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 in need.

Small businesses are the backbone for job creation in the economy. Today, they need help to survive the COVID-19 crisis, especially in services. Forgone restaurant meals are lost forever, but the restaurants will still be valuable to have around once the outbreak subsides.

It is thus commendable that an important 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 with fewer than 500 employees to cover their reasonable costs as ongoing concerns prior to February 15, 2020. Small Business Administration (SBA)-approved lenders are granted authority to make such loans for up to a 10-year term at 4 percent interest without SBA review and with several traditional SBA requirements waived. There is a built-in deferral up to a year of principal and interest payments and the loan amount used for eligible expenses for a duration of eight weeks can qualify for loan forgiveness if the employer maintains payroll.

So far, so good. Clearly, the *PPP* is a desirable expeditious step in the right direction. However, it could be greatly improved to enhance its impact on the American economy. Here are three areas for immediate improvement.

Get the money to where it is needed the most. 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 small businesses would require a budget of $810 billion, an estimate based on the work by economists, Glenn Hubbard of Columbia University and Michael Strain of the American Enterprise Institute. The *PPP* only has a budget of $349 billion. Given that loans are no-recourse, forgivable, and with a variety of traditional SBA requirements waived, they will likely be sought even by firms not in need. This would unfortunately crowd out firms in the greatest need. Therefore, first and foremost, “non-essential” businesses that have discontinued operations in the wake of COVID-19 need to be prioritized. Small businesses in sectors most affected by the economic effects of COVID-19 can be objectively identified and prioritized next.

Greatly expand lenders to include all banks, credit unions, non-banks, and FinTech lenders. 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, non-banks and FinTech lenders for their financing needs. Their market share of small business loans is sizeable. SBA should therefore expand the set of eligible lenders, certainly to all federally guaranteed banks and credit unions but 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 access.

Strengthen governance to reduce abuse. As the set of eligible borrowers is extended beyond traditional banks, but even otherwise, 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 decide on loan forgiveness, which appears to be an intention of the *PPP*. Such sweeping discretion, even if granted in the interest of expediency, could potentially be abused by lenders, who may prioritize insiders, friends, influential borrowers, or pre-existing relationships whose survival may be the most beneficial to them even if these borrowers aren't the most affected by COVID-19.

"Sunshine may be the best disinfectant" to tackle such issues. 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 researchers, with analytics to determine poor allocations and whether fair lending practices and *PPP* guidelines; artificial intelligence could be brought to the table for such analysis. Appropriate fines can be imposed on lenders with egregious allocations and glaring violations, including ineligibility in the future for SBA loans. Such transparency and external scrutiny would keep the lenders in line.

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