid following the trauma of the Great Contraction, and the trivial opportunity cost of reserve holding caused them to accumulate reserves acquired as a result of heavy gold imports. Fed officials therefore concluded that open market purchases would only supply banks with that many more reserves to stockpile. This view was aired by then Fed Governor Marriner Eccles in his now famous exchange, during the hearings on what became the 1935 Banking Act, with Democratic Representative Prentice Brown and Republican Senator Phillip Lee Goldsborough. The exchange began when Representative Brown asked Eccles what the Fed might do were granted greater freedom to engage in open market operations:

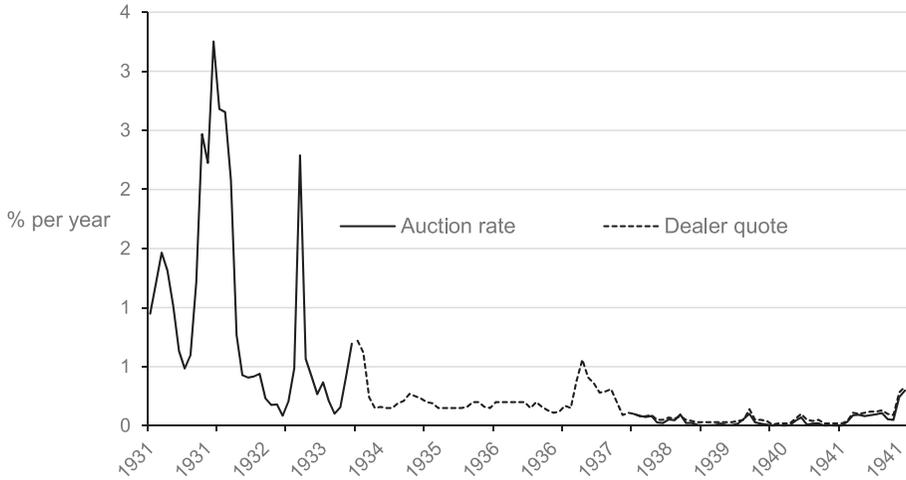


FIGURE 7 Interest rates on three-month Treasury bills, January 1931 to December 1941

Note: The two average monthly rates are the interest rates at auctions of new issues of three-month Treasury bills and the rate quoted by dealers on three-month Treasury bills.

Sources: Auction rate, National Bureau of Economic Research (www.nber.org/series no. m1302b); dealer quote, from the Board of Governors of the Federal Reserve System

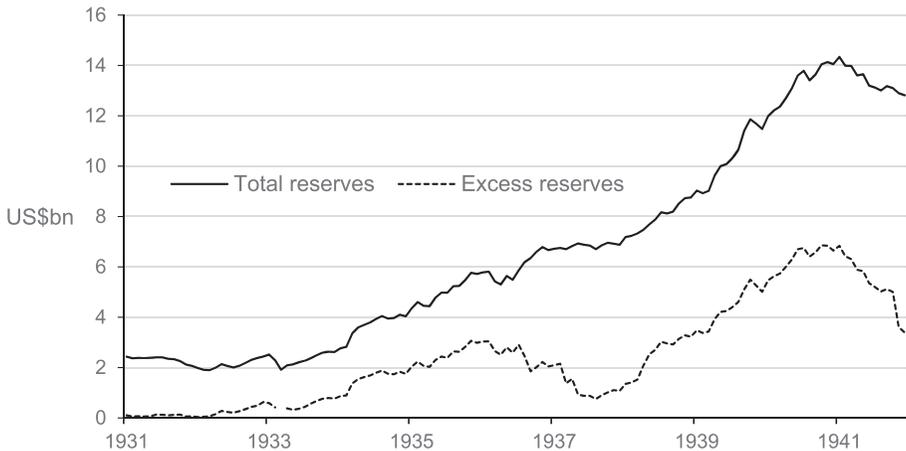


FIGURE 8 Total reserves and excess reserves, January 1931 to December 1941

Notes: Assets in banks that were members of the Federal Reserve System were about 85 per cent of all assets in US banks. Data on excess reserves for March 1933 are missing in the source document.

Source: Dwyer (2010)

GOVERNOR ECCLES: Under present circumstances there is very little, if anything, that can be done.

MR. GOLDSBOROUGH: You mean you cannot push a string.

GOVERNOR ECCLES: That is a good way to put it, one cannot push a string. We are in the depths of a depression and, as I have said several times before this committee,



beyond creating an easy money situation through reduction of discount rates and through the creation of excess reserves, there is very little, if anything that the reserve organization can do toward bringing about recovery. I believe that in a condition of great business activity that is developing to a point of credit inflation monetary action can very effectively curb undue expansion. (Banking Act of 1935, 1935, p. 377)

The accumulation of excess reserves also caused Fed and Treasury officials to worry that, despite the economy's still depressed state, banks would soon attempt to shed those excess reserves, triggering unwanted inflation. In hearing this Keynes is supposed to have quipped that the officials in question “profess to fear that for which they dared not hope”. But the officials were all too in earnest. To avert the risk of inflation, the Fed took advantage of powers granted it by the 1935 Banking Act to double banks' reserve requirements, while the Treasury for its part began to sterilise gold inflows (Irwin, 2012). Inflation, sure enough, never broke out. On the contrary: the measures helped cause the ‘Roosevelt Recession’ of 1937–38, which undid much of the recovery of the preceding four years.

Treasury rates today are roughly as low as they were during the New Deal; and the result now as then is that banks have been accumulating reserves⁴ sent their way, instead of employing them to achieve any corresponding growth in loans or deposits. Figure 9, comparing the relative response of reserves, banks deposits, and M2, to the Fed's asset purchases, shows just how slight the effect of reserve growth has been on broader money measures. If one considers as well the sharp decline in M2 velocity that has taken place since February, it becomes evident that, if the Fed's asset purchases have indeed been helping to revive aggregate demand, they have not done so by way of any of the more conventional money and credit transmission mechanisms. So far as those mechanisms are concerned, today's Fed officials might well be said to have entirely overcome their predecessor's reluctance to go on ‘pushing on a string’.

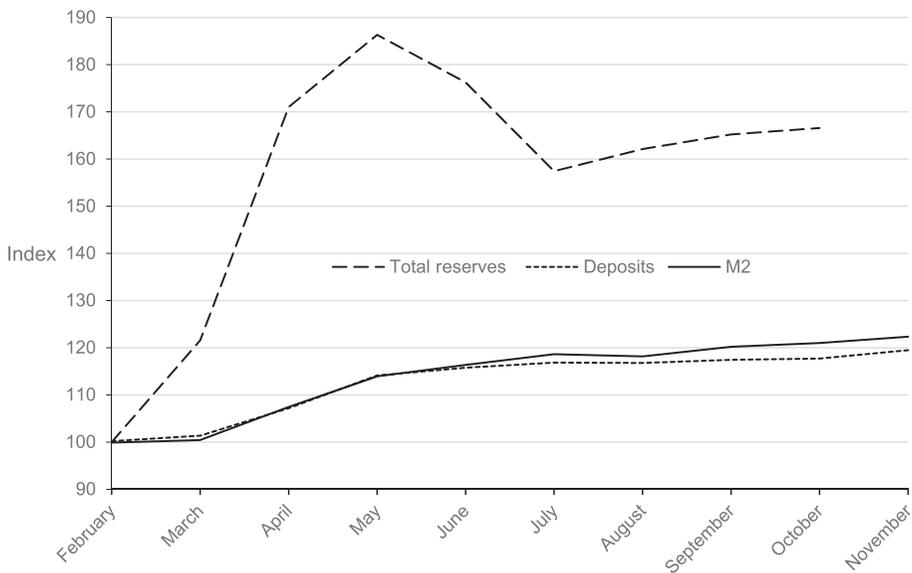


FIGURE 9 Response of reserves, banks deposits, and M2, to the Fed's asset purchases, 2020
Source: Board of Governors of the Federal Reserve System

Banks' accumulation of reserves has nonetheless raised concerns about future inflation echoing those of 1930s – and just as misplaced. As the Fed's balance sheet expanded in April, various experts warned that the long-term result might be “an ugly spell of high inflation” (Long, 2020). Observing that in six weeks the “M2 money supply has increased by 7.7 percent, an annual compounded rate of 90.4 percent”, Martin Hutchinson (2020) claimed on 23 April that “you can't produce money at that rate without the dollar going the way of the continental, the assignat, the reichsmark or the 1946 Hungarian pengo”. In a *Wall Street Journal* opinion piece published that same day, Tim Congdon (2020) employed similar reasoning, albeit more soberly. The going rate of M2 growth, he wrote, approaches peak rates previously seen during the two world wars and the Vietnam War, all of which “were followed by nasty bouts of inflation”. Were inflation to break out again, Congdon concluded, “policy makers today being cheered for their swift, decisive action will instead have to answer for their grave lack of foresight”. The Fed's more recent decision to embrace average inflation targeting raised further alarms: writing in the *Financial Times*, Gavyn Davies (2020) observed that, although the Fed was “justified in deciding to risk higher inflation for the immediate future”, a similar regime “triggered the great inflation of five decades ago”.

Such dire warnings all share the implicit view that banks are bound eventually to try to rid themselves of all the new reserves the Fed's purchases have placed at their disposal, and that this will confront the Fed with an increase in the base money multiplier too sudden and large to be fully offset by any concurrent shrinkage of its balance sheet. But neither view is correct: under the Fed's post-2008 ‘floor’ operating system (Selgin, 2018), the inflation rate no longer depends on the size of the Fed's balance sheet. Instead, to check excessive money growth the Fed has only to raise the interest rate it pays on bank reserves sufficiently to keep the base multiplier at a level consistent with its inflation target. Of course, it might fail to do so; but that possibility, far from being imminent, appears remote at present. Nor, to judge from the ten-year breakeven inflation rate, which on 21 October 2020 was just over 0.142 per cent, do bond speculators suppose otherwise.

Justified or not, the fear that we may be risking a serious outbreak of inflation has thus far been voiced by pundits only, and not by any government officials. That is just as well, because it means that the government is not about to resort prematurely to anti-inflation measures that might prove fatal to the ongoing recovery.

6 | NEW DEAL ‘CREDIT’ POLICY

It is now common for economists to distinguish between monetary policy in the strict sense and ‘fiscal’ or ‘credit’ policy, where credit policy consists of direct central bank support to particular private firms and markets or foreign government entities, while monetary policy operations seek to regulate the general state of credit and liquidity, whether by means of central bank purchases and sales of domestic government securities or by adjusting central bank-administered interest rates.

According to this distinction, the Fed's ‘credit policy’ undertakings during the 1930s were just as limited as its monetary policy undertakings. The Fed's direct lending then was almost entirely confined to Fed member banks (meaning all national banks and the relatively small number of state banks that chose to join the system); and even that aid was legally limited to very short-term loans secured by ‘real’ (commercial) bills. The trivial scale of the Fed's New

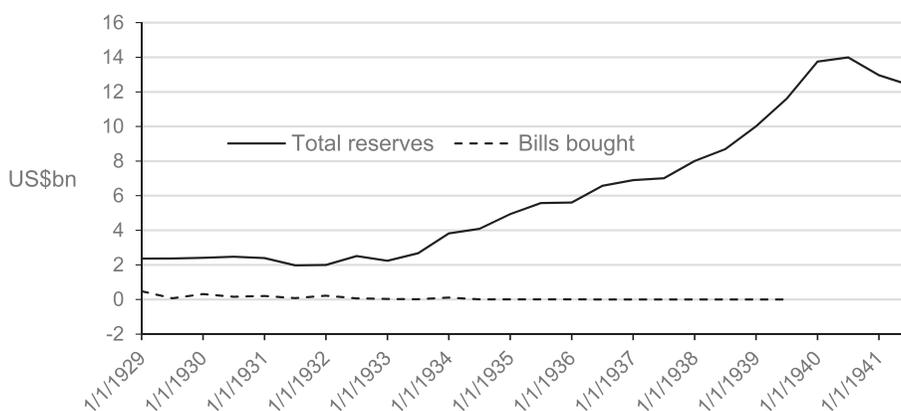


FIGURE 10 The value of the Fed's commercial ('real') bill purchases versus the value of total member bank reserves, 1929–1941

Sources: Board of Governors of the Federal Reserve System; National Bureau of Economic Research

Deal-era discount-window lending is evident from Figure 10, comparing the value of the Fed's commercial ('real') bill purchases with that of total member bank reserves. In January of 1939, for example, member banks held over \$10 billion in reserve balances, while Fed's bill purchases amounted to just \$1 million.

It was mainly to supplement the Fed's limited lending, and especially to make emergency credit available to non-member banks, that the Treasury-funded Reconstruction Finance Corporation (RFC) was established at the start of 1932. With the coming of the New Deal, the scale of the RFC's support for banks increased dramatically. The cause of this was an amendment to the 1933 Banking Act that allowed the RFC to purchase and lend upon banks' preferred stock, and also to purchase their unsecured debt instruments. The amendment law made it possible for banks to take advantage of the RFC's support without having to part with their best collateral. Over the course of the New Deal the RFC purchased over \$1 billion in preferred stock, capital stock, and debentures from thousands of banks. In addition to supporting banks directly, the RFC helped them indirectly by lending to railroads, whose bonds were an important component of many bank portfolios. Eventually it also helped to finance federal public works projects and state unemployment relief programmes. Finally, in mid-1934 the RFC was authorised to lend to ordinary business firms.

Two attempts were also made during the Great Depression to involve the Fed in lending to non-bank businesses. The first, enacted in July 1932 as an alternative to allowing the RFC to lend to ordinary businesses, gave rise to the Federal Reserve Act's now notorious section 13(3) (Board of Governors of the Federal Reserve System, 2017). In its original form, 13(3) granted the Federal Reserve Board the authority, under certain conditions, to authorise member banks

to discount for any individual, partnership, or corporation, notes, drafts, and bills of exchange of the kinds and maturities made eligible for discount for member banks under other provisions of this Act when such notes, drafts, and bills of exchange are indorsed and otherwise secured to the satisfaction of the Federal Reserve Bank.

However, because few businesses held the stipulated collateral, section 13(3) was almost still-born: throughout the entire Great Depression the Fed only made 123 13(3) loans, amounting to just \$1.5 million. Nor would the Fed make any further 13(3) loans until 2008, when modified 13(3) collateral requirements allowed it to lend extensively to non-bank borrowers for the first time (Fettig, 2008).

The second Great Depression attempt to have the Fed lend to ordinary businesses left no permanent mark, but was more important at the time. This took place in 1934, and consisted of another Federal Reserve Act amendment – section 13(b) – which allowed Fed banks to make loans of up to five years to non-bank businesses either directly or in partnership with commercial lenders (Selgin, 2020d). Although the Fed made many more 13(b) than 13(3) loans during the depression – by the end of 1935, the former summed to \$124.5 million spread among 1,993 businesses – this outcome was still disappointing, amounting as it did to a tiny fraction only of concurrent private sector business lending. Even so, the Fed continued to make 13(b) loans until 1958, when section 13(b) was repealed.

7 | COVID-19 CREDIT POLICY

Just as the Fed's limited Great Depression-era open market purchases contrast sharply with its massive post-COVID purchases, its Great Depression exercises in credit policy pale in comparison with those of recent months. Indeed, the Fed's recent undertakings, undertaken mainly on the basis of its 13(3)-lending authority, overshadow the combined efforts of the Fed and the RFC during the 1930s, exceeding them in both scale and scope. Among other steps, the Fed has lent to ordinary business firms both through its own 'Main Street' lending facilities and by extending credit to banks taking part in the Small Business Administration's Paycheck Protection Program; it has provided short-term funding to state and local governments through its Municipal Funding facility; and it has contributed to the supply of credit to larger enterprises through both direct and secondary-market purchases of their securities via its Primary and Secondary Market Corporate Credit facilities.

The Fed's heavy involvement in credit policy has been extremely controversial. Politicians have berated it for doing too much for Wall Street and not enough for Main Street (Saraiva & Matthews, 2020); and even the *Wall Street Journal* (2020) agrees with them. Economists have in turn argued that, by involving itself so heavily in credit policy instead of leaving it to Congress and the Treasury, the Fed has put its independence at risk. Observing that, thanks to its extensive 13(3) programmes, the Fed now resembles a "giant, multi-faceted GSE [government sponsored enterprise]", former Richmond Fed economist Robert Hetzel wonders whether its independence can long survive politicians' discovery that the change allows them "to transfer risk to the Fed's books where it is invisible to taxpayers" (Hetzel, 2020, pp. 25, 35).

8 | MAIN STREET DÉJÀ VU

Of the Fed's current emergency lending programmes, only those aimed at Main Street have a close Great Depression counterpart, consisting of the Fed's previously-mentioned 13(b) lending. As we have seen, the results of that earlier programme were disappointing. One might therefore expect Fed officials this time around to have launched their Main Street facilities only after



studying that earlier experiment and convincing themselves that the new plan would be free of its predecessor's shortcomings.

Alas, that doesn't seem to have happened. Instead, so far as the record reveals, in designing the Fed's Main Street facilities, neither Fed nor Treasury officials referred to the earlier experience. In any event, the new Main Street lending programme very much resembles its predecessor both in its particulars and in its disappointing results thus far (Selgin, 2020d). According to the Fed's disclosure of 8 October,⁵ in four months the Main Street facilities have only taken part in 253 business loans summing to under \$2.2 billion, or just 0.366 per cent of the Main Street facilities' capacity. In comparison, commercial banks had almost \$2.8 *trillion* in ordinary commercial and industrial loans outstanding in September. The number of banks that have taken part in the Main Street programme this far has been even more disappointing: so far fewer than 100 have done so, and just one – the City National Bank of Florida – has originated 40 per cent of the programme's loans, worth almost one-quarter of the outstanding total (McCombie, 2020). It is all but impossible to reflect upon this record, and that of the Fed's depression-era 13(b) lending, without thinking of Santayana's hackneyed saying about the past.⁶

9 | AN UNEQUAL RECOVERY

There is one further, unflattering respect in which current efforts to counter the economic damage from COVID-19 and the activity restrictions it has inspired resemble the New Deal: both have been charged with racial discrimination.

As NPR's Christopher Klein reports (2018), the New Deal's Civilian Conservation Corps assigned African Americans to separate camps, while the Federal Housing Administration refused to insure mortgages made to their neighbourhoods. African Americans were also denied Social Security benefits. Otis Rolley, Senior Vice President of the Rockefeller Foundation's U.S. Equity and Economic Opportunity Initiative, adds that they were also denied the protections that the National Labor Relations Act afforded to other workers. Most of all, African Americans suffered from the Agricultural Adjustment Association, which by paying (mostly white) farm owners to grow fewer crops, forced hundreds of thousands of African-American sharecroppers to take part in the Great Migration from the rural South to northern and western cities, where they added to the already bloated ranks of unemployed African Americans. According to Rolley, this discrimination was not at all inadvertent. "Roosevelt", he explains, "intentionally cut out occupations dominated by people of color, including domestic and agriculture workers, from New Deal initiatives as part of a strategy to win the support of Southern Democrats in Congress." Nor were the consequences temporary. Instead, discriminatory New Deal legislation "created deeply-entrenched racial and financial inequities that persist to the present day" (Rolley, 2020).

The CARES Act has likewise been accused of neglecting African Americans and racial minorities, who thanks to their relative poverty have also suffered disproportionately from the COVID-19 virus itself (Bouie, 2020). Because it relied on tax filers' bank account information, the Treasury Department's chosen method for delivering stimulus checks delayed payments to poorer persons, a disproportionate share of whom are minorities (Davison, 2020). It also denied many immigrants the COVID-19 testing and care benefits offered to US citizens (Waheed & Moussavian, 2020). That only \$10 million of the CARES Act's \$2.3 trillion in relief funding went to the Minority Business Development Agency (MBDA) has also been seen by some as evidence of deliberate discrimination (Perry & Hopkinson, 2020).

For all their merit, such complaints inevitably suffer from some blurring of the distinction between recovery and reform pointed out in section 4. That is, they often call, implicitly if not explicitly, not simply for measures calculated to hasten the general pace of economic recovery, but also for ones that would help to lesson racial inequality regardless of their effects on macroeconomic aggregates. This doesn't mean that some trading-off of one objective for the other isn't worthwhile – nor could there be any scientific basis for such a claim. It is merely a reminder that the two objectives are not always congruent.

NOTES

- ¹ See Cerra and Saxena (2008), Reinhart and Rogoff (2009), Reinhart and Reinhart (2010), and Ikeda and Kurozumi (2018).
- ² See Farrell et al. (2020). According to this study, “unemployed households actually *increased* their spending beyond pre-unemployment levels once they began receiving benefits. The fact that spending by benefit recipients rose during the pandemic instead of falling, like in normal times, suggests that the \$600 supplement has helped households to smooth consumption and stabilized aggregate demand.”
- ³ In fact, as Jason Taylor (2011) explains, because almost all the decline in unemployment between 1933 and 1937 was due to “work sharing” policies rather than to an increase in total working hours, even the conventional unemployment numbers exaggerate the pace of economic recovery during that time.
- ⁴ Because reserve requirements were eliminated in March, it is no longer possible to refer to ‘excess’ reserves.
- ⁵ See Excel file [mbsp-transaction-specific-disclosures-10-8-20.xlsx](#).
- ⁶ “Those who cannot remember the past are condemned to repeat it.”

REFERENCES

- Banking Act of 1935 (1935). *Hearings Before the Committee on Banking and Currency. House of Representatives, Seventy-Fourth Congress. First Session, on H. R. 5357*. Washington, DC: US Government Printing Office. <https://fraser.stlouisfed.org/title/banking-act-1935-831> (accessed 3 December 2020).
- Bernanke, B. (2002). On Milton Friedman's Ninetieth Birthday. Remarks by Governor Ben S. Bernanke at the Conference to Honor Milton Friedman, 8 November, University of Chicago. Federal Reserve Board. <https://www.federalreserve.gov/boarddocs/speeches/2002/20021108/> (accessed 3 December 2020).
- Bird, M. (2020). The coronavirus savings glut. *Wall Street Journal*, 23 June.
- Board of Governors of the Federal Reserve System (2017). Federal Reserve Act, Section 13: Powers of the Federal Reserve Banks. *About the Fed*, 13 February. <https://www.federalreserve.gov/aboutthefed/section13.htm> (accessed 3 December 2020).
- Boehm, E. (2020). The next COVID stimulus bill could cost trillions of dollars or might not happen at all. *Reason*, 14 October. <https://reason.com/2020/10/14/the-next-covid-stimulus-bill-could-cost-trillions-of-dollars-or-might-not-happen-at-all/> (accessed 3 December 2020).
- Bouie, J. (2020). Why coronavirus is killing African Americans more than others. *New York Times*, 15 April.
- Brady, J. (2020). Climate change push fuels split on coronavirus stimulus. NPR, 24 March. <https://www.npr.org/2020/03/24/820268157/climate-change-push-fuels-split-on-coronavirus-stimulus?t=1606992539961> (accessed 3 December 2020).
- Cerra, V., & Saxena, S. (2008). Growth dynamics: The myth of economic recovery. *American Economic Review*, 98(1), 439–457.
- Cohen, L. (2020). The lessons of the Great Depression. *The Atlantic*, 17 May.
- Congdon, T. (2020). Get ready for the return of inflation. *Wall Street Journal*, 23 April.
- Darby, M. (1976). Three-and-a-half million U.S. employees have been mislaid: Or, an explanation of unemployment, 1934–1941. *Journal of Political Economy*, 84(1), 1–16.
- Davidson, K. (2020). Pandemic aid swelled savings of the unemployed, study shows. Now they are running low. *Wall Street Journal*, 16 October.

- Davies, G. (2020). The Fed risks higher inflation to boost jobs. *Financial Times*, 6 September.
- Davison, L. (2020). White households got stimulus checks faster than Black families. *Accounting Today*, 16 July. <https://www.accountingtoday.com/articles/white-households-got-stimulus-checks-faster-than-black-families> (accessed 3 December 2020).
- De Witte, M. (2020). The Great Depression demonstrated the indispensable role of government, says Stanford scholar. *Stanford News*, 29 April. <https://news.stanford.edu/2020/04/29/great-depression-demonstrated-indispensable-role-government/> (accessed 3 December 2020).
- Dwyer, G. (2010). Excess Reserves in the 1930s: A Precautionary Tale. Center for Financial Innovation and Stability, Federal Reserve Bank of Atlanta. <https://www.frbatlanta.org/cenfis/publications/notesfromthetvault/1001> (accessed 3 December 2020).
- Edwards, C. (2020). Federal spending and deficits. *Cato at Liberty*, 23 September.
- Farrell, D., Ganong, P., Greig, F., Liebeskind, M., Noel, P., & Vavra, J. (2020). Consumption Effects of Unemployment Insurance during the COVID-19 Pandemic. JPMorgan Chase & Co. <https://www.jpmorganchase.com/institute/research/labor-markets/unemployment-insurance-covid19-pandemic> (accessed 3 December 2020).
- Fettig, D. (2008). The history of a powerful paragraph. *The Region*, 1 June. Federal Reserve Bank of Minneapolis. <https://www.minneapolisfed.org/article/2008/the-history-of-a-powerful-paragraph> (accessed 3 December 2020).
- Fishback, P. (2010). U.S. Monetary and Fiscal Policies in the 1930s. NBER Working Paper No. 16477. Cambridge, MA: National Bureau of Economic Research.
- Fishback, P. (2020). The COVID crisis in comparison with the Great Depression. *Econlib*, 6 May. <https://www.econlib.org/the-covid-crisis-in-comparison-with-the-great-depression/> (accessed 3 December 2020).
- Friedman, M., & Schwartz, A. (1963). *A Monetary History of the United States, 1857–1960*. Princeton, NJ: Princeton University Press.
- Ganong, P., Pascal, N., & Vavra, J. (2020). US unemployment insurance replacement rates during the pandemic. *Journal of Public Economics*, 191, 104273. <https://doi.org/10.1016/j.jpubeco.2020.104273>
- Hetzl, R. (2020). COVID-19 and the Fed's Credit Policy. Working Paper. Arlington, VA: Mercatus Center, George Mason University.
- Hutchinson, M. (2020). The coronavirus economy will bring inflation. *NR: Capital Matters*, 23 April. <https://www.nationalreview.com/2020/04/the-coronavirus-economy-will-bring-inflation/> (accessed 3 December 2020).
- Ikeda, D., & Kurozumi, T. (2018). Slow Post-Financial Crisis Recovery and Monetary Policy. Globalization Institute Working Paper 347. Dallas, TX: Federal Reserve Bank of Dallas. <https://www.dallasfed.org/~media/documents/institute/wpapers/2018/0347.pdf> (accessed 3 December 2020).
- Irwin, D. (2012). Gold sterilization and the recession of 1937–1938. *Financial History Review*, 19(3), 249–267.
- Kane, P. (2020). Congress deeply unpopular again as gridlock on coronavirus relief has real-life consequences. *The Washington Post*, 1 August. https://www.washingtonpost.com/powerpost/congress-deeply-unpopular-again-as-gridlock-on-coronavirus-relief-has-real-life-consequences/2020/07/31/6d2f10c4-d36a-11ea-8c55-61e7fa5e82ab_story.html (accessed 3 December 2020).
- Klein, C. (2018). Last hired, first fired: How the Great Depression affected African Americans. *History Stories*, 31 August. <https://www.history.com/news/last-hired-first-fired-how-the-great-depression-affected-african-americans> (accessed 3 December 2020).
- Long, H. (2020). The Federal Reserve has pumped \$2.3 trillion into the U.S. economy. It's just getting started. *Washington Post*, 29 April. <https://www.washingtonpost.com/business/2020/04/29/federal-reserve-has-pumped-23-trillion-into-us-economy-its-just-getting-started/> (accessed 3 December 2020).
- McCombie, D. (2020). Main Street lending explained by the banker responsible for 40% of these loans nationally. *Forbes*, 1 August. <https://www.forbes.com/sites/davidwmccombie/2020/10/23/main-street-lending-explained-by-the-banker-responsible-for-40-of-these-loans-nationally/?sh=19cf311941c8> (accessed 3 December 2020).
- New One Entertainment (2020). World Bank: World experiencing one of deepest recessions since Great Depression due to Covid. 15 October. <https://newoneentertainment.com/world-bank-world-experiencing-one-of-deepest-recessions-since-great-depression-due-to-covid-international-business-news/> (accessed 3 December 2020).



- Perry, A., & Hopkinson, N. (2020). Black businesses left behind in Covid-19 relief. *Bloomberg CityLab*, 30 March.
- Rappeport, A., & Smialek, J. (2020). I.M.F. predicts worst downturn since the Great Depression. *New York Times*, 24 June.
- Reinhart, C., & Reinhart, V. (2010). After the Fall. NBER Working Paper No. 16334. Cambridge, MA: National Bureau of Economic Research.
- Reinhart, C., & Rogoff, K. (2009). *This Time is Different: Eight Centuries of Financial Folly*. Princeton, NJ: Princeton University Press.
- Rolley, O. (2020). The New Deal made America's racial inequality worse. We can't make the same mistake with Covid-19 economic crisis. Rockefeller Foundation, 11 June. <https://www.rockefellerfoundation.org/blog/the-new-deal-made-americas-racial-inequality-worse-we-cant-make-the-same-mistake-with-covid-19-economic-crisis/> (accessed 3 December 2020).
- Romer, C. (1992). What ended the Great Depression? *Journal of Economic History*, 52, 757–784.
- Saraiva, C., & Matthews, S. (2020). Powell grilled by Congress on how Fed is helping Main Street. *Quint*, 24 September. <https://www.bloomberquint.com/onweb/powell-faces-questions-on-help-for-main-street-vs-wall-street> (accessed 3 December 2020).
- Schalatek, L. (2020). Urgently wanted: A US stimulus package in which more than the dollar bills are green. *Heinrich Böll Stiftung*, 2 July. <https://us.boell.org/en/2020/07/02/urgently-wanted-us-stimulus-package-which-more-dollar-bills-are-green> (accessed 3 December 2020).
- Selgin, G. (2018). *Floored! How a Misguided Fed Experiment Deepened and Prolonged the Great Recession*. Washington, DC: Cato Institute.
- Selgin, G. (2020a). The New Deal and recovery, Part 6: The National Bank Holiday. *Alt-M: Ideas for an Alternative Monetary Future*, 28 July. <https://www.alt-m.org/2020/07/28/the-new-deal-and-recovery-part-6-the-national-bank-holiday/> (accessed 3 December 2020).
- Selgin, G. (2020b). The New Deal and recovery, Part 7: FDR and gold. *Alt-M: Ideas for an Alternative Monetary Future*, 7 August. <https://www.alt-m.org/2020/08/07/the-new-deal-and-recovery-part-7-fdr-and-gold/> (accessed 3 December 2020).
- Selgin, G. (2020c). The New Deal and recovery, Part 8 (Supplement): The Brookings Report. *Alt-M: Ideas for Alternative Monetary Future*, 14 October. <https://www.alt-m.org/2020/10/14/the-new-deal-and-recovery-part-8-supplement-the-brookings-report/> (accessed 3 December 2020).
- Selgin, G. (2020d). When the Fed tried to save main street. *Alt-M: Ideas for Alternative Monetary Future*, 30 March. <https://www.alt-m.org/2020/03/30/when-the-fed-tried-to-save-main-street/> (accessed 3 December 2020).
- Taylor, J. (2011). Work-sharing during the Great Depression: Did the 'President's Reemployment Agreement' promote reemployment? *Economica*, 78(309), 133–158.
- Waheed, M., & Moussavian, A. (2020). COVID-19 doesn't discriminate – Neither should Congress' response. ACLU.org, 2 April. <https://www.aclu.org/news/immigrants-rights/covid-19-doesnt-discriminate-neither-should-congress-response/> (accessed 3 December 2020).
- Waldman, P. (2020). How to spin a giveaway to the rich. *Washington Post*, 14 April. <https://www.washingtonpost.com/opinions/2020/04/14/how-spin-giveaway-rich/> (accessed 3 December 2020).
- Wall Street Journal* (2020). The Fed's 'Main Street' mistake. 9 April.
- Wheelock, D. (2020). Comparing the COVID-19 Recession with the Great Depression. Economic Synopsis No. 39. Federal Reserve Bank of St. Louis. <https://research.stlouisfed.org/publications/economic-synopses/2020/08/12/comparing-the-covid-19-recession-with-the-great-depression> (accessed 3 December 2020).

LEGISLATION CITED

- Banking Act of 1935 (US). <https://www.govinfo.gov/app/details/USCODE-2010-title12/USCODE-2010-title12-chap3-subchapI-sec228/context> (accessed 8 December 2020).
- Coronavirus Aid, Relief, and Economic Security (CARES) Act 2020 (US). <https://www.congress.gov/116/bills/hr748/BILLS-116hr748enr.pdf> (accessed 8 December 2020).
- Federal Reserve Act 1913 (US). <https://www.federalreserve.gov/aboutthefed/fract.htm> (accessed 8 December 2020).



How to cite this article: Selgin G. The fiscal and monetary response to COVID-19: What the Great Depression has – and hasn't – taught us. *Economic Affairs*. 2021;41:3–20. <https://doi.org/10.1111/ecaf.12443>