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Congress Should Focus on Pandemic Control and Fix the CARES Act for an Economic Rebound

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KEY TAKEAWAYS

Congress must focus on containing the coronavirus through targeted, temporary measures that keep workers attached to employers and avert widespread business failures.

Stimulus spending on unrelated projects would do nothing to reduce the virus's spread and will likely impede an economic recovery.

While the American people fight the pandemic, Congress should resist further policy mistakes and fix problems introduced in the hastily drafted CARES Act.

Sweeping mitigation measures necessary to contain the spread of COVID-19 (a disease caused by a novel coronavirus) are in effect throughout the United States, with most economic activity deemed nonessential by state and local officials shut down to enforce social distancing requirements. At the same time, approximately half of the U.S. population is under an order to stay at home or shelter in place.

The economic ramifications of this extraordinary pandemic response are a direct result of the public health threat. Lawmakers must stay focused on pandemic containment. This includes offering targeted, timely, and temporary measures that keep workers attached to their employers and avert widespread business failures to enable the economy to rebound once the pandemic subsides.

The CARES Act (Public Law 116-136), signed it into law by President Donald Trump on Friday, March

27, 2020, is problematic in several ways outlined in a previous Heritage Foundation paper.[1] The law requires several fixes to ensure that it provides targeted, timely, and temporary relief without undermining the goal of supporting continued employment and without inadvertently prolonging an economic recession.

Stimulus spending with the aim of creating jobs, increasing consumption, or building new infrastructure that is not directly addressing public health threats from COVID-19 is misguided, as well as fraught with opportunities for abuse and special-interest handouts, and will impede an economic rebound rather than help it. Congress should fix problems introduced in the hastily drafted CARES Act, not introduce poorly targeted stimulus measures that will confuse public communication, undermine pandemic mitigation, and distort an eventual economic rebound.

Economic Consequences of the Coronavirus Pandemic

The economic shock of COVID-19 is the result of public fear of contracting or spreading the virus and government-ordered closures of large sectors of the economy to enforce social distancing requirements and contain the spread of the disease. Unlike the financial crisis of 2008, these temporary closures, lost wages, and declines in economic activity did not originate in the financial sector and spread to affect the rest of the economy.[2] Rather, as COVID-19 has spread throughout parts of the United States, the temporary economic decline is a direct result of mitigation efforts to contain a pandemic public health threat. With various quarantine measures in place, the economy has essentially been mothballed and should be ready to pick up where it left off when the pandemic has been effectively contained as long as temporary measures are effective at keeping critical business infrastructure afloat and pre-crisis policy distortions are mitigated: in other words, without allowing the viral contagion to turn into a broader economic contagion.

In February, employers expanded payrolls by 273,000, the unemployment rate ticked down to 3.5 percent, and average year-over-year wage growth was 3 percent—all signs of an economy continuing to expand.[3] The coronavirus recession will likely expose existing weaknesses across the economy, many of which persist from before the 2008 financial collapse and were made worse with hasty and heavy-handed regulatory regimes. Dodd–Frank, for example, expanded the failed regulatory approach that helped to create the 2008 crisis, and it further relied on the federal government to plan, protect, and prop up the financial system.[4] Given the sustained pre-coronavirus economic expansion, many observers agree with former

Federal Reserve Chairman Ben Bernanke that "[t]his is a very different animal from the Great Depression. It's much closer to a major snowstorm or a natural disaster."[5]

At the end of March, weekly unemployment claims jumped from close to historic lows of around 200,000 to nearly 3.3 million—the worst week ever recorded.[6] Many economists and analysts predict precipitous drops in gross domestic product (GDP) while extraordinary pandemic mitigation efforts continue. For example, JPMorgan economists predict that first-quarter growth will be negative 10 percent followed by negative 25 percent in the second quarter.[7] Even if the economy were to get back to normal in a series of weeks (rather than months), it is still very likely that GDP will contract by several percentage points.[8]

Government Response and Relief Efforts

In response, federal and state governments have taken exceptional actions in an attempt to provide relief to affected businesses and individuals and to support extraordinary public health efforts.

First, Congress appropriated $8.3 billion through the Coronavirus Preparedness and Response Supplemental Appropriations Act to address the needs of public health officials for additional resources and to expand the availability of small-business disaster loan assistance. Shortly thereafter, the President declared a coronavirus disease-related national emergency, which made approximately $50 billion in federal financial assistance available for states, localities, and territories. Next, Congress adopted the Families First Coronavirus Response Act, which provides tax relief for paid leave as well as additional resources for social programs, increasing federal spending and reducing federal revenue by well over $100 billion. Most recently, Congress passed the $2.3 trillion Coronavirus Aid, Relief, and Economic Security (CARES) Act.[9] These measures need time to take effect and work their way through the economy.

The Federal Reserve has taken a number of significant actions to keep debt markets functioning,[10] and state governors have embarked on wide-ranging programs to slow infections and facilitate a rapid health-care response. These actions, while problematic in many important ways, have bought public officials time to increase testing, slow the spread of COVID-19, and establish reasonable protocols to reopen the economy.

Following a sudden and steep decline, the recovery still has the potential to be strong, assuming that government policy succeeds in containing the spread of COVID-19 and avoids unnecessary economic distortions.

Good Public Health Policy Is Good Economic Policy

Once shelter-in-place orders are lifted and healthy people can reasonably go back to work, Congress must step back and allow the private sector to lead the recovery. Stemming the spread of COVID-19 is the most important thing Washington can do to help the economic situation. General economic stimulus spending on infrastructure or on any other unrelated issues might very likely impede an economic recovery.

The more than $2 trillion of federal aid in the CARES Act will not create new wealth or serve as a net "stimulus" to the economy. Neither would a more general phase-four package of federal spending. Evidence from the 2008 recovery bills shows that in the best case, federal rescue programs had no effect on—and may actually have crowded out—private activity.[11] Temporary spending increases also tend to shift resources within the subsidized industry rather than resulting in a permanent expansion in the number of firms or jobs.[12] Even if new spending could help in the short run, governments are not well suited to getting new programs up and running quickly. Policymakers looking for quick ways to spend money should remember when President Barack Obama concluded that "there's no such thing as shovel-ready projects."[13] For both practical and theoretical reasons, the results of demand-side stimulus are typically disappointing.

The CARES Act will hopefully succeed at reducing the material harm from a deep government-imposed recession, but policy errors in the legislation will slow the recovery. Congress can mitigate some of the most negative effects of the CARES Act by fixing crucial shortcomings through targeted stand-alone reforms that correct errors introduced during hasty drafting and passage that fail to meet the goals of being targeted, timely, and temporary and focused on maintaining employment and business continuity.

Congress must also allow the existing programs time to reach the businesses and people whom they are targeting for support to be able to assess the sufficiency of the response thus far. Additional spending is not warranted at this point. An additional stimulus package would be misguided, as well as fraught with opportunities for abuse and special-interest handouts, and might impede an economic rebound.

Moreover, government officials should remain consistent in their communications to the public about developments with the novel coronavirus response in the United States and not confuse the American people with mixed messaging concerning an economic stimulus while extraordinary public health efforts that actively depress economic activity remain in effect. Public adherence to enhanced hygiene procedures, social distancing, and reduced economic and social activity relies on a common understanding of the threats that COVID-19 poses and how current measures are mitigating those threats.

Fixing the CARES Act

For Congress to engage in premature negotiations to "stimulate" the economy would only add confusion and could hamper the effectiveness of public health efforts if individuals get the wrong impression about exactly which stage of the coronavirus response is in effect. Consistency across communications among federal and state officials matters a great deal in achieving public compliance with coronavirus threat mitigation. Public officials should stay focused on pandemic control. To this end, Congress should:

- **Fix the unemployment insurance windfall.** Perhaps the greatest failing of the CARES Act is the additional $600 per week federal unemployment insurance benefit, which makes it possible for a majority of Americans to make more money by becoming unemployed than by remaining employed. The "Federal Pandemic Unemployment Compensation" created by the CARES Act vastly expands the group of individuals eligible to receive unemployment insurance benefits. Some of the expansion is helpful, such as including part-time and self-employed workers as well as parents caring for children at home (and who are not eligible for paid sick or family leave because they work for a large employer excluded from paid leave provisions in the Families First Coronavirus Response Act), but eligibility for individuals who quit their jobs as a direct result of COVID-19 is too expansive.

  Section 2102 allows certain employees to receive unemployment benefits if the individual is "unable to reach the place of employment because the individual has been advised by a health care provider to self-quarantine due to concerns related to COVID–19" or "unable to reach the place of employment because of a quarantine imposed as a direct result of the COVID–19 public health emergency" or if "the individual has to quit his or her job as a direct result of COVID–19." This is of particular concern because the CARES Act also provides an extra $600 per week in unemployment insurance benefits through July 31 and extends regular benefit eligibility through the end of 2020.

For many workers, these new unemployment benefits will replace more than 100 percent of their pre-crisis wages—some workers could even earn more in four months of unemployment than they earn in an entire year of employment—creating a strong incentive to leave their employers. This incentive directly counteracts the goal of new tax credits and grants designed to keep people attached to their employers through the crisis.[14] Some workers may be reluctant to stay at work or return to work even if the employer is offering work or paid leave. If they do not return within the loan forgiveness eight-week window specified by the Paycheck Protection Program for small-business forgivable loans, the employer will see its loan forgiveness ratio substantially affected. There will also undoubtedly be employers that make paid leave payments after receiving a small-business loan (since the cost will be forgiven and effectively paid by the federal government) to employees that are also receiving unemployment compensation under the relaxed rules. It is not clear how these double payments will be reconciled or prevented.

Already, workers are walking out of their jobs, and employers are laying off workers that they otherwise might have been able to retain (including through the small-business Payroll Protection Program included in the CARES Act) because it is in all parties' short-term interests to do so. If Congress does not fix this provision, it is possible that unemployment could be twice as high as it otherwise would have been, the downturn will inevitably turn into a deeper recession, and the economy will not spring back into action once the temporary health crisis subsides.

Congress should fix this potential catastrophe by capping the $600 added federal benefit so that workers do not receive more than 100 percent of their previous earnings for becoming unemployed. If quick distribution of benefits prevents administrators from enforcing a cap immediately, workers' future checks could be adjusted over the following weeks to bring benefits within 100 percent of previous earnings.

Alternatively, Congress could maintain the additional $600 per week provision and give state governors the authority to cap the benefit at 100 percent of workers' previous wages to minimize the harm to their state economies and budgets from excessive unemployment and a lack of workers to bring production back online.

- **Tighten eligibility for the Paycheck Protection Program.** The CARES Act provides for up to $349 billion in small-business lending and up to $500 billion in lending to larger businesses, states, and municipalities.[15] The small-business lending program, known as the Paycheck Protection Program,[16] dramatically increases the scope of the Section 7(a) Small Business Administration (SBA) lending program.[17] Banks and other financial institutions administer this program and receive fees for doing so.

  The CARES Act increases the size of the Section 7(a) loan program by a factor of 10,[18] and the loans will not be underwritten based on creditworthiness. In most cases, small businesses will be able to obtain loans by dealing with their regular banks. In general, any business, 501(c)(3) tax-exempt organization, or veterans organization with 500 or fewer employees will be eligible for the small-business loans.[19] The federal guarantee percentage is increased to 100 percent.[20] Neither personal guarantees by business owners nor collateral are required.[21] The loans have an interest rate of 1 percent and a term of two years; initial payments are deferred six months.[22] In general, subject to a $10 million cap, loans can be for up to two months of average monthly payroll costs from the year preceding the loan plus an additional 25 percent of that amount.[23]

  To the extent that the loan is used to pay for wages,[24] paid leave, health or retirement benefits, rent, interest on an existing mortgage, or utilities during the eight-week period after a business takes out the loan, it will be forgiven.[25] The cost of employer payroll taxes will not be forgiven.[26] Importantly, the amount forgiven will be reduced if the number of employees in the eight weeks following the loan is less than in previous years.[27] If the employee count has declined, the forgiveness amount is reduced by multiplying it by the ratio of (a) full-time-equivalent employees per month during the eight weeks following the loan to (b) the average number of full-time-equivalent employees per month employed by the business during the period beginning on February 15, 2019, and ending on June 30, 2019 (or, at the business's election, January 1, 2020, and ending on February 29, 2020).[28] Thus, generally, a business that laid off 60 percent of its workforce (or if they quit) and did not rehire them immediately after receiving the loan would be eligible for forgiveness of only 40 percent of its loan. The forgiven amounts will not be treated as income from discharge of indebtedness.[29]

In the current context, some government support of businesses is appropriate because government has prohibited many businesses from operating and has either encouraged or mandated that their employees and customers stay at home. In principle, however, there should be a closer connection between loan amounts forgiven and a direct adverse economic impact due to the coronavirus epidemic other than a self-certification "that the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations" of the company.

Under the small-business lending program as written, both small business that suffered massive disruption and those that saw minimal disruption will be eligible for the loans and loan forgiveness. Congress made the not unreasonable determination that time was of the essence and that underwriting criteria would slow the process of getting money to businesses that desperately need it. It is not, however, clear that the forgiveness criteria should be so lax. Requiring, for example, that a business's gross revenues have dropped by a specified percentage to be eligible for loan forgiveness or that forgiveness be based on a sliding scale of declines in either gross receipts or earnings would be fair and would limit program costs.

- **Provide clarification for employers as to who counts as an employee.** To help clarify who is an employee, Congress should specify that the "common law" test of employment applies to the definition of employee for the purposes of counting employees under the CARES Act. This test bases employment distinctions on how much control an employer exerts over a worker. A uniform determination of who is and who is not an employee is important, both for purposes of establishing eligibility for "small business" funds under the 500-employee threshold and also to prevent double-payments on behalf of the same worker. Under the CARES Act, contractors, gig-workers, and other self-employed individuals are eligible for small-business loans as well as pandemic unemployment insurance benefits, so they should not also be included in employers' reimbursable payroll costs.

- **Expand access to payroll tax deferral.** Under the new CARES Act–created Paycheck Protection Program for small businesses administered through the SBA Section 7(a) program, loans turn into cash grants if used to cover eight weeks of payroll and other overhead costs, contingent on maintaining a pre-crisis workforce. Employers who participate in the SBA loan program are ineligible for the CARES Act payroll tax deferral. Small businesses receiving SBA loans should also be eligible for the employer payroll tax deferral since the loans do not cover the cost of payroll taxes. Expanding access to this tax deferral will lower the cost of keeping an active payroll and eliminate one of the many complex interactions between the SBA loans and other tax credit programs.[30]

- **Remove restrictions on federal loans for large businesses.** The legislation authorizes the Treasury to make loans, loan guarantees, and other investments of up to $500 billion in support of large businesses, states, and municipalities.[31] This makes the U.S. Treasury Department one of the largest investment banks in the country. Up to $25 billion is allocated to passenger air carriers, $4 billion to cargo air carriers, and $17 billion "for businesses critical to maintaining national security."[32] Until March 1, 2022, the Secretary of Transportation is authorized to require an air carrier receiving loans to maintain scheduled air transportation service as the Secretary of Transportation deems necessary to any point served by that carrier before March 1, 2020.[33] These loans may not be forgiven.[34] They are subject to significant conditions that reduces their attractiveness.

  For loans to air carriers or businesses critical to maintaining national security, the legislation requires that the government take an equity position in the borrower if its shares are traded on a national securities exchange and either take an equity position or senior debt otherwise.[35] For loans not made to air carriers or national security businesses, the Treasury may but need not take an equity position.[36] It is almost always a bad idea for the government to take ownership positions in private enterprise. It leads to a politicization of decisions that should be left to private actors in capital markets. It also often leads to taxpayer losses when political considerations outweigh economic considerations. Taxpayers can be protected by requiring that Treasury loans are senior debt obligations. The provisions requiring the Treasury to take an equity position as a condition of lending should be repealed.

For all loans under this section, the recipient must agree not to reduce its employment by more than 10 percent below its level as of March 24, 2020.[37] Employees of loan recipients who earned more than $425,000 in 2019 can be paid no more than they were paid in 2019 until one year after the loan is repaid.[38] Stock buybacks and dividend payments are prohibited for the duration of the loan plus one year.[39]

Prohibiting stock buybacks and dividends while the federal loan is outstanding is justified as a means of protecting taxpayers. There is no justification for prohibiting the payment of dividends or stock buybacks after the loan has been repaid. The provision allowing the Secretary of Transportation to force carriers to maintain routes that may be uneconomic for as long as two years should be revised. These determinations should be made by competitive markets, not political appointees or bureaucrats. Moreover, forcing carriers to maintain uneconomic routes is a recipe for their being unable to repay the loans. Once the crisis has abated, the Secretary should not have this authority.

Finally, requiring employers that may suffer significant business reversals not to reduce their employment by more than 10 percent for as long as the loan is outstanding may make it impossible for them to repay the loan or once again become profitable. This provision should expire after a set period (for example, one year). Once the coronavirus crisis has ended, we need to allow businesses to right-size if necessary.

- **Allow temporary student loan forbearance to expire as scheduled and remove the new subsidy.** The CARES Act suspends all student loan payments and accruing interest on federal student loans for six months. This avoids blanket loan forgiveness and enables borrowers who are currently having trouble paying their student loans due to coronavirus-induced unemployment to qualify for interest-free forbearance. This temporary policy should expire as scheduled; otherwise, it would provide a backdoor cancellation of student debt for all borrowers. The CARES Act also allows employers to make tax-free payments toward employee student loans through the end of the year. This represents a new expansion of federal subsidies for college debt that disproportionately helps families who are better off financially, burdening noncollege-educated Americans, and should be removed.[40]

- **Expand access to 529 savings accounts.** While millions of children—and their parents—are experiencing homeschooling for the first time, Congress should allow Americans to access their 529 savings plans for homeschooling expenses. Those 529 savings plans are tax-neutral savings accounts funded with after-tax dollars contributed by the account owner or anyone else who wishes to put money into them. Anyone can contribute to a designated beneficiary's 529. Interest that accrues in the fund is tax-free as long as funds are put toward K–12 and higher education expenses. That means that there is no "second layer" of tax on the savings and investment in the account. Withdrawals from 529 savings accounts for qualified education expenses are not included in taxable income.

  Currently, 529 saving plans can pay for a broad swath of education-related costs, such as college expenses and, more recently, private elementary or secondary school tuition in certain states. Yet homeschooling expenses are excluded from the eligible uses of 529 savings accounts. Immediately expanding qualified expenses to include homeschooling—reflecting the fact that nearly every American family currently has to homeschool as a result of COVID-19—would be a timely and targeted policy. While Congress prudently expanded access for people to withdraw their retirement accounts without penalty for COVID-19–related expenditures, lawmakers should not neglect to provide relief for parents and students.

- **Focus on pandemic response and relief.** A stimulus package designed to increase spending will have limited effect in the face of sweeping mitigation measures that have shut down most economic activity deemed nonessential. Nor will stimulus spending on unrelated projects do anything to reduce the spread of the novel coronavirus, which is the primary cause of economic contraction. Lawmakers must stay focused on containing the pandemic through targeted, timely, and temporary measures that keep workers attached to their employers and avert widespread business failures. These policies will enable the economy to rebound once the response to the pandemic allows for it.

Conclusion

Before moving on to a new stimulus bill, Congress should fix problems introduced in the hastily drafted and passed CARES Act as outlined in this paper. The American people are busy fighting the pandemic and preparing for the eventual recovery. They do not need to fight against easily avoidable policy mistakes at the same time.

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