BREAKING DOWN BARRIERS TO OPPORTUNITY #5

Promoting Economic Recovery Through Entrepreneurship Not Government

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PRI PACIFIC RESEARCH INSTITUTE

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Executive Summary

As previous studies in the *Breaking Down Barriers to Opportunity* series have demonstrated, high and excessively complex taxes, diminished access to capital, and rising regulatory burdens create significant impediments to a vibrant entrepreneurial sector, especially for lower- and middle-income individuals. Unfortunately, the federal government's economic response to the pandemic has worsened all of these obstacles, which will severely diminish the vibrancy of the entrepreneurial sector going forward.

As Milton Friedman famously noted, "keep your eye on one thing and one thing only, how much government is spending".[1] During the pandemic, the federal government has spent unprecedented sums, most of which have been dedicated toward minimizing its economic consequences. Counting only the pandemic spending that was enacted starting in March 2020, a total of $5.9 trillion has been authorized of which approximately $4.7 trillion has been disbursed through August 2021.

Regardless of whether these expenditures were spent well or not, having spent an additional $4.7 trillion in a mere 18-months has adversely impacted the nation's growing debt problem. Compared to the first quarter of 2020, the total debt held by the public increased by $4.8 trillion through the first quarter of 2021 due to pandemic expenditures. The nearly $5 trillion increase in the total debt held by the public in one-year was larger than the entire increase in the debt during President Trump's first 3-years ($2.9 trillion increase) or more than half the increase in debt during President Obama's 8-years ($7.5 trillion increase).

> "As Milton Friedman famously noted, "keep your eye on one thing and one thing only, how much government is spending."

This historic increase in the government's burden on the private economy, if not reversed, portends higher future taxes that will diminish the after-tax return from starting a new business or operating a small business. Lower after-tax returns meaningfully diminish the incentive to start new ventures or expand operations, which leads to a less vibrant entrepreneurial and small business sector.

Importantly, whether it was the $835 billion spent on the Paycheck Protection Program (PPP) or the $815 billion spent on the three stimulus check programs, these expenditures were wasteful and ineffective. Consequently, it is difficult to argue that these expenditures were a worthwhile trade-off (e.g., it was necessary to impose future tax increases that would lower the after-tax returns for small businesses and entrepreneurs to respond to the "once in a century" emergency). Instead, the economy is bearing the costs associated with high debt and tax burdens without having gained any appreciable benefits in the present in terms of efficiently offsetting the economic costs associated with the pandemic.

The Federal Reserve worsened the entrepreneurial environment by enabling the historically large increase in federal spending and distorting the mortgage markets, which is an important source of funding for many budding entrepreneurs. Adding to these problems, Congress and the Trump Administration authorized the Fed to create or expand several emergency lending facilities, which empowered the central bank to make fiscal policy decisions on behalf of taxpayers. It is not only inappropriate for non-elected bureaucrats to decide how taxpayers dollars are spent, dragging the Federal Reserve into fiscal debates threatens monetary stability. A vibrant entrepreneurial sector requires a stable financial and credit system.

Similar problems have arisen with respect to regulatory policies. Erratic regulations, such as the eviction moratorium, have imposed unnecessary economic costs that will last well into the future. In the near-term, these regulations directly harm many small businesses. Longer-term the pall of regulatory uncertainty diminishes entrepreneurial incentives.

> “A vibrant entrepreneurial sector requires a stable financial and credit system.

Due to these adverse outcomes on entrepreneurship, fundamental economic policy reforms are necessary. These reforms should establish an affordable level of government, implement fundamental tax reform that simplifies the current tax system and increases the incentive to work and invest, and conduct a comprehensive regulatory review with the goal of simplifying the code and reducing the cost of compliance.

Introduction

A vibrant entrepreneurial sector is essential for promoting broad-based prosperity, as discussed in previous parts of PRI's *Breaking Down Barriers to Opportunity* series. These analyses further illustrated that rising regulatory burdens, high and excessively complex taxes, and diminished access to capital are significant impediments to a vibrant entrepreneurial sector, especially for lower- and middle-income individuals. While progress reducing these burdens had been occurring, continued reforms were needed to ease the tax compliance burden, reduce regulatory complexity, and improve budding entrepreneurs' access to loans and other forms of financing. But then came COVID-19.

The economic responses to the pandemic from the Trump Administration, the Biden Administration, Congress, and the Federal Reserve have reversed pro-entrepreneurial policy gains and created additional barriers to entrepreneurship. These reversals have come in many forms.

For starters, the federal government has spent trillions of dollars that it cannot afford over the past 18 months. Undoubtedly, money had to be allocated to address the health consequences of the pandemic. To the extent that government shutdowns were imposed, compensating business owners and employees for the losses these shutdowns caused was also warranted. But the fiscal spending authorized by Congress and both the Trump and Biden Administrations went well beyond these needs. Even when the spending addressed a core need, the programs were wasteful and ineffective. As a result, the economy is now burdened with trillions of dollars in additional government spending that will have to be financed through a combination of higher taxes, increased government borrowing, and/or continued monetization of the debt by the Federal Reserve.

> "Without fundamental pro-growth policy reforms, the vibrancy of the entrepreneurial sector will be severely diminished going forward.

If financed through higher taxes, then the burden (and likely complexity) of the tax code will worsen, diminishing the vibrancy of the entrepreneurial environment. If financed through debt and the Fed's continued accumulation of an outrageous amount of long-term government debt, then the capital distortions in the economy will increase and the goal of maintaining a sound money environment will be harder to achieve. An unstable monetary environment makes it more difficult for entrepreneurs and small businesses to obtain the financing they need to survive or expand.

Additionally, throughout the pandemic the regulatory state has been expanding, increasing the arbitrariness and costliness of the regulatory burden – the eviction moratoriums that are harming landlords, particularly small landlords, exemplify the problem. As there are no signs that the increased regulatory burdens will be rolled back – and increasing signs of greater regulatory burdens in the future – the pandemic represents a breakpoint between an environment that was lessening the regulatory burden on entrepreneurs and an environment that is increasing this burden.

In combination these actions increase the costs and complexity of the income tax system; further distort the capital markets making it more difficult for start-up ventures and small businesses to access the lending they need; and increase the costs and burdens from the regulatory state. As a result, the fallout from the pandemic's economic policies creates another barrier for entrepreneurs. It is important to note that these impacts do not

include the negative consequences for entrepreneurship from both the continued tax-and-spend program of the Biden Administration and the continued enabling of this spending by the Federal Reserve.

Without fundamental pro-growth policy reforms, the vibrancy of the entrepreneurial sector will be severely diminished going forward. The economic consequences will include fewer entrepreneurial opportunities, particularly for lower- and middle-income families, and diminished prosperity that will be felt for years to come. This paper, Part 5 in the *Breaking Down Barriers to Opportunity* series, reviews the federal government's economic response to the pandemic and details how these policies will hamper small businesses and entrepreneurs – now and in the future.

These adverse outcomes strongly argue for a radical change in economic policies that focus on establishing an affordable level of government, implementing fundamental tax reform that simplifies the current tax system and increases the incentive to work and invest, and conducting a comprehensive regulatory review with the goal of simplifying the code and reducing the cost of compliance.

Massive Debt Increase Harms Entrepreneurs

The federal government has spent unprecedented sums in response to the pandemic, most of which have been dedicated toward minimizing its economic consequences. Counting only the pandemic spending that was enacted starting in March 2020, a total of $5.9 trillion has been authorized of which approximately $4.7 trillion has been disbursed through August 2021, see Table 1. Table 1 tracks the total amount spent, or the total value of the tax breaks enacted, categorized by recipient rather than tracking the spending by Congressional Act.

TABLE 1
TOTAL FEDERAL SPENDING ENACTED IN RESPONSE TO THE PANDEMIC (IN BILLIONS)

ENACTED	DISBURSED EXPENDITURES	PROGRAM/PURPOSE	RECIPIENT
$835.0	$835.0	Paycheck Protection Program	Small business
$50.0	$22.9	Economic Injury Disaster Loans – the $50 billion authorization can support up to $475 billion in loans. As of 8/2/2021, $229 billion in loans have been approved.	Small business
$4.0	$0	Debt relief for socially disadvantaged farmers & ranchers	Farmers and ranchers
$53.4	$25.0	Payments to farmers	Farmers
$12.0	$1.3	Support for minority and community lenders	Minority and community lenders
$13.3	$6.7	Paid Leave Tax Credit for Small Companies	Small businesses
$967.7	$890.9	TOTAL SMALL BUSINESS DIRECT SUPPORT & TAX CREDITS	
$10.0	$6.3	Small business credit initiative	State, territory and tribal governments for S.B. credit programs
$9.6	$6.1	Loan programs to cover administration and 6 months of loan payments and interest to qualified small businesses	Small business administration

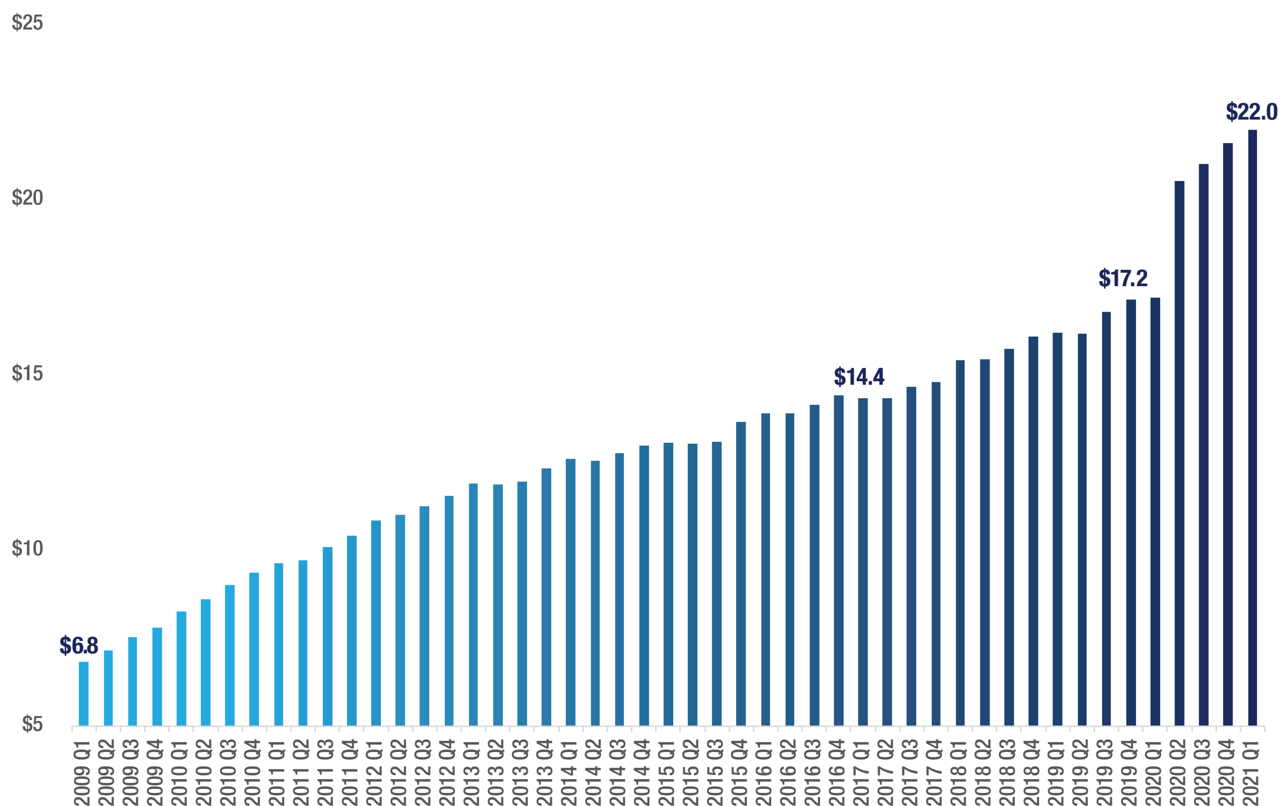
$19.6	$12.3	TOTAL SMALL BUSINESS INDIRECT SUPPORT	
$86.5	$80.1	Airline grants and loans	Airline industry
$28.6	$28.6	Grants to cover pandemic related losses	Restaurant Industry
$16.3	$12.0	Grants for venues who experienced at least 25% reduction in revenues	Venue operators
$0.7	$0.7	Loans to firms critical to national security	Businesses
$25.0	$25.0	Support Federal Reserve loan facilities	Businesses and state and local governments
$193.0	$193.0	Loosen Limits on Business Losses	Businesses
$85.0	$3.0	Delay of Employer Payroll Tax	Businesses
$45.8	$18.4	Employee Retention Payroll Tax Credit	Businesses
$13.4	$13.4	Loosen Limits on Interest Deductibility	Businesses
$6.3	$0	100% Business Meals Deduction Through 2022	Businesses
$11.7	$7.1	Other Tax Cuts (e.g., suspend airline and liquor taxes)	Businesses
$512.3	$381.3	TOTAL BUSINESS SUPPORT PROGRAMS & TAX CREDITS NOT S.B. TARGETED	
$706.0	$633.0	Unemployment benefits	Individuals
$80.2	$60.1	Nutrition funding	Individuals
$70.2	$55.8	Child & family services	Individuals
$39.0	$39.0	Delay student loan payments	Individuals
$869.0	$815.0	Direct Payments ($3,200 / person)	Individuals
$411.0	$400.0	Stimulus checks ($1,400 / person)	Individuals
$294.0	$274.0	Stimulus checks ($1,200 / person)	Individuals
$164.0	$141.0	Stimulus checks ($600 / person)	Individuals
$82.7	$64.3	Housing programs	Individuals
$100.0	$100.0	Accelerated and advanced Medicare payments	Individuals
$133.1	$105.9	Income support programs	Individuals
$110.0	$0	Extend education and disaster loan deferral	Individuals
$113.0	$14.9	Child Tax Credit Expansion	Individuals
$25.8	$25.8	Earned Income Tax Credit Expansion	Individuals
$25.0	$14.0	Unemployment Insurance Tax Relief	Individuals
$14.4	$14.3	Retirement Provisions	Individuals
$9.9	$0.9	Charitable Tax Breaks	Individuals
$8.8	$0.5	Health Savings Accounts Expansion	Individuals
$8.0	$0	Child and Dependent Care Tax Credit Expansion	Individuals
$4.1	$0	Earned Income and Child Tax Credit Lookback	Individuals
$1,973.4	$1,673.3	TOTAL INDIVIDUAL SUPPORT PROGRAMS & TAX CREDITS	
$662.0	$364.0	Health Spending	
$10.0	$10.0	Support for U.S. postal service	U.S. postal service
$884.0	$645.0	State and local funding	State and local governments
$601.0	$502.0	Broad tax benefits (e.g., cost to delay Tax Day)	Various
$222.8	$171.6	Other spending and administrative	Federal government agencies
$5,852.8	$4,650.4	TOTAL ENACTED/DISBURSED SPENDING	

Source: Committee for a Responsible Federal Budget

To put this $5.9 trillion in new spending in perspective, the dollar value of the new spending that the federal government authorized exceeded total federal outlays in 2019, which were $4.4 trillion.[2] Total federal revenues in 2019 were only $3.5 trillion, indicating that the government suffered from a chronic spending problem prior to the pandemic.[3] With the additional $5.9 trillion in spending, the spending problem has become a full-blown spending crisis.

Regardless of whether these expenditures were spent well or not, having spent an additional $4.7 trillion in a mere 18-months has adversely impacted the nation's growing debt problem. Compared to the first quarter of 2020, the total debt held by the public increased by $4.8 trillion through the first quarter of 2021, see Figure 1. The nearly $5 trillion increase in the total debt held by the public in one-year was larger than the entire increase in the debt during President Trump's first 3-years ($2.9 trillion increase) or more than half the increase in the debt during President Obama's 8-years ($7.5 trillion increase).

FIGURE 1
TOTAL TREASURY DEBT HELD BY THE PUBLIC
2009 Q1 THROUGH 2021 Q1
(IN TRILLIONS)



Source: St. Louis Fed, FRED

These data demonstrate that, any way you look at it, the total amount spent by the federal government just on the pandemic is unprecedented during peace time. From an entrepreneurial perspective, this crisis portends higher future taxes that will diminish the after-tax returns from starting a new business or operating a small business. Lower after-tax returns meaningfully diminish the incentive to start new ventures or expand operations, which will lead to a less vibrant entrepreneurial and small business sector.

Tax Relief Would Have Helped Small Businesses More Than Big Spending

Another way to understand the unprecedented size of these expenditures is to think of a less expensive alternative policy. Instead of passing all these programs and tax breaks, the federal government could have simply suspended the collection of all federal taxes and fees for 12 months. Such a proposal would have meant that over the 12 months between March 2020 and February 2021, no individual or business would have needed to pay payroll taxes, personal income taxes, corporate income taxes, excise taxes, capital gains taxes, etc. While not focused on those who are harmed, which is a problem with the spending programs that were implemented, such a proposal would immediately increase everyone's take home income. Businesses, large and small, facing less revenues due to the pandemic, would have received an immediate cost reduction that would have helped them keep their employees on staff. And entrepreneurs would have had an incentive to expand, offsetting the strong headwinds created by the pandemic.

This radical sounding program would have had a smaller fiscal cost, somewhere around $3.5 trillion, than the spending packages implemented. The reality that a complete tax moratorium would have had a smaller fiscal cost than the actual tax and spending packages implemented demonstrates the sheer enormity of the fiscal response.

> "Lower after-tax returns meaningfully diminish the incentive to start new ventures or expand operations, which will lead to a less vibrant entrepreneurial and small business sector.

Lack of Focused Spending Harms Entrepreneurs

Not only were the sheer sums that the federal government spent disconcerting, but the manner in which these expenditures were spent was not efficient. Start with one of the targeted programs that makes sense – spending money to compensate small businesses for losses that resulted from mandatory lockdowns and business closures. Once the government imposed forced business shutdowns and closings, then compensation for those who were impacted was warranted. Across the five rescue packages, about 19 percent of the total money spent through August 2021 was directed towards helping small businesses harmed by the pandemic. The vast majority (94 percent) was distributed through the Paycheck Protection Program (PPP).

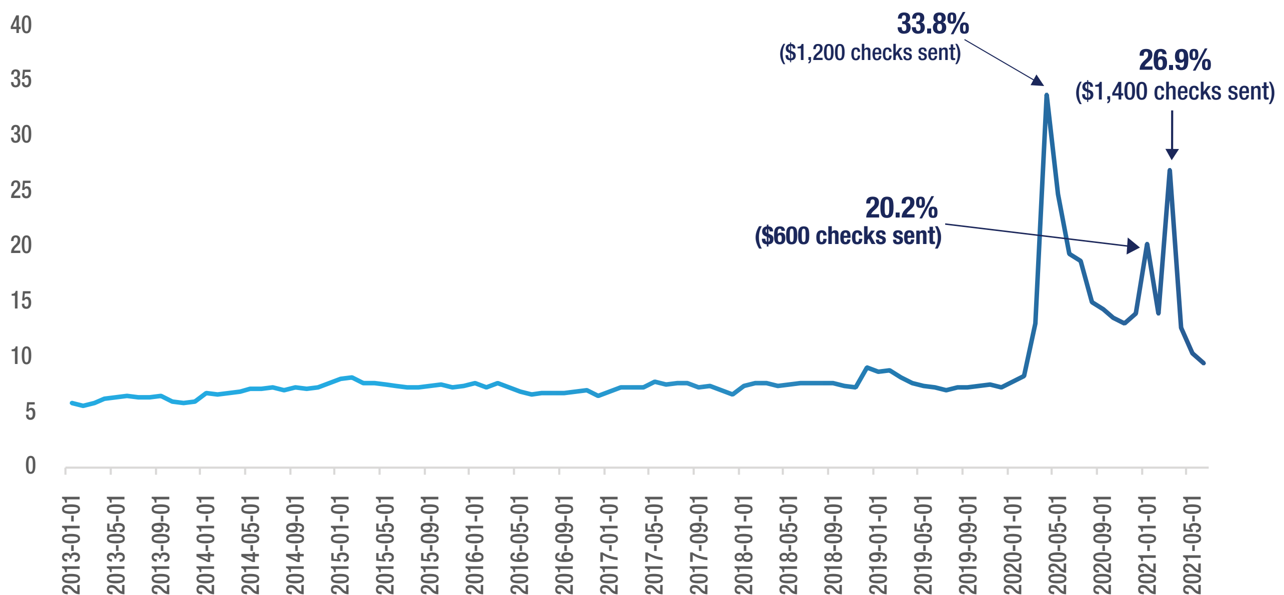
Undoubtedly, programs such as the PPP had some successes and enabled some small businesses to keep their employees on staff. Unfortunately, taken as a whole, the spending packages were inefficient, excessive, and poorly targeted. The initial rollout of the program was particularly troubling and failed to help small businesses. As Fischer (2020) noted, "the early evidence suggests that the Paycheck Protection Program is struggling to meet its intended goals" because the PPP did not generally go to small businesses in the hardest hit areas and did not "have a statistically significant impact on preventing avoidable layoffs."[4]

The results were not much better over the longer term. A study by Chetty et al. (2020) quantified the effectiveness of the PPP program finding that the "Paycheck Protection Program loans increased employment at small

businesses by only 2%, implying a cost of $377,000 per job saved."[5] The Federal Reserve's 2021 Small Business Credit Survey found that nearly one-half of the 77 percent of small businesses who received the entire value of the requested PPP loan still reduced the number of workers they employed.[6]

Besides directing income to small businesses, making direct payments to individuals was also a policy priority as Table 1 illustrates. In fact, even more of the funding (36 percent) were payments made directly to individuals. The three "stimulus checks" totaling $3,200 comprised about one-half of this funding (49 percent). These payments were sent to individuals based on income, not whether a family was adversely impacted by the pandemic-induced shutdowns. This lack of focus blunted the effectiveness of these expenditures. Rather than sending money to families who were facing pandemic-induced economic hardships, an exceptionally large share of the payments went to families whose incomes were not adversely impacted, which is why the personal savings rate spiked to unprecedented levels each time stimulus payment checks were sent out, see Figure 2.

FIGURE 2
PERSONAL SAVINGS RATE
JANUARY 2013 THROUGH MAY 2021
(IN PERCENT)



Source: St. Louis Fed, FRED

Since 1990, and prior to the pandemic, the personal savings rate in the U.S. had been averaging around 6 to 7 percent. As Figure 2 demonstrates, when each one of the stimulus payments was sent out, the savings rate jumped to between 20 and 34 percent. Families that lost their jobs due to the pandemic would not be able to save these payments – they would need to spend them on mortgage/rent, food, and utilities. Having the ability, and desire, to save these checks demonstrates that many of the recipients were not facing income shortfalls due to the pandemic and treated the payments as a financial windfall.

The same logic applies to the 14 percent of the spending that went to state and local governments. While there was widespread concern regarding the pandemic's fiscal impact on the states initially, the impact on most states was significantly less than feared and state revenues quickly recovered. As the key takeaways from a Federal Reserve Bank of St. Louis report noted,

> Although 2020's pandemic-related recession was deep, state tax revenue losses were not as severe as in past recessions…
>
> Projections for state tax revenues in 2021 are optimistic, although overall recovery slowed at the end of 2020, and uncertainty remains.[7]

These three areas (sending payments to small businesses, individuals, and state and local governments) account for 69 percent of the spending. Most of these expenditures were either ineffective (e.g., the PPP program) or poorly targeted (e.g., checks to individuals whose incomes were not adversely impacted by the COVID-19 shutdowns). This same critique also applies to the remaining 31 percent of the spending. For instance, the current estimated cost for deferring student loan payments is $39 billion. Individuals and families qualify for this benefit based on whether they have school loans, not whether the pandemic has adversely impacted them financially. Therefore, just like with the stimulus checks, this money was sent out based on a criterion other than whether someone was adversely impacted financially. And just like with the stimulus checks, such a criterion is a recipe for waste and ineffectiveness. The pervasiveness of this problem throughout the pandemic expenditures is an indication that the majority of the $5.9 trillion was wasteful and/or poorly designed.

The pervasive waste indicates that it was not necessary to lower future after-tax returns for small businesses and entrepreneurs to respond to the "once in a century" emergency. Instead, the economy is bearing the costs of associated high debt and tax burdens without having gained any appreciable benefits in the present in terms of efficiently offsetting the economic costs associated with the pandemic.

Unsound Money Impacts Entrepreneurs' Ability to Invest in Growth, Jobs

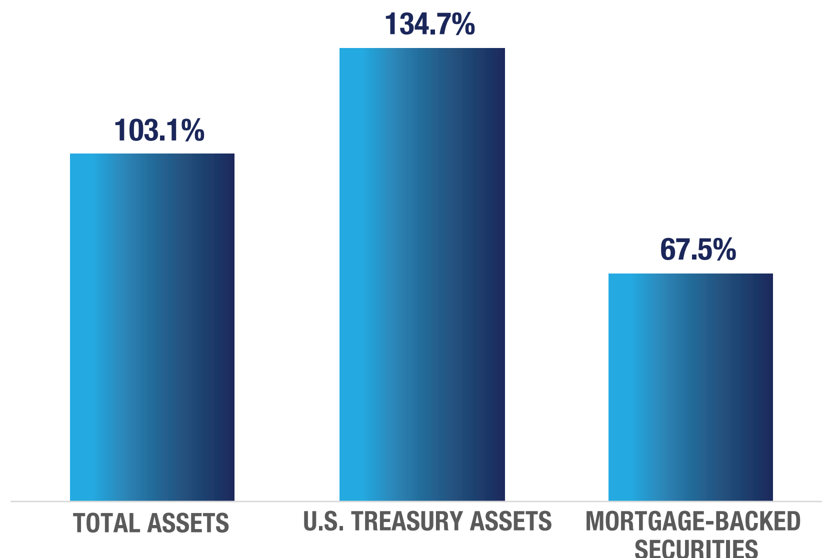
The economic consequences from the fiscal profligacy have been magnified by the supportive actions of the Federal Reserve, which are creating a more volatile inflationary environment.

Clearly there is a role for monetary policy during times of economic distress. However, the Federal Reserve went well beyond these roles during the pandemic. Part of the problem stemmed from the Fed's policy of Quantitative Easing (QE). QE occurs when the Federal Reserve purchases bonds with longer-term durations. Typically, the Fed's QE operations purchase longer-term government bonds, but it also has purchased corporate bonds, and mortgage-backed securities. Figure 3 illustrates the magnitude of the latest iteration of Quantitative Easing (the Federal Reserve first engaged in Quantitative Easing following the 2008-09 financial crisis). Figure 3 demonstrates that compared to the size of its balance sheet prior to the pandemic, the Federal Reserve is now holding more than double the amount of total assets (+103.1 percent) and double the amount of federal government bonds (i.e., Treasuries, +134.7 percent), and significantly more mortgage-backed securities (+67.5 percent).

The announced purpose of the QE was to stimulate the economy, ensure that capital markets continued to function properly, and ensure markets had sufficient liquidity.[8] Whether intentional or not, the Federal Reserve's QE policy also enabled the government's fiscal profligacy, see Figure 4. Figure 4 breaks down the ultimate holders of the newly issued federal debt in 2020 and 2021. As demonstrated in Figure 4, the Federal Reserve was the primary purchaser of this debt. While the publicly held debt of the federal government increased by $4.8 trillion during the pandemic, the Federal Reserve increased its holdings by $2.8 trillion, or 57 percent of the total increased debt. The increased demand for government Treasuries by the Federal Reserve made it easier for the federal government to engage in its unprecedented spending spree – essentially, the Fed has taken on fiscal policy responsibilities. As will be discussed below, the Federal Reserve cannot double its balance sheet without consequence, many of which will make entrepreneurial ventures more difficult in the future unless these trends are reversed.

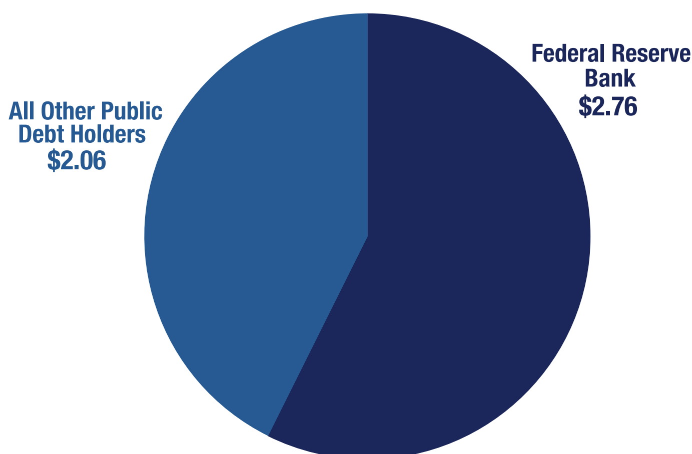
A similar phenomenon is happening in the mortgage markets.[9] Figure 5 presents the year-over-year percentage change in the Federal Reserve's purchases of mortgage-backed securities compared to the year-over-year percentage change in the median sales price of a home in the U.S. Not unexpectedly, the change in the median sales price will fluctuate for reasons other than whether the Federal Reserve is purchasing mortgage-backed securities or not. However, there is also a clear connection to significant changes in the Fed's purchases of

FIGURE 3
PERCENTAGE GROWTH IN FEDERAL RESERVE'S TOTAL ASSETS, TREASURY HOLDINGS, AND HOLDINGS OF MORTGAGE-BACKED SECURITIES
DECEMBER 2019 THROUGH AUGUST 2021



Source: St. Louis Fed, FRED

FIGURE 4
HOLDERS OF $4.8 TRILLION INCREASE IN FEDERAL DEBT HELD BY THE PUBLIC
FEDERAL RESERVE COMPARED TO ALL OTHER HOLDERS
CHANGE BETWEEN 2019 Q4 AND 2021 Q1
(IN TRILLIONS)

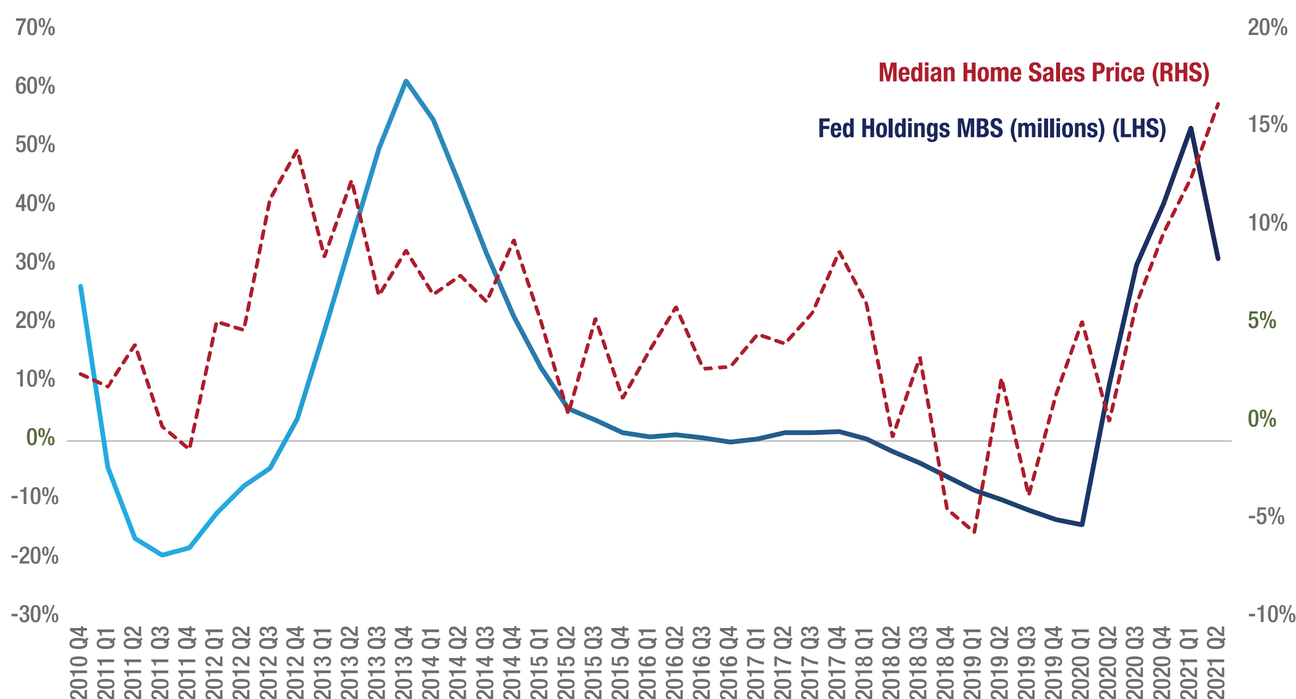


Source: Author calculations based on data from St Louis Fed, FRED

mortgage-backed securities and the change in the median sales price of a home. When the Fed accelerated its purchases, such as during 2013 and 2014, and once again in 2020, growth in the median sales price of a home increased. When the Fed's purchases of mortgage-backed securities slowed, or even declined, the growth in the median sales price of a home decelerated or even declined.

This close relationship is precisely what you would expect. By increasing the liquidity in the mortgage market, the Federal Reserve incentivized increased home buying that increased home price pressures once the supply constraints are recognized. When the Fed stopped distorting the capital allocation process, the incentive to purchase homes lessened, lessening the pricing pressures.

FIGURE 5
YEAR-OVER-YEAR PERCENTAGE CHANGE IN FEDERAL RESERVE PURCHASES OF MORTGAGE-BACKED SECURITIES
COMPARED TO YEAR-OVER-YEAR PERCENTAGE CHANGE IN MEDIAN U.S. HOME SALES PRICES
2010 Q4 THROUGH 2021 Q2



The Federal Reserve has not just created distortions in the amount of government spending and the mortgage markets. Congress and the Trump Administration authorized the Fed to create or expand several emergency lending facilities that could lend up to $2.3 trillion. Specifically, the lending facilities

> were intended to provide credit to a variety of sectors—including small- and medium-sized businesses, money market mutual funds, consumer lending, and corporate and municipal borrowing. As required under the Dodd-Frank Act, Treasury Secretary Steven Mnuchin approved the establishment of these 13(3) facilities.

In conjunction with the creation of these facilities, Congress passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act that allocated up to $454 billion in Treasury funds to augment the Fed's lending resources and absorb potential losses from defaults on emergency loans. Concerns about the Fed's legal authority to engage in risky lending may have prompted this infusion of Treasury capital.[10]

Table 2 summarizes the breadth and use of these lending facilities. In theory, their purpose was to ensure that the economy had sufficient resources so businesses could cover their necessary expenditures. In practice, these lending facilities signal a dramatic change that threatens the Fed's ability to maintain the dollar's value.

TABLE 2
FEDERAL RESERVE LENDING FACILITIES IN RESPONSE TO THE COVID-19 ECONOMIC CRISIS AMOUNTS AS OF MARCH 2021

	(in billions)		
	Maximum Amount Authorized	Total Loans Outstanding	Loans Share of Authorized Amount
Commercial Paper Funding Facility	-	-	-
Main Street Lending Program	$600.0	$16.5	2.8%
Money Market Mutual Fund Liquidity Facility	-	$0.5	-
Municipal Liquidity Facility	$500.0	$6.2	1.2%
Paycheck Protection Program Liquidity Facility	$659.0	$57.4	8.7%
Primary Dealer Credit Facility	-	-	-
Corporate Credit Facility	$750.0	$14.0	1.9%
Term Asset-Backed Securities Loan Facility	$100.0	$2.6	2.6%
TOTAL FUNDING FACILITIES	**$2,609.0**	**$97.2**	**3.7%**

Source: Cheng et. al.[11]

Traditionally, one of the primary roles of the Federal Reserve is to act as a lender of last resort to the banking sector. In serving this role, the Fed does not allocate credit to different economic sectors or firms. Instead, it provides sound financial institutions access to funds when solvent financial institutions are facing liquidity constraints. This lending is an important component of money policy because if liquidity problems cause solvent financial institutions to go bankrupt, an economically destructive contraction in the money supply can occur. The financial crises that can arise from such an unnecessary contraction in the supply of money is behind many recessions and depressions throughout history – taking away access to credit and capital relied upon by entrepreneurs to grow their businesses and create jobs.

The newly established lending facilities serve a very different function than the already difficult task of ensuring adequate market liquidity. These lending facilities are not part of the Fed's lender of last resort responsibilities because the programs create a relatively new power to directly lend money to nonfinancial institutions. These loans are not designed to manage the money supply, instead their purpose is to allocate credit to firms and industries that politicians want to see supported. It empowers a supposedly non-political institution to pick economic winners and losers.

The Federal Reserve is not a venture capitalist, nor a bank. It has no expertise in making these types of loans, meaning their ability to evaluate their creditworthiness is suspect, which makes it likely that these loans will not be extended efficiently. Adding in the reality that taxpayers are backing these loans, regardless of whether the policy is a good idea or not (they are not), these actions clearly fall under the domain of fiscal policy – the allocation of taxpayer dollars should be explicitly made by Congress and the President who are directly accountable to voters. In this way, should the loans go bad voters know who was responsible rather than a supposedly non-political institution.

Taken together, these Federal Reserve actions have the troubling impact of interfering with the Fed's ability to execute one of its prime directives of maintaining a sound monetary environment. As discussed below, an unsound monetary environment worsens one of the major obstacles for a vibrant entrepreneurial sector – credit availability.

So-Called COVID-19 Relief Actually Creates New Regulatory Obstructions

While less visible, the regulatory burden has also increased during the COVID-19 pandemic. According to the Regulatory Studies Center at George Washington University, there were 215 new regulations issued in 2020 that were due to the COVID-19 pandemic.[12] Some of these changes were geared toward regulatory relief, and regulatory relief is undoubtedly necessary for promoting a more pro-growth entrepreneurial environment. However, even in the cases where the regulatory changes attempted to reduce regulatory burdens, these changes were poorly designed and added increased uncertainty instead of creating a less burdensome regulatory environment. Take the payroll tax deferral as an example.

In an attempt to put more dollars into workers' pockets, the Trump Administration offered a temporary deferral of the employee's share of the payroll tax that became effective in September 2020. However, the increase in paychecks was not only temporary, but it had to be repaid by April 30, 2021. The temporary nature of the relief coupled with the uncertain impact that the repayment would have on their employees, discouraged businesses large and small from availing themselves of the regulatory relief. As *The Hill* reported at the time, private sector employers were reticent to participate in the program because

> they're concerned their employees may end up with smaller paychecks next year because of the need for individuals to repay the deferral by April 30.
>
> The decision by many business leaders to pass on the program marks a setback for Trump's attempt to increase workers' paychecks during the pandemic just weeks before the presidential election….
>
> "We recognize that for some, it may have been helpful to have more money in their paychecks in 2020," Zaccara added. "Yet, not all employees have professional tax planning needed to prepare effectively for the added obligation they would face in 2021."[13]

Most regulatory changes were not implemented for the purpose of providing regulatory relief, however. The majority were justified as necessary to implement the fiscal programs (e.g., the Paycheck Protection Program) or to directly address the health crisis (e.g., the implementation of travel restrictions or the implementation of the eviction moratorium). As discussed in the next section, the consequences from the eviction moratorium exemplify the anti-entrepreneurial legacy from these actions.

The Adverse Consequences for a Vibrant Entrepreneurial Sector

These policy responses have created broad negative consequences for the economy, some of which are already manifesting themselves (e.g., increasing inflation that has arisen in the summer of 2021). This paper focuses on the negative impacts for entrepreneurs and small businesses, and these implications are troubling.

Before evaluating the future impacts, it is important to recognize that small businesses and entrepreneurial ventures were disproportionately impacted by the pandemic's economic consequences. Fairlie (2020) evaluated the initial impact from the pandemic on small businesses finding that,

> the number of active business owners in the United States plummeted by 3.3 million or 22% over the crucial 2-month window from February to April 2020. The drop in active business owners was the largest on record, and losses to business activity were felt across nearly all industries. African-American businesses were hit especially hard experiencing a 41% drop in business activity. Latinx business owner activity fell by 32%, and Asian business owner activity dropped by 26%.[14]

Through the first quarter of 2021, small businesses had still not fully recovered. According to an analysis by the Small Business Administration, the number of self-employed people were still 3.6 percent below the first quarter of 2020.[15] The bounce back in the self-employed has also stagnated, which could portend continued struggles for the small business sector in the future. The number of small business closures confirm these hardships. A study by the World Economic Forum found that "on a national scale, 34% of small businesses are closed [as of January 2021] compared to January 2020. San Francisco is one of the most affected metro areas, with a 48% closure rate of small businesses. New York City has spiraled the most since the end of September 2020."[16]

A study by the Kauffman Foundation supports these findings. Overviewing their results, their study found that

> In general, during the pandemic, entrepreneurs with a younger business were more likely than those with an older business to report that potential barriers were a challenge.
>
> Across business ages, entrepreneurs were most concerned with *finding new customers*. Among entrepreneurs with a new business, *finding new customers* surpassed *funding to start the business* as the top reported challenge during COVID-19.
>
> Accessing startup and growth financing during COVID-19 conditions was a bigger challenge for entrepreneurs with a new business less than 1 year old, compared to entrepreneurs with a young or mature business.[17]

Taken together, these studies demonstrate that the entrepreneurial sector has taken a big hit from the pandemic that the support programs were unable to prevent. While advocates for these programs may respond with the counterfactual that the entrepreneurial sector would be worse off if not for these programs, the more important issue is the impact from these policies and their consequences for the entrepreneurial economy going forward. And there are many reasons to be concerned that these policies have created additional barriers that make it more difficult for entrepreneurs to innovate and thrive.

Let's start with the future tax implications of the new debt that has been issued. Even at the exceptionally low interest rates that prevail as of August 2021, just paying the interest on the $4.9 trillion in debt requires substantial future tax increases. According to the U.S. Treasury, the current weighted average maturity of outstanding debt is 63.4 months, which is around the historical weighted average of 60 months (5-years).[18] The interest rate on a 5-year Treasury bond as of August 11, 2021, was 0.81 percent.[19] Financing the additional $4.9 trillion in debt that largely resulted from all this fiscal spending will cost taxpayers nearly $40 billion a year, or $331 per household, just to cover the additional interest expenses.

> "And there are many reasons to be concerned that these policies have created additional barriers that make it more difficult for entrepreneurs to innovate and thrive.

The cost for entrepreneurs will be even higher, however. The Tax Policy Center's analysis of "tax units with zero or negative income tax" estimated that as of 2021 there were only 76.5 million individual income taxpayers relative to 178.1 million tax units.[20] Since only 43 percent of tax units actually pay the income tax, the burden on those taxpayers, which include many entrepreneurs and small businesses, will be even higher. Dividing the $40 billion annual cost over the 43 percent of tax units that pay the income tax implies a per taxpayer cost of $753.

This is a best-case scenario, however, since interest rates are at such historically low levels. Should interest rates rise from these historical lows to 1.7 percent, which is the average 5-year Treasury Bond interest rate between 2009 and 2019, then the costs per taxpaying household would increase to nearly $1,600. Should rates return to the average during the early 2000s, around 4 percent, then the costs jump to over $3,700 per taxpaying household.

These figures demonstrate that the excessive spending that has not achieved much has created a large future fiscal cost. Without offsetting spending cuts, then the direct way to just cover the interest costs on this debt requires substantial tax increases that will, among other adverse consequences, reduce the after-tax return from entrepreneurial ventures. As these tax increases inevitably come with more complexity, the COVID-19 spending spree also threatens the economy with a more complex tax system that will require entrepreneurs to allocate even more time and costs toward tax compliance. As a result, the consequences from the COVID-19 spending spree will be dampened incentives for continued entrepreneurship.

Directly raising taxes is not the only way that the government can finance the debt it has incurred, unfortunately. As Figures 3 and 4 illustrated, the Federal Reserve has accommodated the increased government debt by purchasing government bonds and allowing inflation to increase. A rising inflationary environment decreases the real burden of the government's debt making it possible for the federal government to cover the debt costs without having to raise taxes (or with smaller tax increases). While the uptick in inflation helps the government manage the costs associated with its pandemic spending, it has pernicious impacts on entrepreneurs.

Andres and Hernando (1997) performed a comprehensive analysis of the impact of inflation on economic growth across many developed economies.[21] Their results confirmed that higher inflation always undermines a country's sustainable rate of economic growth by reducing the level of business investment and the efficiency of that investment. As the previous analyses in PRI's *Breaking Down Barriers to Opportunity* series demonstrated, such economic environments are detrimental to small businesses and new entrepreneurial ventures.

Burdensome and uncertain regulations, another barrier to entrepreneurship, has also worsened since the pandemic hit the U.S., indicating dire consequences for the future entrepreneurial environment. Perhaps more than any other regulatory action, the eviction ban exemplifies the potential future damage.

While ostensibly implemented as a public health measure, the eviction moratorium is an economic taking from landlords without any compensation for their losses. And the economic taking is quite large. According to the Pew Trusts, "the nationwide total rent debt is upward of $20 billion, with more than 5.8 million renters, or 14 percent, in arrears."[22] Making things worse for the small business economy, as CNBC documented,

> The majority of the nation's landlords are individual investors. They own about 23 million units in 17 million properties, according to the U.S. Census. More than 6 million renter households are behind on rent, also according to the Census. Landlords have next to no recourse.[23]

Of course, there are undoubtedly renters who have lost their income due to the economic shutdowns and require help. But the blanket moratorium is the wrong way to help them. The economics of the eviction moratorium does not help anyone on net. All it does is fund an economic benefit for renters by taking money away from landlords.

Keep in mind that many landlords are not corporate owners as you might expect. Many landlords are small entrepreneurs. Some rent out a small apartment building or second home that has been in the family for generations to help make ends meet. Many landlords are senior citizens who rely on rental income for a primary income, or secondary income when combined with small pensions or Social Security checks. Often landlords can be seen as the ultimate small entrepreneur.

"Many landlords are senior citizens who rely on rental income for a primary income, or secondary income when combined with small pensions or Social Security checks. Often landlords can be seen as the ultimate small entrepreneur.

To the extent that a transfer to renters is warranted, then it is the responsibility of all taxpayers to fund this transfer through an explicit subsidy paid to the renters. The government has implemented programs that are designed to directly help renters who have been economically harmed by the pandemic and cannot afford their rent, but these programs have been ineffective. Nevertheless, the government's incompetence is no excuse to force these costs on to landlords.

The adverse consequences of the moratorium are even worse, however. The moratorium is a blunt policy that subsidizes people who are not adversely impacted by the economic shutdowns in addition to those who have been. Therefore, the moratorium forces landlords to bear costs that are significantly higher than necessary to help the intended population.

There are long-term consequences from these policies as well. Harming small businesses and landlords today reduces their ability to meet their financial goals and invest in the future success of their business. The vibrancy of these small businesses is compromised as a result. Additionally, imposing capricious and arbitrary regulations such as eviction moratoriums sends an anti-growth message to current and potential entrepreneurs that will disincentivize future business start-ups. And, ironically, these policies can be the catalyst to push small or family entrepreneurs that own apartment buildings or a few rental homes to sell their properties to corporate ownership.

The Path Not Taken – Will We Follow Reagan or Sanders?

The federal government's response to the pandemic leverages the same wrong-headed theories encouraging President Biden to implement Bernie Sanders' vision of a radically expanded welfare state. Whether through fiscal, monetary, or regulatory actions, the federal government is operating based on the premise that active government management of the economy drives economic prosperity. Yet, the economic response to the pandemic demonstrates the opposite.

The government's response to the pandemic's economic consequences has been a costly failure. The size and scope of the federal government's operations drastically expanded, but these actions have been inadequate relative to the challenges the economy faced. Fiscal policy has spent trillions of dollars, while still failing to provide an adequate safety net for those people harmed by the economic shutdowns. Monetary policy has devalued the dollar, primed the economy for a destructive bout of inflation, and helped enable the fiscal spending spree by monetizing a majority of the newly issued debt. Regulatory actions have been ineffective, erratic, and costly. With respect to entrepreneurs and small businesses, these policies have created new barriers that, if not broken down, will make it more difficult for small businesses and entrepreneurs to thrive. Consequently, the government's response to the pandemic is another demonstration that when government expands beyond its core competencies, its actions become detrimental to prosperity.

> "Instead of hoping that an expanded federal bureaucracy will increase entrepreneurial innovation, policy reforms should empower individuals by reducing the government created barriers to entrepreneurship.

And so, we have come to a defining moment. It is likely that the Democratic Congress and President Biden will leverage the economic actions taken during the pandemic to dramatically expand the welfare state. If implemented, the anti-entrepreneurial incentives initiated during the pandemic will be enshrined. The consequences will be a less prosperous future with fewer entrepreneurial ventures, fewer opportunities for lower- and middle-income families to increase their wealth, and less innovation and prosperity.

The economic lesson from the pandemic reinforces President Regan's maxim that "outside of its legitimate function, government does nothing as well or as economically as the private sector." Instead of hoping that an expanded federal bureaucracy will increase entrepreneurial innovation, policy reforms should empower individuals by reducing the government created barriers to entrepreneurship.

Such reforms should begin by putting the federal government on a strict budget. As PRI's *Beyond the New Normal* research program demonstrated, economic growth is compromised when the size of the government expands beyond its affordable level.[24] Prior to the pandemic, total government spending had already far exceeded that level, and the current spending blowout has only made things worse.

To regain spending control, the government should limit the growth of spending to below the growth in the economy until an affordable level of government spending is established – ideally setting government expenditures equal to around 15 percent of the economy. Reaching such a goal requires fiscal discipline that has been

missing in Washington D.C. for decades. Yet empowering a more vibrant entrepreneurial sector demands it. As I documented in *Beyond the New Normal*,[25] a sustainable fiscal path, which is financially simple but politically complicated, can be established by:

- Reforming Social Security by eliminating the practice of over-adjusting benefits for inflation and adjusting the full retirement age.
- Reforming health care programs by implementing a market-based system and implementing broad-based health care reforms that have a demonstrated track record of reducing health care costs while improving health care quality.
- Reforming income transfer programs by eliminating corporate welfare and consolidating the income support programs into a simple cash-based system.
- Capping the growth in defense spending while enabling the reprioritization of existing military spending to reflect military, rather than political, priorities.
- Paying down the debt by privatizing government assets including gold holdings, land holdings, buildings the federal government owns (many of which are under-utilized and unneeded), oil held in the strategic petroleum reserve, and mineral deposits. An orderly sale of federal assets can stabilize the national debt and interest costs.
- Imposing a hard spending cap on the remaining discretionary programs and prioritizing programs so important needs like infrastructure receive more funding, while other programs receive less or are eliminated.

Lessening the government's fiscal burden on entrepreneurs must go beyond the amount of spending. The current tax system is overly complex and punitive, which has a particularly anti-growth impact on the entrepreneurial sector. Individuals and businesses pay substantially more than $1 for the government to receive $1 of federal tax revenue. These costs include the time collecting records, organizing files, and wading through the tax code to determine exactly what their tax liability is; the direct outlays hiring accountants, lawyers, tax professionals, and purchasing tax software to track, measure and pay the tax liability; and, the administrative costs of the IRS, which are solely required to enforce the tax code. The costs also include the efficiency losses to the economy when business change their behavior based on the potential tax consequences rather than whether the actions better serve customers. A 2011 study by Laffer, Winegarden, and Childs estimated that a partial accounting of these costs still equaled "$431.1 billion annually, or 30 percent of total income taxes collected".[26]

Entrepreneurs and small businesses lack the scale of larger businesses, meaning these costs are disproportionately imposed on the entrepreneurial sector. Consequently, another reform priority must be to establish a simpler, less costly tax system that improves the after-tax returns to entrepreneurship and reduces the time and expenses associated with tax compliance. Ideally Congress and the White House should consider scrapping the federal tax code altogether and implement a simple flat tax that would junk the complexities of the Internal Revenue Service and its massive tax bureaucracy and instead put in place a clear and easy-to-understand tax system that reduces the cost of tax compliance and the cost of the tax-collection bureaucracy.

As the first paper in PRI's *Breaking Down Barriers to Opportunity* series demonstrated, "the complex regulatory state also promotes crony capitalism, wastes millions of hours of work on low-productivity compliance activities, and distorts the capital structure."[27] Further, this labyrinth of federal regulations, like the costs of tax compliance, is a barrier for entrepreneurs that disadvantages smaller firms relative to their larger competitors. Fundamental regulatory reforms are necessary. To strengthen the small business economy, the federal government should be focusing on streamlining these regulations and reducing compliance costs, particularly

the regulatory barriers that increase the financing costs for small businesses – one of the oft-cited barriers to entrepreneurship – rather than the current push to worsen these barriers.

Entrepreneurs play an irreplaceable role in the economy. Without their efforts, there would be fewer innovations and less economic opportunities. The economic response to the COVID-19 pandemic has created new barriers to entrepreneurship that the current Administration and Congress intend to increase. Without a course correction, the results will be as predictable as they are undesirable.

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