The Heritage Foundation

BACKGROUNDER

No. 3477 | MARCH 17, 2020

The "Third Inning": Next Steps for Congress in Addressing the Coronavirus

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KEY TAKEAWAYS

The robust federal response to the coronavirus so far has been appropriately targeted to public health and alleviating economic effects.

Congress must give these robust responses time to work and resist exploiting the crisis to bail out politically connected interests.

The third coronavirus package should include improvements that will provide incentives to aid public health efforts.

The pandemic associated with Covid-19 has significantly disrupted daily life in virtually every country over the past few months. As the number of reported cases in the United States has increased, Congress has passed an emergency appropriations bill, and the House has passed a bill providing tax relief for paid leave as well as additional resources for social programs aimed at alleviating the spread of the disease and any economic consequences of the epidemic. In addition, the Federal Reserve has taken a number of actions to prevent the coronavirus epidemic from leading to a broader economic breakdown.

The federal budgetary impact of the coronavirus and cost to private employers are likely to be substantial. Until now, the federal response has been appropriately targeted to public health and directly alleviating the economic effects of the coronavirus.

However, a number of other things should be done to improve on the measures already taken.

As Congress debates further action, the Senate should make several changes in the House-passed Families First Coronavirus Response Act to improve the public health response while mitigating the economic effects of the virus. These include expanding the tax credit to apply to businesses with more than 500 workers and to all persons who cannot reasonably telecommute in an epidemic area, as well as to employees of businesses required to shut down or significantly slow down operations per government orders and recommendations. It should also apply to businesses that need to reduce the number of employees who perform work or the hours of employees performing work. Furthermore, additional flexibility should be provided for states to receive federal assistance to respond directly to the public health challenges.

In addition to these amendments to the House bill, Congress could also create a program that allows the federal government to prepay anticipated future expenses for airlines, hotels, restaurants, and other businesses directly affected by the coronavirus epidemic to help mitigate the fall in revenue that is associated with people having to change their behavior dramatically over a limited period of time. Finally, there are several tax changes that Congress should enact that would help businesses by allowing income taxes to be smoothed over the business cycle while delaying payments.

Economic Consequences of the Coronavirus

Coronavirus disease 2019 (COVID-19) originated in Wuhan, China, in late December 2019.[1] It is a disease caused by a new coronavrirus.[2] There are now confirmed cases in every major country in the world. The virus has spread rapidly even in such developed countries as Italy, South Korea, France, and Germany.[3] On February 26, 2020, the first case of unknown origin was announced in the United States.[4] As of March 17, 2020, there were 3,487 (Centers for Disease Control and Prevention) to 4,661 (Johns Hopkins University) confirmed cases in the U.S.[5] Forty-nine states have reported cases along with the District of Columbia, Puerto Rico, Guam, and the U.S. Virgin Islands.[6] There are undoubtedly many more actual cases, and the disease continues to spread.

The potential economic effects associated with the coronavirus epidemic are substantial. Fears over the epidemic have already had a substantial adverse impact on financial markets globally. The Dow Jones Industrial Average, for example, has declined by about 31 percent in the past month and has exhibited a great deal of volatility.[7] Travel to the U.S. from Europe and China has been shut down. The crisis has substantially affected supply chains, oil prices, travel and tourism, restaurants, conferences, and sporting events.[8] It has resulted in a substantial increase in sales of staples and products that people believe will enable them to deal with virus-related disruption.[9] It has resulted in widespread school and university closures.[10] In many states, large public gatherings are now prohibited. Many workplaces in the U.S. and throughout the world have been effectively closed. Very large numbers of people in the U.S. are now telecommuting. Extended business closures and supply chain disruptions increase the likelihood of a recession, although many of the existing efforts are aimed at helping businesses to maintain employment even as their sales suffer.

At this stage, a number of issues that are specific to the coronavirus pandemic should determine the appropriate economic policy response.

First, the disease does not seem to have a substantial effect on the mortality of young people or working-age adults. Therefore, unlike the 1918 influenza pandemic that disproportionally affected men and women between 15 and 44, the coronavirus pandemic is unlikely to have the same long-term effects on labor supply, wages, or human capital.[11]

Second, the trouble with using traditional fiscal policy tools during the coronavirus pandemic is that there is a binding constraint on labor. In other words, people are out of work because they either are sick or must stay home. While the situation could change, people are currently much less likely to be out of work because they do not have jobs. Therefore, it is important for Congress to maintain a targeted response that helps to stop the spread of the virus, addresses the current economic difficulties appropriately, and avoids making the economic situation worse.

The Federal Reserve's Response to Date

Starting on March 3, 2020, the Federal Reserve has taken several powerful measures to prevent the coronavirus epidemic from leading to a broad economic slowdown. First, the Fed announced an emergency 0.5 percentage point (50 basis point) cut in its main interest rate target. This decision brought the federal-funds rate target to a range of 1 percent to 1.25 percent.[12] The Fed made this move two weeks ahead of its regularly scheduled policy meeting, and it was the first time since the 2008 financial crisis that it has changed the rate target between scheduled meetings.

Next, on March 12, the Fed announced plans to inject an additional $1.5 trillion into short-term credit markets through its repurchase agreement (repo) operations.[13] As Bill Nelson, former Deputy Director of the Federal Reserve's Division of Monetary Affairs, has pointed out, the amount injected could actually end up being as large as $4.5 trillion.[14] Separately, the Fed also announced that it would start buying Treasury securities of all different maturities, as opposed to only short-term notes. As of March 12, the Fed planned to conduct purchases across 11 different maturities.[15]

Then, in a surprise move on Sunday, March 15, the Fed announced that it would cut its target for the federal funds rate even further, bringing the target to a range of 0 percent to 0.25 percent.[16] The Fed further announced that it would conduct a new round of quantitative easing (QE), resulting in purchases of up to $500 billion in Treasuries and $200 billion in mortgage-backed securities.[17] Separately, on March 15, the Fed also announced several other moves meant to support the flow of credit in the economy.

Thus, in a little over a week, the federal government has committed to spend well over $100 billion on efforts to combat the coronavirus and committed to purchase around $700 billion in assets from investors.[18] These commitments are in addition to other Federal Reserve efforts to provide more than $1.5 trillion in additional liquidity support to enable financial firms to continue meeting the credit needs of customers.

First, the Fed cut the main lending rate at the discount window, an avenue that provides loans to banks directly from the Federal Reserve. Specifically, the Fed cut the main discount window rate (the primary credit rate) by 150 basis points to 0.25 percent.[19] Simultaneously, the Fed extended the term on discount window loans, allowing banks to borrow from the discount window for as long as 90 days with loans renewable by the borrower on a daily basis.[20] Next, the Fed announced its explicit support for financial firms to use their own liquidity and capital buffers,[21] an important change given that the use of these buffers would otherwise trigger regulatory scrutiny (or be outright prohibited). Finally, the Fed reduced reserve requirements to zero,[22] thus enabling banks to get even more liquidity into the economy.

Congress's Fiscal Response

On March 6, 2020, Congress passed the Coronavirus Preparedness and Response Supplemental Appropriations Act, 2020, appropriating $8.3 billion to address the needs of public health officials for additional resources.[23] On March 13, the President declared a coronavirus disease–related national emergency, which is expected to provide access to up to $50 billion in federal financial assistance for states, localities, and territories.[24]

On March 14, the House passed the Families First Coronavirus Response Act (FFCRA)[25] with bipartisan support and support from the President. The Senate is expected to take up this legislation quickly. This legislation will increase federal spending or reduce federal revenue by well over $100 billion.[26]

These Actions Need Time to Work

While the Fed's actions would likely have been more effective had they all been announced at once rather than strung out over the two weeks leading up to a regularly scheduled policy meeting, the Fed deserves credit for doing precisely what it should be doing in a crisis: getting as much liquidity into the system as possible. However, these actions will undoubtedly take effect with a lag, so it is important for Congress to allow these policy changes to run their course.

It is time for the United States to take a collective breath. The federal response over the past week has been robust. While it is clear that the U.S. economy has suffered a shock, it is far from clear that a recession, which is commonly viewed as two consecutive quarters of negative GDP growth, is likely. That depends primarily on the effectiveness of the public health measures being taken and secondarily on whether the Families First Coronavirus Response Act, as finally enacted, effectively promotes good public health practices that mitigate economic damage.

These actions should be given time to take effect. Traditional monetary policy often takes effect with a lag of at least a few months, and the Fed's actions were announced only a few days ago. It is premature to move on to further measures before we know whether the actions already taken are sufficient to stem liquidity problems associated with fears about the spread of the virus.

The only economic data we have so far reflect the strong reaction of the stock market, but a large drop in stock prices does not necessarily connote the start of a recession. For example, the largest percentage drop in the Dow Jones Industrial Average (–22.6 percent) occurred on October 19, 1987. On the whole, the Dow fell from 2,641 to 1,766 (33.1 percent) over the course of a few months and did not return to its previous level for nearly two years.[27] Yet quarterly real gross domestic product (GDP) and monthly total non-farm employment continued to grow on trend until the business cycle peak in the summer of 1990, nearly three years after the crash.[28]

Good policy is served by good information. We should look to see the effects of previous actions reflected in the economic data before deciding whether further steps are necessary.

What the Third Inning Should Look Like

At the same time, we should look ahead so that if additional measures to stop the virus are required, good policy is ready to be put in place. U.S. Treasury Secretary Steven Mnuchin has said that we are in the "early innings" of the federal response to the coronavirus, using a reference to baseball, which includes nine innings of regular play. The Coronavirus Preparedness and Response Supplemental Appropriations Act, 2020, was the first inning, and the Families First Coronavirus Response Act is the second inning. Both Congress and the Administration have launched discussions regarding a large fiscal stimulus package, to be passed in the next week or two, that will be designed to prevent a recession. This will be the "third inning."[29]

Any policy response by Congress to address the adverse economic consequences of the coronavirus epidemic should be targeted, temporary, and directed at aiding public health efforts. It should not increase spending permanently.

The Senate should amend the Families First Coronavirus Response Act. Division G of the House-passed FFCRA provides a tax credit to employers with fewer than 500 employees equal to 100 percent of the wages paid as sick leave to those on leave due to the coronavirus. The credit is more complex than it should be. It consists of separate credits for 10 days of fully paid sick leave, capped at $511 per day and a total of $5,110 per employee when addressing the employee's own illness and $200 per day and a total of $2,000 when addressing a family member's illness or school or day care closure,[30] and a separate, secondary family leave credit (taking effect after the initial 10 days of 100 percent pay) equal to two-thirds of employees' wages for up to 50 days, capped at $200 per day and a total of $10,000 in aggregate.[31] For employees making less than about $52,000 per year, the credits could provide up to 60 days or 12 weeks of fully paid leave. Individuals with higher income levels would not be eligible for fully paid family leave credits.

Given that the objective of this policy is to achieve social distancing and slow the epidemic, the leave should apply to all persons who cannot reasonably telecommute in an epidemic area, as well as to employees of businesses required to shut down or significantly slow down operations per government orders and recommendations. It should also apply to businesses needing to reduce the number of employees who perform work or the hours of employees performing work.

Because many workers are able to work remotely, at least in part, and others will be asked to cut back on their hours, the credit should allow for partial wage replacement to allow employees still to perform some work (whether remotely or on-site) for which they are paid by their employers while also receiving a credit for the work they otherwise would have performed absent the epidemic. A partial credit could help to limit the reduction in economic activity by continuing the safe production of goods and services while providing additional income to workers who might otherwise receive only partial wages.

Finally, the House-passed bill excludes businesses with 500 or more employees. Such employers often employ lower-wage and middle-wage workers, and their large size does not necessarily mean they have the financial means to provide the equivalent level of sick and family leave that is made available to workers of smaller employers under this provision. These workers could be left behind with little access to paid sick or family leave. The credit already stipulates that employers cannot reduce their existing sick leave policies, so large employers would still bear the initial costs of providing paid sick leave to their workers. All workers, regardless of their employer's size, should have equal access to this credit—including the recommended partial credit for workers who perform reduced work hours.

Extending the credit to larger employers could help some of the big industries, like travel and tourism, which have been most affected by the coronavirus and could eliminate the demand for Congress to provide selective bailouts to those industries. Equal access to targeted tax relief is a far better solution than picking winners and losers.

Division F of the House-passed FFFCRA provides the public with access to coronavirus-related testing during the emergency designation. Specifically, the bill requires, during the emergency designation, that private insurers offering group or individual coverage (including grandfather plans) and government health care programs (Medicare, Medicare Advantage, Medicaid, CHIP, TRICARE, VA, IHS, and FEHBP) cover coronavirus-related testing and services with no cost sharing. This bill also allows states to provide testing-related services with no cost sharing to uninsured individuals through the state Medicaid program and compensates states 100 percent of the costs, and it increases the general federal Medicaid reimbursement to the states during this emergency.

This approach is generally targeted (limited to testing and related services); temporary (policies and funding end with the emergency); and flexible (allows but does not require the states to cover the uninsured through Medicaid).[32] The Senate could provide even more flexibility by allowing states to receive federal funding to serve the uninsured outside of the Medicaid structure, either with a stand-alone grant or through other existing reimbursement mechanisms.

The Senate could also better target the increase in federal Medicaid reimbursement based on state need rather than an across-the-board increase. The across-the-board increase using the Medicaid financing formula is not ideal, and its deficiencies further underscore the need for a fundamental reform of the financing of Medicaid in the future.

Profligate Spending Not Warranted. The fiscal situation for the United States government is grave. Even though the economy is healthy, the federal deficit is projected to remain at $1 trillion in fiscal year (FY) 2021 and steadily increase to $1.7 trillion in FY 2030.[33] The debt owed to the public is projected to increase by 76 percent and increase from 81 to 98 percent of GDP within 10 years.[34] Spending on a subset of programs continues to grow much faster than economic growth, and one in every five dollars spent by the federal government is borrowed.[35]

Emergencies such as the coronavirus further highlight the need for reforms that will lower the growth in federal spending so that resources will be more readily available in such unforeseen situations. Needlessly adding to the debt in the present will dampen growth in the future.

Virtually every interest group in Washington will attempt to exploit the coronavirus crisis to further its interest. The aphorism "Never let a good crisis go to waste" exists for a reason. Congress should not allow the crisis to be exploited by special interests seeking bailouts or special favors or by those seeking to achieve policy aims that are only tangentially related to the crisis. There is no justification for an exercise in profligate spending under the cover of the coronavirus crises.

The Appropriate Scale of the Response. Many businesses will suffer losses for the period during which the public health crisis keeps people from carrying on their ordinary lives. To the extent that those losses are caused by specific government orders making it unlawful for them to carry on their businesses, some relief may be appropriate, but socialization of these losses should be based on the actual demonstrated losses, not on rushed guesses as to the appropriate level of relief.

A Better Way to Provide Additional Support to Businesses. Many businesses are calling for special treatment from the federal government to help them mitigate the consequences of the coronavirus pandemic. As this paper discusses, this creates an environment that is ripe for abuse as virtually every interest group seeks a bailout.

The principal goal of policymakers should be to deal with the direct economic effects of the coronavirus while avoiding handouts to politically favored firms. One way that Congress might achieve this is by allowing the federal government to prepay for some of its planned expenses if businesses are willing to accept a discount. Firms that are tight on cash because of the coronavirus epidemic will receive liquidity to provide some reserve until the infection recedes, and the federal government can reduce its future expenses in a time when its annual budget deficit already exceeds $1 trillion.

The federal government can mitigate problems associated with a reduction in cash flow by paying for goods and services in advance for industries that have been directly affected by the coronavirus epidemic. Firms with an otherwise healthy business facing an unexpected cash crunch would get cash in advance. By tying the cash payment to future purchases, the government can prevent assistance from becoming a handout that pads the wealth of politically connected firms.

More important, such a purchasing arrangement would not be a bailout for irresponsible firms. By buying at a discount, the federal government imposes a cost that should limit the aid to the firms that need it most. Any firm that has enough cash flow to pay its bills would want to wait to collect payment rather than accept a discounted payment now.

Such an advance purchase program should come with several safeguards to prevent it from being abused.

First, the advance purchases should be available only to firms whose operations are interfered with by efforts to fight the virus. For example, the ban on travel from China and Europe has limited flights for airlines, and restrictions on public gatherings have hurt restaurants.

Second, purchases should be limited to expenses already contracted or expected for the next year to prevent unnecessarily adding to the federal debt. The point of the program is to help with cash flow by smoothing the timing of expenses, not to prop up the economy today by burdening the future with additional debt and taxes.

An advance purchase program is not the same as the federal government buying assets to support asset prices. When the government provides liquidity through asset purchase programs, it drives up the price of assets that have fallen in value, possibly for good reason. The purchase benefits whoever can remove a bad asset from their books and transfers the loss in value to the public. The advance purchase program, on the other hand, drives down the price of what the government purchases, creating a situation in which businesses benefit from better cash flow and the government benefits from reduced expenditures.

This is also an option that it is perfectly feasible for the private sector to implement on its own. Many people may jump at the chance to buy a flight or a meal at a discount, even knowing that there will be a few weeks of social distancing before they get to collect on their purchase. The federal government, being a larger purchaser of goods and services, should accommodate any business that is willing to offer a discount for up-front payment.

Congress should also expand access to net operating losses and delay estimated tax payments in order to help mitigate the economic consequences of the coronavirus epidemic. In years when businesses are not profitable, the tax code allows net operating losses (NOLs) or negative profits to be carried forward to future years and used to offset subsequent positive taxable profits. NOLs are a normal part of the tax code that allows businesses' tax liabilities to be smoothed over time. Following the 2017 tax cuts, businesses are no longer able to carry back NOLs to receive refunds on taxes paid in past years. NOL carryforwards are limited to 80 percent of net income. Congress should allow NOLs to be carried back for an immediate refund for two years or more and remove the limitation on carryforwards.

For even more immediate relief for the hardest hit industries, such as airlines and hospitality services, Congress could consider allowing firms to estimate the coming year's losses under the assumption of several months of significant disruptions. These estimated losses could also be carried back for an immediate refund, injecting much-needed cash into struggling industries. Estimated losses and actual loses or profits would be reconciled at the end of the tax year once the immediate economic uncertainties have subsided. This will allow struggling businesses to benefit more immediately from existing safeguards in the tax code that allow income taxes to be smoothed over the business cycle.

Additionally, businesses and individuals not subject to automatic withholding (such as corporations and the self-employed) must pay their taxes in four quarterly estimated payments. Estimated taxes for the first quarter of 2020 are due April 15, 2020. Underpaying estimated taxes can lead to significant penalties. Congress should allow businesses and self-employed workers to delay their estimated tax payments until the Q3, September 15 deadline at the earliest or entirely eliminate estimated tax payments and associated penalties. This delay would give businesses and many independent workers immediate liquidity to bridge the temporary decline in commerce. Treasury can also delay the April 15 deadline for filing 2019 taxes to ease the pressures for those Americans who will owe the IRS money at the end of the year.

Conclusion

There are a number of steps that Congress has taken and can still take to mitigate the economic effects associated with the coronavirus epidemic.

Any action that Congress takes should be targeted, temporary, and linked directly to the coronavirus epidemic in order to address the source of the economic shock while limiting any political abuse that can develop in a moment of crisis. The specific reforms outlined in this paper, if adopted by Congress and implemented, would help to achieve these goals. However, Congress must also resist the urge to overreact while giving the robust fiscal and monetary policy response time to work.

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33. Table 1-1, "CBO's Baseline Budget Projections, by Category," in Congressional Budget Office, *The Budget and Economic Outlook: 2020 to 2030*, January 2020, p. 7, https://www.cbo.gov/system/files/2020-01/56020-CBO-Outlook.pdf (accessed March 17, 2020).
34. Ibid.
35. Paul Winfree, "Causes of the Federal Government's Unsustainable Spending," Heritage Foundation *Backgrounder* No. 3133, July 7, 2016, https://www.heritage.org/budget-and-spending/report/causes-the-federal-governments-unsustainable-spending.