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BROOKINGS CAFETERIA PODCAST

Brookings experts on the $2 trillion coronavirus response package

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P R O C E E D I N G S

DEWS: This is a special edition of the Brookings Cafeteria, the podcast about ideas and the experts who have them. I'm Fred Dews. The U.S. Congress has just passed a $2 trillion economic support package in response to the Coronavirus pandemic. To analyze what's in the measure, a group of scholars from the Economic Studies Program at Brookings linked up in a conference call.

This episode is a replay of that conversation, which was moderated by Senior Fellow David Wessel, Director of the Hutchins Center on Fiscal and Monetary Policy. After his introduction, you'll hear from Jay Shambaugh, Ryan Nunn, Nellie Liang, Josh Gotbaum, and Louise Sheiner.

Shambaugh is a Senior Fellow and Director of the Hamilton Project at Brookings. Nunn is Policy Director of the Hamilton Project and a Fellow in Economic Studies. Liang is the Miriam K. Carliner Senior Fellow in Economic Studies and is affiliated with the Hutchins Center. Gotbaum is a Guest Scholar in Economic Studies and served as Director of the U.S. Pension Benefit Guaranty Corporation, and as Assistant Secretary of Treasury for Economic Policy, and, finally, Sheiner is the Robert S. Kerr Senior Fellow in Economic Studies and Policy Director of the Hutchins Center. Here is David Wessel.

WESSEL: We have a lot to cover in an hour. I'm going to start it off, and then we have five of our colleagues, Jay Shambaugh, Ryan Nunn, Nellie Liang, Josh Gotbaum, and Louise Sheiner are going to talk about specific parts of the Senate passed package. We have lots of stuff on the Brookings website, including the bios of all the speakers. We have a COVID-19 webpage with a cornucopia of material, which I invite you to look at.

I just want to start this off by saying that these are, obviously, extraordinary times. One of the first government indicators to show how severe the recession is, today, we got initial claims for unemployment insurance, 3.3 million claims last week. The previous record set in the recession of 1982 was less than 700,000 claims.

Clearly, this is the tip of the iceberg. More workers will be laid off this week or furloughed, and until the bill working its way through Congress passes, there a number of people without paychecks who aren't yet eligible for unemployment benefits. We have slammed the brakes on the U.S. economy in a very unusual fashion. Output of goods and services in the second quarter was perhaps five percent lower than in the first quarter. That translates, in the way we report these things, into an annual rate of decline that's something like 20 percent. Goldman Sachs said, today, that they expect GDP in 2020 to be $700 billion below 2019, or $1.2 trillion less than we would have had if we continued on trend growth. I don't think anybody knows how long this will last. That depends on how effective our lockdowns and public health system are. There is a lot of optimistic talk that we'll rebound in the second half, maybe, we'll see.

Our goal today is to talk about this bill. Nearly 10 percent of GDP passed the Senate last night. It's likely to pass this—House by the end of the week. It will not prevent the recession. It has three goals, I think. One is there's some money to shore up the hospitals and the healthcare system. Two, it's intended to ameliorate the pain by sending money to people, enlarging a UI and so forth, basically strengthening the safety net, and, three, it's going to keep businesses on life support with loans and grants, so that we can more easily start the economy when this virus recedes.

It has a number of unusual features. There are loans to small business, that Josh will talk about, that will be turned into grants, if they keep people on the payroll. The banks are going to be asked to make loans with unusual conditions to small businesses. You know, the loans are going to be forgiven under certain circumstances. I suspect state unemployment insurance offices are already overwhelmed, and it'll get worse, and the Fed is going to, according to Jay Powell, take the $450 billion, that Congress has given it, to leverage that into $4.5 trillion in loans. The Fed is going to have to do more and do it more quickly than it did during the Great Recession.

We're not going to be able to summarize the whole bill. There are summaries around this, you know, 800 odd pages, but I'm going to start, first, with Jay Shambaugh. I've asked each of my colleagues to speak very briefly, not to try and summarize, but to give us some of the most interesting features. Jay is going to talk about the stimulus checks, Ryan, unemployment insurance, Nellie, about the Fed lending efforts, Josh, about small business, and Louise, about state and local government. So, with that, Jay, I turn it over to you.

SHAMBAUGH: Great. Thanks, David. So, first, let me just reiterate one thing David said, which is, well, I feel like everyone's referring to this as a stimulus bill. It is not a stimulus bill. This is an economic support package designed to cushion the downturn that we know is going to be really sharp. We're not trying to stimulate activity today, as much as support people and lay, kind of, the conditions for a recovery. That being said, the checks are probably the closest piece to something that has stimulus properties, in the sense that the goal there is to provide cushions to people who aren't kind of getting caught by the safety net, on the hand, and make sure there's some purchasing power out there, such that, after we take the restrictions off the economy, people have the capacity to go out and spend.

So, the very rapid-fire summary is $1,200 per person, $500 per child or dependent. Early proposals had it phasing in as you kind of went up the income scale. They got rid of that. So, everyone's getting it, except for maybe the top seven percent or so of households, where it starts phasing out. Maybe top 10 percent is where it starts phasing out, but at least 90 percent of households are supposed to get this money. It's real money, in the sense that I've heard some people say, well, what's $1,000 going to do for me? My mortgage is more than that. A family of four is going to get $3,400. There's a lot of money being disbursed.

The second thing I would say very quickly about it is totals. We think it's in the summaries of the bill they keep talking about, around $250 billion going out this way. I've seen other people run numbers, where they think it might be a little more, so somewhere between $250 and $300 billion going out as fast as possible. This isn't something new. We have done this before. There were recovery checks or stimulus checks in 2001 and 2008. So, this is not some kind of hairbrained scheme, and research suggests it's actually a very effective way to get support to households and support the economy over time.

The very last thing I'll say is, in terms of, if there are any loopholes, it doesn't go to undocumented immigrants, which means it also is not going to U.S. citizen children of undocumented immigrants. Also, there is a concern about how you're going to get the money. So, you may have heard people say when are the checks going out? Well, the people who get the money fastest are the ones who are not going to get it by check. So, if the IRS has on file direct deposit information for you, there is hope, at least, that some people will start seeing money in around three weeks, via direct deposit, coming back, so anyone who got a refund in 2018 or 2019, and got it by direct deposit, and that is actually a large share of households out there. So, there's some hope they can get that money out.

The harder thing is actually figuring out who gets it and how much, and that's both because of the income cap, phasing it out, and trying to match dependents, from my understanding is one of the more complicated pieces. The tricky thing is anyone who did not file taxes. Those people, it looks like, unfortunately, are going to have to, as in 2008, file an informational return, where they don't owe anything, but they're basically just raising their hand and telling the IRS where they are and how to get the money, and the concern there is that can take a while because people have to learn about it, learn that they need to do this, learn how to file an information return when there aren't going to be storefront accountants open or anything like that. So, that part may get complicated, and may actually require non-profits to do some work to try to help people realize they're eligible for this, but the short story is a lot of money going out fast. This is far and away the simplest piece. So, I'll now turn over—back over to David for people to talk about the really complicated things.

WESSEL: Hey, Ryan, do you want to turn to unemployment compensation?

NUNN: So, as David said, we had some really shocking news this morning, that there were about 3.3 million initial claims in the unemployment insurance system, just over the last week, which is almost five times the previous all-time high on record. That 3.3 million number is in some ways an underestimate, actually, because it's reflecting the fact that we have a UI system that is incredibly overburdened.

A lot of folks are trying to apply and are unable to get their application through. We will see substantial additional claims in subsequent weeks, just from that alone, and what we have here, I think, is a system that is a good automatic stabilizer and is a sort of first line of defense for workers. States have moved very quickly, sort of realizing that, even before the legislation that we're talking about today. They've been doing things like relaxing search requirements. Typically, those receiving UI benefits must indicate that they are continuing to search for work. That's something that doesn't make as much sense right now. So, states have, by and large, removed those requirements. They're also moving to expedite the receipt of benefits to remove what's called the waiting week, a one-week period at the beginning, in which recipients wouldn't get any benefits, and they're taking similar actions to try to broaden UI benefits where they can.

The Federal government, for its part, has taken two stabs at this so far. In the Phase 2 legislation that we saw, previously, there was some money for states to kind of pay for administration of the UI system. That money was linked to some encouragements to do a lot of the things I just described, and, so, that's part of what underlies what states are doing on UI.

In the Senate bill, that was passed last night, we have a few different really large changes to the UI system. One is a 13-week extension of benefits, so beyond the regular 26 period that most states implement. The other piece that is quite unprecedented is a really broad expansion in eligibility. So, the legislation provides for those who are self-employed, including gig workers, to receive benefits, those with insufficient hours and earnings experiences, that typically would disallow them from receiving UI, and then the last piece, and perhaps the biggest, is a $600 per week flat add on to the UI benefit that workers receive. So, workers get whatever they were—would previously have been entitled to, which is often about 50 percent of their previous wages, subject to a state specific weekly benefit cap, but then the Federal government is adding on $600 per week. So, this is quite a large amount. The rationale for it is that we are entering a time in which it's going to be extremely difficult, even after the shutdowns have been relaxed for workers to find new work. So, this is something that will eventually provide a stimulus benefit and really helps to smooth those consumption during this really difficult time.

WESSEL: Ryan, can you speak—there's a lot of criticism of this because --

NUNN: Yeah.

WESSEL:—instead of increasing the fraction of workers' wages that are going to be covered by UI, there's a flat $600 a week increase, which means that some people are going to get more than their weekly earnings, and there's some concern that that'll actually discourage people from working.

NUNN: I actually am worried about that. That was what I was going to get to next, actually. I would much prefer an enhancement to benefits that worked through that replacement rate. So, they took that, that replacement rate, that's often between 35 and 55 percent, and boosted it to something, like, 75 or 85 percent. Unfortunately, it seems the state UI agencies cannot quickly implement that sort of change, and, so, that's why they've gone with this flat increase, and it does exactly what you said, David.

For many low wage workers, in particular, that ends up being substantially more than their wages were previously, and I think this is something to be concerned about, in particular, as the experience rated taxes, that employers pay for UI, get relaxed in this period, and as the work, itself, becomes more dangerous and something that workers might want to get away from. So, I think we will need to address this. One way to address it is to subsidize wages, for workers who are in this category, to try to make employment relatively attractive to the UI that they now have on offer.

WESSEL: Okay. Nellie?

LIANG: So, I'm going to speak on the Fed. The Fed's been very busy this week, even before the legislation was passed. They announced large-scale asset purchases for the purposes of promoting market liquidity, in Treasury and agency securities. They committed to buying $375 billion of Treasury securities, this week, if needed, plus more agency securities, and they expanded the portfolio to include agency CMBS, something they've never done. They also announced, and this was Monday morning or Sunday night, a couple of things that go beyond some—the facilities they created in the financial crisis of 2008. Two facilities address credit markets, corporate bonds, and this is something that they had not addressed, specifically, in the last time.

So, there is a new primary market corporate bond facility, where investment grade issuers can issue directly to a SPV, which is funded by the Treasury, through the Exchange Stabilization Fund, and lending by the Fed. There are limits on the size. The maturity is up to four years, but this is a pretty big step forward. They also created a secondary market facility for corporate bonds, which would buy corporate bonds and certain types of bond ETS on the secondary market. They haven't released much in the way of terms of that. We understand they have hired BlackRock to help execute that particular facility. I would mention two other small things. One is they expanded some facilities aid, announced just the week before, to include short-term municipal securities. So, the Tax-Exempt Money Funds, the municipal securities, those funds that are having trouble, that can be addressed through either the CPFF or the MMLF, two facilities it announced the week before.

So, now, the legislation is going to permit the Fed to get more capital from the Treasury. The facilities they've announced, so far, are pretty limited in size. I think they'll probably test how much is needed, but it was $10 billion each, in capital, which, if you took 10 to one, would make it $100 billion. They are now going to have maybe up to $450 billion from government capital in this new bill. There are some limits. I'm just going to mention one thing.

The one program that they announced they wanted to do, which would be yet one more huge step, is a facility for small Main Street lending, small and mid-size businesses, and it's meant to compliment the SBA Program, but the loans will be conditional on retaining your workforce. One, they're going to have to figure out how to make loans to businesses with between 500 and 10,000 employees, that typically don't have access to credit markets. This will be difficult to design. They will need a lot of capital for this. I think they've been told they really want this. So, I think that's going to be the biggest challenge.

WESSEL: Josh, do you want to talk about the small business portion, the— there's two parts of this. There's money at --

LIANG: Yeah.

WESSEL:—the Fed, that the Fed will lend in this so-called Main Street thing, but there's also several hundred billion dollars that's supposed to go through the SBA to lots of banks to small business. Josh?

GOTBAUM: Actually, I think Jay's admonition that this is more a safety net than it is a stimulus bill is really important to reemphasize. As with unemployment insurance, everyone has recognized that small businesses are being shut down. Everyone recognizes that they don't have the same kind of financial flexibility, financial resources, access to credit that larger businesses do, and as a result, there have been already two bites of the apple. The first one that we were over, a week ago, expanded the SBA's emergency loan program and that was a subsidized interest rate loan program operated through local financial institutions, which is the real strength of this system, and what they did is they expanded it beyond small businesses, to include non-profits, because they recognize basically, everybody is shutting down.

The basic theory behind all of these actions is it's going to take a while to get these programs up and running, even in competent organizations, and, so, the first they expect small businesses to do is to rely on their existing credit cards and bank credit cards. Then, they will get access to a variety of SBA and whatever the Fed gets up, Fed loans, and the last piece is tax relief. In terms of the loan program, the initial one was their Disaster Assistance Program, an existing program limited in size, up to $2 million, depending on the age of the business, et cetera. What the bill would—we hope they'll pass tomorrow—will do is it will take SBA's Flagship 7A Loan Program and expand it rather dramatically in a bunch of ways. It will expand the limits. It will enable businesses to access credit with fewer impediments and, most important of all, it is forgivable, to the extent that the funds are used for payroll over the next four months. That is expected to cost around $350 billion in the U.S.

They have also done a series of other measures to help small business cash flow. FICA is going to be deferred for this year and repaid over the following two years. There is, in addition, a separate pool of money to cover businesses that are already borrowing from the Small Business Administration to cover their principle and interest over the crisis period, and there is, in addition, a $10 billion, up to $10,000 per business, Emergency Grant Program, for those that don't qualify for the loan program. So, they're trying to be—in addition, there are some tax measures and things I don't know that we need to talk of. You announced that, --

WESSEL: Right.

GOTBAUM:—but what they are clearly trying to do is to provide a safety net under small business is their primary objective. Their secondary objective is to keep people employed by small business, and that's the reason why the small business—the revised 7A Loan Program is forgivable, which is the—usually the case in SBA loans. It's forgivable to the extent you use it for payroll. You extend—you maintain payroll.

WESSEL: Right.

GOTBAUM: What I would say, however, on that is that even though that's the intent, many businesses are simply not going to be able to do it, which is why the unemployment insurance needs to be so important. What they do hope is that the combination of loan money, tax deferrals, et cetera, will keep these businesses intact, so that they can recover.

The last point I'll make is that, fortunately, the Small Business Administration, A, works through local financial institutions, that—so, it's got an established network of private institutions and, B, it is historically, by the standards of Federal agencies, a more responsible net.

WESSEL: Nellie, can I just ask you one question on what Josh just said? So, the government is telling the banks we'd like you to make loans through the SBA program, we're going to guarantee 100 percent of it, we're going to give you a five percent fee for making the loans, and we're going to forgive these loans, if businesses meet certain conditions. Are banks going to be reluctant to get involved in a program, where they have to decide whether some business has met the conditions?

LIANG: Yeah, that's a big open question, right now. I've been trying to keep up with the legislation. They have put in some language that will protect the lender from either SBA penalties or they'll protect them from the SBA. The question is whether the banks can be protected against lenders, who subsequently claim you gave me a loan and I really had no ability to repay this, that kind --

WESSEL: You mean a borrower? The borrower?

LIANG: Yeah, the borrower. I'm sorry, the borrower. So, there's still some questions, and, so, I think they're working through this because the SBA has only a limited number of lenders that normally do 7A Loans. If they want the entire pool of banks to participate in this, they really have to clarify that they're just a conduit, that they aren't being asked to underwrite and certify that the businesses meet the number of employee requirements or payroll requirements and that kind of thing.

GOTBAUM: That was, in fact, the intent of the amendments to the 7A Program.

LIANG: Be --

GOTBAUM: That's why the SBA guarantee rate, which was normally 75 percent of the corpus of the loan, is now 100 --

WESSEL: Right. That's right.

GOTBAUM:—under the law, will be 100 percent.

LIANG: Exact.

WESSEL: All right.

GOTBAUM: That's why the fee that SBA pays the bank, or the financial institution, has five percent, and, meanwhile, the loan relief is staying at the SBA measure, which is, like seven percent. It's a serious return.

WESSEL: Okay, thanks. Louise, can we turn to state and local governments?

SHEINER: Yeah. So, I think it's interesting, well, how Jay started off because, as I was thinking about it, I think that's right. This is not a fiscal stimulus bill and it's not even a fiscal stimulus bill for state and local governments and I think you could argue that it should have been, for them, because their spending is not going down like individual spending right now. So, state and local governments are likely to be hit very hard by the crisis. They, first of all, have, unlike other recessions, huge increased demands on spending for public health, and that is one thing that the stimulus bill did cover. So, the stimulus bill had $150 billion in health, very strictly related to COVID related spending, from what I read, I don't know personally. It is not very fungible or flexible. So, you shouldn't think of it as $150 billion kitty that can be yours for whatever.

We don't really know how much states and localities are going to be spending on COVID related stuff, but if you look at New York, what they're saying that they've spent already, $15 billion alone, and they're expecting to get 4, the question is: is $150 billion—it's pretty generous, but it may actually be needed for the COVID related health. So, if we think about the state and local situation, in general, they're hit very hard in recessions. If you take the Goldman Sachs estimate, which I think is relatively optimistic, that everything starts to get better in the second half of the year, then I think you're looking at, maybe, $120 billion decline in state and local revenues this year, not counting any increases of spending on Medicaid or other recession related stuff, and more next year. There's nothing in the bill for that.

There was an increase in the Federal Match Rate, already enacted, six percentage points, which is less than we did in the Great Recession, but still above $40 billion, if the public health emergency lasts throughout the year. So, that does help, but I think that there's going to be more needed. There is going to be more stimulus, and, if anything, we'll—what we learned in the last recession is ignoring the state and local sector and not helping them out enough is very bad for macroeconomic stabilization and very bad for the recovery.

Another thing I wanted to mention, that's kind of different and interesting this year, is that the Federal government delayed the tax date for filing your income taxes, that many states have gone along, and I think they all will because they're tied together so much. That means states are out of cash that they were counting on for this year. They can't borrow as easily as the Federal government when the money gets put into the next fiscal year. Some of them can borrow, depending on their rules.

Like, Arkansas already announced that they're going to try to cut spending right away, in anticipation of this, and, finally, at least for the last two weeks or last week, the municipal market reported problems, and, so, that was a real worry, that even these short-term loans were going to be expensive and hard to get. That seems to be getting better, but exactly how states are going to react to this sort of lack of cash immediately and whether or not they're going to cut faster than they had typically have, where they usually cut with a lag, is yet to be seen.

WESSEL: Nellie, is it a big step for the Federal Reserve to start buying municipal bonds? Isn't this something they've resisted in the past?

LIANG: Yeah. First, to clarify, they're not buying municipal bonds, just like they're not buying corporate bonds.

WESSEL: Okay.

LIANG: They are creating a facility, and those securities are being purchased or lent against in that facility.

WESSEL: Okay.

LIANG: So, it is a big step, in part, because the Fed has always, one, viewed municipalities to be government, and that's the role of the Treasury and the Congress to decide how those entities should be funded. Also, in the Federal Reserve Act, they are prohibited from purchasing municipal bonds, it's actually in there, except up to six months notes, so tax anticipation.

WESSEL: Right.

LIANG: So, it is a big step, but they're, again, through a facility and collateral.

WESSEL: Right.

LIANG: They're backing them for now.

WESSEL: With that, I want to thank Ryan, Jay, Nellie, and Louise, and Josh. We will be doing more calls like this. We're experimenting with how best to do it, and I think that, as I mentioned earlier, I'll be trying to figure out if we can get more insight into the details of the small business thing and share them somehow, whether in a conference or in something in writings, since there seems to be so many questions about that and is so interesting.

DEWS: The Brookings Cafeteria Podcast is the product of an amazing theme of colleagues, starting with Audio Engineer, Gaston Reboredo; and Producer, Chris McKenna. Bill Finan, Director of The Brookings Institution Press, does the book interviews, and Lisette Baylor and Eric Abalahin provide design and web support; finally, my thanks to Camilo Ramirez and Emily Horne for their guidance and support.

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