Keeping business alive: The government will pay

By Emmanuel Saez and Gabriel Zucman
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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 implementation details, 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.'

Several European countries have moved in this direction—most notably Denmark with its temporary wage compensation scheme and France with the address by the president, Emmanuel Macron, on March 16th. It is crucial to stanch the flow of mass layoffs and business destruction already starting.

Output loss

Social-distancing measures, essential to fight the epidemic, are sharply reducing demand in many sectors, such as transport, restaurants, hotels and entertainment. This direct output loss is expected to be short, probably a few months.

It is possible to estimate this loss roughly by summing up output in sectors that are going to shut down—nationwide lockdowns have already been decided in Italy, Spain and France, among other countries. For the United States, we estimate that the direct output loss will be around 30 per cent. If this lasts a quarter, the annual loss to gross domestic product will be 7.5 per cent—comparable to a very severe recession.

Government cannot undo this, but it can alleviate economic hardship during the epidemic and prevent lasting damage to the economy. In other words, government can prevent a very sharp but short recession 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 that many businesses liquidate, severely affecting workers' families.

The death of a business has long-term costs: links between entrepreneurs, workers and customers are destroyed and often need to be rebuilt from scratch; laid-off workers need to find new jobs. Keeping businesses alive through this crisis and making sure workers continue to receive their pay cheques is essential—even for businesses and workers that have to remain idle due to social distancing. (Standard economic models assume zero transaction costs for hiring workers, finding customers, deploying capital and so on, and hence cannot capture the issue well.)

Social insurance

In the context of this pandemic, we need a new form of social insurance, one that directly helps 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 paying their necessary bills (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 rehiring 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 (being 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 programme we envision, businesses on lockdown would report their necessary monthly 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 vital for the maintenance of the business, even if no longer operating.

For partially shut-down 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 loan the government could recoup over several years.

Key advantage

The key advantage of this policy is that businesses can hibernate without bleeding cash and hence without risking bankruptcy. There are two reasons why it would work in the case of the coronavirus pandemic.

First, it is clear what is driving the shock—a health crisis which has nothing to do with any business's decision and will be temporary. Secondly, 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 but just allow them to smooth costs over a longer time horizon.

In the case of the coronavirus crisis, it makes sense for the government to compensate businesses and workers for their losses through social insurance. Each business can then 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 programme cost? Based on national account statistics by industry, we estimate for the US that, with a nationwide lockdown, up to 30 per cent of aggregate demand could evaporate over the next three months, leading to a 7.5 per cent drop in annual GDP.

Compensating idle workers and necessary business-maintenance costs would involve government payments of around half this total. Unemployment insurance replaces about 50-60 per cent of wages, and essential maintenance costs of businesses are probably less than half of normal operating costs (for example, non-flying planes do not burn fuel).

The total cost for the government would thus be around 3.75 per cent 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, that is to say socialised.

Not enough

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 would help businesses but would not compensate them for their losses. Postponing tax payments would help with liquidity but is not well targeted, since it also benefits individuals and businesses not directly affected. Direct payments to individuals would help alleviate temporary economic hardship but this policy is poorly targeted as well—too little for those who lose their jobs and not needed by 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. Existing 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 programme will work if it is limited in time (say three 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-chain distortions will happen, no matter what, due for instance to quarantine measures.

But a payer-of-last-resort programme would alleviate the hardship for 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.

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