Targeting the Paycheck Protection Program to those Most in Need

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To significantly reduce the impact of COVID-19 on small businesses, government stimulus must be targeted towards the most needy.

A part of the $2 trillion stimulus package introduced by the government to tackle the economic downturn caused by COVID-19 is the Paycheck Protection Program (*PPP*) – a $349 billion program targeted at small businesses. The *PPP* provides non-recourse, forgivable, 100 percent federally-guaranteed loans of up to $10 million per business -- including sole-proprietors, eligible self-employed, contractors, and gig economy workers, among others -- with fewer than 500 employees to cover payroll costs, mortgage payments, rent/lease obligations, utilities, and interest on debt obligations existing prior to February 15, 2020.

Initiated with the intention to provide much-needed quick funding for small businesses, Small Business Administration (SBA)-approved lenders are granted authority to make loans under PPP without SBA review. Loans are available for up to a 10-year term at 4 percent interest, up to a year in deferral of principal and interest payments, without personal guarantees, without collateral, and without SBA or prepayment fees. The amount of the loan used for the covered expenses for a duration of eight weeks will be eligible for loan forgiveness if the employer maintains payroll.

While a desirable expeditious step in the right direction, the impact of the *PPP* on the American economy can be significantly enhanced with three simple adjustments.

First, the program must target businesses that are in the greatest need of help. Based on a conservative estimate that small businesses have a 10% profit margin and 90% of the business costs are operating costs, replacing eight weeks of expenses for all small businesses would require a budget of $810 billion. This estimate is based on the work by economists, Glenn Hubbard of Columbia University and Michael Strain of the American Enterprise Institute, for private sector firms with fewer than 500 employees outside the manufacturing, health, education, and finance industries. The *PPP* only has a budget of $349 billion. Given that loans are no-recourse and forgivable, as well with a variety of traditional SBA requirements being waived, there is a high chance of their being sought even by firms not in need, crowding out firms in the greatest need. We, therefore, recommend prioritizing "non-essential" businesses that have discontinued operations in the wake of COVID-19, and also small businesses in sectors most affected by the economic effects of COVID-19. An objective classification of businesses into fraction of jobs that can be done from home is provided by Jonathan Dingel and Brent Neiman of the University of Chicago.

Second, to reach all small businesses across the nation equally, the set of SBA-eligible lenders must be expanded, as already indicated in briefings by the Treasury Secretary. Currently, only SBA-certified lenders -- around 1700, nearly all only banks or credit unions and few non-banks -- are permitted to make the *PPP* loans. Many small businesses rely on smaller banks or non-bank and FinTech lenders for their financing needs. To put things in perspective, in 2018, the total volume of small business loans originated by banks under the Community Reinvestment Act (CRA) was $242 billion while finance companies had $397 billion in outstanding business loans; FinTech lenders had originated $26 billion of loans in 2017. SBA should therefore expand the set of eligible lenders, certainly to all federally guaranteed banks and credit unions but perhaps even more broadly. Non-bank and FinTech lenders are equipped to disburse loans more quickly than traditional banks which could be beneficial at this juncture. The expanded list of SBA-certified lenders should be made available on the SBA website for easy borrower accessibility.

Finally, and especially if the set of eligible borrowers is extended beyond traditional banks, the program requires oversight and lender governance. Under the *PPP*, lenders have been delegated the authority to make loans without SBA review as well as to make a determination on loan forgiveness. Normally, the non-repayment of SBA-guaranteed loans is considered to be a black mark on the lender's performance. However, non-repayment on loans appears to be an intention of the *PPP*. Even if such latitude has been granted in the interest of expediency, without adequate oversight and well laid-out governance standards, sweeping discretion could potentially be abused by lenders, especially as loans are federally-guaranteed. In particular, lenders may prioritize insiders, friends, influential borrowers, or pre-existing relationships whose survival may be the most beneficial to the lender even if these borrowers aren't the most affected by the COVID-19 outbreak.

We suggest a two-pronged approach to tackle such issues. First, guidelines on which sectors or businesses should be targeted can reduce lender discretion. Second, "sunshine may be the best disinfectant" -- the SBA and bank regulators should collect and publish data on all *PPP* loan applications received by the lender along with their approval and forgiveness decisions on a daily basis. Such data can then be scrutinized by outsiders, including forensic scholars, with analytics to determine poor allocations and whether fair lending practices and *PPP* guidelines were followed by the lender; even artificial intelligence could be brought to the table for such analysis. Appropriate fines can be imposed on the lender for egregious allocations and glaring violations, including ineligibility in the future for SBA loans. Such transparency and external scrutiny would be essential to keep lenders in line.

The *PPP*, a bold decision by the United States Treasury, if implemented right, can significantly help reduce the economic impact of COVID-19 and quicken the pace of eventual recovery.