THIRD WAY

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Emergency Payroll Subsidy: A Better Way to Help Workers Through Recessions

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In the first nine weeks of the COVID-induced economic downturn, 38.6 million Americans lost their jobs. Four in ten workers with a household income of less than $40,000 became unemployed in March alone. [1] Unfortunately, "once-in-a-century" economic shocks like this are far more common than we want to believe. We've had two in the last 12 years, and it's possible another pandemic, a cyber-attack, or a climate catastrophe could upend the economy in the future.

In light of that, we must reimagine work and how to support workers in a future recession. Our current safety net is woefully inadequate, leading to mass waves of unemployment and workers having to navigate the antiquated and meager unemployment insurance system on their own. We need a new, reimagined model, one that lets people stay attached to their employer during bad economic times.

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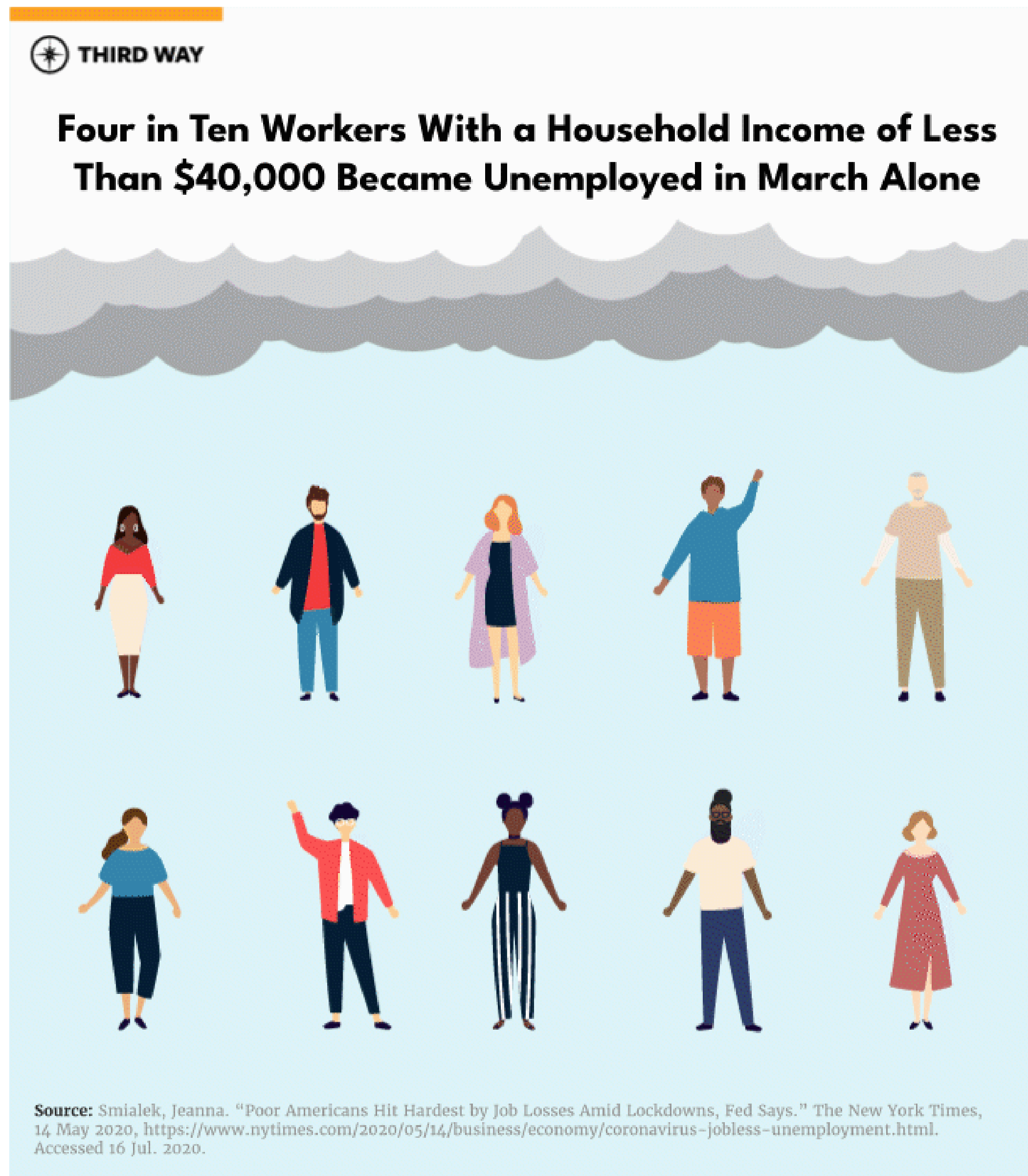
An Emergency Payroll Subsidy would radically change recessions so workers don't have to bear the brunt of economic hardship. It would allow businesses to keep workers on the payroll—reducing the number of people who must rely on unemployment insurance. And it would ensure the federal government has a plan when recessions hit so policymakers don't have to recreate the wheel when economic disaster strikes.

In this report, we lay out what this program would look like, how it would work, and how it would ensure far more stability and security for all working Americans.



What is an Emergency Payroll Subsidy?

Simply put, the Emergency Payroll Subsidy (EPS) would be a federal program that pays some portion of a worker's salary during specific times of economic crisis. It would exist alongside the regular unemployment insurance (UI) system, but it would dramatically reduce the

number of people who would need to rely on UI benefits because far more workers would stay

number of people who would need to rely on UI benefits because far more workers would stay attached to their employer during economic downturns. It would dramatically modernize the safety net for workers—helping them better weather recessions and emerge stronger once the economy recovers.

House and Senate lawmakers from both parties have proposed similar payroll support programs since this pandemic began wreaking havoc on our economy. These proposals have each contributed to ongoing discussions among policymakers on how to respond to the current pandemic and how to ensure workers can remain attached to their employers and continue to pay for necessities.

- Under the Paycheck Recovery Act (H.R. 6918), proposed by Representative Pramila Jayapal (D-WA) and her colleagues, employers of all sizes that have lost revenue during the pandemic would be able to receive grants from the IRS to ensure they can pay their workers up to a $90,000 salary cap. [2]

- Senators Bernie Sanders (I-VT), Mark Warner (D-VA), Doug Jones (D-AL), and Richard Blumenthal (D-CT) have introduced the Paycheck Security Act (S. 3793). Under this plan, businesses that have seen revenues fall in this pandemic would be eligible for an expanded Employee Retention Tax Credit, allowing them to rehire and pay workers who have been laid off or furloughed. The credit would be enough to pay workers up to $90,000 per year, including health care benefits. This support would be available until the end of 2020. [3]

- Senator Josh Hawley (R-MO) has proposed a refundable payroll tax rebate to employers of all sizes that would cover 80% of payroll costs up to median wages. [4]

- Representatives Suzan DelBene (D-WA), Stephanie Murphy (D-FL), John Katko (R-NY), Brian Fitzpatrick (R-PA), and Chris Pappas (D-NH) introduced the Jumpstarting Our Businesses' Success Credit (JOBS Credit) Act of 2020 that would expand the Employee Retention Tax Credit. Their bill provides refundable tax credits equal to 80% of up to $15,000 in qualified wages per quarter that affected employers pay to workers through 2020. [5]

States have administered similar programs aimed at keeping workers on the payroll, but these have had limited reach. Currently, 26 states have Short-Time Compensation (STC) programs, otherwise known as shared work programs. Under these programs, workers experiencing a reduction in hours due to economic conditions can receive a portion of what they would receive in unemployment benefits if they lost their job altogether. However, even within states that have operational STC programs, most employers don't know that this option is available to them even though shared work programs have existed for years, so take-up is low. [6]

Our proposal would look beyond the current pandemic and show how federal emergency

Our proposal would look beyond the current pandemic and show how federal emergency payroll subsidies can become a permanent and visible feature of the labor market, automatically providing a buffer for workers during future economic downturns.

When would the Emergency Payroll Subsidy kick in?

Businesses of all sizes would be eligible to receive payroll subsidies—including self-employed individuals and nonprofit organizations—if two conditions are met.

First, macroeconomic indicators would have to trend downward for a certain period of time (e.g. three or six consecutive months of decline), indicating the onset of a recession. Specific economic indicators could include things like GDP, the Industrial Production Index, personal income, or retail sales that tend to change with the economy. [7] There may be a lag between when economic conditions change and when government agencies record and report those changes, so subsidy payments should be retroactive to the beginning of each downturn.

Second, companies must *also* experience declines in US revenues. This means companies can only receive subsidies when the economy is bad *and* they are experiencing revenue loss. For example, in the case of this current economic crisis, employees of an airline would receive the subsidy, but employees of Amazon would not. Treasury could allow subsidies to go to any employer experiencing declines in year-over-year monthly revenues, or it could also establish revenue loss thresholds. Under the Paycheck Security Act (introduced by Senators Sanders, Warner, Jones, and Blumenthal), employers that have seen gross receipts fall by at least 20% would be eligible for the full Employee Retention Tax Credit, while employers that have seen receipts fall by 15-20% would be eligible for a portion of the credit. Under Canada's Emergency Wage Subsidy, created in response to the coronavirus pandemic, employers are eligible for the subsidy if they experience revenue declines of 15% or 30% depending on when they claim the subsidy. However, in setting thresholds, it should be noted that revenue loss during a public health emergency may be larger than revenue loss during something like the Great Recession. Thresholds could also be set by industry, so each company would be eligible for wage subsidies when its revenue loss reaches the industry average in the last three recessions.

Because there are lags in macroeconomic data, Congress could always pass and the President could sign legislation directing the Treasury and IRS to begin subsidy payments. This option would allow Congress to provide relief if a recession is seen on the horizon—like, for example, what was forecasted at the onset of the COVID-19 pandemic.

In all cases, subsidies should only be made available when employers are suffering—or are expected to suffer—significant enough revenue loss to threaten employment. When subsidies are made available, employers would be responsible for applying for them. Further, large

companies would not be permitted to implement executive pay raises or stock buybacks when

companies would not be permitted to implement executive pay raises or stock buybacks when the EPS is in effect.

How long should subsidies be available?

Subsidies should stop when the macroeconomic indicators used to trigger subsidies show solid signs of recovery. Treasury should compare current levels of economic indicators to their levels prior to the economic downturn and note the direction of those indicators. For example, Treasury could decide to end subsidies after real GDP or the Industrial Production Index increase for 6 or 12 straight months.

Congress could also require employers to recertify each quarter that their revenues have not recovered in order to continue receiving subsidies. Some employers simply won't make it out of a recession, and policymakers shouldn't prop up businesses that won't be viable on their own in the long run. If macroeconomic indicators have recovered but a company's revenues have not, that company should not continue to receive subsidies. Subsidies triggered through congressional action should end when conditions return to pre-downturn or pre-crisis levels or are at least solidly heading in that direction. In drafting legislation, Congress can include guidance for the Treasury on when to end subsidy payments based on relevant conditions or economic indicators.

What would the subsidies cover?

Subsidies would cover 80% of a worker's total compensation, and subsidies would be capped at $90,000 for each employee. Total compensation includes base salary as well as the value of benefits like health insurance and employer retirement contributions. Here are three scenarios to illustrate how this would work:

- A worker's total compensation is $75,000 (for example, base salary of $60,000 a year plus $15,000 a year in benefits). The worker's employer would receive enough in subsidies to cover $60,000 of the worker's pay and benefits while subsidies are in effect (80% of $75,000).

- A worker's total compensation is $90,000 (for example, base salary of $75,000 a year plus $15,000 a year in benefits). The worker's employer would receive enough in subsidies to cover $72,000 of the worker's pay and benefits while subsidies are in effect (80% of $90,000).

- A worker's total compensation is $120,000 (for example, base salary of $95,000 a year plus $25,000 a year in benefits). The employer would only receive enough subsidies to cover $90,000 of the worker's pay and benefits (since 80% of $120,000 is $96,000, which is above the $90,000 cap).

Employers could choose to cover the remaining 20%, and Congress should also be given the

Employers could choose to cover the remaining 20%, and Congress should also be given the option of increasing the replacement rate from 80% to 100% during extreme circumstances, such as a pandemic that halts economic activity. Congress can also limit participation in the program to those earning below a certain threshold or phase out subsidy eligibility as total compensation rises above that threshold.

For businesses like restaurants that employ tipped workers, those workers' subsidies should be based on the full minimum wage in the area rather than the tipped minimum wage. When restaurants apply to the IRS for subsidy payments, they should specify on their application form the number of tipped workers they employ and each tipped worker's average number of hours per week. The full minimum wage should be multiplied by average number of hours per week to calculate subsidy amounts that employers will pass on to each tipped minimum wage employee.

The $90,000 subsidy cap should be indexed to inflation. Companies should not have to pay taxes on subsidy payments, though workers would pay income and payroll taxes as they normally do.

The Emergency Payroll Subsidy should provide relief to as many workers as possible, including part-time workers, self-employed individuals, and independent contractors. Employers would have to keep part-time workers on the payroll along with full-time employees.

How do we discourage bad actors?

All subsidy payments need to end up in the pockets of workers. If companies receive more than they need to pay their workers, they don't get to keep this overpayment.

Companies should only receive enough subsidy payments to pay workers who are actually on the payroll. This means if, in a given subsidy payment period, a company receives a sum of money to cover 300 workers but proceeds to lay off 50 of those workers, the company would have to return to the government an amount equal to the subsidies that would have gone to those 50 workers, unless those 50 workers received subsidized paychecks before being laid off.

This program is not meant to prevent companies from restructuring if they determine it's in their best interest to do so. This program is solely meant to help companies keep workers on the payroll that those companies know they'll need once the economic downturn has ended. If a company decides to restructure, workers can fall back on the regular unemployment insurance system. Third Way's Reemployment proposal would modernize the UI system and turn it into more of a springboard back to work.

How would subsidies be distributed to employers?

The IRS, in coordination with the Treasury Department, would be responsible for distributing

The IRS, in coordination with the Treasury Department, would be responsible for distributing subsidies to employers. Employers would have to apply to the IRS to receive subsidies. Congress should direct the IRS to create a form (in both electronic and paper formats) that employers can use for this purpose. The form would certify that the employer needs payroll assistance and would also tell the IRS how large a subsidy payment the employer needs in order to pay workers each month. Specifically, this confidential form should require employers to report the company's current revenues compared to last year's revenues, the total number of employees at the time of filing, and the total compensation amounts for each of those employees. Employers with tipped workers should specify on their application form the number of tipped workers they employ and those workers' average number of hours per week.

Companies that lay off workers could be required to submit an amended form to the IRS with the revised number of workers. Alternatively, when companies recertify their revenue losses each quarter, they could also be required to report any layoffs.

What would this cost?

Recessions vary in size and scope, but we estimate that if policymakers implemented Emergency Payroll Subsidies to respond to another recession on the scale of the Great Recession—one of the worst recessions we've experienced—the gross cost for the program could be $540 billion. [8] This estimate is based on the following assumptions:

- A total compensation replacement rate of 80%.
- A cap on subsidy per worker of $90,000.
- Subsidies distributed for one year.
- Subsidies only covering private sector workers, with the public sector receiving relief through other channels.

The net cost of Emergency Payroll Subsidies during recessions would likely be lower, however, because fewer Americans would need to rely on the safety net since they would remain employed and continue receiving paychecks. A group of economists analyzed two proposals that aim to keep workers on the payroll during the current pandemic-related economic downturn: The Paycheck Recovery Act led by Representative Jayapal and the Paycheck Security Act from Senators Sanders, Warner, Jones, and Blumenthal. They find that these proposals have net costs that are about 56% of their respective gross costs due to offsetting budget savings, such as lower safety net spending on programs like unemployment insurance and Medicaid due to fewer people becoming unemployed. [9] Applying this to our proposal, the net cost of Emergency Payroll Subsidies would have been roughly $300 billion during the Great Recession.

How would we finance this?

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There are several ways policymakers could finance Emergency Payroll Subsidies.

First, the government could borrow the funds and pay for it by increasing the deficit. Many economists argue that deficit spending is essential during recessions and economic crises—helping ameliorate economic pain across the country. Then, during economic expansions, more attention can be paid to long-term finances. By being willing to deficit spend during recessions, the government can also reduce uncertainty about how it will respond in the future.

Second, since Emergency Payroll Subsidies would allow employers to keep workers on the payroll and avoid recruitment and training costs, employers could be required to help pay some or all of the cost during times of economic expansion. For example, the government could slightly increase the payroll tax when the economy is doing well, saving that revenue in a fund to be used during recessions. Raising the payroll tax rate by one percentage point would generate roughly $700 billion in revenue over 10 years. [10] Or, the government could require businesses to contribute some flat rate such as 2.5% of gross revenue, with an exemption for the first $1 million in gross revenue to spare small businesses from too heavy a burden. Further, the corporate tax rate could be raised slightly. Based on Congressional Budget Office projections, increasing the corporate rate from 21% to 25% would generate an additional $700 billion over 10 years (not accounting for tax avoidance).

Conclusion

The coronavirus pandemic, as well as the Great Recession a decade earlier, led millions of Americans to lose their jobs and experience financial hardship. Yet, as Representative Jayapal and her colleagues wrote earlier this year, “Mass unemployment is a policy choice.” [11] In this paper we have proposed an Emergency Payroll Subsidy that would fundamentally change the impact of future recessions in the United States. With the EPS program, the federal government would step in and pay a portion of each worker’s paycheck when the economy falls into recession. This would help employers keep workers on the payroll until the economy recovers, rather than laying them off. Employers would benefit too; by retaining employees, businesses would avoid recruitment and retraining costs and be able to bounce back more quickly when the economy recovers. And importantly, it would reduce uncertainty about how the federal government will respond to future recessions. We may not be able to prevent recessions from happening, but we can lessen their impacts on workers and their families and make sure everyone can continue to pay for necessities while they wait out the storm.

ENDNOTES

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