Economic Policy Institute

EPI testimony regarding Title IV of the CARES Act

Testimony before the United States Senate Committee on Banking, Housing, and Urban Affairs

Testimony • By Heidi Shierholz • June 2, 2020

Chairman Crapo, Ranking Member Brown, and members of the committee, thank you for the opportunity to testify today. My name is Heidi Shierholz and I am a senior economist and the director of policy at the Economic Policy Institute (EPI) in Washington, D.C. EPI is a nonprofit, nonpartisan think tank created in 1986 to include the needs of low- and middle-wage workers in economic policy discussions. EPI conducts research and analysis on the economic status of working America, proposes public policies that protect and improve the economic conditions of low- and middle-wage workers, and assesses policies with respect to how well they further those goals. Prior to joining EPI in 2017, I was the Chief Economist at the U.S. Department of Labor.

Title IV of the CARES Act provides $500 billion in emergency relief in order to support liquidity for eligible businesses, states, and municipalities affected by COVID-19. This assistance has been referred to as "bailouts."

While numerous concerns have been raised about the lending programs in Title IV, the biggest problem with them has arguably not received enough attention: Title IV primarily takes the form of loans, not grants. In an economy where nonessential activity has been largely shut down for an extended period—by a widespread, justifiable fear of contracting a potentially lethal virus and by official lockdown measures—it is not illiquidity that is often the primary problem. Many businesses, states, and municipalities are seeing their revenues drop to such an extent that the real threat they face is not illiquidity, it is bankruptcy. Further, households are facing huge challenges just meeting basic needs in the wake of the shutdown, and having a large tranche of aid that does nothing to directly alleviate their suffering—or to keep them from needing to slash their spending, making the recession worse and the recovery weaker—is a huge missed opportunity.

Relatedly, the $454 billion in this Title that is designated for supporting facilities established by the Federal Reserve to provide liquidity is money that is solely for insuring the Federal Reserve against losses in the event borrowers default on their loans. This is not solving any meaningful *economic* problem. It is likely that, in the end, this money won't even be "spent." It is more likely that the Fed will see gains, not losses, on these loans. This was the conclusion of the Congressional Budget Office in determining that there was no deficit impact from the $454 billion appropriation.[1] However, the implication of no losses on this lending is also that the lending will provide very limited concrete economic stimulus, and instead will simply act as an insurance policy to backstop the normal functioning of credit markets through the pandemic. While this provides some benefit, it means that this $454 billion is not actually going toward boosting incomes and stimulating the economy during this recession. Most destructively, the high "cost" associated with this Title could well have convinced policymakers and the public that substantial aid is being provided and, as a result, reduced their sense of urgency in providing more direct aid.

Any displacement of direct aid caused by the allocation of the $454 billion in this Title would have horrifying consequences for working families. Further, it signifies the continuation of a very damaging theme in policymaking over the past decade or more: Congress outsourcing responsibility for fighting recessions to the Federal Reserve. The tools the Federal Reserve has for fighting recessions have become extremely weak—not just because what is primarily needed now are grants, not loans, but also because the Federal Reserve's main tool, lowering interest rates, doesn't go very far when interest rates are already near zero. The need for major *fiscal* policy in fighting this recession could not be more urgent. But if policymakers and the public are convinced that the Federal Reserve can handle the emergency response and, as a result, a further, massive fiscal response is not forthcoming, we are virtually guaranteed to face an extended depression.

One example of Federal Reserve assistance that is well-intentioned and could potentially support benefits for the broad public, but is fundamentally less effective than its fiscal counterpart, is the Municipal Liquidity Facility (MLF) established by the Federal Reserve under Title IV to help state and local governments better manage cash flow pressures. State and local governments are currently forecast to be facing revenue shortfalls as large as $1 trillion in coming years.[2] These shortfalls demand fiscal aid to state and local governments, and the MLF cannot be viewed as any kind of substitute for grant aid to states and localities. The aid state and local governments need is not loans, but direct fiscal grants that will allow them to close their massive budget shortfalls—shortfalls that will otherwise force them to lay people off and enact deep budget cuts, given their balanced-budget requirements. It would be deeply misguided to argue that the existence of this lending facility means that states don't need direct aid because they can now borrow from the Federal Reserve—as has unfortunately been done by administration officials.[3]

With that said, credit from the Municipal Lending Facility could be of use to states and localities in buying time to manage the fiscal impacts of the pandemic. However, the current restrictive MLF rules will limit its use even for this purpose. The three-year term of MLF loans is much too short. It is extremely likely that states will still be facing fiscal gaps in three years, making them reluctant to use credit that is due at that time. Despite the fact that state and local governments are far more likely to repay loans than private businesses, the three-year MLF loan term is shorter than the four-year loan term granted to highly leveraged companies using the Main Street Lending Facilities, or the five-year loan granted to airlines. Another barrier is the fact that MLF loans can only be taken out through the end of 2020. Because of the level of state budget shortfalls, various state legal restrictions, and the mechanics of state budget cycles, many states will still need to use the facility during 2021. Finally, MLF credit is expensive. It is comparable in expense to what is being offered to private businesses through the Main Street Lending Facilities, despite the fact that municipal credits are far safer than private credits and municipal credit finances key public services. Without changes in these rules, such as those proposed in the HEROES Act, the MLF will be even more severely limited in what usefulness it can provide to states and municipalities navigating the coronavirus crisis.

The public benefits of the private-sector facilities in Title IV are also significantly limited by the notable lack of requirements or conditions that would link loans to the creation of social benefit, the maintenance of employment, or response to the coronavirus pandemic. For example, the corporate credit facilities have apparently *no* requirements for borrowers to maintain employment or payroll or limit executive compensation. This means that companies could sell bonds to the Federal Reserve and use the proceeds for share buybacks or other increases in executive compensation while laying off their lower-paid workers.

Conditions on the Main Street Lending Facilities are also deeply inadequate—for example, companies do not even need to attest that they will make an effort to keep workers; there is simply a toothless statement that companies “should” make “commercially reasonable” efforts to maintain employment.[4] Further, since there are no limits on the types of entities that could use these facilities, it is likely that highly aggressive and sophisticated entities such as large private equity firms will seek out opportunities to channel funding to reward capital owners instead of supporting workers and the response to the pandemic. Such uses of the facilities could effectively loot money from taxpayers. For example, a private equity fund could have a portfolio company borrow money from the Federal Reserve, transfer that money up to the private equity parent in the form of monitoring fees or other payments rather than using it to support employment, and then the private equity fund would not be responsible for repaying funds to taxpayers if the portfolio company went bankrupt.

Given the lack of requirements or conditions that would link loans to the maintenance of employment, disclosure and transparency are profoundly important. Making transaction-level information on the identity of borrowers and the details of specific loans public is a crucial way to help ensure that borrowers use the funds to genuinely support the economy rather than simply seek profits for capital owners. Public transparency will help limit the extent to which companies can misuse funds. The Federal Reserve has announced that it will publish the names and details of participants in its facilities set up in the CARES Act. This effort should be monitored to ensure that the disclosures include detailed transaction-level information such as the identity of borrowers (including beneficial owners of legal entities), the terms of the loans, copies of the underlying deal documents, and the intended use of the proceeds. The CARES Act also imposed some basic oversight of these programs, but given that President Trump immediately began undermining these provisions,[5] Congress should pass stronger oversight provisions.

The major exception in Title IV to the key concern that the Title primarily takes the form of loans, not grants—and also to the concern that the Title places virtually no conditions on the use of the funds—is with the aid directed toward industries related to passenger air travel and cargo air carriers (this is referred to as the “airline bailout”). This aid was largely composed of direct grants, and it included prohibitions on layoffs, involuntary furloughs, stock buybacks, and limits on executive compensation. The conditions could have been even stronger—for example, many airlines are attempting to skirt the conditions by reducing hours and therefore pay—but the conditions have undoubtedly saved many jobs. Unfortunately, the airline bailout was a limited exception to the general approach employed in Title IV of unrestricted loans.

It is also important to note that the outsourcing of rescue policy to the Federal Reserve has tended to channel government assistance toward the wealthiest in our society. The monetary policy tools used by the Federal Reserve work indirectly through support for capital markets, not directly through fiscal assistance to those who need it the most. We have seen this pattern during the response to the COVID-19 crisis, where Title IV of the CARES Act provided enormous support to investors and capital owners. Given that the richest 10% of households control 84% of the total value of stocks,[6] the most direct effect of this support primarily benefited the wealthy. Policymakers must keep this fact at the forefront of their minds in the current negotiations on additional fiscal relief. The federal government must step up to minimize the suffering of low- and middle-income households as a result of the pandemic, as it has stepped up to minimize the negative effect of the coronavirus recession on the wealthy.

Further, if Congress doesn’t step in with substantial additional fiscal relief, the country will almost surely face an extended depression. The official unemployment rate was 14.7% in mid-April, up from 3.5% in February. And even though that is the highest unemployment rate since the Great Depression, it is not actually reflecting all coronavirus-related job losses. In fact, as of mid-April, *only about half* of people who were out of work as a result of the virus were showing up as unemployed. About a quarter were being misclassified—they had been furloughed and should be counted as unemployed and on temporary layoff, but were instead being counted as “employed but not at work.” Another quarter were being counted as having dropped out of the labor force altogether, rather than unemployed. This is because jobless people who have not been furloughed are only counted as unemployed *if they are actively seeking work*, which is currently impossible for many. If all workers who are out of work as a result of the virus had shown up as unemployed, the unemployment rate would have been 23.5% in mid-April instead of 14.7%. And since mid-April, another nearly 18 million workers have applied for unemployment benefits. Typical forecasts predict that the *official* unemployment rate will be around 25% in June, that it will still be in double digits at the end of 2020, and that it will be around 8% at the end of 2021. As a reminder, the highest the unemployment rate ever got in the early 1990s downturn or the early 2000s downturn was 7.8%.

Job loss is occurring across virtually the entire economy, but it is hitting low-wage sectors particularly hard (think restaurants, bars, hotels, personal services, and brick-and-mortar retail). Because of disparate access to education, occupational segregation, discrimination, and other labor market disparities, black and Latinx workers and women of all races are more concentrated in these jobs. As a result, they are facing greater job loss. Further, many people who have managed to hang on to their jobs have seen their hours cut (think of restaurant workers whose place of work is now only doing takeout). The number of people who want full-time hours but are working part time because their employer didn't have enough work for them has more than tripled since the coronavirus crisis began.

The one bright spot in the available jobs numbers is the fact that as of mid-April, about three-quarters of the officially unemployed—and about two-thirds of all workers who are out of work as a result of the virus—report that they expect to be called back to the jobs they had before the coronavirus shock.

Whether they will *actually* be called back or whether those furloughs will turn into layoffs is the fork in the road we are standing in as a nation right now.

If effective public health measures are enacted (widespread testing, contact tracing, self-isolation of those who have been exposed, and mask-wearing), nonessential sectors of the economy that have been shut down will be able to successfully reopen in phases, making it possible for the country to start climbing out of this recession. Simply lifting the lockdowns without these public health measures will not lead to a successful reopening because most people will remain afraid of contracting a potentially lethal virus and will understandably be unwilling to fully reengage in the economic activity that is a prerequisite for recovery.

But that alone will not be enough. If the federal government does not provide sufficient direct aid, then as the economy begins to reopen, confidence and demand will be not be high enough for businesses to actually need to call furloughed workers back, and those furloughs will turn into permanent layoffs.

The most important provision to help generate a rapid recovery is substantial aid to state and local governments. As mentioned above, state and local governments are currently forecast to be facing revenue shortfalls as large as $1 trillion in coming years.[7] Further, due to balanced budget requirements, these governments are tightly constrained from taking on large amounts of debt to maintain spending in the face of this downward shock to their revenues. The result is intense pressure for large cutbacks in public spending by state and local governments in coming years. Such cutbacks would be devastating to the cause of restarting the economy, even if the virus has completely abated. We know how devastating these cutbacks would be because we have lived through the mistake of allowing them to drag on growth in the recent past. The lack of sufficient aid to state and local governments in the aftermath of the Great Recession led to state and local spending austerity that delayed the recovery from the Great Recession by *over four years*.[8] As of mid-April, state and local governments had already lost more jobs than they did during the entire Great Recession. In this crisis, if federal aid is passed that is sufficient to close the enormous revenue shortfalls the economic crisis will cause for state and local governments, it will save 5–6 million net jobs in the public and private sectors by the end of 2021. Without this aid, those jobs will be lost.

It is also crucial to extend the expansions of unemployment insurance that were part of the CARES Act well past their current expiration dates. The modifications the CARES Act made to the nation's unemployment insurance (UI) system are a crucial lifeline for tens of millions of American workers. Aside from temporarily expanding the eligibility criteria for who qualifies for unemployment benefits through the end of the year and providing an additional 13 weeks of state UI benefits, the CARES Act also provided an extra $600 per week in UI payments through the end of July.

This $600 top-up has been fiercely criticized by some since the Act passed, but the criticism is either ill-informed or in bad faith. The extra $600 has been *by far* the most effective part our economic policy response to the coronavirus shock. It is perhaps worth noting that my preference would have been for a 100% replacement rate up to a quite generous maximum benefit, instead of a flat-rate increase. But decades of disinvestment in the administrative capacity of state UI offices left them incapable of flexibly calculating each new applicant's benefit amount with a 100% replacement rate. (Case in point: Most offices are still using the 1970s-era programming language COBOL to run their computers.[9]) State offices *are* capable of administering a flat-rate increase, however. So policymakers in Congress appropriately chose the second-best solution of picking a flat-rate increase in benefits that would leave the average worker (and most workers overall) with 100% of their pre-crisis earnings.

But the necessity of the one-size-fits-all approach means that workers who earned less than the average worker before the crisis will receive benefits that are somewhat higher than 100% of their previous wage. Many conservatives claim this is somehow an economic disaster, but in fact, for the purpose of generating a rapid macroeconomic recovery from this shock, the more money getting into the pockets of low- and middle-wage workers, the better.[10] These workers are likely to be in households that will have little choice but to quickly spend any unemployment benefits on necessities, boosting the economic recovery. Dropping the additional top-up would mean unemployed workers would have to survive on a maximum of *half* of their prior earnings—and many on much less than half, given the extremely low caps on regular state UI benefits. Without the top-up, unemployed workers and their families would have to severely cut back on their spending, hampering the recovery.

The primary complaint against the extra $600 is that it will impede the otherwise efficient functioning of low-wage labor markets. But, of course, the labor market is not "efficient"; instead, it has been rigged against low- and moderate-wage workers for decades, and pre-crisis earnings for these workers were far too low, on both moral and efficiency grounds.[11] Further, the official unemployment rate will likely be well over 20% at the end of July—and the unemployment rate that takes into account everyone who is out of work as a result of the virus will be even higher. Even without the epidemic, it would be terrible policy on humanitarian and economic grounds to use cutbacks to UI benefits that make them too stingy to live on as a cudgel to demand people attempt to find a job quickly when the labor market is that weak.

Some have pointed to stories of low-wage businesses trying to reopen reporting they can't find workers because potential employees can make more on unemployment benefits and not expose themselves to health risks on the job. Policymakers could easily solve this potential "incentives" problem by allowing laid-off workers keep their extra $600 weekly payment (or at least some increment of it) even after they find a new job; strengthening health and safety standards so workers know their workplaces are required to be as safe as possible; and offering premium pay to front-line workers who face risk on the job.

It is also important that none of these provisions (for example, emergency unemployment compensation provisions and aid to state and local governments) be allowed to expire at arbitrary end dates, and instead that automatic triggers for their expiration be enacted. There is an enormous amount of uncertainty around how the economic impact of the coronavirus will unfold. Assigning arbitrary end dates to provisions to sustain the economy makes little sense when the process could be handled automatically, by having provisions phase out as the unemployment rate declines or, better yet, as the employment-to-population ratio rises. Using automatic stabilizers would not be any more expensive than the cumulative cost of multiple extensions of the programs in the bill—but it would prevent destructive lapses in critical programs while Congress negotiates extensions, and it would alleviate corrosive uncertainty by giving businesses, states, and households crucial confidence around budgeting and planning.

If the federal government provides sufficient aid during this crisis so that people's incomes don't drop dramatically (even if they have been unable to work), so that businesses stay afloat (even if they have been totally or significantly shuttered), and so that state and local governments whose tax revenues are plummeting are not forced to make drastic cuts that will hamstring the economy, then today's furloughed workers could get back to their prior jobs and the recovery could be rapid because confidence and demand would be relatively high. But if the federal government doesn't act, then those furloughs will turn into permanent layoffs and the country will face an extended period of high unemployment that will do sweeping and unrelenting damage to the economy and the people and businesses in it. Federal lawmakers get to choose which path we take.

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1. Congressional Budget Office, Memorandum, Subject: Preliminary Estimate of the Effects of H.R. 748, the CARES Act, Public Law 116-136, Revised, with Corrections to the Revenue Effect of the Employee Retention Credit and to the Modification of a Limitation on Losses for Taxpayers Other Than Corporations, revised April 27, 2020.

2. Josh Bivens, "A Prolonged Depression Is Guaranteed Without Significant Federal Aid to State and Local Governments," *Working Economics Blog* (Economic Policy Institute), May 19, 2020.

3. C-SPAN, "Secretary Mnuchin Remarks to Reporters," April 19, 2020.

4. Specifically, "an Eligible Borrower should undertake good-faith efforts to maintain payroll and retain employees, in light of its capacities, the economic environment, its available resources, and the business need for labor." See page 27 of Boston Federal Reserve, *Main Street Lending Program: Frequently Asked Questions*, last updated May 27, 2020.

5. The White House, "Statement by the President," March 27, 2020.

6. Edward N. Wolff, "Household Wealth Trends in the United States, 1962 to 2016: Has Middle Class Wealth Recovered?," National Bureau of Economic Research Working Paper no. 24085, November 2017.

7. Josh Bivens, "A Prolonged Depression Is Guaranteed Without Significant Federal Aid to State and Local Governments," *Working Economics Blog* (Economic Policy Institute), May 19, 2020.

8. Josh Bivens, "A Prolonged Depression Is Guaranteed Without Significant Federal Aid to State and Local Governments," *Working Economics Blog* (Economic Policy Institute), May 19, 2020.

9. Alicia Lee, "Wanted Urgently: People Who Know a Half Century-Old Computer Language So States Can Process Unemployment Claims," CNN, April 8, 2020.

10. Josh Bivens, *What Should We Know About the Next Recession?*, Economic Policy Institute, April 2019.

11. Josh Bivens and Heidi Shierholz, *What Labor Market Changes Have Generated Inequality and Wage Suppression?*, Economic Policy Institute, December 2018.