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TESTIMONY

CONGRESS SHOULD REFLECT ON PAST FINANCIAL RELIEF BEFORE PROVIDING MORE

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US Senate, Committee on Homeland Security and Governmental Affairs
Oversight of COVID-19 Financial Relief Packages

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As Congress prepares to pass another financial relief package before the August recess, I would like to offer an assessment of some of the federal policies pursued to assist Americans through the COVID-19 pandemic:

1. The extension of federal unemployment insurance, meant to ameliorate the effects of the economic slowdown, has also inadvertently made it difficult for employers to attract workers back to work.
2. The Payroll Protection Program worked poorly and did little to help the small businesses and single proprietorships that are the backbone of America's economy. A simpler policy, such as a universal line of credit, might have been more effective and less expensive
3. The overall relief packages added significantly on US national debt, which will weigh on America's labor market and economic growth.

These results should be in the forefront of policymakers' minds when designing any new policies.

UNEMPLOYMENT INSURANCE EXTENSION

The federal government typically provides supplemental funding to increase the unemployment insurance (UI) provided by the states during nationwide economic downturns. It can also increase the number of weeks unemployed workers are eligible for UI. During the Great Recession, the federal government allowed UI recipients to receive up to 99 weeks of benefits. It also funded an across-the-board increase in benefits of $25 per week in addition to state benefits, and it imposed a few other mandates.

The Coronavirus Aid, Relief, and Economic Security (CARES) Act expands UI benefits by $260 billion through multiple channels.[1]

1. Committee for a Responsible Federal Budget, "What's in the $2 Trillion Coronavirus Relief Package?," *Bottom Line*, March 25, 2020.

First, it expands UI benefits to workers who were already eligible for UI benefits under state or federal regulations. Workers receive from the federal government a $600 check weekly, regardless of hours worked, in addition to their regular UI benefits under state law, until July 2020.[2] If workers remain unemployed after their state unemployment benefits are exhausted, which usually occurs in 26 weeks, the federal government will fund up to 13 weeks of additional UI benefits at $600 per week during that 13-week period.[3]

The CARES Act also provides funding to states that implement a short-time compensation (STC) program for employers that reduce their employees' hours instead of laying employees off. Until December 31, 2020, the federal government will fund 100 percent of the prorated cost of employees' UI benefits in states that don't have such a program and 50 percent of the cost in states that choose to implement one.[4]

Second, the CARES Act creates the temporary, federally funded Pandemic Unemployment Assistance (PUA) program, which is available to those who would not otherwise qualify for state UI but who nevertheless cannot work because of the ongoing pandemic.[5] This group includes self-employed workers, independent contractors, part-time employees, and those who quit their jobs for coronavirus-related issues (e.g., workers who are sick or taking care of a dependent, if these workers do not otherwise have paid-leave benefits or the option of telework).

Under the PUA program, these displaced workers are not required to seek other work. Benefits will cover 100 percent of these workers' foregone weekly compensation while guaranteeing each of them a weekly check of at least $600. Eligible workers can sign up for the program between January 27, 2020, and December 31, 2020, and their benefits will continue for up to a maximum of 39 weeks.

Between February and May, unemployment benefits increased by $100 billion, according to the Center for Responsible Budget; about three-quarters of this expansion came from the CARES Act (the rest came through actions by the state governments).[6] This expansion of benefits explains in large part the 5.4 percent increase in total disposable income during that period.[7]

Economists Peter Ganong, Pascal Noel, and Joseph Vavra of the University of Chicago find that more than two-thirds of "of unemployed workers who are eligible for UI will receive benefits which exceed lost earnings."[8] The average replacement rate was roughly one-third more than previous earnings, and some workers received benefits twice their previous wages.

A recent report by the Congressional Budget Office (CBO) confirms those results, finding that the share of those earning more in UI than in wages is even higher than what others had predicted, with five out of six unemployed workers receiving more benefits than they received in previous wages.[9]

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2. Coronavirus Aid, Relief, and Economic Security Act § 2014, Pub. L. No. 116-136, 134 Stat. 281 (2020).
3. Coronavirus Aid, Relief, and Economic Security Act § 2107, Pub. L. No. 116-136, 134 Stat. 281 (2020).
4. Coronavirus Aid, Relief, and Economic Security Act §§ 2108–2109, Pub. L. No. 116-136, 134 Stat. 281 (2020).
5. Coronavirus Aid, Relief, and Economic Security Act § 1202, Pub. L. No. 116-136, 134 Stat. 281 (2020).
[6] Committee for a Responsible Federal Budget, "Income Has Risen through the COVID Recession but That May Soon Change," *Bottom Line*, July 20, 2020.
[7] Committee for a Responsible Budget, "Income Has Risen."
8. Peter Ganong, Pascal Noel, and Joseph S. Vavra, "US Unemployment Insurance Replacement Rates During the Pandemic" (BFI Working Paper No. 2020-62, Becker Friedman Institute for Economic Research at the University of Chicago, Chicago, IL, May 14, 2020).
9. Phillip L. Swagel, *Economic Effects of Additional Unemployment Benefits of $600 a Week* (Washington, DC: Congressional Budget Office, 2020).

While a social safety net might be desirable, one should not ignore the cost associated with this particular policy. There is already a large literature on the disincentive effects of UI benefits, which includes data from the significantly smaller expansion of UI during the Great Recession. And this time, workers can quit their jobs and still be eligible for UI.

The impact on employment is and will continue to be massive. Much anecdotal evidence shows that restaurants and small businesses are now having a hard time retaining workers or bringing workers back to work. The Board of Governors of the Federal Reserve System *Beige Book* provides numerous examples from across the nation of how the generosity of UI benefits is a major obstacle for businesses trying to attract workers.[10] In some cases, its significance rivals even the risk of infection.

If Congress is serious about helping the cautiously reopening economy to recover, a conversation about extending unemployment benefits should be informed by these costs too, including the CBO's finding that renewing the benefits as written in the CARES Act would reduce both employment and output.

THE PAYCHECK PROTECTION PROGRAM

According to the Small Business Administration (SBA), around 28 million businesses, or 99.9 percent of all firms in the United States today have fewer than 500 employees. In addition, 81 percent of these small businesses have *no* employees. Yet these sole proprietors—the smallest of small businesses—are not considered real businesses in the eyes of the federal government. Helping the many diverse firms in different industries, geographic locations, and markets requires that eligibility be as flexible and as wide as possible.

That is exactly what the Payroll Protection Program (PPP)—Congress's attempt at helping small businesses propelled by the pandemic into a severe cash crunch and loss of income—failed to do.

Legislators had two goals in mind: (1) help small firms by giving them needed liquidity while (2) creating incentives to transform each loan into a grant, which could be accomplished by the recipient firms putting the money toward payroll expenses for two months. This attempt to preserve the ecosystem of small businesses has, in theory, some merit.[11] First, it would allow workers to stay connected to their employers and mitigate the financial and psychological hardship of unemployment. Second, by allowing most small businesses to survive, PPP would make it easier for unemployed workers to find jobs when the economy finally reopens.

In practice, however, the PPP proved problematic in many ways. Its implementation was messy and left many small businesses unable to get a loan. Part of the problem was the sheer scale of the task. During regular times, the SBA makes about 60,000 loans, totaling $30 billion. Of that amount, $2 billion are disaster loans and $23.2 billion are 7(a) loans. Under the CARES Act, the SBA had to process more than 10 times its annual load in the span of a few weeks, responding to each application within a three-day window, with very little guidance from Congress about how to proceed.

The PPP also followed a one-size-fits-all model, making it hard to serve every company in need. The application process was so complicated that it effectively locked out many borrowers. The SBA and the banks' interpretations of the legislation resulted in the arbitrary exclusion of thousands of businesses such as commercial cleaners, home-repair companies, and hair salons, all of whom had been hit hard by the pandemic.

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10. Board of Governors of the Federal Reserve System, *The Beige Book: Summary of Commentary on Current Economic Conditions by Federal Reserve District*, May 2020.
11. Michael R. Strain, *The Paycheck Protection Program: An Introduction* (Washington, DC: American Enterprise Institute, 2020).

The two original goals set by legislators ended up being in tension with one another, because they imposed some unreasonable conditions on how borrowing firms could spend the money and how many employees the firms had to keep on payroll to be able to have the loan to be forgiven. These restrictions made it harder for some firms to survive, while imposing a large cost on taxpayers.

The PPP nonetheless provided an opportunity for firms to get essentially free money, regardless of their needs, an opportunity that many firms with few liquidity concerns—some small, some not—took advantage of. The consequences were predictable: the rush to get a loan created long lines and waiting period for borrowers with pressing needs, and it made accountability and oversight nearly impossible.

A central goal of program was the prevention of mass layoffs and firm bankruptcies through the injection of liquidity into the affected companies. In theory, that should have meant that more of the funds flow to places hit the hardest by the pandemic. That did not happen. If anything, funds tended to flow to areas where the effect was less severe, and firms seemed to use the funds for building up savings rather than for immediate needs.[12]

According to economist João Granja and his coauthors, there is no evidence that the "PPP had a substantial effect on local economic outcomes—including declines in hours worked, business shutdowns, initial unemployment insurance claims, and small business revenues—during the first round of the program."[13]

While the public continues to be outraged by the news that larger and more well-connected firms received the bulk of the high-dollar loans, this result was predictable, since bigger firms tend to have more resources and are more savvy at navigating the SBA application process than the owners of small businesses are. It could also simply be that the employees of the bigger firms are better informed about what is in the CARES Act than a lone freelancer is.

There was a better way to help small businesses, and it is not too late for Congress to consider this alternative. It was originally developed by Arnold Kling: give to *every* individual and business with a bank account low-cost overdraft protection in the form of a credit line. This credit line would be backed by the government, which assumes the risk burden for the banks. All loans taken would be repayable and could be used for anything, a feature that also reduces the exposure of taxpayers, since it eliminates the need for detailed oversight on how the funds are spent. The line of credit would enable borrowers to continue meeting their obligations, including rent and utility bills, despite short-term losses of income. The advantage of this alternative is that it is simple, universal, and flexible while limiting the intrusiveness and cumbersomeness of government today and limiting the costs to taxpayers tomorrow.

NATIONAL DEBT

Understandably, Congress was under pressure to act quickly. The result, unfortunately, was a set of incoherent and conflicting approaches bundled together in the CARES Act. Rather than figuring out whether the government should rescue companies or individuals, Congress tried to rescue both. And when it gave money to individuals, Congress didn't just send individual checks; it also implemented paid leave, as well as massively expanded UI benefits and more.

Making the situation worse, UI benefits created incentives to drop out of the workforce, while the PPP's condition for loans to be forgiven was that companies needed to keep their employees. This COVID-19 response was, to say the least, poorly thought through.

12. João Granja et al., "Did the Paycheck Protection Program Hit the Target?" (working paper no. 2020-52, Becker Friedman Institute for Economics at the University of Chicago, Chicago, IL, July 3, 2020).
13. Granja et al., "Did the Paycheck Protection Program Hit the Target?," 1.

The result is a massive increase in spending. According to the Center for Responsible Budget, "The Federal Reserve has authorized nearly $6 trillion in economic support and disbursed roughly $2.2 trillion. Another $3.6 trillion of support has been authorized through legislation, of which $2 trillion has been either disbursed or committed (net deficit impact will be roughly $2.4 trillion). Finally, the Administration has authorized nearly $400 billion of support through executive action and disbursed roughly $300 billion (net deficit impact will be less than $100 billion)."[14]

This level of spending will have a lasting effect on the deficit and the national debt, and in turn on the country's economy. As of now, deficit in fiscal year 2020 is expected to be $3.7 trillion, or 17.9 percent of GDP, and is expected to average $1.6 trillion per year from 2021 through 2030. Debt as a share of GDP is expected to grow from 79 percent of GDP (before the pandemic) to 101 percent by the end of 2020 and 118 percent of GDP by 2030. The debt as a share of GDP was 35 percent in 2007, by the way. By 2050, debt is expected to reach 220 percent of GDP.[15] This debt-to-GDP ratio will exceed even the one America had at the height of World War II. The national debt came down after that war ended, but continued Social Security and Medicare shortfalls have kept, and will continue to keep, the current debt rising indefinitely. The numbers mentioned earlier assume no new additional spending.

In a review of academic papers published since the Great Recession, my colleague at the Mercatus Center at George Mason University, Jack Salmon and I confirm that the evidence supports that increases in national debt adversely affect economic growth. All but two of the examined studies find a negative relationship between high levels of government debt and economic growth. The empirical evidence overwhelmingly supports the view that a large amount of government debt hurts economic growth, and in many cases the impact gets more pronounced as debt increases. Before the COVID-19 crisis, Salmon and I calculated that "the effects of a large and growing public debt ratio on economic growth could amount to a loss of $4 trillion or $5 trillion in real GDP, or as much as $13,000 per capita, by 2049."[16] And spending has only shot upward since.

CONCLUSION

Before Congress votes for more spending, members should take a moment to assess what has already been done. As of July 23rd, $2.1 trillions of dollars have already been authorized and spent with little oversight.[17] It leaves $1.5 trillion to be distributed. Many of the relief programs have put money in the pockets of individuals and companies, but they have also created disincentives to work and have had little benefit for economic growth and job retention while leaving future generations with an unprecedented amount of debt.

Members of Congress should pause, assess the already-undertaken measures, and try reopening economy before undertaking even more spending and debt.

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[14] "COVID Money Tracker," Committee for a Responsible Federal Budget, accessed July 23, 2020, http://www.crfb.org/project/covid-money-tracker.

[15] "Projecting COVID's Fiscal Impact," Committee for a Responsible Federal Budget, June 29, 2020, https://www.crfb.org/events/projecting-covids-fiscal-impact.

[16] Veronique de Rugy and Jack Salmon, "Debt and Growth: A Decade of Studies" (Mercatus Policy Brief, Mercatus Center at George Mason University, Arlington, VA, April 2020).

[17] Committee for a Responsible Federal Budget, COVID Money Tracker: Policies Enacted to Date," *Bottom Line*, April 20, 2020.