# Support Policies and Inflationary Pressures: A Critical Review of 2020-2022 in the Light of the 2008 Experience

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## Abstract

We examine the relationship between expansionary monetary and fiscal policy and inflation in two different periods: the 2008 global financial crisis and the COVID-19 pandemic period from 2020 to 2022. In the first case, we analyze the response of central banks through interest rate cuts and quantitative easing in an environment of negative inflation and low demand. In the second, the much more intense monetary and fiscal intervention is examined, accompanied by direct transfers to households and firms, leading to widespread inflationary pressures from 2021 onwards. We attempt to compare the features and effects of the two policies, highlighting the effects of excessive liquidity, deficit financing, and delayed tightening. We conclude that treating inflation as a "transitory phenomenon" was a critical miscalculation. The need for macroeconomic stability, timely interest rate adjustment, and restoration of monetary credibility is stressed.

**Keywords**: monetary policy, inflation, Federal Reserve, European Central Bank, interest rates, quantitative easing, 2008 crisis, COVID-19 pandemic

## Introduction

The 2020s began in a way that no one had predicted. The COVID-19 pandemic not only brought an unprecedented health crisis; it radically changed everyday life, work, travel, and, of course, economic life. Within weeks, entire countries were placed under restrictions, production plants shut down, supply chains were disrupted, consumption plummeted and unemployment soared. It was a break with normality at a time when the need for decisive state intervention was becoming more urgent than ever.

Governments and central banks reacted quickly and forcefully. They introduced support programs, suspended payments, made subsidized loans available, and cut interest rates to historically low levels. In some cases, government intervention has reached heights that, until recently, would have seemed unrealistic. The term "stimulus" entered everyday parlance, while public spending took on a central role in stabilizing the economy. This political stance has admittedly prevented mass redundancies, protected the cohesion of societies, and averted a deeper recession.

But every economic choice has its costs. From 2021 onwards, it started to become apparent that the support measures may have caused new problems. Prices began to rise, and inflation - a concept almost forgotten by younger generations - returned with momentum and duration. The question immediately arose: was the global context responsible for the rise in prices or were the policies adopted to contain the crisis itself?

This was not the first time that economic policy had faced such a challenge. In the 2008 financial crisis, the intervention of governments and central banks was more limited and cautious. The emphasis was on bailing out banks and stabilizing markets, rather than on stimulating demand or supporting incomes.

In contrast, a clear shift was recorded in the period 2020-2022: support was more direct and consumer-oriented. A significant part of the resources was channeled directly to households, in the form of benefits, tax cuts, and one-off payments. Money reached the final consumer at a pace reminiscent of helicopter money, accompanied by a spirit of practical apology to hard-pressed societies.

This paper attempts to examine, in a sober and critical spirit, whether the support policies of the period 2020-2022 contributed decisively to the rise in inflation, and how these practices compare with those of 2008. Through the study of scholarly sources analyzing the effects of monetary and fiscal intervention, the commonalities, differences, and internal contradictions of these two crises will be highlighted.

Perhaps, after all, the essential question is not only what caused inflation, but how a society can balance the need to protect the present with concern for the future. If the pandemic has been one of the greatest tests of our time, then the policy responses that have been given deserve serious consideration - not to assign blame, but to shape wiser choices when the next crisis comes.

**Results -Discussion**

## Theoretical framework and historical background

The link between expansionary monetary and fiscal policy and inflation is a classic topic in macroeconomics. Typically, governments implement such policies during economic crises, with the aim of increasing economic activity, reducing unemployment, and supporting demand (Friedman 1968).

The 2008 crisis, also known as the Great Financial Crisis, erupted in the United States after the collapse of the housing market and the problems arising from subprime mortgages. The crisis spread around the world, causing turmoil in the banking system and serious consequences for the real economy. In response, central banks, such as the FED in the US and the ECB in Europe, adopted quantitative easing policies, significantly increasing the available liquidity in the market (Bernanke 2012). The aim was to stabilize financial markets and regain investor confidence. Despite the success of these policies in the first phase, several economists expressed concerns about the possible long-term effects of inflation due to the extensive increase in money in circulation (Bernanke 2022).

The COVID-19 pandemic crisis (2020-2022), although of a completely different nature, also led to major economic interventions. The pandemic, as a primary health crisis, led many countries to forcibly close their economies, imposing severe restrictions on business. To cope with the consequences, governments embarked on large-scale fiscal stimulus, with benefits and support to households and businesses, while central banks further increased available liquidity (World Bank 2022).

Hazlitt (1946) noted as early as the last century that while such policies may stimulate the economy in the short run, in the long run, they may increase inflation, especially if they are financed through an increase in the money supply. Lucas (1972), for his part, added that economic agents adjust their expectations accordingly, thus reducing the long-run effectiveness of such policies.

## The 2008 crisis: policy interventions, impacts and lessons learned

2008 was a world-historical turning point where even liberal governments were forced to implement bailouts, bank nationalizations, and public investments. Regional economies were affected differently depending on their structure, but all resorted - to some extent - to state interventionism. The 2008 crisis shattered confidence in the self-regulating market, leading to high levels of state intervention, both in the financial and fiscal sectors (Klagge et al.,2008).

Despite unprecedented monetary support, inflation transmission mechanisms in 2008 were weak due to a collapse in demand. (Ball&Mazumder, 2011). Despite the deep recession and high unemployment, inflation in the US and other advanced economies remained stable or even slightly increased. The expansion of the monetary base by the FED(QE) did not have direct inflationary effects due to the low velocity of money. Moreover, the inertia of prices and the stability of inflation expectations explain why there was no deflation.

Exogenous shocks add to volatility, as financial markets become more sensitive to energy prices in times of high uncertainty. (Mollick&Assefa, 2013). Increases in oil prices had a negative impact on equity returns in 2008-2009.

The relationship between budget deficits has been extensively analyzed in the past. When deficits are financed by issuing new money, they lead to an increase in inflation in the medium term.  The effect is non-linear and the larger the deficits, the greater the probability of an inflationary shock (Dwyer, 1982). It seems, however, that the degree of confidence in monetary policy can mitigate or enhance the effects. When markets do not trust the central bank's commitment to inflation control, inflation expectations eventually become self-fulfilling(Blackburn& Christensen, 1989). The Fed did not cause inflation in 2008, but it did in 2021-2022, after months of telling a temporary inflation narrative. The difference in central bank credibility and expectations in the two periods under consideration could largely explain the inflationary boom of the post-Covid era.

**The 2020-2022 period**

Inflation in the US was predictable and preventable if there had been careful planning in fiscal policy and more timely determination by the Fed (Ball et al., 2022). 75% of inflation is attributed to excess demand and only 25% is explained by supply shocks, while the central bank did not raise interest rates in time due to forecasting model errors and complacency. Thus, it becomes obvious that the principles of stability of the 2008-2012 era were not followed, hence we were led to increased inflationary pressures.

Policy choices determine a large part of inflation, not just shocks. The US experience was not the norm, as in the EU it was the result of energy shocks and shortages rather than excessive fiscal measures (Dao et al., 2024). Countries that avoided large stimulus, such as Germany, had lower core inflation.

Prokopowicz (2022), making a historical comparison with the hyperinflationary periods of the 1970s, formulates a clear and harsh position: The inflationary crisis of 2022 is a political construct, not an economic necessity. Explosive growth in the money supply combined with bloated state interventionism caused inflation, and measures such as helicopter money and the distraction of monetary policy from price stability led to a dramatic loss of credibility. This is a clearly monetarist but fair-minded view of things.

It is not only the size of the fiscal and monetary expansion that matters but also how the resources are spent. Consumption transfers to households cause a rapid and strong rise in inflation through an increase in marginal consumption (Klein et al., 2023). On the other hand, public investment has a smaller impact and boosts potential output. Essentially, the inflationary effect of support during the pandemic period is not only due to volume but also because the policy took the form of consumption through subsidies instead of productive investment. Thus there is some theoretical basis for the distinction between 'good' and 'bad' fiscal expansion.

The ability of countries to control inflation depended not only on the crisis itself but also on the quality of the institutional framework (Arsic et al., 2022). Countries with firm inflation targeting, strong institutions, and central bank independence, experienced smaller deviations from targets during the pandemic period. In contrast, countries that succumbed to fiscal pressure experienced stronger inflationary surges. It is therefore safe to conclude that the existence of institutional credibility acts as a shield in times of sudden and exogenous crisis.

The majority of central banks deactivated or temporarily suspended the inflation-targeting framework during the COVID period. Bankers focused mainly on stabilizing the money market and asset prices instead of goods inflation (Kruskovic, 2022). Inflation targeting ceased to function as a principle of monetary policy, as it was chosen to support the economy and the capital market at all costs, thereby undermining the long-term credibility of the authorities.

Many initiatives during the pandemic period and afterward, although well-intentioned (e.g. green growth), did not take into account their inflationary consequences (Mirza et al., 2023). Green targeting cannot be fragmented and non-holistic and needs a comprehensive strategy that aligns price stability with the energy transition.

The expansionary policies of 2020-2021 contributed significantly to house price growth, as house prices reacted positively to liquidity and government spending. Essentially, the housing market is a predictor of inflation and quickly incorporates market expectations and expansionary policy moves (Khoirudin et al.,2023). The effect of any monetary tightening comes with a lag in the housing market. We thus see that inflation occurred not only in consumer goods but also in assets, thus reinforcing the thesis that expansionary policies during the pandemic period had broader inflationary effects than officially recorded.

Stock market behavior during and after the pandemic was not rational but was strongly influenced by supportive policies (Yank et al., 2022). During the period of excessive monetary expansion, mainly by the FED, many bubble episodes were recorded in markets such as the US, Europe, and Asia.

**Conclusions-Future prospects**

The experience of the 2020-2022 period has highlighted the limits of temporary and provisional narratives, such as that of "transient inflation", and underlined the importance of institutional credibility and timely central bank responses. Failures in policy timing and forecasting demonstrate that expansionary intervention, when not accompanied by a clear macroeconomic equilibrium framework, can have serious costs in terms of prices and expectations.

The future outlook calls for a new balance between state intervention and monetary restraint. Maintaining the credibility of monetary policy, strengthening the institutions that protect price stability, and making a clear distinction between productive and consumer interventions are crucial to avoid similar inflation crises in the future.

Although each crisis has its own characteristics, the scientific evidence shows that policy design should be based on principles of long-term equilibrium rather than short-term reflexes. The experience of recent years provides valuable material for laying the foundations of a more stable and less vulnerable economic architecture.

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