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The Impact and Accessibility of the Paycheck Protection Program for Small Businesses During COVID-19

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OVERVIEW

The COVID-19 pandemic has profoundly impacted small businesses across the United States. In 2020, at least 26% of small businesses closed temporarily, while 56% reduced their day-to-day operations.[1] On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security (CARES) Act was enacted, through which the Small Business Administration (SBA) launched the Paycheck Protection Program (PPP). The PPP allowed small businesses to obtain up to $10 million in low-interest loans to cover up to six months of average monthly payroll costs. Firms could also use up to 40% of their loans to cover non-payroll expenses, including mortgage payments.[2] By the end of the program in May 2021, the SBA had approved over 11 million loans (first and second withdrawals) at a total cost of nearly $800 billion.[3] However, much debate remains regarding the success of the program. While the PPP helped cover employment-related expenses and mitigated unemployment, the program remained inaccessible to some firms.

THE PPP AND WORKER RETENTION

At the start of the pandemic, the United States had 31.7 million small businesses, which added 1.6 million net jobs[4] and contributed to 44% of the nation's gross domestic product (GDP) in 2019.[5] By design, small businesses were the primary beneficiaries of the PPP, as "96% of all approved PPP loans went to firms with fewer than 50 employees, in contrast with firms of over 250 employees, which received 0.4% of all approved loans."[6]

Of firms that received full loans through the PPP, 54% did not have to reduce their workforce, while 71% of firms that did not receive funding were forced to do so. Some firms that received PPP loans also rehired employees who had previously been laid off due to pandemic-related closures; the Federal Reserve found that 77% of firms that received full loans attempted to rehire employees.[7] As a result, businesses that received loans through the PPP were more likely to maintain workforce levels than firms that did not receive funding, suggesting the PPP's usefulness in maintaining business employment. Indeed, the U.S. Department of the Treasury estimated in December 2020 that the PPP saved approximately 18.6 million jobs.[8]

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FACTORS IN PPP SUCCESS: BANK SIZE, FIRM SIZE, AND FIRM-BANK RELATIONSHIPS

In applying for PPP assistance, businesses turned to both small and large banks, with similar success. Among applicants who applied through small banks, 78% secured all of the funding they sought, while 70% of applicants to large banks secured all of the funding sought.[9] In both cases, a preexisting relationship between the firm and the bank was an important factor, as firms having previous relationships with banks received loans more quickly.[10] The benefits of a preexisting relationship can be explained by the bank's knowledge of the firm and subsequent lower application costs, as well as the bank's long-run interest in supporting its clients.[11]

In particular, the importance of preexisting relationships is linked to both the size of the lending bank and the size of the borrowing business. Compared to small lenders, large banks disproportionately loaned to businesses previously known to them. In fact, for firms that secured PPP loans through large banks, 95% of applicants reported a preexisting relationship with the bank, whereas for firms that applied through small banks, only 83% of applicants had such a relationship.[12] Moreover, researchers found that in the absence of a previous relationship, both large and small banks tended to give priority to larger businesses.[13] When prior banking relationships are taken into account, small banks prioritized small firms with preexisting bank relationships, but large banks did not.[14]

In sum, while the lack of an existing firm-bank relationship was generally disadvantageous for businesses seeking PPP assistance, the disadvantage was most pronounced for firms (especially small firms) applying through large banks.

BUDGETARY COST

The $800 billion cost of the PPP has undoubtedly contributed to record U.S. budget deficits. In fiscal year 2020, the federal deficit of $3.13 trillion comprised 15% of GDP, falling only to $2.77 trillion and 12.4% of GDP the following year. These figures represent the two largest U.S. budget deficits relative to GDP since World War II.[15] These large deficits pose implications for future tax policy and government spending.

CONCLUSION

The PPP has provided a unique opportunity to examine the benefits and consequences of direct, large-scale government aid to businesses. Overall, the data suggest that the PPP, while costly, allowed many small businesses to maintain workforce levels and to cover other expenses. However, challenges in the accessibility of PPP aid and its dependence on existing relationships between firms and banks may have marginalized some smaller firms, potentially mitigating the program's benefits. These limitations suggest areas of improvement for future federal aid programs. Specifically, future programs could include mechanisms to reduce dependence on existing banking relationships. Improving access for smaller firms would enable them to receive aid in a timelier manner, thereby enhancing the effectiveness of the aid in reducing layoffs and business closures.

ENDNOTES

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