The CARES Act Isn’t Careful Enough

By George A. (Sandy) Mackenzie *Thu, Apr 16, 2020*

If this agonizing period leads to genuine reform, our 'blood, sweat and tears' (to borrow Winston Churchill’s famous words) won't have been in vain, writes our contributor.

The “blitz” of World War II, when German bombs rained down on London and England’s other large industrial and commercial cities from November 1940 to May 1941, had relatively little effect on the operations of small businesses, despite the physical destruction and loss of life they wrought.

Will the COVID-19 pandemic’s effects be even more devastating to the U.S.’s small businesses and their employees than the Luftwaffe’s bombs were to English shops?

This column provides an updated summary of the Coronavirus Aid, Relief and Economic Security (CARES) Act, and then turns to the growing debate over how best to aid American small businesses—businesses with less than 500 employees—and their workers.

The CARES Act

Including its tax measures—mostly tax breaks for businesses—the CARES Act is now estimated to amount to $2.3 trillion, not $2 trillion, in stimulus measures. This does not include the measures that the Federal Reserve is taking to support credit markets. Given its massive size and impact on the federal debt, it will be important to ensure that this money is spent effectively. CARES’s main features, as described by the Committee for a Responsible Federal Budget (CRFB) are as follows:

Measures to benefit households and individuals

- Issuance of checks or direct deposits to taxpayers of $1,200 for single filers with AGI up to $75,000 and $2,400 for joint filers with AGI up to $150,000 plus up to $500 per child ($290 billion) Rebates are phased out at a rate of $50 for every $1,000 in income above these limits.
- Expansion of the coverage of state unemployment insurance (UI) and increase the weekly payment by a flat rate of $600 for about four months, while increasing the maximum payment period by thirteen weeks ($260 billion)
- Expansion of the social safety net, including the SNAP and other nutritional aid ($42 billion)

Measures to support business

- Loans and other assistance to large corporations ($510 billion), of which $454 billion will support loans to corporations, states and municipalities through a Federal Reserve facility and $29 billion will be loaned to airlines. The Federal Reserve will be providing massive support to all sectors of the economy by financing the purchase of loans, whose collateral terms will be relaxed. (For some reason, large corporations receiving aid were not required to offer paid sick leave to their furloughed employees.)
- Loans and other assistance to small businesses ($377 billion)—also known as the Paycheck Protection Program (PPP)—as explained below. Congress has already begun to debate an expansion of this program.
- Support to transportation providers and industries ($72 billion), including $33 billion to airlines and their contractors to avoid furloughs and pay cuts.

Other expenditure programs to support critical infrastructure and public services

- Grants and other assistance to hospitals and other medical facilities (at least $180 billion)
- Assistance to state and local government ($150 billion)
- An increase in FEMA's disaster assistance fund ($45 billion)
- Increased education spending (at least $32 billion)
- Other (at least $25 billion)

Tax measures

- Corporate tax reductions (mainly increased interest and operating loss deduction allowances ($210 billion) and payroll tax reductions for businesses that retain workers at a loss (an additional $55 billion)
- Personal tax reductions ($20 billion)

The stimulating effect of the tax relief for businesses is highly uncertain. It is unlikely to result in anything close to a dollar-for-dollar increase in investment. Its effect on decisions to retain workers is also uncertain. As noted in my March 26th **column**, the direct payments to taxpayers are not well targeted to those in need. No money is provided for non-filers, who are among the most vulnerable. The effect of that provision is therefore hard to predict.

Rescuing small businesses and their employees—the United States contrasted with Europe

In the U.S., small businesses are being offered loans through the banking system and the Small Business Administration (SBA). The loans will be converted to grants if the recipients keep all of their employees on the payroll for at least eight weeks, even if they are not working. Funds may also be used to cover rental payments and other operating costs.

Small businesses will need assistance along the lines of the PPP to cover the wages and salaries of their employees, if these are not to be laid off, and to pay for their employees' health insurance. Unemployment insurance will help support workers who have been laid off, particularly the low-paid, but will not pay health insurance premiums. Small businesses will also need help with rental and mortgage payments, property tax, and certain other expenditures.

Some prominent American economists and economic journalists have criticized this approach as being too indirect, and unlikely to prevent the permanent closure of many businesses. They contrast it with the approaches of the United Kingdom and Denmark, where the central government *directly* supports firms that retain their workers by paying a very high share of their wages, while also providing money to make rental and mortgage payments for other obligations.

In the United Kingdom, private sector workers will receive 80% of their pay, and in Denmark 75%. Canada has also just approved legislation that will provide funds to businesses to pay up to 75% of their employees' salaries to keep them on the payroll.

The success of the U.S. approach will depend on how quickly and efficiently the program can be implemented. Similarly, relief to laid-off workers, including the self-employed who are now without work, will depend on how speedily their states can handle the huge increase in UI claims. Many or most of those workers who do not remain at least nominally attached to their employer will lose their health insurance, although furloughed workers are an exception.

It would be grim indeed if large numbers of small businesses proprietors were forced into bankruptcy. Unlike London during the blitz, however, the pandemic will not destroy physical premises. Their businesses can in principle be reopened, possibly by new owners. That said, they might well be shuttered for some time even after the pandemic has done its worst. Large-scale bankruptcies obviously have to be avoided, and the economic and social consequences of the associated unemployment would be dire.

The United Kingdom and Denmark have important advantages in implementing their approach. In particular, they are both highly centralized. The U.K., the devolution of some governmental responsibilities to Scotland and Wales notwithstanding, is a highly centralized country. It has only one UI administration, as does Denmark, which has the added advantage of being very small. Its labor market is about one-thirtieth the size of the U.S. labor market.

In addition, in neither country does unemployment spell the end of health insurance. Canada’s federal system is in some respects like that of its giant neighbor, but UI is centralized, which is easier because of Canada’s much smaller population. The more flexible character of the U.S. labor market may have one notable advantage over Europe: workers can more easily move to those few sectors where labor demand is growing, like delivery services and health.

The U.S. cannot remake its institutions into a European model overnight, even if there were sufficient public support for so great a political and constitutional sea change. It must work with the institutions it has. Every effort has to be made to make the loans program work.

News reports speak of banks’ being swamped by requests, and processing only applications from established customers. Banks themselves are also reported as needing more guidance. The states differ in their ability and perhaps their eagerness to process UI claims, and news reports suggest that some states are definitely behind the curve.

Federal legislation may be needed to prevent the loss of health insurance by the unemployed. There is no good reason for the exemptions of large corporations from offering paid sick leave. On the plus side, the direct payments to households from the IRS have started to flow.

The pandemic will inflict staggering losses in life unless the stay-at-home rule is rigorously enforced for a sufficient time. That said, a prolonged absence of workers from the workplace, necessary as it is, is bound to have a heavy cost in purely economic terms and in personal misery.

The writer, a naturalized citizen born in Nova Scotia, believes that the pandemic has made clearer than ever the inequities and inefficiencies of his adopted country’s social safety net and health insurance system. If this period of agonizing trial can lead to genuine reform, perhaps we may say that the blood, sweat and tears (to borrow Winston Churchill’s famous words in 1940) of our most vulnerable citizens will have not been entirely in vain.

The author was founding editor of the Journal of Retirement *and a former International Monetary Fund official. He would like to thank Dallas Salisbury, Allison Schrager and Elaine Weiss for valuable comments. He alone is responsible for any remaining errors of fact or interpretation.*