The Global Financial Crisis of 2007-2008, also known as the Great Recession, caused the failure of major financial institutions. Trying to prevent the breakdown of the financial system, Secretary of the Treasury Paulson called for the U.S. government to purchase about several hundred billion dollars in distressed assets from financial institutions. The Emergency Economic Stabilization Act of 2008 created the $700 billion Troubled Asset Relief Program to purchase toxic assets from banks. The funds for purchase of distressed assets were mostly redirected to inject capital into banks and other financial institutions.

The idea of this massive intervention was controversial and faced backlash from the public and the academia. Back of the envelope calculations suggest that the cost per capita was more than $2000. Joseph Stiglitz, one of the most prominent critics of the Emergency Economic Stabilization Act of 2008, expressed concern that the bill is yet another example of trickle-down economics: it will benefit the Wall Street at the expense of taxpayers, the Main Street. Discontent with the sluggish recovery and increasing wealth and income inequality gave rise to the advent of social movements such as Occupy Wall Street. Strong opposition to the Emergency Economic Stabilization Act of 2008 and calls for more redistribution indicate that the disgruntled public perceived these issues as important, most likely because of their redistributive nature.

This project aims to shed light on the interaction of financial crises and inequality. We want to understand how financial crises affect the rich and the poor and how they redistribute resources between households. We also seek to explore how the response of macroeconomic aggregates to financial shocks depends on the preexisting inequality in wealth, income and portfolio heterogeneity. Financial crises affect the economy through multiple channels. They reduce capital accumulation and decrease productivity and in consequence wages. This will harm those for whom labor income is the primary source of income. Some households are directly affected as the value of their assets falls. These people tend to be rich. If households who are hit by the crisis reduce consumption sharply, the initial effects will be amplified through the fall in the aggregate demand.

In order to investigate effectiveness of various macroeconomic policies, such as bank bailouts and asset purchases we will build a quantitative model. Our model features many households, who differ in terms of their productivity and assets they hold. Prices in the model cannot adjust immediately, so aggregate demand matters. We also model a banking sector that finances firms' activity and collects deposits. This approach will allow us to simulate effects of financial market intervention and will be useful to see who is affected the most by various stabilization policies. These findings might guide policymakers when they are confronted with a breakdown in financial intermediation.