



# The Paycheck Protection Program: An Introduction

By Michael R. Strain

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## Key Points

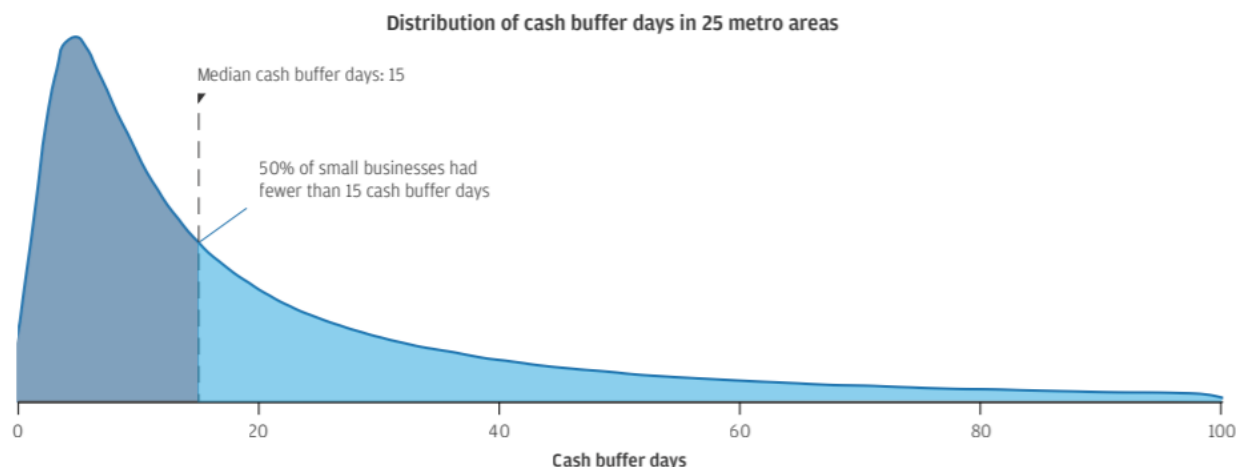
- The Paycheck Protection Program (PPP), established as part of the CARES Act, offers “forgivable loans” (essentially, government grants) to small businesses with the goal of helping these businesses avoid closure and avoid laying off their workers.
- Borrowers are eligible for loan forgiveness equal to the amount spent on payroll costs, mortgage interest, rent, and utilities for an eight-week period beginning with the origination of the loan, provided they do not lay off workers or make large reductions in their pay. Business that have already laid off workers due to concerns about the coronavirus can rehire them and receive loan forgiveness.
- The program relies on banks to issue these loans. Banks are authorized to charge interest and generous processing fees and are shielded from enforcement activities and penalties by the government related to loan forgiveness for eligible uses. The government pays the fees, not the borrowers.
- The Treasury Department will have PPP operational on April 3 for small businesses and sole proprietorships.
- To make the program as effective as possible, the government should (1) assure banks that the law’s “hold harmless” provisions will be strictly interpreted and enforced, (2) communicate that more money will be provided for the program if needed, (3) help PPP lenders issue a large amount of loans quickly, and (4) engage in an active program of public messaging to encourage both lenders and small businesses to participate.

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This report provides basic information about the Paycheck Protection Program (PPP), established in Title 1 of the Coronavirus Aid, Relief, and Economic Security Act, Congress’ coronavirus economic recovery package (“Phase 3”), signed into law on March 27. The program, scheduled to come online on April 3, offers government grants to small businesses with the goal of helping these businesses avoid laying off their workers. It treats commercial banks essentially

as conduits to get critically needed federal money into the hands of business owners.

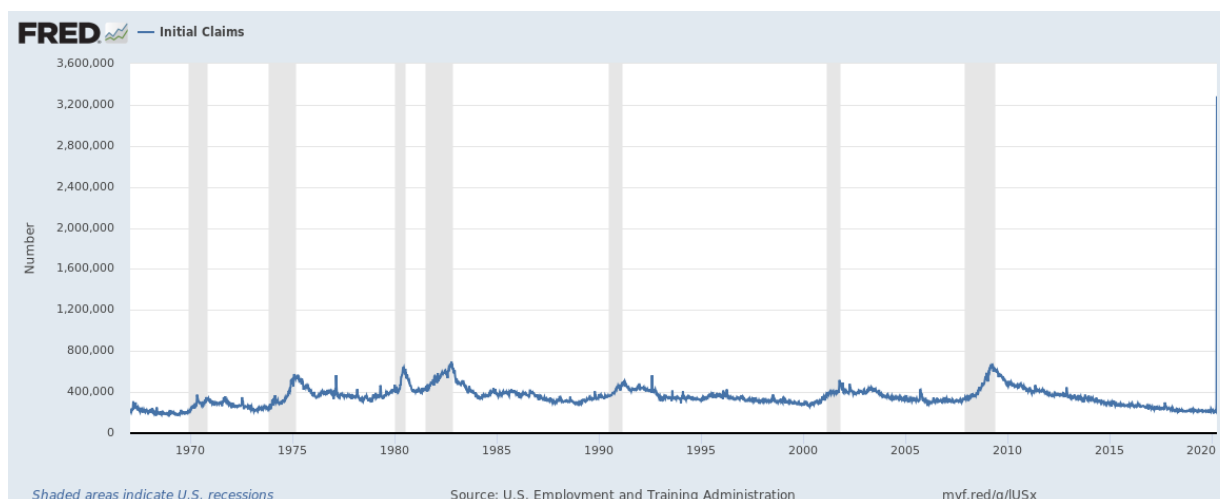
PPP may prove to be the most important part of the government’s economic-policy response to the coronavirus. Preserving the ecosystem of small businesses and avoiding mass business closures will be essential to ensuring that the US economy can quickly bounce back from the shutdown, once public-health conditions allow for economic activity to resume. And keeping workers paid by their



Note: Profit margin and cash buffer days measured from 2013 to 2017 in the cross-sectional sample.

Source: JPMorgan Chase Institute

Source: JPMorgan Chase & Co. Institute, *Place Matters: Small Business Financial Health in Urban Communities*, September 2019, 10, <https://institute.jpmorganchase.com/content/dam/jpmc/jpmorgan-chase-and-co/institute/pdf/institute-place-matters.pdf>.



Source: Department of Labor data retrieved from FRED, March 31, 2020.

employers—even if there is much less work for those workers to do—will mitigate soaring unemployment rates and avoid a long and painful process in which unemployed workers search for new jobs.

## The Problem

According to a 2019 report by the JPMorgan Chase Institute,<sup>1</sup> only half of small businesses have cash reserves sufficient to cover 15 days. Four in 10 small businesses have a three-week cash buffer. In Miami, the median firm has 11.8 cash buffer days. In San Francisco, the median firm has 17.9 days of liquidity. These statistics leverage JPMorgan Chase data on businesses that have deposit accounts with the

bank. They illustrate how desperately small businesses need liquidity today in all parts of the US.

As of March 31, the time of this writing, roughly three in four Americans (265 million people) are being told to stay home. Thirty-two states, 18 cities, 80 counties, the District of Columbia, and Puerto Rico have issued shelter-in-place orders to their businesses and residents.<sup>2</sup>

This has already added millions of workers to the unemployment-insurance rolls, with 3.3 million new filers added in the week ending March 21 alone.<sup>3</sup> The previous weekly record, set in 1982, was 695,000.

Economists at Goldman Sachs are currently forecasting that the unemployment rate will hit 15 percent—a 50 percent increase over the Great

Recession-era peak. They also forecast annualized real quarterly gross domestic product (GDP) growth of –9 percent in the first quarter of 2020 and –34 percent in 2020’s second quarter. On a Q4-to-Q4 basis, they currently expect annual GDP growth of –5.4 percent.<sup>4</sup>

## The Paycheck Protection Program

To stem the tide of mass layoffs and do what it can to prevent soaring unemployment and widespread business closures, Congress passed PPP as part of its \$2 trillion “Phase 3” economic recovery package.<sup>5</sup>

The way the program is intended to work is simple: A small business owner would go to his or her local bank and take out a loan that is guaranteed by the government. The business can borrow up to 2.5 times its average monthly payroll costs, not to exceed \$10 million. The amount of the loan spent on payroll costs (including benefits), rent, utilities, and mortgage interest during the eight-week period after the loan is originated will be forgiven—in other words, the loan will convert into a grant—provided that the business does not lay off workers or reduce their pay by more than 25 percent.

Businesses that lay off workers would have a smaller amount of their loan forgiven. The amount forgiven would be reduced proportionately by any reduction in employee head count relative to one year prior and by any reduction in any employee’s compensation beyond 25 percent of his or her prior-year compensation.

The program encourages businesses that have already laid off workers due to the COVID-19 crisis to rehire them. Borrowers that quickly rehire workers or restore full wages will not be penalized for having reduced payroll.

Some businesses may be concerned that there is less work for their employees to do while much of the economy is shut down and economic demand is reduced. The program is designed to socialize the cost of keeping workers on their employers’ payrolls despite the reduction in demand and allow businesses to avoid closure while also avoiding layoffs.

To qualify for the “forgivable loan,” a business or nonprofit organization must have fewer than 500 employees; be a sole proprietor, independent

contractor, or self-employed individual; or be a small business, 501(c)(19) veteran organization or Tribal business concern that otherwise meets the Small Business Administration’s size standard. For businesses in the accommodation and food services sector (NAICS code 72), the 500-employee rule is applied for each physical location, not the corporation as a whole. For these businesses, regulators need to make clear that each physical location is eligible for its own loan, rather than issuing only one loan to a tax ID number.

To streamline the process and get money to businesses quickly, borrowers do not need to demonstrate actual economic harm from the coronavirus outbreak. Instead, lenders will ask for good faith certifications that the business needs the money to avoid layoffs or continue operating due to uncertainty from the virus and that the business intends to use the money for payroll and other operating expenses. Borrowers will also be asked to certify in good faith that they are not applying for a duplicative loan and that they have not received a duplicative loan for these purposes and amounts since February 15, 2020.

The program has several additional provisions designed to get cash out the door quickly. It delegates authority to lenders to determine borrower eligibility and creditworthiness so businesses do not have to go through the usual government process. Lenders do not need to assess borrowers’ ability to repay the loan; instead, they simply need to establish that the business was operational on February 15, 2020, and verify its payroll. No collateral or personal guarantees from borrowers are required under the program. No credit-elsewhere test will be applied.

This is a good deal for banks. Lenders will receive generous fees: 5 percent of principal on loans up to \$350,000, 3 percent of principal on loans between \$350,000 and \$2,000,000, and 1 percent of principal above \$2,000,000, up to \$10,000,000. Lenders can charge interest for these loans. The loans are guaranteed by the government, have a zero weight in the bank’s capital requirements, and come with a ready customer base.

For the loan to be forgiven, the business must present documentation to the lender that it used the money for payroll costs, mortgage-interest payments, rent, utility payments, or additional

wages for tipped employees. The business must verify with documentation that it did not lay off workers or reduce their wages beyond the allowable limit. (Loan forgiveness cannot exceed the principal borrowed.)

Provided that lenders that forgive loans receive that documentation, the law has a “hold harmless” provision protecting them from any enforcement action and shielding them from any penalties by the government related to this program.

## Strengthening PPP

The Treasury Department will have this program operational on April 3 for small businesses and sole proprietorships.<sup>6</sup> To make the program as effective as possible, four things should happen.

First, some banks are concerned that they may be held responsible if borrowers misrepresent their situations to receive a loan or go bankrupt shortly after taking out the loan.<sup>7</sup> Regulators must assure banks that this will not happen. The legislation envisions banks as a conduit to get what are essentially government grants to small businesses. The regulations currently being written need to treat banks as such by offering ironclad guarantees that government agencies will strictly enforce the hold-harmless provisions.

Second, the government should send the message that more money will be provided to the program if needed. The economist Glenn Hubbard and I estimate that demand for forgivable loans could easily be over \$1 trillion, while Congress allocated \$349 billion for the program.<sup>8</sup> This situation is confusing some lenders, who want to know how those limited funds will be allocated if more are needed.

In addition, Congress should stand ready to increase funding for the program if needed to help the economy. If the initial funding allocation is spent quickly, that is a sign that businesses are using the program and it is succeeding in ensuring business

continuity and avoiding layoffs. It would suggest that businesses are willing to keep their employees on payroll, provided they have the financial resources to do so during a period of exceptionally weak economic demand.

Third, PPP lenders need to be able to issue a large amount of loans very quickly. Technology from the private sector needs to be leveraged to assist the government in quickly issuing loans and in producing loan numbers in a form that commercial banks find easy to work with using their own systems. Wherever possible, the process of loan issuance should be automated. In addition, the government should remit payments to banks after loans are forgiven as quickly as possible. (The law allows 90 days for remittance.)

Fourth, all levels of government need to engage in an active program of public messaging to encourage both lenders and small businesses to participate. Lenders should be assured that hold-harmless provisions will be enforced, even if clear cases of fraud and abuse occur. Small businesses need to know that the program offers grants for payroll and operating expenses, not just loans.

## Conclusion: The Need to Preserve Small Businesses

America’s ecosystem of small businesses is a complex web of networks, relationships, and firm-specific knowledge and productivity. It is being devastated by a once-in-a-century pandemic. The ability of the US to bounce back quickly once the coronavirus threat has been adequately mitigated will depend in large part on whether this ecosystem remains intact.

The Paycheck Protection Program is designed to keep this ecosystem intact, make sure the economy does not lose the productive capacity of businesses that were thriving just a few weeks ago, and keep workers being paid by and attached to their employers.

## About the Author

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## Notes

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