

## **AN ANALYSIS OF TWO FINANCIAL AID PROGRAMS FROM BOTH THE GOVERNMENT AND BUSINESS PERSPECTIVES**

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### **Introduction**

As not only a high school student, but also a part-time employee at a bubble tea shop, I noticed the struggle of our company during the pandemic. In August 2020, with a prediction that the pandemic would get better as the summer progressed, my manager decided to reopen the Lynnwood store, four months after the announcement of lockdown in Washington State. Motivated by the idea that people would be bored at home and thus would start coming out to parks, malls, and other public places, my manager made this choice. However, things didn't turn out the way we wanted. An increase in COVID-19 during the 2020-2021 winter contributed to a decline in business. During that winter, fewer customers came in and therefore management reduced the weekly hours of employees. By this time, the pandemic was worse than ever before, and fewer people were willing to risk their lives just for a cup of bubble tea. Even though my manager had been creating more promotions to attract both old and new customers, the store continued to struggle. Thankfully, the store benefited from the Paycheck Protection Program loan, which the government provided as the pandemic continued. Because of my own experience, I wanted to dive deeply into the different types of loans offered by the government and analyze the factors that maximized the efficiency for the firms that borrowed.

Although the last pandemic of the Spanish Flu in 1918 devastated the U.S., other disasters have impelled the U.S. government to provide financial support to American businesses. For example, in 2008, Congress introduced the Emergency Economic Stabilization Act, which later was included in Public Law 110-343. Due to the financial crisis of 2007–2008, the government purchased nearly \$700 billion in distressed assets from financial institutions. Moreover, similar to the Main Street Lending Program, this program also required a payback with 0.6% interest rate, which helped the government to make a profit of \$15.3 billion. An additional example can be found during the Great Depression, when the government paid farmers not to farm and

offered them a partially forgivable loan (Poppendieck 1986). Under this program, farmers could use their crops as collateral to borrow money from the government. If the value of their crops decreased, the farmers were allowed to give up their crops and not repay the loan. This partial forgiveness provision is similar to the forgiveness provision in the PPP loan, which I will compare with the Main Street Lending Program in my analysis.

With a detailed comparison of the Paycheck Protection Program loan (later referred to as the PPP loan) and the Main Street Lending Program loan (later referred to as the MSLP loan), I came to the conclusion that the MSLP would benefit the government and the country's economy as a whole, since it simultaneously brings profits for the government as well as serves as a motivation for firms to recover. There are two advantages that the MSLP program has over the PPP program. First, the MSLP program is less expensive and potentially profitable for governments and second, the MSLP program is better targeted towards firms with long-run viability. Thus, when comparing two different types of loans with different policies of forgivenesses, one which requires a payback with interest rate (Main Street Lending Program loan), and one which offers forgiveness (Paycheck Protection Program loan), the one requires a payback with a moderate interest rate is better targeted to firms that actually need financing. Giving money away is especially costly because distortionary taxes must be collected to fund the transfers. For instance, the government may tax labor or capital income to collect revenue, however these taxes have the harmful effect of reducing the incentive to work and invest. To support this, Ballard, Shoven, and Whalley (1985) estimate that the cost of raising a dollar of revenue is \$1.17 to \$1.56 after accounting for distortions caused by additional taxation.

The goal of this paper is to help people analyze the different approaches of the PPP loan and the MSLP loan in order to provide support and future suggestions for businesses and government. This paper is divided into four main sections. First, I will analyze the differences between the PPP loan and the MSLP loan (i.e their target groups, eligibility, forgiveness, and payback policies) and next examine the interaction with other loans and affiliation. Then, I will explain my opinion on which loan would be more efficient while citing evidence to support this stance. After that, I will interpret the impact of the pandemic on businesses and lifestyle changes induced by the pandemic. Lastly, I will include my suggestion for increasing demand, which might help solve the issues certain industries face of a decreasing demand due to the pandemic.

## **Methods**

Before diving deeply into the comparison of the PPP loan and the MSLP loan, I want to explain the three levels of business' conditions due to the pandemic. We assume that most businesses are

in a healthy condition before the outbreak of COVID-19, which means that they can make a profit on their own operations, can cover their employees' monthly payrolls regularly, and do not need financial support from the government. Additionally, we assume businesses that are not healthy prior to COVID-19 are suffering from issues that are unrelated to the COVID-19 pandemic. After the announcement of the lockdown, people were quarantined at home and indoor gatherings were not encouraged; therefore the demand for service businesses decreased. For example, fewer people went to public shopping malls, restaurants and parks. I organized these businesses that have been affected by the pandemic into three categories: businesses that retained their pre-COVID health, businesses that had temporary problems, and businesses that were no longer viable. The group of businesses that had not been affected by the pandemic, which included delivery services, online retailers, and companies that sold sanitizing products, did not need the financial boost from the government and some were not even eligible for it. The second group of businesses, businesses that were still in operation but would need financial support from the government, include privately owned restaurants, and were the target group for both the PPP loan and the MSLP loans.

Finally, businesses that were no longer viable were unlikely to receive a MSLP loan, however they were likely to be eligible for the PPP loan. After clarifying the target groups for both loans, we can take a closer look at the PPP loan and the MSLP loan.

The PPP loan was promoted by the US Small Businesses Administration, with its first distribution in March 2020 and its second in January 2021. As the name suggests, the PPP loan was initially designed to cover the monthly payrolls of employees who were soon about to lose their jobs due to the low profits businesses in their industry were making. After each business had submitted their application and was approved by the US Small Businesses Administration, their corresponding banks would receive the money and send it to the business. If businesses were qualified for the first draw and were still struggling to pay for their employees' paychecks, certain businesses were allowed to apply for the second draw.

They could also apply for forgiveness, as long as they were eligible.

On the other hand, the MSLP loan has an overall similar purpose and process, but a slightly different target group. The MSLP loan, promoted by the Federal Reserve System (FRS) in July 2020, targeted larger businesses, who were not qualified for the PPP loan but who still wanted financial support from the government to get through the pandemic. Similar to the PPP loan, applicants who were interested in the MSLP loan were required to submit an application to be verified by the FRS, and then receive their allocated amount. However, unlike the PPP loan,

where businesses could apply for forgiveness, the MSLP required a payback with interest, which will be analyzed in more depth later in this paper.

### **Eligibility**

As stated above, the PPP loan targeted smaller businesses that had been affected by the pandemic. Therefore, in many cases, only employers with 500 or fewer employees were eligible. To be eligible, businesses also must have been in operation since February 15th, 2020, in order to eliminate businesses that were opened after the pandemic and businesses that opened for the sake of receiving free money by applying to this loan. Additionally, the PPP loan applicants were required to have “employees for whom salaries and payroll taxes were paid or paid individuals with no employees.” Businesses who are qualified for the first draw of the loan received their loan from their corresponding banks.

Moreover, the eligibility for the second wave of the PPP loan was slightly different from the first draw and had some additional limitations. The second draw was only eligible for businesses that employed 300 or fewer employees, since the SBA assumed that larger businesses would survive with the first draw of loan. Unlike the first draw, the second draw aimed to target businesses that were struggling tremendously through this pandemic; therefore, businesses who wanted to apply to the second wave had to experience a revenue reduction of 25% or more in 2020, relative to 2019. Since it was an additional loan to the first one, the second wave was only offered to businesses who (1) had received the first draw loan and (2) had used or would use the full amount of their previous PPP loan before the expected date they would have received their second draw loan. If the businesses met all the requirements of the second draw loan, they would most likely have received their second loan from their corresponding banks.

Unlike the PPP loan, there is only one draw for the MSLP loan, which occurred from July 2020, to January 2021. The MSLP targeted medium-size firms, therefore, one of the eligibility criteria was that firms could employ no more than 15,000 employees, including corresponding full-time, part-time, seasonal, and other employees, and excluding volunteers and independent contractors. Moreover, under this loan, firms should have also experienced an annual revenue of less than \$5 billion in 2019, in order to target firms that were too small for Federal Reserve facilities supporting the corporate bond and commercial paper markets to assist. Similar to the eligibility of the PPP loan, the firms were required to have significant operation and a majority of employment based in the US. This eligibility criterion directs funds towards the group of firms that the US government cares most about: the firms that employ Americans. The firms also must not have been included in an Ineligible Business list of 13 CFR 120.110 (b)-(j), (m)-(s). If firms qualified

for all of the requirements stated above, they would have most likely received their required amount from their corresponding banks.

### **Forgiveness and Payback**

As mentioned above, businesses who received the PPP loan could apply for forgiveness once they had received all their loans and if they met all the requirements. On the other hand, if businesses did not apply for forgiveness after 10 months after the last covered day of the loan, they were required to pay back the loan at an interest rate of 1%. The PPP loan eligibility for forgiveness included a maintained employment rate and compensation level. Additionally, loans received from business' corresponding banks were spent on payroll for employees and other eligible expenses. Moreover, 60% of the loans were designated to be spent on payroll. However, MSLP loans had a five-year maturity for firms that received the amount in which they previously requested. MSLP loans were also pre-payable without penalty. In addition, if unpaid interest accrued during the first year, it would be capitalized and as a result become part of the principal of the loan, thus accruing additional interest. At the end of each year, annual principal amortization payments of 15%, 15%, and 70% are required, and the adjustable interest rate for this loan would be LIBOR plus 300 basis points.

### **Interaction with Other Loans and Affiliation**

For the PPP loan, since it had a maximum of 500 employees as an eligibility criterion, the SBA affiliation policy did not apply to this program. In terms of its interaction with other loans, businesses could reapply to this loan, which was the second draw, if they were qualified according to the eligibility criteria stated above.

According to the MSLP loan's affiliation policy, if an affiliate was involved in the application, then the affiliate was only allowed to participate by choosing the same loan accessed by its core company. In addition to this term, the employment of all affiliates in a single Main Street facility could not exceed the maximum loan size that the affiliated group requested and was eligible to receive on a consolidated basis.

Since several businesses were both eligible for the PPP loan and the MSLP loan, this meant that they met all the requirements for both loans and those businesses could apply for both the PPP loan and the MSLP loan. However, there were a group of businesses that exceeded the maximum employment for the PPP loan and should therefore not have been able to participate in the MSLP loan, since it was intentionally designed for much larger businesses. Lastly, firms that were eligible for the MSLP loan could only obtain one of the Main Street loans and were not allowed

to participate in the federal government's PrimaryMarket Corporate Credit Facility to avoid firms receiving multiple rounds of loans.

### **Loan Efficiency**

In order to measure the efficiency from the government's perspective, we argue that the Main Street Lending Program would ensure a greater profit for the government.

Additionally, it would strengthen the overall economy of the country. Since the MSLP loan does not allow any firms to apply for forgiveness, the government will inevitably make a profit as long as they get repaid after the five-year term. The MSLP is also designed to ensure that only creditworthy firms who can repay the loan with interest will receive a loan. One of the policies of the MSLP loan, as stated by the FRS, is that the corresponding banks are supposed to keep 5% of the loan, which encourages banks to accept only firms that would be able to pay back the loan within five years. Under this program, banks would have professionals who would then evaluate the firms that applied and decide whether or not to accept their requested loan amount. Thus, the government would not need to pay extra attention and spend time filtering out the firms that might not be able to pay their loan back within the five year period. Currently, the government can borrow money at a competitively low rate. During the period in which MSLP loans were made (April 9, 2020 to January 8, 2021), the yield on 5-year government debt ranged from 0.19% to 0.49% (U.S. Department of the Treasury 2021). Based on LIBOR data (fedprimerate.com 2020), the interest rate change on MSLP loans was between 3.13% and 4.1% and the volume of MSLP loans exceeded \$16.2 billion. Therefore, assuming that no firm defaults or repays its loan early, the government would not only receive all the money loaned to those firms, but it also will receive a profit of approximately 1 to 2 billion dollars.

Moreover, when considering the country's economy, it is important to determine what will happen to borrowers that are unable to repay either the principal or the interest on the loan. The lender may give the borrower a grace period if the borrower simply needs more time to repay the loan. However, if the firm ran out of business, the government would then take the firm over, and then make a decision whether they would sell them to other owners or keep operations. The government would have people to evaluate and make a reasonable decision. Therefore, even though the government will not see a repayment on their loans, they will not lose anything. The price of selling or keeping operations would balance out the loan they lost. Since the MSLP started in 2020, we would know the results of how much the government would lose or gain in 2025.

In contrast, the Paycheck Protection Program would be costly for the government relative to the benefits it provides to businesses. The Paycheck Protection Program is expensive since a majority of businesses have applied for forgivenesses and more than 99% of the loan value with forgiveness applications has been forgiven.

According to Chetty et. al (2020), the PPP loan only helped eligible businesses increase their employment by 2%. After the experiment, Chetty et. al (2020) reach their conclusions by comparing eligible businesses with fewer than 500 employees with ineligible businesses with more than 500 employees. One limitation of this analysis is it does not analyze the food services industry. Thus, this strategy could not be used to analyze the food services industry, because having fewer than 500 employees was not necessary for a food services firm to be eligible for a PPP loan. This result shows that the PPP is a relatively inefficient method of increasing employment. This is because the cost per job saved of the PPP is \$377,000. One likely reason that the PPP was expensive relative to its effectiveness in saving jobs is that most PPP loans went to businesses that did not plan to lay off many workers. Chetty et. al (2020) also stated that the main factor that caused businesses to decline is the decrease in demand, which will be explained in detail in the subsequent section.

The poor targeting of the PPP loans is not the only reason why the PPP loan is less efficient. Another reason for this is that the PPP loan does not pressure businesses to operate and make profit. Once businesses have received the full amount of what they requested, they can apply for forgiveness, as long as the employment rate and compensation levels are maintained. We predict that the employees would put less effort in, as long as they can keep the business in operation. A variety of employees are receiving fixed salaries. As long as they are not in danger of losing their jobs, there is little reason for them to pay more attention or do more than what they are supposed to do. However, employees who are in danger of losing their jobs because their firm is struggling have more of an incentive to work hard in order to ensure their firm survives. The government cannot and will not provide financial support with forgiveness forever. Because the PPP loan has only two draws, once the businesses have used all the money, if they still are not profitable, they would need to find a new solution.

Eventually, they would cut employees in order to reduce the money spent on payroll or sell their businesses to other owners.

In contrast, the MSLP loan pressures the firms to make profit, since this loan requires a repayment with interest. Even though they only need to repay their bank within five years, this

policy still pressures firms to operate. The MSLP loan therefore provides firms with stronger incentives to recover and operate just as before the pandemic.

Furthermore, it is likely sensible to reallocate labor from jobs that are no longer very useful to those that are in higher demand. For example, Barrero et. al (2020) argues that many jobs that existed prior to the pandemic will not exist afterwards. Furthermore, interfering with the reallocation process can be costly. The PPP can encourage an employer to retain employees in jobs that contribute little social value. As a result, the PPP can delay the reallocation of employees to jobs with high social value. It therefore is not necessarily desirable for the government to encourage employers to keep all employment relationships that existed prior to COVID-19.

### **Results and Discussions**

In conclusion, the PPP loan can have an immediate effect on businesses, while the MSLP can have a long-term benefit and help the businesses to recover. However, will the businesses that have been helped by both loans fully recover to their pre-COVID stage?

The first case of the virus in the US was reported in January 2020, almost 20 months ago. People's daily lives have definitely been disrupted due to the effects of the pandemic. In Washington state, for example, the governor announced the quarantine policy in April 2020, which forced people to work at home and students to shift their studies off-campus and online. After more than a year, many people are getting used to the new environment, where they do not need to drive to their office every day and can simply stay at home. Barrero et. al (2021) finds that working remotely might be more efficient, since employees would save time on transportation and could lower the risk of spreading the virus. Currently, a variety of leading companies have announced that they are switching to remote work for an indefinite period of time, including Amazon, Facebook, Microsoft, and Twitter. In some cases, this transition will be permanent. For instance, Horwitz (2020) reports that Facebook will move to a "substantially remote workforce over the next decade".

However, this decision could lead to a decrease in demand for some industries, including for the food service industry. For example, if a company is not planning for in- person work, then the nearby restaurants would lose a majority of their customers. One reason a lot of restaurants choose their locations close to an office is because proximity to an office could bring customers and therefore raise profits. If the majority of customers stay at home, restaurants would shut down eventually, even with the assistance of either loan. Even though customers can still order food from that restaurant through delivery apps, the restaurants won't be able to receive full



profit, since the delivery company would take part of what the customer has paid. Furthermore, eating in person is considered a risky decision, especially since the dangerous Delta variant has been responsible for an increase in

COVID-19 cases in July and August 2021 (Delta Variant). People would likely stay at home; therefore, the restaurants would need to develop a new solution to solve the problem of decreasing demand.

### **Conclusion**

As mentioned above, one way to help businesses to recover for the future is to increase demand. Here are a few suggestions that can be accomplished in order to accomplish this task. First, restaurants can adapt to changing consumer preferences. For instance, Chipotle Mexican Grill included an online-order-only, drive-thru Chipotle in 45 of its 56 restaurant locations it opened in Q2 2021. By giving customers the option to order and pick up food in a manner that minimizes contact with others, Chipotle has catered to customers who fear extensive in-person interaction. Another option for restaurants is to diversify into the food delivery business. For instance, Domino's has been successfully delivering its own food. Restaurants that are experiencing depressed dine-in levels could experience especially large benefits from delivering their own food because they have the opportunity to repurpose underutilized servers as delivery drivers.

In conclusion, in order to recover from the COVID-19 pandemic, firms should be encouraged to think of creative ways to increase the demand, then make profit out of it. By diverging using creative and responsive strategies, firms hopefully can make a comeback in the post-COVID world.