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OPINION | COMMENTARY

Main Street Needs More Fed Help

Right now, getting aid to small businesses is more important than protecting the Treasury's investment.

By Glenn Hubbard and Hal Scott

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Main Street in Annapolis, Md., March 31.

PHOTO: SUSAN WALSH/ASSOCIATED PRESS

The U.S. economy is in free fall. Leading economic forecasters predict as much as an 11% year-over-year decline in second-quarter gross domestic product. Small businesses—those with under 500 employees, which constitute 50% of the workforce and 44% of GDP—have closed their doors and are teetering from illiquidity to insolvency. Depression is around the corner. The priority should be to get funds to these firms to avoid disaster. Unfortunately, the Main Street Expanded Loan Facility, designed by the Treasury and Federal Reserve, will fail to do so.

It wrongfully prioritizes preventing losses over rescuing the economy. The Treasury needs to allocate much more than $75 billion to this program if it is to succeed.

The Main Street Facility is an essential expansion of the $349 billion Congress initially provided to small business through the Cares Act's Paycheck Protection Program—money that ran out Thursday. Lawmakers rightly prioritized saving small business over the substantial cost involved. Most of the PPP loans won't be repaid, because the program forgives loans if borrowers spend 75% on retaining employees. Congress is expected to allot another $250 billion to PPP.

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Saving the country from ruin is worth $600 billion. Yet PPP isn't nearly sufficient to save small business, for three reasons. First, it covers only core expenses like payroll, health insurance and mortgage interest or rent. For many small businesses this won't constitute even half their expenses. Coverage leaves out payments to suppliers, maintenance and loan repayments (including mortgage principal). Second, it covers only businesses with 500 or fewer employees. Third, even $600 billion won't be enough to save all eligible businesses.

Congress recognized these limitations. This is why the Cares Act provided the Treasury with an additional $454 billion to back Fed lending. Secretary Steven Mnuchin and Chairman Jay Powell said this could be leveraged 10 times to provide up to $4.2 trillion of funding, in substantial part to small business.

The Treasury has thus far used $75 billion of the $454 billion to back a $600 billion Fed Main Street facility (at eight times leverage), which will help small and medium-size businesses cover their costs. But the priority has been protecting Treasury's $75 billion investment rather than quickly getting small businesses the loans they need.

The $75 billion backing of a $600 billion program anticipates a maximum loss rate of 13%. This loss rate may be accurate for firms with closer to 10,000 employees. But the smaller and neediest employers will experience higher defaults. To manage the 13% loss rate, the facility requires bank risk-sharing, a $1 million minimum loan amount, interest rates of at least 2.5% to 4% plus 200 basis points of origination fees, and a short (four-year) loan maturity. These features ensure less loss for the Treasury and less borrowing—and thus more bankruptcies of small and midsize businesses. As now designed, it will only serve larger, creditworthy borrowers who may already get funding without the Main Street facility.

Congress should determine how much money the country is prepared to lose. This is a fiscal-policy decision that shouldn't be left to coordinated policy of the Treasury and the Fed. But once that spending decision has been made—as here, to the tune of $454 billion—Treasury should be prepared to spend, and lose, this money to help small business and in turn the economy.

Treasury is still sitting on $215 billion from Congress, which it should immediately add to the Main Street Facility. That would bring total backing up to $290 billion. This amount should enable the Fed to redesign the program to take more credit risk and make it more attractive to risky borrowers. It can do so by buying 100% of the loans on a first-come-first-served basis and improving their terms. The leverage in the expanded program should reflect the expected loss rate of the more generous program. If it becomes clear that actual losses would exceed $290 billion or the leverage provided by $290 billion was inadequate, the Treasury and Fed could go back to Congress for further appropriations, as they've done with PPP.

In 2008, Congress appropriated $700 billion for the Troubled Asset Relief Program, $250 billion of which was used to bail out banks. Congress was prepared to lose those funds to deal with a much less severe threat to the economy than we face today. It turned out the banks were fully able to repay. The money the Fed lent to the financial system, as lender of last resort, was also fully repaid. But the primary goal wasn't full repayment. It was to rescue the economy.

The Government Accountability Office has stated that U.S. output losses associated with the 2007-09 financial crisis ranged from several trillion to more than $10 trillion. Losses from coronavirus will be even higher. We should be willing to spend—and lose—much more than $75 billion in the Main Street facility to help avoid this result.

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