



## Special Series on COVID-19

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# Are Macro and Credit Policies Enough?<sup>1</sup>

*Sebnem Kalemli-Ozcan*

The COVID-19 crisis is having a disproportionate and catastrophic impact on small businesses (SMEs). Indispensable containment measures limit the effectiveness of traditional fiscal and monetary measures and jeopardize the viability of millions of small businesses. This note argues for the importance of keeping these businesses alive through direct cash transfers conditional on keeping employment and quantifies the cost of such policies for the US economy. Other policies targeted towards SMEs, such as emergency loans, will achieve the same objective, though they may fall short in terms of timely availability and implementation issues. Speedy application of the support is critical as otherwise solvent businesses can go bankrupt, leading to massive layoffs.

## I. NON-STANDARD POLICIES FOR A NON-STANDARD SHOCK

The COVID-19 outbreak is a health shock rather than a standard slowdown in economic activity. The collective attempts to avoid the spread of the virus are an obvious priority, but such containment action will also lead to an almost full suspension of economic activity; especially in certain sectors. The recourse to standard expansionary fiscal and monetary policies may not be effective right now. A “war time” economic thinking should dictate that the virus is the external enemy and needs to be defeated at all costs to recover an economy that functions in a regular way, calling for targeted policies.<sup>2</sup>

### Importance of SMEs for the Aggregate Economy, Growth and SME Financing

SMEs are most in need of such targeted policies. SMEs are firms with less than 500 employees as defined by the Small Business Administration (SBA) in the US.<sup>3</sup> They account for 99.7 percent of all US employer firms, 64 percent of new private sector jobs, 50 percent of private sector employment, 46 percent of private sector output and they produce 16 times more patents per employee than large patenting firms. Their largest financing source

<sup>1</sup> This note was prepared on April 9 and focuses on US SMEs. A new note that will be available soon will focus on SMEs globally.

<sup>2</sup> See the VOX CEPR Policy Portal and early call by Gita Gopinath on targeted policies.

<sup>3</sup> In other countries definition change: SMEs are firms with less than 250 employees.

are bank loans, where 90 percent of SMEs are financed with a loan from a bank.<sup>4</sup> This is not surprising as most of the SMEs are not publicly listed firms.<sup>5</sup> Large firms are mostly publicly listed and have access to other forms of financing including credit lines that they can draw upon, whereas SMEs lack such resources.

SMEs' liquidity problems can be solved through a loan, but the issue at hand is not only one of liquidity. A pure liquidity problem arises when one learns that the return coming today will instead come tomorrow; all that is needed is to manage liquidity accordingly, through a loan. A pure solvency problem is associated with a lack of long-term viability. Solvency issues likely do not apply to the majority of these small businesses affected by the current paralysis. Once the pandemic is over and the economy recovers, most of these businesses should be as profitable as before. However, losses during the lockdown will make these businesses, who are viable in the long-run in the absence of the COVID-19 shock, insolvent now, and if they do not get the emergency funds they may go bankrupt. This means that solvent business pre-COVID can turn into insolvent businesses due to COVID-19 related liquidity shock. The effects from such defaults are well-known: lay-offs, NPLs, weaker banks, weaker demand, sluggish investment, and a sluggish recovery. In the case of bankruptcies of a large number of SMEs, there will be permanent effects beyond the business cycle as the innovation activity slows down, reducing long-term growth.

### Potential Policies to Address the Liquidity Squeeze Faced by Small Businesses

Several governments have already taken decisive action to address companies' looming liquidity shortfalls.<sup>6</sup> An early example was the German government, which was quick to legislate a package of economic measures targeting SMEs including tax deferrals, as well as unlimited access to loans via Germany's state-owned development bank KfW. While these policies are extremely welcome and legislation was rapid, there might still be an issue on the magnitude and timely implementation.<sup>7</sup> First, tax deferrals will allow business to delay payment of outstanding tax liabilities. There is large variation across firms in how the magnitude of these liabilities compares to the dramatic reduction in revenues from the contraction in economic activity. Second, it is unclear whether the administrative process involved in asking for emergency loans can be executed timely enough. For example, will the owner of a small café or a laundry store be able get access to such an emergency loan to service outstanding payments while demand has already virtually collapsed to zero? In fact, a similar program in the US, the CARES act, is currently facing several implementation difficulties where SMEs cannot get the loans, in particular because they are loans administered by banks instead of direct transfers from the Treasury.<sup>8</sup> So far, 40 percent of SMEs have reduced salaries and 30 percent laid-off employees.<sup>9</sup>

### Alternative: An Immediate Negative Lump Sum Tax for SMEs<sup>10</sup>

Many firms need liquidity urgently, and it is a matter of survival within weeks or even days. What if the government provides small businesses with an immediate negative lump sum tax? The negative tax could come with conditionality, for example by requiring firms to hold on to their employees. It could either come as full-on transfer (pretty much making it "helicopter money") or could be partly reversed in later tax years, when the economy has recovered. It has the benefit that practical implementation may be swift. For small businesses the problem is a lack of cash and time is already running out. Even if there is the political will to help these

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<sup>4</sup> See the Federal Reserve Bank of New York Small Business Credit Survey.

<sup>5</sup> Publicly listed firms in the U.S. only account for 25 percent of aggregate US employment and 45 percent of aggregate US output, per Dinlersoz et al. (2019).

<sup>6</sup> See the IMF Policy Tracker. The policies noted here are as of first week of April.

<sup>7</sup> Germany also provided 50 billion Euro grants to SMEs and the self-employed.

<sup>8</sup> See for the other problems related to this program, [MCM Note on "Considerations for Designing Liquidity Support to Business"](#)

<sup>9</sup> See the Federal Reserve Bank of New York Small Business Credit Survey.

<sup>10</sup> As originally suggested by Dreschel and Kalemli-Ozcan (MARCH 23, 2020).

businesses, it is logistically tricky to actually send money to firms. A negative lump sum tax would allow a *cash* transfer of a magnitude that could exceed that of a deferral of existing tax liabilities. Importantly, immediate means that the government quite-literally directly wires the money to the business’ bank account via the existing tax system infrastructure, without requiring firms to do any paperwork. The IRS, which should have the required information and infrastructure, could transfer money within days, the way it would do with a standard tax refund. When the threat of bankruptcy is so immediate, it comes down to practical details such as having a database with the firms’ identifiers and bank account numbers, which can be further linked to U.S. Census database with full information on firms.

## How Much Will It Cost?

Since the payroll is typically the largest cost item for businesses, and job losses have started piling up, we focus on the payroll costs. Note that the UK, for example, has now decided to cover 80% of wages for employees that cannot work because of the outbreak of the virus.<sup>11</sup> Table 1 presents statistics on employment and the size of the payroll across the US firm size distribution for the year 2017.

**TABLE 1. Firm Statistics by Size**

Firm size group	Firm size group	Employment	Annual Payroll (bn USD)
<b>Less than 5 employees</b>	3,698,086 (61.7%)	5,937,081 (4.6%)	277 (4.1%)
<b>5 to 9 employees</b>	1,009,851 (16.8%)	6,656,073 (5.2%)	255 (3.8%)
<b>10 to 19 employees</b>	631,981 (10.5%)	8,503,293 (6.6%)	338 (5.0%)
<b>20 to 99 employees</b>	544,485 (9.1%)	21,348,103 (16.6%)	928 (13.8%)
<b>100 to 499 employees</b>	92,358 (1.5%)	18,111,531 (14.1%)	914 (13.6%)
<b>More than 500 employees</b>	20,139 (0.3%)	68,035,731 (52.9%)	4,014 (59.7%)
<b>Total</b>	5,996,900	128,591,812	6,725

Source: 2017 SUSB Annual Data Tables, United States Census Bureau.

It is evident in Table 1 that a large bulk of US employment is accounted for by relatively small firms. Based on the information in Table 1, we provide calculations for different “policy scenarios”. In each scenario, we postulate that a certain group of firms (as defined by their size in terms of number of employees) receives direct cash payments to cover their payroll for a specific time period: one quarter, two quarters or a year. How costly would these policies be? Table 2 gives the answer by providing the corresponding calculations. To put dollar values into context, we show the cost of potential support policies as a share of US GDP and also include the employment numbers that would fall under a given policy as a share of total US employment.

<sup>11</sup> See the Guardian.

**TABLE 2. Cost of Policy by Duration and Firm Size**

Subsidize payroll for	Cost of policy (bn USD)	Cost as share of annual GDP	Coverage of total US employment
Firms <100 emp., one quarter	449	2.26%	28.77%
Firms <100 emp., two quarters	889	4.51%	28.77%
Firms <100 emp., one year	1,797	9.02%	28.77%
Firms <500 emp., one quarter	678	3.40%	41.04%
Firms <500 emp., two quarters	1,356	6.81%	41.04%
Firms <500 emp., one year	2,712	13.61%	41.04%
Firms 100-499 emp., one quarter	229	1.15%	12.27%
Firms 100-499 emp., two quarters	457	2.30%	12.27%
Firms 100-499 emp., one year	914	4.59%	12.27%
All firms, one quarter	1,681	8.44%	87.15%
All firms, two quarters	3,363	16.88%	87.15%
All firms, one year	6,725	33.76%	87.15%

Note: Annual GDP and total US nonfarm payroll employment, used to compute columns 2 and 3, are taken from FRED for the year 2017. GDP is 19.9 tn USD and total employment is 147.6 Mio. This includes more employees than our numbers in Table 1, which covers only the non-farm, non-government sector.

## Can This Intervention Be Afforded?

If Congress is willing to cover the entire payroll of all firms with more than 500 employees for 3 months, this policy would cover the wage bill of 61 million US workers. This would cost around 3% of US annual GDP. The policy can be made conditional on firms keeping the workers on their payroll, and if not then the difference can be returned to the government during next year's filing. As a given firm's costs are in principle likely to include another firm's revenue, delaying default will likely help other firms. Furthermore, making sure that firms will be able to cover their wage bill will put money in households' pockets and alleviate additional negative effects of the contraction through the labor market.

## Early Programs for SMEs on Direct Cash Transfers in Other Countries and Comparisons to US

France has set up a "Solidarity Fund" for very small businesses, freelancers, micro-entrepreneurs and liberal professions with up to 10 employees, making less than 1 million euros in turnover and less than 60,000 Euros in profits.<sup>12</sup> To be eligible, a firms' March 2020 turnover must have fallen by more than 50% year-on-year. These firms and the self-employed receive a one-off direct transfer of 1,500 EUR. For "severe cases" an additional 2,000

<sup>12</sup> See the IMF policy tracker and also "Coronavirus COVID-19: Les mesures de soutien aux entreprises".

EUR may be granted. This is decided on a case by case basis. As mentioned above, in Germany, firms with up to 5 employees and self-employed persons can receive up to 9,000 EUR and firms up to 10 employees up to 15,000 EUR.<sup>13</sup> Eligibility is based on a statutory declaration of a significant liquidity shortfall for the coming 3 to 5 months. In both countries, these policies are part of broader packages that include a variety of additional measures targeted towards the business sector, such as state loans and tax deferrals. To put these numbers into the U.S. perspective, our calculations for the US indicate that firms with less than 5 and less than 10 employees have a monthly average payroll of 6,232 and 9,401 USD, respectively. It is important to point out that our calculations using Census Data do not include self-employed, but the French and German policies do.

Another noteworthy case is Switzerland. Although Switzerland chose to implement a policy through small business loans rather than direct cash transfers, they did so with extreme speed.<sup>14</sup> This is an interesting example, given our emphasis on timeliness. Switzerland introduced a 20 billion USD package of emergency loans to support small businesses, and firms can apply for an immediate loan worth up to 10 per cent of their annual revenue. The loan is interest free and provided by Swiss banks. It is underwritten with a full credit guarantee on the amount by the government. What is interesting about the Swiss policy is the extreme speed with which it was applied: companies are getting loans within 2 days. The Swiss plan runs through the existing banking network and its customer relationships, so did not need any new information on firms. In a similar vein, a negative SME tax in the US will put first and foremost the speed of implementation that will save millions of jobs. Going through the IRS as opposed to banks will help weak borrowers that are cut from the banking system as an additional benefit.

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<sup>13</sup> See "Kampf gegen Corona: Größ-tes Hilfs-pa-cket in der Ge-schich-te Deutsch-lands" for details.

<sup>14</sup> See the IMF policy tracker and FT for implementation.

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