



## A BUSINESS FISCAL RESPONSE TO A COVID-19 RECESSION

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March 20, 2020

The federal government should offer significant assistance to small- and mid-sized service sector businesses so that they can retain their workers. Financial assistance to small business *is* financial support to workers, allowing workers to continue being paid *by their employers* during the coronavirus crisis. The goal should be to replace a large portion of the revenue (not just the payroll expenses) those businesses would have generated in the absence of being shut down due to the coronavirus. Low-margin businesses will face great financial difficulty losing multiple months of revenue, and many if not most small businesses would rather shut down or lay off a significant fraction of their workforce than take out a loan, even with a favorable or zero interest rate. The number of potential layoffs the U.S. economy is facing is deeply troubling, and an aggressive policy response is urgently needed. We estimate the cost of replacing 80 percent of the revenue for three months of private-sector firms with fewer than 500 employees, excluding the manufacturing, health, education, and finance industries, to be \$1.2 trillion.

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\* Hubbard: Columbia Business School and American Enterprise Institute. Strain: American Enterprise Institute.

### *How would this work?*

- The owner of an eligible business goes to a commercial bank—including the bank he or she currently uses—and requests a loan.
- The business owner presents his or her 2018 or 2019 tax return to the bank. This information is all that is needed to verify the size of the loan. For newer businesses, accounting information could be used.
- Congress provides a formula to the banks that converts the tax return information to a maximum eligible loan amount, equal to revenue for a period (say, 12 weeks), or a significant portion of revenue.
- The loan is guaranteed by the government, so the bank assumes no risk.
- The bank can charge interest, and the congressional formula will include enough assistance so that the businesses owner is not responsible for the interest expense.
- The businesses owner receives a letter from the bank guaranteeing that the government will pay off the loan in calendar year 2020, under the conditions that the business does not lay off any workers and that the business continues to pay workers their full wages, salaries, and benefits. (Workers would still be free to quit.)
- The program will include enforcement provisions and penalties, and will expire on December 31, 2020, but can be renewed.

### *Why grants and not loans?*

Service business face a permanent revenue loss. Unlike manufacturing firms, they will not return to a backlog of orders. Any sales missed over the next two or three months

represent permanently lost revenue. Even at a favorable, or zero, interest rate, many small business would be forced to shut down or lay off workers rather than take out a loan, because the expense of paying back the loan, even over a long period of time, would swamp their profits.

*Why replace revenue, and not just payroll?*

Many small businesses have significant non-payroll expenses. Rent in Washington, New York, and San Francisco, as examples, is very high. Simply offering to replace payroll, while much better than doing nothing, would still lead to significant layoffs and business closures.

### **A PLAN TO REPLACE SMALL BUSINESS REVENUE**

*The problem*

Initial market reaction to the economic threat of the coronavirus missed some long-term problems (*e.g.*, increases in transactions costs from supply-chain disruptions) and, importantly, the potential for a short-term aggregate demand doom loop. The latter is both serious and avoidable. That is, the inevitable recession from a sudden stop in activity should be short, though likely deep (think the Carter credit controls in 1980 or the recession accompanying the 1918-1919 flu pandemic).

Stabilizing infection rates and present conditional mortality rates through health policy actions can yield *health and mortality* consequences of the COVID-19 pandemic not as large or long-lasting as many fear. But there's an *economic* catch: The very policies (social distancing,

no mass gatherings, closure of many businesses, etc.) to make the infection curve *less steep* will *steepen* demand shortfalls and recession losses.

Much attention has been placed on the Fed, but the Fed cannot tackle completely the present task (though the Fed has taken constructive action -- *e.g.*, standing up its commercial paper program). To avoid a doom loop of recession losses accompanying the health crisis response, *a fiscal initiative to support business continuity is essential.*

*Other, non-business steps will not be sufficient*

Avoiding the aggregate demand doom loop can start with some familiar policy steps to support a demand collapse associated with the virus. The first is increasing support to states to support Medicaid spending so that other parts of state budgets do not get cut. The idea of rebate checks targeted to low-income households is a very good idea and should get bipartisan support. And the 2001 experience suggests that a quick implementation is possible. A payroll tax cut is a less good idea because it delivers support slowly, does not help those who may have lost a job, and is not targeted.

*But businesses – particularly, small and mid-sized businesses are key*

These sensible steps alone will not stop the aggregate demand doom loop, as they do not address the problems of struggling firms, as many businesses will be damaged significantly and possibly forced to shutter or layoff their workers with the sharp decline in revenue from a sudden stop in demand.

*To stop the doom loop in its tracks*, the federal government would need to make up a large fraction of this demand for a short period of time while the slope of the infection curve

flattens (second derivative) then stabilizes (first derivative). To receive this support, firms would be required not to lay off workers during the period. Such a policy is an important complement to aid to individuals (via Unemployment Insurance or rebate checks), who are relatively confined while businesses are shuttered.

How large would such a program be? Between \$1.2—\$1.5 trillion over a three month period, depending on the share of revenue Congress wishes to replace. While such a figure is large, it is one-time, in a period with historically low interest rates, and avoids an even-more-costly-to-taxpayers clean-up from an expanded aggregate demand doom loop. And there are other important offsets: By keeping workers employed, the demands on social insurance programs (*e.g.*, Unemployment Insurance) and safety net programs (*e.g.*, food stamps and Medicaid) would be mitigated. In addition, businesses and workers would still be paying taxes. *The overall costs are less than the headline number.*

#### *How to implement such a program*

We are essentially talking about making grants to businesses to recover a significant portion of revenue over a defined period of time (*e.g.*, twelve weeks). Standing up a new government facility would be difficult to do in a timely way. Commercial banks already have relationships with businesses and could make loans equal to a fraction of revenue based on past tax returns (or other accounting information).

The loans would be guaranteed by the federal government, then forgiven at the end of the period, conditional on businesses not laying off any workers over that period and on continuing to pay their workers their full wages, salaries, and benefits. (Workers would still be free to quit.)

It is important to allow the loans to replace lost revenue, not just lost payroll expenses. A small business with a low profit margin might not be able to pay the rent and stay open if it only receives relief for payroll expenses.

#### *Thoughts on budget cost of the proposal*

We gratefully acknowledge the Dun and Bradstreet Corporation for working with us to generate these estimates. We estimate the potential cost of replacing revenue for 12 weeks to be approximately \$1.5 trillion for service-sector businesses — that is, for businesses in industries other than manufacturing, health care, educational services, and finance and insurance — with fewer than 500 employees. Replacing 80 percent of the revenue of service-sector businesses with fewer than 500 employees for 12 weeks would cost \$1.2 trillion.

#### *Avoiding too much targeting*

We would argue against targeting this program on places in the U.S. experiencing severe outbreaks. Given the limited knowledge we have on the virus's spread, it would be difficult to specifically identify the states and cities that need help. It would also be difficult to identify a trigger — say, a certain number of confirmed diagnosis in a state — that would be an effective targeting mechanism. Similarly, it would be difficult to establish a procedure for businesses to demonstrate hardship. Any sort of hardship test would, in practice, be reduced to taking the business owner at his word or risk delaying the delivery of urgently needed assistance. A higher evidentiary standard would risk delaying relief to businesses in need, threatening more layoffs and business closures.

Better targeting would be ideal, of course, but it is necessary to provide immediate relief to small businesses. The risk of providing too much relief due to no targeting is much smaller than the risk to the economy, small businesses, and workers of providing too little relief for the sake of better targeting.

*The need to act quickly even with philosophical concerns*

The actions suggested here will raise the deficit and federal borrowing substantially for a period of time. Four observations are in order, though: The counterfactual against which to judge potential interventions is *not* a “do nothing” scenario. Such a “plan” risks more massive clean-up spending and a much more severe downturn. It also risks downstream effects. For example, if many small businesses go under, the U.S. would likely see a reduction in startup rates and entrepreneurship in the future.

Second, failing to act risks a major loss in business confidence and the alienation of many small- and mid-sized business, just as homeowners were frustrated by the lack of attention to their woes during the financial crisis.

Third, the economic damage from mass service sector layoffs could easily turn the recession from a “V” shape to a “U” shape, in which more workers are unemployed and average unemployment duration increases. A “U” shaped recession can be avoided with immediate and aggressive government policy. Indeed, we believe that if the government can make up the revenue small businesses will lose, the economy can quickly and fully recover from this downturn shortly after the coronavirus threat has passed.

Fourth, we are not especially worried about moral hazard. The threat facing businesses — and the need to provide them relief — is driven by a once-in-a-century pandemic. These businesses are not at risk because of bad decisions they have made, because their competitors are providing higher-quality service, or because a new technology has been invented. And you can't buy pandemic-driven-shutdown insurance in the same way you can insure against the risk of a fire. Government should communicate clearly that this assistance is not to be confused with the promise of assistance under normal circumstances.

The vast majority of these businesses are passing the market test. They are productive and profitable. If they go under, the economy will lose more than employment relationships. It will lose the networks and specialized knowledge that allowed these businesses to grow and thrive. Avoiding mass layoffs is the most important goal. But those losses, along with layoffs, should be avoided as well. With the right policy response, both can be.

The scale of the challenge facing the economy this spring is enormous. The policy response needs to match the challenge. Congress needs to act aggressively and urgently to save businesses and jobs, and to help workers.