ARTICLE

When Does Pandemic Financial Relief Become Excessive?

As Congress and the White House debate over the next round of pandemic financial relief, it's an opportune moment to ask an uncomfortable question: Is it possible for such relief measures to be excessive, misdirected or wasteful? Many politicians and economists believe not. Put them in the "whatever it takes" camp. Fed Chair Powell is among those who believe another round of stimulus is essential to sustain a stalling recovery and cannot be overdone.

Powell recently stated, *"Too little support would lead to a weak recovery, creating unnecessary hardship for households and businesses… By contrast, the risks of overdoing it seem, for now, to be smaller. Even if policy actions ultimately prove to be greater than needed, they will not go to waste."*[1] Many in Washington share this sentiment. Apparently, no amount of financial relief is too great, and there is no such thing as an unproductive use of taxpayer money in these circumstances. But surely there is some amount of stimulus spending beyond which such sentiment cannot be validated. We touched on this topic a couple of months ago, but it's worth a deeper discussion, given the current showdown in Washington over the next stimulus bill.

The CARES Act was passed quickly by Congress in late March as the prospects of stay-at-home orders and business shutdowns across large parts of the U.S. economy were looming large. The act authorized more than $2 trillion of federally financed relief, much of it in the form of direct payments to individuals and businesses, which was more than twice the size of the stimulus package passed during the Great Recession of 2008-09. Given the urgency to act quickly, the specific programs and provisions of the CARES Act were broadly defined and not very targeted. For instance, at a total estimated cost of at least $260 billion, more than 150 million Americans received a one-time stimulus payment of at least $1,200 — far in excess of the 30 million workers who became jobless at some point during the pandemic.

Tens of millions of households unaffected economically by the pandemic received a windfall of a few thousand dollars to encourage a spending spree paid for by Uncle Sam. However, Forbes recently cited results of a consumer survey conducted by the Federal Reserve Bank of New York that indicated more than two-thirds of these stimulus checks went towards debt reduction or savings instead of consumption.[2,3] Similarly, there was no need-based requirement for smaller businesses to qualify for forgivable loans under two rounds of the $600+ billion Paycheck Protection Program (PPP). This broad, scattershot approach to stimulus was effective perhaps for no other reason than its sheer enormity. Stimulus-related financial relief has been widely credited with providing meaningful financial support to millions of furloughed and laid-off workers, saving jobs from further cuts, spurring consumer spending and generally kick-starting the recovery.

But the fairy dust has settled, the checks have been cashed and spent, and the recovery is slowing even as some White House advisors insist that a V-shaped recovery scenario is intact. The prospects for the labor market are particularly worrisome, with layoffs picking up as more than 25 million Americans still file weekly unemployment claims — more than twice the number of unemployed workers that correspond to the current 7.9% unemployment rate.[4]

So, whether it's time for another round of stimulus has been debated in Congress since late July, when the Federal Pandemic Unemployment Compensation (FPUC) program expired. While both parties agree that more stimulus is needed, there is a wide divide over what that amount should be. Democrats have moderated from a $3.4 trillion price tag under the original Heroes Act to a $2.2 trillion package under the recent bill passed by the House(the Heroes Act II), including a second round of "one-time" stimulus checks, full restoration and extension of FPUC, an expansion of other unemployment benefits, more PPP funds and several hundred billion dollars of financial assistance for state and local governments; Republicans reportedly began negotiating at $600 billion and have moved above $1 trillion as we write this. President Trump has changed his position several times and may not have his party's support for a larger stimulus deal that Treasury Secretary Mnuchin has been negotiating with House Speaker Pelosi. Many Congressional Republicans are quietly bristling at any sticker price that begins with a "T," and some have found fiscal rectitude now that the economy has reopened and moved back from the precipice. There is substantial doubt that a deal above $1.5 trillion, which the Trump administration is moving towards, can garner enough Senate support to pass before the election.

As matters stand currently, the Congressional Budget Office (CBO) expects the U.S. budget deficit in the fiscal year just ended will be $3.1 trillion , or 15% of GDP[5] — the largest relative deficit since 1945. Moreover, this is not merely the case of one outlier year, as CBO projects cumulative federal budget deficits totaling $13 trillion from 2021 to 2030. U.S. federal debt now exceeds 100%[5] of GDP, a threshold indicative of profligate countries. In financial markets, the value of the dollar falls and the price of gold rises nearly every time there are reports that stimulus talks are advancing, as markets recognize the long-term fiscal damage of such measures. One might reasonably ask how much is enough.

For a clear-eyed view of things, let's look north to Canada and its handling of the economy during the pandemic's rage. (For purposes of this discussion, it's helpful to note that Canada is approximately one-tenth the size of the United States for most economic and demographic statistics.) The pandemic and accompanying shutdown hit the Canadian economy hard, too. There was a net loss of 3 million jobs, or nearly 16% of pre-COVID employment levels, in the three months between February and May — roughly in line with the U.S. experience. Canada's unemployment rate spiked to 13.7% from 5.6% in that three-month period, while GDP contracted by 38.7% in 2Q20 compared to a U.S. contraction of 31.4%. Like the U.S. economy, the Canadian economy bottomed in 2Q20 and is expected to rebound in the second half. Canada's unemployment rate has already fallen to 9% in September from its May peak.[6]

Canada was very aggressive in its early lockdown measures and in addressing the economic fallout of the pandemic. It enacted the Canada Emergency Response Benefit (CERB) in mid-March, providing C$2,000 of monthly payments for up to six months to those who stopped working or had work interruptions as a result of COVID-19. CERB expired at the end of September and was transitioned to its Employment Insurance (EI) program, which will continue paying these benefits for up to 26 weeks. CERB has paid benefits to 8.6 million recipients. The Government of Canada also enacted business relief with the Canadian Emergency Wage Subsidy (CEWS), which funded 75% of the wages of employees up to C$847 weekly for businesses that met requisite revenue declines. As of early October, there were 1.3 million approved applications under CEWS from 327,000 unique applicants.[7] Other federal financial assistance included business loan programs for sole proprietorships, small and large companies, commercial rent assistance for qualifying property owners, student relief, childcare benefits and support for senior citizens.

These relief programs have not come cheaply for the Canadian government. Its COVID-19 response plan of direct assistance to support businesses and individuals comes with a hefty price tag of C$230 billion. Canada's budget deficit is expected to soar this fiscal year, to C$343 billion from C$34 billion in 2019, with little sign of reined-in spending for 2021. National debt will increase by a whopping 47% in 2020-2021, to C$1.2 trillion, and Canada intends to tap credit markets in a big way in the months ahead at near record-low rates.[8] In short, Canada has paid a huge financial price to support its economy during the pandemic, and its journey is far from over. Fortunately, Canada's fiscal health prior to the pandemic was relatively strong compared to other industrialized nations, and it will be able to withstand the assault on its finances in 2020 — though it's unclear how much longer the current trajectory can be maintained.

A funny thing happened while Canada was experiencing its worst recession of the post-War era: insolvency filings plunged compared to pre-pandemic levels of the previous year. In fact, insolvency filings in the five-month period from April through August fell to their lowest level since 1997, according to Bloomberg, with filings by Canadian individuals and businesses falling by 44% and 35%, respectively,[9,10] in this recent five-month period (**Exhibit 1**) compared to 2019. COVID-related filing delays, backlogs and restricted court access in the early months of the pandemic undoubtedly contributed to the falloff, but this development also raises the distinct possibility that massive financial payments made to combat the effects of the pandemic may have been overdone. What was supposed to be a government safety net meant to prevent financial ruin for Canadians hit by COVID's impact may have also been a sizeable windfall for many other individuals and businesses. How else can one explain such a precipitous decline in filings?

Domestically, U.S. commercial Chapter 11 filings increased nearly 40% (YOY) in the same five-month period — exactly what one would expect amid a sharp economic downturn — but commercial Chapter 7 filings (which account for a large majority of all business filings) were down 22% (YOY), as many smaller businesses tapped government-sponsored loan programs (**Exhibit 2**). Non-commercial filings plunged by 40% (YOY) in 2Q20 to their lowest quarterly total since 1Q06 subsequent to the enactment of the Bankruptcy Reform Act of 2005 and continued to decline by double-digit rates (YOY) in July and August.[11,12] Direct payments to individuals under various Cares Act provisions undoubtedly contributed to this outcome.

There is no historical precedent for bankruptcy filings to decline during periods of recession. This seemingly good news on insolvencies and Chapter 7 bankruptcies is no vindication for proponents of unlimited government support, since many potential filings have likely been pushed out rather than averted as the economy struggles to get back to pre-pandemic performance. Had filings remained at or near pre-pandemic levels, one could better make the argument that financial relief served its intended purpose — that is, to help those who were doing okay prior to the pandemic but then struggled. However, the plunge in filings to multi-year lows since COVID-19 struck is arguably evidence that many businesses

and individuals that were faltering long before the pandemic arrived also got a financial reprieve. Some prominent bankruptcy experts expect filings to again spike and remain elevated for a while as financial relief eventually fades away. These arguments will sound self-serving coming from a restructuring guy, but it's hard to see it any other way. As Washington struggles with this dilemma and considers another round of huge stimulus payments more than eight months after COVID hit us, it shouldn't be off-limits to ask aloud, "How much is too much?" Let that conversation begin.

Exhibit 1 - Monthly Canadian Insolvency Filings

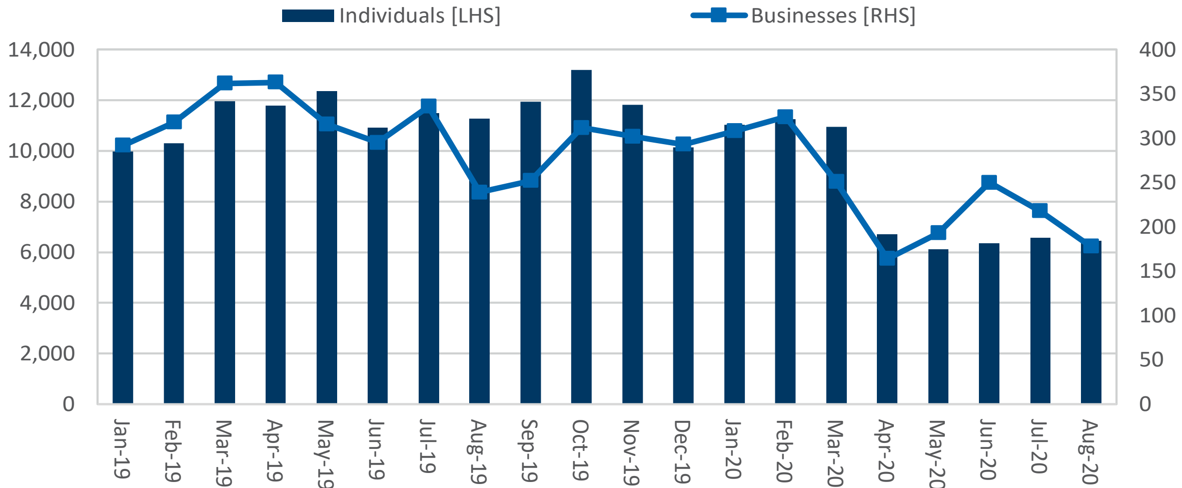

Exhibit 1, Source: Statistics Canada

Exhibit 2 - Monthly U.S. Commercial Bankruptcy Filings

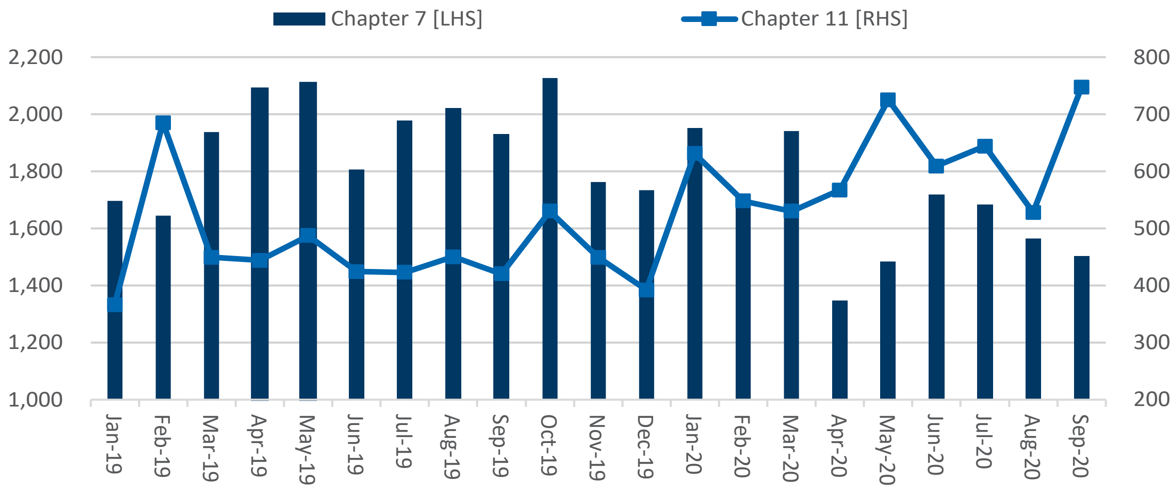

Exhibit 2, Source: Epiq Systems

Endnotes

1. https://www.washingtonpost.com/business/2020/10/06/powell-recovery-stimulus/
2. https://www.washingtonpost.com/business/2020/03/26/senate-stimulus-bill-coronavirus-2-trillion-list-what-is-in-it/, https://www.pgpf.org/blog/2020/09/how-many-coronavirus-stimulus-checks-have-been-sent-out-so-far
3. https://www.forbes.com/sites/zackfriedman/2020/10/19/how-americans-spent-1200-stimulus-checks/, https://libertystreeteconomics.newyorkfed.org/2020/10/how-have-households-used-their-stimulus-payments-and-how-would-they-spend-the-next.html
4. U.S. Department of Labor, Weekly Claims Report, October 15, 2020
5. Congressional Budget Office (CBO), An Update to the Budget Outlook: 2020-2030, September 2020
6. Statistics Canada, https://www.statcan.gc.ca/eng/start
7. Government of Canada, Canada's COVID-19 Economic Response Plan, https://www.canada.ca/en/department-finance/economic-response-plan.html
8. Government of Canada, Department of Finance, Economic and Fiscal Snapshot 2020, https://www.canada.ca/en/department-finance/services/publications/economic-fiscal-snapshot.html
9. Bloomberg, *Insolvencies in Canada Plunge to 23-Year Low on Trudeau Support*, October 1, 2020,
10. Government of Canada, Insolvency Statistics in Canada, https://open.canada.ca/data/en/dataset/4444b25a-cd38-46b8-bfb8-15e5d28ba4e7
11. AACER Commercial Bankruptcy Statistics, September 2020, https://www.aacer.com/bankruptcy-statistics-and-trends
12. Administrative Office of the U.S. Courts, Statistics, https://www.uscourts.gov/statistics-reports

MICHAEL EISENBAND
Global Co-Leader, Corporate Finance & Restructuring
+1.212.499.3647
michael.eisenband@fticonsulting.com

FTI Consulting is an independent global business advisory firm dedicated to helping organizations manage change, mitigate risk and resolve disputes: financial, legal, operational, political & regulatory, reputational and transactional. FTI Consulting professionals, located in all major business centers throughout the world, work closely with clients to anticipate, illuminate and overcome complex business challenges and opportunities. The views expressed herein are those of the author(s) and not necessarily the views of FTI Consulting, Inc., its management, its subsidiaries, its affiliates, or its other professionals. FTI Consulting, Inc., including its subsidiaries and affiliates, is a consulting firm and is not a certified public accounting firm or a law firm. ©2020 FTI Consulting, Inc. All rights reserved. **www.fticonsulting.com**

FTI CONSULTING™