

# Sound Policy Responses to the Economic Consequences of the Coronavirus

*David R. Burton, Norbert J. Michel, PhD, Parker Sheppard, PhD, and Paul Winfree*

## KEY TAKEAWAYS

Any policy response to the adverse economic consequences of the coronavirus pandemic should be targeted, temporary, and directed at aiding public health efforts.

Congress should not exploit a crisis by bailing out special interests or handing out favors to those seeking to achieve policy aims unrelated to the outbreak.

An “epidemic tax credit” for private firms in epidemic areas would help provide flexible paid leave, aid public health efforts, and reduce the risk of infection.

Coronavirus disease 2019 (COVID-19) originated in Wuhan, China, in late December, 2019.<sup>1</sup> It is a disease caused by a new coronavirus.<sup>2</sup> On March 7, 2020, the World Health Organization announced that the global number of confirmed cases of COVID-19 has surpassed 100,000.<sup>3</sup> There are now confirmed cases in almost every major country in the world. The virus has spread rapidly even in such developed countries as Italy, South Korea, France, and Germany.<sup>4</sup>

On February 26, 2020, the first case of unknown origin was announced in the United States.<sup>5</sup> As of March 11, 2020, according to the Centers for Disease Control and Prevention (CDC) and Johns Hopkins University, respectively, there were from 647 to 1,039 confirmed cases in the U.S.<sup>6</sup> According to the CDC, 35 states have reported cases.<sup>7</sup> There are undoubtedly many more actual cases, and the disease continues to spread.

This paper, in its entirety, can be found at <http://report.heritage.org/ib5046>

The Heritage Foundation | 214 Massachusetts Avenue, NE | Washington, DC 20002 | (202) 546-4400 | [heritage.org](http://heritage.org)

Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

The economic effects associated with the coronavirus epidemic are potentially significant. In the United States, they represent an economic shock to an otherwise healthy economy. The response to the coronavirus should be targeted, temporary, and transparent. Any emergency fiscal policy response should link directly to the coronavirus in order to address the source of the economic shock while limiting any political abuse that can develop in moments of crisis. The epidemic tax credit outlined in this paper would achieve these purposes. Should policymakers want to improve the underlying fundamentals of the economy, they should look to other pro-growth policy tools.<sup>8</sup>

## Economic Consequences of the Coronavirus

Fears over the coronavirus epidemic have had a substantial adverse impact on financial markets globally. The Dow Jones Industrial Average, for example, has declined by about 19 percent in the past month.<sup>9</sup> The epidemic has substantially affected supply chains, oil prices, travel and tourism, restaurants, conferences, and sporting events.<sup>10</sup> 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.<sup>11</sup> It has resulted in school and university closures.<sup>12</sup> Even though a great deal has yet to be learned about its effects, the virus has affected workplaces throughout the world.

There have been calls in Congress for the adoption of policies to mitigate these adverse economic effects.<sup>13</sup> The White House is also considering economic policy proposals in response to the crisis.<sup>14</sup>

## Principles of a Sound Economic Policy Response

The coronavirus epidemic has already demonstrated the potential for significant shocks to both the supply of and demand for goods and services that will have far-reaching effects on the economy. However, the coronavirus also exposes parts of the economy that were already in weak financial positions. Therefore, the policy response should focus not simply on alleviating economic outcomes, but rather on containing the source in order to limit the potential negative economic impact.

Congress has just passed legislation designed to address the needs of public health officials for additional resources.<sup>15</sup> 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 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.<sup>16</sup> The debt owed to the public is projected to increase by 76 percent and increase from 81 percent to 98 percent of gross domestic product (GDP) within 10 years.<sup>17</sup> 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.<sup>18</sup>

Virtually every interest group in Washington will attempt to exploit the coronavirus crisis to further its own aims. The aphorism “Never let a good crisis go to waste” exists for a reason. Congress should not allow the crisis to be exploited either by special interests seeking bailouts or special favors or by those seeking to achieve policy aims that are only tangentially related to the crisis.

A good test is to ask whether the policy is something that the government should implement in the absence of an outbreak. If the answer is “yes,” then it is probably not appropriate at the moment. If a policy does pass this test, however, then it qualifies as a targeted response. For example, a payroll tax cut is the type of tool that might address a recession, so it is probably not the best tool to use to combat a pandemic. Moreover, a payroll tax cut does not assist those who help to minimize the public health risk by staying at home rather than reporting to work during the epidemic, and payroll tax cuts have a small impact on the economy because labor supply elasticities are low.

Policy responses that are not targeted are unlikely to help with the epidemic and likely to introduce other problems. The customary arguments in favor of fiscal or monetary stimulus depend on its support of aggregate demand. That is, monetary stimulus can make new investment by firms more profitable, so they purchase new capital goods, and fiscal stimulus enables consumers to spend more. However, the efforts to contain the outbreak will throw a wrench in these policy transmission mechanisms. Businesses are not going to invest in new projects no matter the price if their staffs need to stay at home to prevent infecting others. It is harder for consumers to go on shopping sprees if they are quarantined at home.

Congress must also be careful not to allow any fiscal response to be used by policymakers in the Administration or Congress to distribute benefits selectively in exchange for political support. Linking the fiscal response directly to the coronavirus epidemic will help to combat both of these potential problems.

## The Federal Reserve

The political temptation in a crisis is always to extend and expand “emergency” assistance of every kind. The Federal Reserve has been no exception to this rule. While the record clearly shows that it can successfully provide market-wide liquidity without special emergency lending powers, the Fed also has a long history of focusing support on favored industries.<sup>19</sup> Invariably, these instances have included some combination of (1) direct lending to institutions to which the Fed would not normally lend, (2) purchases of assets the Fed normally would not buy, and (3) providing below-market rates/above-market prices for anyone receiving loans or selling assets. In the wake of the 2008 financial crisis, for instance, the Fed used its Section 13(3) emergency lending authority to provide more than \$16 trillion in loans to financial firms (an amount roughly equal to annual U.S. GDP at the time).<sup>20</sup>

Now, due to fears over a coronavirus pandemic, officials are arguing that Congress may need to expand the Federal Reserve’s ability to purchase a broader array of assets.<sup>21</sup> This approach is unnecessary because the Fed already has all the tools it needs to provide system-wide liquidity, and it is dangerous because the Fed has yet to unwind its unconventional operating framework.<sup>22</sup> Thus, expanding the Fed’s ability to purchase assets runs the risk of blurring the lines between monetary and fiscal policy, increasing the risk of uncontrolled spending.<sup>23</sup>

While Congress can improve the Fed’s ability to provide system-wide liquidity by giving it a single mandate for monetary neutrality,<sup>24</sup> it can safeguard the Federal Reserve’s independence and credibility by revoking Section 13(3) of the Federal Reserve Act and ending the Fed’s ability to make emergency loans. Providing emergency funds through the government should remain a part of fiscal operations so that they remain as transparent as possible and so that voters can hold their elected federal officials accountable.

## Epidemic Tax Credit

An “epidemic tax credit”<sup>25</sup> could serve the function of providing income support for those workers whose incomes are threatened by the epidemic. It would also discourage people from congregating at workplaces where they are likely to contract or spread the disease and would discourage people from going to work while sick because they need income.<sup>26</sup> As proposed, the epidemic tax credit would pay for 90 percent of the costs of providing paid leave to employees who cannot reasonably telecommute and who work in

declared epidemic areas. It would take effect immediately and would not require the delay and expense entailed by the creation of a bureaucracy to administer a program.

In general, businesses are either pass-through entities (partnerships, limited liability companies, S corporations, business trusts) or C corporations. Except in very rare instances, pass-through entities do not pay income tax themselves but instead provide information reports to their owners and the Internal Revenue Service (Schedule K-1s). The business owners report their share of the business's income and other tax attributes (including tax credits) on their personal tax returns. C corporations are "regular" corporations that pay corporate tax at the entity level.

Both C corporations and pass-through entities would receive the tax credit as with other business tax credits. In the case of C corporations, it would reduce the corporation's annual tax liability and the quarterly estimated taxes that they must remit. In the case of pass-through entities, the tax credits would be reported on owners' Schedule K-1 and personal tax return. It would reduce the owners' individual tax liability and reduce the amount of quarterly estimated tax that they must remit. General business tax credits can typically be carried back one year or forward 20 years if a business is unprofitable in the current year.

Under the proposed credit, for purposes of Internal Revenue Code Section 38, in the case of an employer, the tax credit would be an amount equal to the applicable percentage of the amount of applicable wages paid to qualifying employees for a period of up to eight weeks. Because the general business credit applies only to taxable employers, additional language would need to be added to include tax-exempt employers.<sup>27</sup> The applicable percentage would be 90 percent.

Applicable wages would be defined as wages paid to an employee who:

1. Is on leave,
2. Does not come to the workplace, and
3. Performs no substantial work for the employer.

Congress should limit qualifying wages to no more than a specified amount per worker per week. For example, a highly compensated employee, as defined by Internal Revenue Code Section 414(q), earns \$2,500 per week. Alternatively, the level could be set to a specified percentile of wages as determined by the Bureau of Labor Statistics.

A qualifying employee would be defined as an employee of the employer who:

1. Normally performs substantially all of his or her work in a designated “epidemic area”;
2. Is not a part-time employee (as defined in 26 U.S. Code § 4980E(d)(4)(B)); and
3. Cannot, given the nature of his or her employment, reasonably be expected to telecommute.

An “epidemic area” would be defined as any county declared by the Director of the Centers for Disease Control and Prevention as an epidemic area. The Director would be authorized to declare as an epidemic area, for a period of up to 90 days, any county of a state, any territory, or the District of Columbia that has:

1. A substantial number of cases of a communicable disease and such communicable disease is reasonably expected to be life-threatening to at least one-half of 1 percent of those that contract the disease and
2. A person or persons who have been quarantined or otherwise isolated to prevent the introduction, transmission, or spread of such communicable disease,

provided that:

1. A public health emergency has been declared pursuant to 42 U.S. Code § 247d and
2. The Director finds that preventing the introduction, transmission, or spread of a communicable disease will be facilitated by encouraging people not to come to work.

Limiting the credit to wages paid other than pursuant to an existing leave policy would reduce the associated revenue loss. However, this would disadvantage employers with generous leave policies and entails a risk that it would induce employers to provide less generous leave in the future because of the epidemic tax credit. The credit should be effective through December 31, 2020.

Our rough estimate is that this credit would reduce federal revenues by as little as \$2 billion and as much as \$80 billion depending on assumptions about infection rates (determining the number of epidemic areas); the length of time people would be on leave; the percentage of people that could telework; the percentage of employers that would take advantage of the credit; and the weekly earnings limitation adopted by Congress.<sup>28</sup>

## Conclusion

As expected with a newly discovered virus, not much is known about how far it will spread or how long the outbreak may last. Currently, the CDC suggests that the coronavirus epidemic is not widespread in the United States and that most people have a low risk of being exposed.

Just as we are not certain about the extent to which the virus will spread, we do not know how severely the virus will affect the economy. While the stock market has dropped recently in anticipation of temporary disruptions in the supply chain, there are as yet no indications that the coronavirus will result in a change in the business cycle that would suggest the use of broader monetary and fiscal policy tools. The February jobs report solidly beat expectations, and the unemployment rate remained unchanged at its 50-year low.<sup>29</sup> The most recent estimate of real GDP growth came in at 2.1 percent,<sup>30</sup> and the Atlanta Fed's "nowcast" of 2020 Q1 growth is 3.1 percent.<sup>31</sup>

Although the economic outlook could change, the policy response to address the adverse economic consequences of the coronavirus epidemic should be targeted, temporary, and directed at aiding public health efforts. Specifically, targeted policy responses are appropriate when they either prevent the coronavirus from spreading or help those infected by the virus to recover. The proposed epidemic tax credit would help sick workers to take time off while limiting the spread of the virus in workplaces.

**David R. Burton** is Senior Fellow in Economic Policy in the Thomas A. Roe Institute for Economic Policy Studies, of the Institute for Economic Freedom, at The Heritage Foundation.

**Norbert J. Michel, PhD**, is Director of the Center for Data Analysis, of the Institute for Economic Freedom. **Parker Sheppard, PhD**, is Senior Policy Analyst, Dynamic Modeling and Simulations, in the Center for Data Analysis, of the Institute for Economic Freedom.

**Paul Winfree** is Director of and Richard F. Aster Fellow in the Thomas A. Roe Institute for Economic Policy Studies of the Institute for Economic Freedom.

## Endnotes

1. World Health Organization, "Novel Coronavirus (2019-nCoV) Situation Report-1," January 21, 2020, [https://www.who.int/docs/default-source/coronaviruse/situation-reports/20200121-sitrep-1-2019-ncov.pdf?sfvrsn=20a99c10\\_4](https://www.who.int/docs/default-source/coronaviruse/situation-reports/20200121-sitrep-1-2019-ncov.pdf?sfvrsn=20a99c10_4) (accessed March 10, 2020).
2. World Health Organization, "Q&A on Coronaviruses (COVID-19)," March 9, 2020, <https://www.who.int/news-room/q-a-detail/q-a-coronaviruses> (accessed March 10, 2020); Centers for Disease Control and Prevention, "Coronavirus Disease 2019 (COVID-19) Situation Summary," updated March 9, 2020, <https://www.cdc.gov/coronavirus/2019-nCoV/summary.html> (accessed March 10, 2020).
3. World Health Organization, "WHO Statement on Cases of COVID-19 Surpassing 100[,] 000," March 7, 2020, <https://www.who.int/news-room/detail/07-03-2020-who-statement-on-cases-of-covid-19-surpassing-100-000> (accessed March 10, 2020).
4. Johns Hopkins University, "Coronavirus COVID-19 Global Cases by the Center for Systems Science and Engineering," <https://www.arcgis.com/apps/opsdashboard/index.html#/bda7594740fd40299423467b48e9ecf6> (accessed March 11, 2010). As of March 11, there were 10,149 cases in Italy, 7,755 cases in South Korea, 1,784 cases in France, and 1,622 cases in Germany.
5. Sarah Moon, Holly Yan, Jen Christensen, and Christina Maxouris, "The CDC Has Changed Its Criteria for Testing Patients for Coronavirus After the First Case of Unknown Origin Was Confirmed," CNN, updated February 28, 2020, <https://www.cnn.com/2020/02/27/health/us-cases-coronavirus-community-transmission/index.html> (accessed March 10, 2020).
6. Centers for Disease Control and Prevention, "Coronavirus Disease 2019 (COVID-19) in the U.S.," updated March 10, 2020, <https://www.cdc.gov/coronavirus/2019-ncov/cases-in-us.html> (accessed March 11, 2020); Johns Hopkins University, "Coronavirus COVID-19 Global Cases by the Center for Systems and Science Engineering."
7. Centers for Disease Control and Prevention, "Coronavirus Disease 2019 (COVID-19) in the U.S.," updated March 10, 2020.
8. Adam Michel, "Coronavirus Doesn't Change Good Economic Policy," *The Daily Signal*, March 5, 2020, <https://www.heritage.org/monetary-policy/commentary/coronavirus-doesnt-change-good-economic-policy>.
9. "Dow Jones Industrial Average: 1 month," as of March 9, 2020, <https://www.google.com/search?client=firefox-b-1-e&q=DJIA> (accessed March 10, 2020).
10. Jesse Newman and Jennifer Smith, "Coronavirus Snarls Trans-Pacific Shipping and Ripples Through U.S. Business," *The Wall Street Journal*, March 5, 2020, <https://www.wsj.com/articles/coronavirus-snarls-trans-pacific-shipping-and-ripples-through-u-s-business-11583432172> (accessed March 10, 2020); Eric Morath, "Coronavirus Risk Rises for U.S., Global Economies," *The Wall Street Journal*, March 6, 2020, <https://www.wsj.com/articles/coronavirus-risk-rises-for-u-s-global-economies-11583528339> (accessed March 10, 2020); CNN, "How the Coronavirus Is Impacting Sport," updated March 2, 2020, <https://www.cnn.com/2020/02/26/sport/coronavirus-sport-impact-list-spt-intl/index.html> (accessed March 10, 2020).
11. BBC, "Coronavirus: Can You Stop People Stockpiling?" March 9, 2020, <https://www.bbc.com/news/business-51737030> (accessed March 10, 2020); Antonia Noori Farzan, "'It's Been Nuts': Costco's Sales Spike Amid Coronavirus Panic-Buying of Bottled Water, Hand Sanitizer and Toilet Paper," *The Washington Post*, March 6, 2020, <https://www.washingtonpost.com/nation/2020/03/06/costco-coronavirus/> (accessed March 10, 2020).
12. Anya Kamenetz, "More Than 40 Colleges Cancel In-Person Classes in Response to Coronavirus" NPR, March 9, 2020, <https://www.npr.org/2020/03/09/813750481/more-than-20-colleges-cancel-in-person-classes-in-response-to-coronavirus>; Nicole Gaudiano, "Schools Step up Closures amid Coronavirus Outbreak," *Politico*, March 9, 2020, <https://www.politico.com/newsletters/morning-education/2020/03/09/schools-step-up-closures-amid-coronavirus-outbreak-785937> (accessed March 10, 2020).
13. Cristina Marcos, "Congress Debating Ways to Help Boost Economy Hit by Coronavirus," *The Hill*, March 9, 2020, <https://thehill.com/policy/finance/486683-congress-debating-ways-to-help-boost-economy-hit-by-coronavirus> (accessed March 10, 2020).
14. Andrew Restuccia and Kate Davidson, "Trump to Propose Steps to Ease Economic Fallout from Coronavirus," *The Wall Street Journal*, March 9, 2020, <https://www.wsj.com/articles/trump-white-house-officials-to-discuss-coronavirus-economic-response-plan-11583764176> (accessed March 10, 2020).
15. H.R. 6074, Coronavirus Preparedness and Response Supplemental Appropriations Act, 2020, Public Law No. 116-123, 116th Cong., March 6, 2020, <https://www.congress.gov/bill/116th-congress/house-bill/6074/text> (accessed March 10, 2020).
16. 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 10, 2020).
17. *Ibid.*
18. 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>.
19. Norbert J. Michel, "The Fed's Failure as a Lender of Last Resort: What to Do About It," Heritage Foundation *Backgrounder* No. 2943, August 20, 2014, <https://www.heritage.org/report/the-feds-failure-lender-last-resort-what-do-about-it>.
20. Norbert J. Michel, "Dodd-Frank's Title XI Does Not End Federal Reserve Bailouts," Heritage Foundation *Backgrounder* No. 3060, September 29, 2015, <https://www.heritage.org/markets-and-finance/report/dodd-franks-title-xi-does-not-end-federal-reserve-bailouts>.
21. Michael S. Derby, "Fed's Rosengren: Fed Needs to Broaden Assets It Can Buy," *The Wall Street Journal*, March 6, 2020, <https://www.wsj.com/articles/fed-s-rosengren-fed-needs-to-broaden-what-assets-it-can-buy-11583515431> (accessed March 10, 2020).

- 
22. Norbert J. Michel, "The Crisis Is Over: It Is Time to End Experimental Monetary Policy," November 9, 2017, Heritage Foundation *Backgrounder* No. 3265, November 9, 2017, <https://www.heritage.org/monetary-policy/report/the-crisis-over-it-time-end-experimental-monetary-policy>.
  23. *Ibid.*
  24. Norbert J. Michel, "Give the Fed a Single Mandate: Monetary Neutrality," Heritage Foundation *Backgrounder* No. 3367, April 24, 2019, <https://www.heritage.org/monetary-policy/report/give-the-fed-single-mandate-monetary-neutrality>.
  25. Specifically, Congress should adopt a new Internal Revenue Code Section 45T creating an epidemic tax credit.
  26. Another way to help accomplish this goal would be to eliminate regulations that prohibit private wage earners from choosing between overtime pay and overtime paid time off. The Working Families Flexibility Act would eliminate this type of regulation. See Rachel Greszler, "Mike Lee's Bill Would Boost Paid Family Leave Without Growing Government," *The Daily Signal*, April 11, 2019, <https://www.dailysignal.com/2019/04/11/mike-lees-bill-would-boost-paid-family-leave-without-growing-government/>.
  27. This would include organizations exempt under Internal Revenue Code Sections 501, 521, 527, and some others.
  28. The estimate was derived from Bureau of Economic Analysis data in Table 2.2B, "Wages and Salaries by Industry," in U.S. Department of Commerce, Bureau of Economic Analysis, "National Data: National Income and Product Accounts," last revised February 27, 2020, <https://apps.bea.gov/iTable/iTable.cfm?reqid=19&step=2&isuri=1&1921=survey#reqid=19&step=2&isuri=1&1921=survey> (accessed March 11, 2020) making various assumptions, including that the percentage of workers that cannot reasonably telecommute ranges from 50–70 percent, the percentage of workers that would be provided the leave and take it ranges from 10–50 percent, and the percentage of workers in epidemic areas ranges from 10–25 percent.
  29. Jeff Cox, "Job Growth Smashes Expectations for February as Unemployment Falls Back to 3.5%," *CNBC*, March 6, 2020, <https://www.cnbc.com/2020/03/06/us-jobs-report-february-2020.html> (accessed March 10, 2020).
  30. News release, "Gross Domestic Product, Fourth Quarter and Year 2019 (Second Estimate)," U.S. Department of Commerce, Bureau of Economic Analysis, February 27, 2020, <https://www.bea.gov/news/2020/gross-domestic-product-fourth-quarter-and-year-2019-second-estimate> (accessed March 10, 2020).
  31. Federal Reserve Bank of Atlanta, "GDPNow," <https://www.frbatlanta.org/cqer/research/gdpnow.aspx> (accessed March 10, 2020).