Monetary Stimulus: Through Wall Street or Main Street?

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Abstract

In the last couple of years we have observed a variety of tools used to stimulate the economy, from the tax rebates of 2008, to the monetary infusion to the financial institutions in 2009. At the same time, loud questioning of the perceived favoritism for the financial system has emerged, with suggestions that recoveries should also include infusions to "Main Street" to propel consumption bursts that promote economic activity and growth. A simple limited participation model is developed to examine the effect of alternative distributions of monetary injections, through the financial intermediaries or through consumers, on the main macroeconomic aggregates of the small open economy. It is found that the higher the proportion of the monetary injection channeled through the consumers leads to a less vigorous recovery of output, but diminishes the negative effect on the utility of the representative household.

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