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Keeping Businesses Alive: The Government Will Pay

Emmanuel Saez and Gabriel Zucman

The coronavirus threatens the world's economic life. The most important message that needs to come from heads of state immediately, even before any new law or complete implementation details are provided, is: "Do not lay off your workers or liquidate your business. Government will pay your idle workers and your necessary maintenance costs while you are shutdown. Government money is coming soon."[1] This is crucial to stanch the flow of mass layoffs and business destruction that is already starting. Why is such a measure necessary, and how to implement it in practice?

Social distancing measures, essential to fight the epidemic, are sharply reducing demand in many sectors such as transportation, restaurants, hotels, and entertainment. This direct output loss is expected to be short, probably a few months. It is possible to roughly estimate this loss by summing up output in sectors that are going to shut down (as of writing, nation-wide lockdowns have already been decided in Italy, Spain, and France, among other countries). In the United States, we estimate that the direct output loss will be around 30%. If this direct loss lasts a quarter, the annual GDP loss will be 7.5%—comparable to a very severe recession.

The government cannot undo this direct output loss, but it can alleviate economic hardship during the epidemic and prevent the direct output loss from causing lasting damage to the economy. In other words, the government can prevent a very sharp but short recession from becoming a long-lasting depression. Absent government actions, the direct output loss will create large losses for businesses and will lead to mass layoffs. Many businesses and workers do not have enough liquidity to weather dramatic shortfalls in demand. The risk is to see many businesses liquidate, severely affecting workers' families. The death of a business has long-term costs: the links between entrepreneurs, workers, and customers are destroyed and often need to be rebuilt from scratch; laid off workers need to find new jobs.[2] Keeping businesses alive through this crisis and making sure workers continue to receive their paychecks is essential—even for businesses and workers that have to remain idle due to social distancing.[3]

In the context of this pandemic, we need a new form of social insurance, one that directly helps both workers and businesses. The most direct way to provide this insurance is to have the government act as a payer of last resort so that hibernating businesses can keep paying their workers (instead of laying them off) and can keep paying their necessary bills such as rent, utilities, interest, etc. (instead of going bankrupt).

In practice, the key step is to make sure that cash flows to idle workers and businesses immediately. Payments should be set in the simplest form. Idle workers should immediately start receiving special unemployment insurance benefits so that they are no longer a cost to their employers—even though they stay formally employed—and no re-hiring process is needed once they can come back to work. The unemployment insurance system is already up and running. This makes it possible to compute and deliver compensation to idle workers. Self-employed individuals (such as gig workers) could report themselves as idle and be eligible for this special unemployment insurance. In case of partial idling, unemployment insurance benefits would be prorated. Unemployment insurance benefits are progressive, since they replace a higher fraction of earnings for low-paid workers. This is a desirable feature, as low-paid workers are more likely to be affected by the lockdown (i.e., less likely to be able to work from home) and less likely to have savings to replace a temporary loss in earnings.

In the payer-of-last-resort program we envision, businesses on lockdown would report their monthly necessary costs of maintenance and receive payment from the government. Necessary costs are rent, utility payments, interest on debt, health insurance of idle workers, and other costs that are vital for the maintenance of the business even if the business is no longer operating. For partially shutdown sectors, the government would pay a fraction of the maintenance costs. The amounts don't need to be exact; verification and correction can take place once the lockdown is over. Any excess government payment could be transformed into an interest-free interest loan that the government could recoup over several years.

The key advantage of this policy is that businesses can hibernate without bleeding cash and hence without risking bankruptcy. The reason why such a policy would work in the case of the coronavirus pandemic is twofold. First, it is clear what is driving the shock: a health crisis that has nothing to do with any business's decision and will be temporary. Second, different industries are affected differently. That's in contrast to normal recessions, where the drop in demand is widely spread and has no clear timeline.

Providing liquidity—in the form of interest-free loans, for example—can help businesses and laid off workers weather the storm, but this policy is insufficient. Loans do not compensate businesses and workers for their losses; loans just allow them to smooth costs over a longer time horizon. In the case of the coronavirus crisis, however, it makes sense for the government to compensate businesses and workers for their losses through social insurance so that each business can re-emerge almost intact after the hibernation due to social distancing ends, rather than loaded with a heavy coronavirus debt burden.

How much would such a payer-of-last-resort program cost? Based on national account statistics by industry, we estimate that with a nation-wide lockdown, up to 30% of aggregate demand could evaporate in the US over the next 3 months, leading to a 7.5% drop in annual GDP. Compensating idle workers and necessary business maintenance costs would involve government payments of around half of this total. Unemployment insurance replaces about 50-60% of wages, and essential maintenance costs of businesses are probably less than half of their normal operating costs (for example, non-flying planes do not burn fuel). The total cost for the government would be around 3.75% points of GDP, financed via an increase in public debt. The direct output loss from social distancing measures would in effect be put on the government's tab, i.e., socialized.

Current proposals to deal with the economic consequences of the pandemic do not go far enough or are not well targeted to the ailing sectors. Business loans help businesses but do not compensate them for their losses. Postponing tax payments helps with liquidity but is not well targeted, since it also benefits individuals and businesses not directly affected by the pandemic. Direct payments to individuals (such as $1,000 checks to each household) help alleviate temporary economic hardship but this policy is poorly targeted as well: it's too little for those who lose their jobs, and it is not needed for those who don't. During social distancing, the goal should not be to increase aggregate demand, since people can no longer spend on many goods and services. Unemployment insurance and paid sick leave policies come closest to helping laid off workers and those unable to work, but they do not prevent layoffs and do not help businesses.

A payer-of-last-resort program will work if it is limited in time (e.g., 3 months), so that the cost remains manageable and business decisions are not affected. It would not fully offset the economic cost of the coronavirus. No matter what governments do, there will be real output losses. Even if airlines workers are paid, the plane rides won't happen. For other sectors, supply-chains distortions will happen no matter what, due, e.g., to quarantine measures. But a payer-of-last-resort program would alleviate the hardship on workers and businesses. It would maintain the cash flow for families and businesses, so that the coronavirus shock has no secondary impacts on demand—such as laid-off workers cutting down on consumption—and a quick rebound can take place once demand comes back. Business activity is on hold today, but with an intravenous cash flow, it can be kept alive until the health crisis is over.

Gabriel Zucman *is an Assistant Professor of Economics at the University of California, Berkeley. Contact: zucman@berkeley.edu*

Emmanuel Saez *is a Professor of Economics at the University of California, Berkeley. Contact: esaez@berkeley.edu*

Endnotes

1 Indeed, as we were writing this article, several European countries have moved in this direction, most notably Denmark with its temporary wage compensation scheme and France with President Macron's address on March 16, 2020.

2 This point on direct losses and indirect losses through feedback effects is well explained in Gourinchas, Pierre-Olivier "Flattening the Pandemic and Recession Curves", March 13, 2020.

3 Standard economic models assume zero transaction costs for hiring workers, finding customers, deploying capital, etc. and hence cannot capture the issue at hand well.