Government Aid to Business:
Lessons from the COVID Recession

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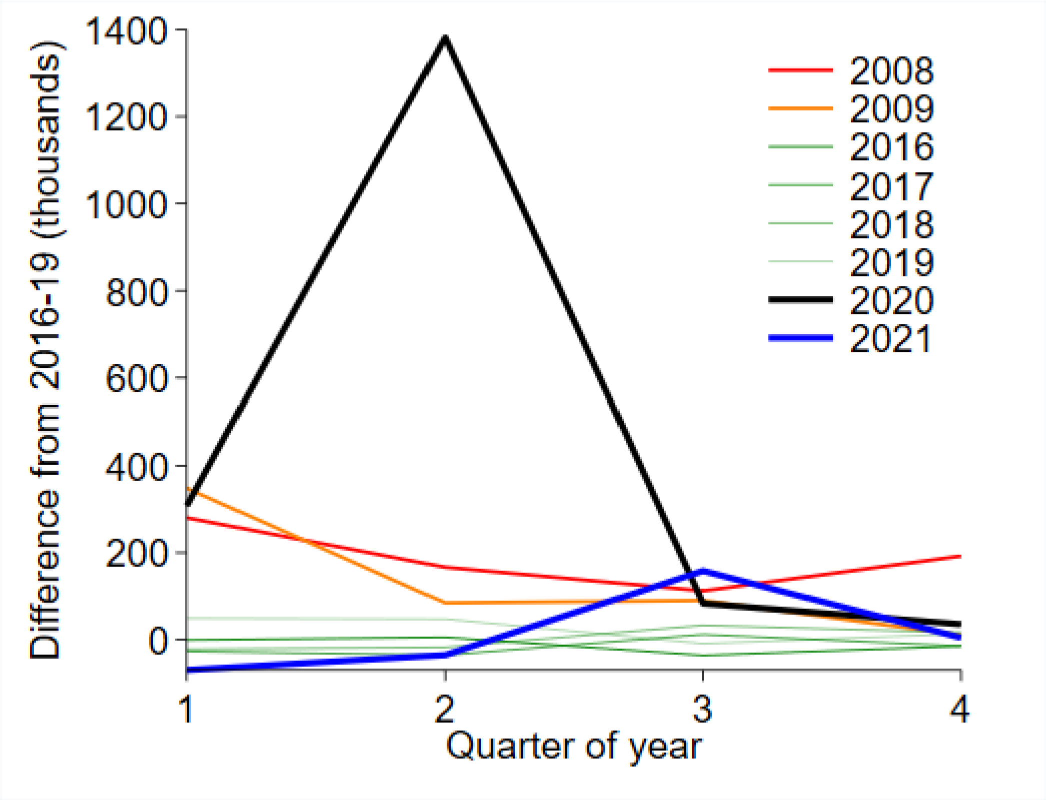
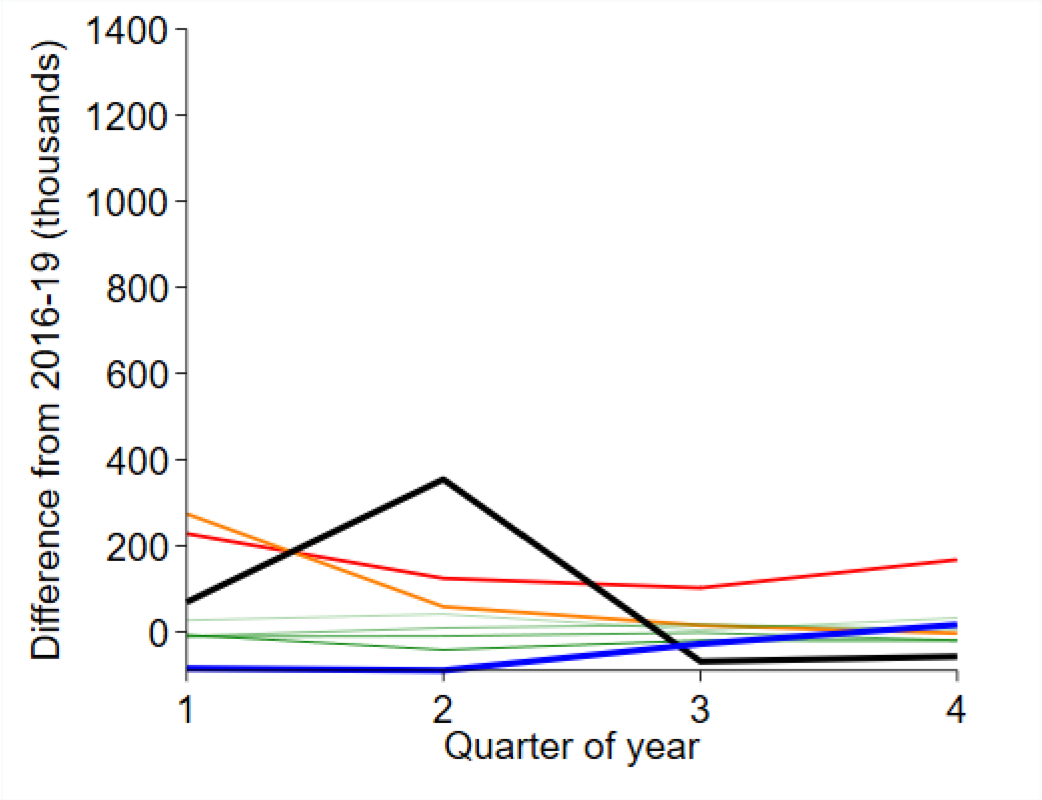
Business Armageddon Risk Real But Avoided

Employment at Temporary and Permanent Establishment Closures Relative to Pre-Pandemic Average

Employment at All Closures



Employment at Permanent Closures



Source: Bureau of Labor Statistics Business Employment Dynamics.

Rationales For Aid to Businesses

1. **Frictions in financial markets.**
   - Bank balance sheet constraints.
   - Asymmetric information about firms and future earnings not fully pledgable to current lenders.

2. **Frictions in labor markets.**
   - Wage rigidity causes inefficient separations.

3. **Externalities.**
   - Labor market congestion.
   - Bankruptcy congestion.
   - Aggregate demand.

4. **Conduit for aid to households.**

5. **Social insurance.**
   - *Ex post* redistribution because no *ex ante* markets for insuring pandemic risk.

Lessons

1. Be clear about **objectives**.
2. **Policies interact** with each other.
3. Target direct aid to **small firms**: bigger bang-for-buck and fewer bucks.
4. No one-policy-fits-all: the **nature of the shock** matters to policy design.
5. Policy can act fast if there is **administrative capacity**.

PPP versus MSLP

- **Paycheck Protection Program (PPP)**:
  - SBA forgivable loan program to firms with less than 500 employees.
  - Amount 2.5xmonthly payroll, capped at $10M (lower in later rounds).
  - Rationale: alleviate borrowing frictions; avoid inefficient layoffs (sticky wages, labor market congestion); aggregate demand externalities.
  - 5.1M disbursements in April-August 2020 totaling $522B (total 12M loans for $800B).
  - 80% of loans under $100K, 1/3 of cost from loans above $1M.

- **Main Street Lending Program (MSLP)**:
  - Federal Reserve facility to support bank lending to mid-size market (<$5B revenue).
  - Standardized terms; banks earn fees and retain 5% of loans, sell 95% to Fed.
  - Rationale: alleviate financial frictions from banking crisis such as in 2008.
  - Total take-up of $17B out of $600B authorized.
  - Low take-up feature not bug in recession where banks remained well-capitalized.

Further Reading

David Arseneau, José Fillat, Molly Mahar, Donald Morgan, and Skander Van den Heuvel (2022). "The Main Street Lending Program." FRBNY Economic Policy Review 28 (1): 58-92.

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Gabriel Chodorow-Reich and John Coglianese (2021). "Projecting unemployment durations: A factor-flows simulation approach with application to the COVID-19 recession". Journal of Public Economics 197: 104398.

Gabriel Chodorow-Reich, Ben Iverson, and Adi Sunderam (2022). "Lessons Learned from Support to Business during COVID-19". In: Recession Remedies: Lessons Learned from the U.S. Economic Policy Response to COVID-19. Ed. by Wendy Edelberg, Louise Sheiner, and David Wessel: pp. 153-179.