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The Company Newsletter for Supply Chain Finance.

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Are COVID19 Economic Stimuli Working in the United States ?: Evidence on the Paycheck Protection Program (PPP).

Escrito por Edgardo A. Ayala G.

Synthesis.

The United States launched major and fearless programs to contain the economic decline from COVID19. In this issue, we reviewed the first scientific evidence about the effectiveness of the Paycheck Protection Program, or PPP, which awarded $ 659 billion to small businesses. The evidence indicates that:

- While the program was successful in distributing such an amount of money in a few weeks, the aid does not seem to necessarily go to the areas where COVID19 raged the most
- The design and implementation of the program itself seems to have caused a ***self-selection*** in ***reverse***, distancing businesses at risk of closure from the program, and motivating loan applications from companies with more medium-term viability.

- This occurred more frequently in loans assigned through commercial banks. The 15% that was distributed through Fintechs helped replace banking where there are not many branches, and compared to banking, it more broadly included racial minorities.

Analysis.

The PPP is an employment stimulus program launched by the federal government of the United States with the intention of maintaining the occupation and workers' compensation due to the repercussions of COVID-19. In two rounds, it consisted of 659 billion dollars (mmd), equivalent to half of Mexico's GDP in 2019, in loans that do not have to be paid if certain conditions are met. The program operates under the supervision of the Small Business Agency (SBA), and consists of credits of no more than 10 million dollars to companies with up to 500 workers, with a term of 3 years in the first round and up to 5 in the of the second, at an interest rate of 1% per year. Companies applied through banks (including Fintechs), most of the loans were for 150 thousand dollars. Loans may not be repaid if two conditions are met: (a) within 8 weeks of obtaining funds, they are only used to cover payroll, mortgages, interest, rents and services; (b) the level of employment and compensation in the applicant company remains at the levels of February (before COVID19).

To apply to the program, no analysis of the financial viability of the company was required, just fill out a two-page application and provide evidence of the payroll. The financial agents involved in the application did not run any risk in granting the credit, the SBA assumed it in its entirety. Under these circumstances, the 349 billion dollars of the first round were exhausted by April 16, 2020, that is, 13 days after being started. Later a second round with 310 billion dollars was approved in Congress. Without a doubt, the PPP is the largest stimulus program in the history of small businesses in the United States.

Were PPP credits allocated to geographic areas whose economies were hit hardest by COVID19? That is, did they hit the mark or did the funds end up in companies that weren't the most affected? Researchers from the University of Chicago and MIT[1] just published results of a study that tries to answer this question. To do this, they contrast exposure to PPP credits by district, with claims for unemployment benefits, hours worked, business closings, and other indicators of economic activity. For the study, they divided the weeks considered into Before COVID19, COVID19-before PPP, After PPP, with the idea of finding a significant difference according to the penetration of PPP credits.

The statistical contrasts they carry out are conclusive; the exposure to PPP credits does not seem to produce any change in the indicators between the weeks before the program was launched and what happened after the credits were assigned. In other words, there is not enough evidence to even affirm that the PPP credits were directed to the areas hardest hit by COVID19.

Why could it be that the most ambitious program in US history to support small businesses did not significantly impact economic indicators in the areas hardest hit by COVID19? Quite possibly for two reasons:

[1] See Granja, Makridis, Yannelis & Zwick (2020). Did the Paycheck Protection Program hit the target? National Bureau of Economic Research, Working paper 27095. Cambridge, Massachusetts.

Resources were not tagged. Any company-bank could apply for the PPP resources, the request was very simple and the first requests obtained the resources until the bag was exhausted. The program did not give any priority to the areas most affected by COVID19, I assume that due to the difficulty of having timely information and the urgency of action. The point is that, by not segmenting it, banks prioritized their customer network, regardless of whether these businesses were the hardest hit by COVID19 or not. The alternative was to incur substantial costs to prospect troubled businesses, which delays the application for resources, with the consequent risk that the application will go unfunded if the fund is depleted first.

The rules for obtaining credit forgiveness. The most attractive part of the PPP credit is not paying it, but for that you had to keep the job and the level of compensation at the level of before COVID19. This is difficult to achieve for a company severely hit by the pandemic, but relatively easy for one that was not as damaged. Let's take an example, a party dress rental business versus a restaurant. After COVID19, both businesses suffer from social distancing, but to a lesser extent the restaurant as it is transformed into a take-out business, instead there will be no parties for at least a year. If the clothing rental business takes 150 thousand dollars from the PPP, as it does not have income from clothing rental during that period, it will have to dedicate all the credit to pay payroll and other services. On the other hand, the restaurant can pay 80% of the payroll with take-out meals, with the credit it pays the rest of the payroll and has enough to create a "mattress" that allows it to pay for the COVID19 crisis. Obviously, the restaurant will be more eager to apply to the program because it knows that it will achieve its forgiveness, instead, the optimal action of the clothing rental establishment is to finally close the business[2].

Apparently, the very foundations of the program first promote the self-selection of businesses and banks, privileging clients of banks that already have a history. Additionally, self-selection is in reverse, those who are truly most affected by the crisis have no prospects of obtaining credit forgiveness, leveraging at 1% per annum in poor profitability conditions is not advisable either. Instead, the PPP motivates more businesses less hit by COVID19, since they can more easily erase credit from their balance sheet in the short term.

Do we think that the PPP program is a failure?, not necessarily. A significant proportion of the companies that received funds from the program will use them to ensure their existence in the medium term. This result is positive. But definitely, the program did not help save the companies most vulnerable to the pandemic from extinction, in this sense, if this was one of its objectives, the program was much owed, especially because it implied a significant increase in debt for the US government.

The lesson is important, in public policy it is common for program results to have unintended consequences. The PPP sought to launch a lifeline to the most shaken businesses, many of them no longer reached it, but those who were in better conditions took it, to the extent that they will surely not even have to pay the loans. The banks partly gained by placing the funds, but many will end up losing, since the companies that obtained funds from the PPP, many of them in a position to demand bank credit, will surely stop borrowing from the banks for a time.

[2] To this must be added that another CARES stimulus program increased unemployment benefits by $ 600, so that up to 68% of the unemployed ended up receiving more income from unemployment insurance than from the salary of the job they lost. To re-establish lost jobs, businesses must surely have increased wages paid See Boar & Mogney (2020). Dynamic trade-offs and labor supply under the CARES Act. National Bureau of Economic Research, Working paper 27727. Cambridge, Massachusetts.

Implications for the Fintech Sector. In a complementary study, Erel & Liebershon (2020)[3], researchers from Ohio State University, examined the role of Fintech companies in the allocation of PPP funds, concluding that: (a) this channel distributed almost 15% of the money; (b) the Fintech allocation occurred mainly in areas with fewer branches of traditional banking; and (c) compared to traditional banking, Fintech loans were directed more intensively to areas with a lower weight of Anglo-Saxon population. The study concludes that Fintech companies replaced banks in an important way, and apparently contributed to **"democratize"** the allocation of these stimuli to the general population.

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[3] See Erel & Liebershon (2020). Does Fintech substitute for Banks? Evidence from the Paycheck Protection Program. National Bureau of Economic Research, Working paper 27095. Cambridge, Massachusetts.