

Policies to Improve Financial Health and Expand Economic Opportunity in America

2021 holds tremendous promise and potential – to collaboratively combat and contain the COVID-19 pandemic; to support the dreams of small business owners; to improve the financial health of millions of Americans; to advance racial equity and social justice; and to restart the engine of the national economy. Quarantines and shutdowns have suppressed local economic activity, driven unprecedented sectoral job losses, depressed incomes and reduced consumer spending. Small and medium- sized businesses (SMBs) and lower-income populations, particularly communities of color, have been the hardest hit.

With the vaccine rollout and potential return to economic normalcy, we have an opportunity to rebuild and reshape our economic underpinnings in a way that makes us stronger, more resilient, and more equitable than before. In pursuit of this opportunity, PayPal offers the following insights and policy recommendations.

Solutions to Drive SMB Growth & Resiliency

The Challenge

The COVID-19 pandemic is a once-in-a-hundred-year event that has devastated SMBs. It has driven a severe contraction in business activity and caused one of the highest rates of commercial bankruptcies in the past decade.¹ The economic conditions have had a disproportionate impact on minority-owned businesses, with Black-owned businesses seeing a 41% drop in revenue in Q2 of 2020.² Absent federal relief and related interventions, the damage would have been even more severe.³ And more will need to be done in 2021 to help restart the SMB engine that has been powering the U.S. economy. Treasury Secretary Janet Yellen said that “We need to make sure that we provide a bridge so that people aren’t scarred indefinitely by this crisis. [...] We want to make sure [...] that these small businesses that need help survive.”⁴ According to a survey jointly conducted by Morning Consult and PayPal in November 2020, 60% of SMBs have \$25,000 or less cash on hand and 41% have less than \$10,000.⁵ These businesses would only be able to maintain operations for four months if their revenue dried up or they didn’t get immediate access to capital. Moreover, respondents from Black, Indigenous and People of Color (BIPOC) communities were twice as likely to list access to capital as a key challenge.⁶

Proposed Solutions

Digital tools will be increasingly important for the ongoing competitiveness, resiliency, and indeed survival of many SMBs.⁷ Innovative policies are needed to help SMBs enhance their digital strategies and adoption of digital tools, including the access to capital needed for related investment.

An “SMB Digital Transformation” package would support SMBs and create a more equitable environment to promote the survival and competitiveness of a sector that is critical to the national economic and social fabric:

- i Enhance SBA Digital Lending Programs and Products.** Access to capital with flexible repayment terms and appropriate safeguards during the coming year will be critical in helping SMBs navigate this period and implement digital strategies.

By leveraging the existing Paycheck Protection Program (PPP) infrastructure and targeted loan products, policymakers should create an extended 12-month loan guarantee program with a time-based phase-out mechanism in order to support SMBs. The program should leverage the

¹<https://www.abi.org/newsroom/press-releases/total-bankruptcy-filings-drop-30-percent-in-calendar-year-2020-commercial>; <https://www.globenewswire.com/news-release/2020/10/05/2103688/0/en/Chapter-11-U-S-Commercial-Bankruptcy-Filings-up-78-in-September.html#:~:text=Continuing%20the%20trend%20from%20the.a%20total%20of%205%2C529%20filings>.

²https://www.newyorkfed.org/medialibrary/media/smallbusiness/Doublejeopardy_COVID19andBlackOwnedBusinesses

³ PayPal research has demonstrated that digital solutions, including commerce platforms, financial tools, and loans provided through the PPP enabled SMBs to transact, conduct business online, and meet financial obligations. More specifically, “digital” small businesses using PayPal payment systems saw 25% year-over-year (YoY) growth in Q2 of 2020, compared to a publicly reported 9% drop in revenue for overall SMBs and a -3.6% growth in overall U.S. retail in the same quarter. Additionally, digital SMBs that received PPP loans in April recorded -15% YoY revenue growth in the month before the loan and recorded an average of 14% YoY growth in the three months after the loan.

⁴<https://www.wsj.com/articles/yellen-says-we-need-to-act-big-on-covid-relief-1161244711>

⁵ Respondents to this survey have between 1 to 500 employees with less than \$75million in annual revenue. For more details, please refer to https://publicpolicy.paypal-corp.com/sites/default/files/MC_PayPal_SMB_Confidence_Index_Report_Q4_2020.pdf

⁶<https://newsroom.paypal-corp.com/2020-01-19-Introducing-the-PayPal-Morning-Consult-Small-Business-Confidence-Index>

⁷https://publicpolicy.paypal-corp.com/sites/default/files/policy/C19_and_Digital_SMBs_PayPal.pdf

existing PPP framework since bank and non-bank lenders have built systems that can integrate with existing government/Small Business Administration (SBA) processes. And the SBA should approve a broader range of eligible SMB loan products that can serve different business types, needs, and use cases. For example, shorter-duration term loans (2-3 years) and revenue-based repayment loan products are ideally situated to an SMB borrower navigating a gradual (and bumpy) business restart.

Partnerships between the SBA and non-bank fintech lenders can also be an effective way to provide funding access to SMBs that have traditionally been underserved by the financial system. For example, PPP loans provided through PayPal in 2020 were over-indexed in the majority of the top 30 counties that have the highest density of Black business activity, contrary to overall PPP lending. Also, the average size of PayPal-facilitated PPP loans was \$28,000, far below the overall PPP average of \$100,729.⁸

- ii **SMB Digitization Deduction.** Enhancements to the Tax Cuts and Jobs Act, which expanded deductions for technology, software and IT purchases, could further help SMBs make necessary digital infrastructure investments. One proposal would be to double the effective expense deduction for every dollar that SMBs spend on digital tools, such as payments, online marketplaces, internet or mobile delivery partnerships, and website upgrades, to support their transition and integration to the broader digital economy. These cuts would target stimulus to productive investments that would help SMBs during and emerging from the pandemic.
- iii **Rebuild Main Street by Digitizing It.** As part of a broader national digital connectivity and 5G implementation strategy, the federal government and local officials should carefully consider the impact and benefits to SMBs. Small and medium-sized businesses should be prioritized to receive connectivity assistance, as should lower-income individuals who would then be empowered to access needed goods and services from these businesses. PayPal data from Q2 2020 shows that digital SMBs saw 25% year-over-year (YoY) growth in Q2 of 2020, in sharp contrast to a publicly reported 9% drop in revenue for overall SMBs and a -3.6% growth in overall U.S. retail in the same quarter.⁹

Promoting Consumer Financial Health & Opportunity

The Challenge

The pandemic has highlighted the persistent and significant economic divides across the population and exacerbated the financial vulnerability of millions of underserved Americans. In other cases, government infrastructure struggled with the timely distribution of COVID relief money, tax refunds and PPP loans.¹⁰ Upgrades to digital infrastructure and the provision of digital financial tools can enhance access for millions of underserved Americans, lower costs, reduce fraud, increase savings, and ultimately, improve financial security.

⁸ https://publicpolicy.paypal-corp.com/sites/default/files/policy/C19_and_Digital_SMBs_PayPal.pdf

⁹ https://publicpolicy.paypal-corp.com/sites/default/files/policy/C19_and_Digital_SMBs_PayPal.pdf

¹⁰ <https://finance.yahoo.com/finance/news/watchdog-report-stimulus-checks-tax-refunds-irs-missteps-165139090.html>

Proposed Solutions

A “Digital Financial Health” package should focus on upgrading financial systems and infrastructure in order to reach underserved and underbanked populations, and would facilitate access to digital tools that support financial health and opportunity:

- i Modernize Digital and Online Identity.** Access to digital financial services and tools is predicated on the ability of providers to verify the identity of individuals seeking such access. Digital identity solutions that are inclusive, interoperable, and broadly adopted can also be used as reliable enablers for the delivery of a range of services that require proof of identity, such as licenses and welfare payments.

The development of digital identity solutions would benefit from API access to government-held data that can increase speed and accuracy of identity confirmation. There have been discrete efforts to build such APIs, including an IRS income verification initiative, but these efforts need to be far more comprehensive and coordinated across agencies.¹¹

The government could also foster the creation of digital identity solutions by convening cross-sector stakeholders, ensuring that existing regulation is not chilling further innovation, and helping develop common standards. A broad policy initiative, such as the *Improving Digital Identity Act of 2020*,¹² can establish a government-wide effort to develop secure methods for Federal, State, and local agencies to validate identity attributes and to support interoperable, secure, and privacy-preserving digital identity verification in both public and private sectors.

- ii Upgrade Payments Infrastructure.** Cost and time lags in the delivery of payments could be substantially reduced through the upgrade of public and private sector payments infrastructure. For example, the FedNow Service will be a real-time gross settlement (RTGS) payment system and will be an important advancement that gives people greater flexibility to manage their money and make time-sensitive payments.

In order to harness the potential for even more efficient, accessible and low-cost systems, policymakers should also formally and systematically explore application of new technologies such as cryptography and blockchain-based innovation. The challenging logistics of stimulus payments during the pandemic has further highlighted the need to explore an infrastructure such as a “Digital Dollar” that can be used for large-scale and/or time-sensitive government-to-person (G2P) disbursements. Beyond the Economic Impact Payments for the COVID-19 pandemic, unemployment benefits, SNAP benefits, and tax returns can all be much more efficiently and quickly disbursed using a “Digital Dollar,” which will also deliver tangible benefits when applied in other sectors of the economy. According to a recent survey commissioned by PayPal, 73% of respondents indicated they would likely use “a new, secure, digital form of money that is issued by the US government and is usable online and everywhere cash is accepted.”¹³

¹¹ <https://www.irs.gov/taxpayer-first-act>

¹² <https://www.govtrack.us/congress/bills/116/hr8215/text>

¹³ PayPal surveyed 1,000 adults in the U.S. in January 2021. The question was “The U.S. Government is currently considering issuing a new, secure, digital form of money that is usable online and everywhere cash is accepted. How likely would you be to use this type of money?”

Advancing Racial Equity through Financial Services

The Challenge

The events of 2020 further revealed what has been the reality for far too long: Black, Indigenous, and People of Color (BIPOC) continue to face barriers to achieving security and opportunity in America. Given these challenges, many companies have made commitments to launch various programs to fight racial injustice, including Apple (\$100 million),¹⁴ Netflix (\$100 million)¹⁵ and JPMorgan Chase & Co. (\$30 billion).¹⁶ In June 2020, PayPal announced a \$535 million commitment to support and invest in Black- and minority-owned businesses and communities in the U.S., particularly those that have been hit hardest by the pandemic. While we believe that the private sector has an important role to play, we also strongly believe that progress toward racial equity can only be achieved through joint efforts by both the private and public sectors. In particular, there are unique ways that public policy can address issues that would be difficult for company initiatives, and even catalyze corporate commitments to make a difference at scale and over the long run.

Proposed Solutions

A “Racial Equity through Financial Services” package would leverage financial resources to address racial inequity, and increase financial security and opportunity. The following are examples of potential solutions:

- i Foster Utilization of the CFPB Special Purpose Credit Program (SPCP).** The Consumer Financial Protection Bureau (CFPB) has taken positive and proactive steps to enhance clarity around the SPCP and encourage its use in expanding access to credit to underserved communities. The CFPB should build on these efforts by showcasing successful SPCP models, especially within the context of digital lending platforms that are able to reach underserved borrowers. The more clarity CFPB can provide around the program, the more likely borrowers will benefit from access to credit and related credit innovation.
- ii Support Expansion and Innovation of CDFIs and MDIs.** Community Development Financial Institutions (CDFIs) and Minority Depository Institutions (MDIs) play a critical role in serving local communities, including minority SMBs and low-income populations. Support for these mission-driven financial institutions through increased funding can help deploy capital in underserved areas. A key area of focus should be supporting entrepreneurship and business creation, as this can be an important driver in advancing wealth formation. Technical and policy support can also help to accelerate technology-driven modernization of community lending activity and lending partnerships that can increase scale and community impact.

¹⁴ <https://www.apple.com/newsroom/2021/01/apple-launches-major-new-racial-equity-and-justice-initiative-projects-to-challenge-systemic-racism-advance-racial-equity-nationwide/>

¹⁵ <https://about.netflix.com/en/news/building-economic-opportunity-for-black-communities>

¹⁶ <https://www.jpmorganchase.com/impact/path-forward>

- iii Revise and Revive the SBIC program under the SBA.** Small Business Investment Corporations (SBICs) are licensed private equity fund managers that can access low-cost, government-backed capital to invest in U.S. SMBs.¹⁷ The SBIC Program, administered by the Small Business Administration (SBA), was created in 1958 with a strong history and invested in some breakthrough companies like Intel, but have largely fallen out of favor over the last few decades.¹⁸ Moreover, SBICs are not well known in BIPOC entrepreneurial communities. In fact, a study by the Stanford Latino Entrepreneurship Initiative found that 51% of Latinx business owners had never heard of SBICs.¹⁹ We believe that there is an opportunity to revive and repurpose the SBIC Program with a specific focus on BIPOC funds to address the funding gap that disproportionately affects the minority SMB ecosystem. Similar suggestions can be found in a recent proposal to allocate \$7 billion for a Small Business Equity Fund that would be targeted exclusively at minority founders.²⁰

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Inclusive Growth Through Building Employee Financial Health

The Challenge

In a healthy capitalist economy, businesses play a critical role in driving inclusive growth by serving the interests of all stakeholders, including employees.²¹ A steady income alone is no longer sufficient for building financial security, as evidenced by the oft-cited statistic that 40% of Americans, if faced with an unexpected expense of \$400, would either not be able to cover it or would cover it by selling something or borrowing money.²²

Proposed Solutions

PayPal implemented a robust Employee Financial Wellness Programs in 2019, which included wage adjustment, healthcare cost reduction, stock ownership, and financial education.²³ JUST Capital and PayPal, in collaboration with the Financial Health Network and the Good Jobs Institute, have since established a new initiative to make workers' financial security and health a C-suite and investor priority.²⁴ There are several policy innovations the government can consider putting in place to support employee financial wellness.

- i Revisit Federal Minimum Wage for Companies with More than 500 Employees.** The federal minimum wage has not been raised since 2009, even though the Consumer Price Index (CPI) between 2009 and today has increased by 23.4%.²⁵ In setting the new federal minimum wage,

¹⁷ <https://www.sba.gov/partners/sbics>

¹⁸ Taking Stock of Venture Capital Krein, Julius.American Conservative; Arlington Vol. 18, Iss. 3, (May/June 2019): 53-56.

¹⁹ <http://globalpolicysolutions.org/wp-content/uploads/2016/04/Color-of-Entrepreneurship-report-final.pdf>

²⁰ Entrepreneurs of color are getting passed over by investors. Elizabeth Warren wants to fix that CNN Wire Service; Atlanta [Atlanta]02 Aug 2019.

²¹ <https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans>; average household size is 2.6.

²² <https://www.federalreserve.gov/publications/files/2017-report-economic-well-being-us-households-201805.pdf>

²³ <https://ideas.ted.com/tag/dan-schulman/>

²⁴ <https://justcapital.com/reports/worker-financial-wellness-initiative/>

²⁵ https://www.bls.gov/data/inflation_calculator.htm

Congress could consider exempting small business (companies with fewer than 500 employees, and/or other benchmarks provided by the Small Business Administration²⁶) or phasing in the minimum wage over time to give small businesses time to adapt, as Treasury Secretary Yellen wrote.²⁷ It is also important to consider anchoring to living wages (beyond the threshold of poverty wages) and to account for regional differences. Doing so would ensure the private sector is investing in creating economic opportunity for all workers.

- ii Incentivize Employers to Reduce the Burden of Healthcare Costs on Lower-Income Earners.** The cost of healthcare often functions like a regressive tax – the cost of the same plan takes a larger percentage of income from lower-income earners. As a result, low-wage earners tend to choose a lower-cost plan that may not meet their needs. Reducing the cost of healthcare led many PayPal employees to upgrade their healthcare plans. The government can incentivize companies to make similar adjustments to increase the employers' contribution for workers who are lower-income earners. Since the majority of Americans get healthcare coverage through employers, making it affordable for more workers is an impactful lever to drive inclusive growth.
- iii Incentivize Companies to Create and Expand Employee Ownership.** Similar to incentives that improve retirement savings plans (e.g., "SECURE Act 2"), the government can provide tax breaks to incentivize companies to create and/or expand employee ownership. Creating and/or expanding employee stock ownership is one meaningful way that companies can help employees save for the long term.
- iv Incentivize Employer-Sponsored Emergency Savings Accounts.** Roughly half of Americans live paycheck to paycheck²⁸ and many households draw down retirement savings to weather financial shocks despite penalties²⁹ to help individuals and families prepare for short-term and long-term needs, the government should consider incentivizing employers to sponsor emergency savings accounts, through means similar to tax advantages associated with retirement savings.

²⁶ https://www.sba.gov/sites/default/files/2018-02/size_standards_methodology.pdf

²⁷ United States Senate Committee on Finance, Hearing on the nomination of Dr Janet Yellen, Responses by Dr. Yellen, January 21, 2021. "Raising the minimum wage will lift tens of millions of Americans out of poverty while expanding access to opportunity for countless small businesses nationwide. It matters how it's implemented, and the President's minimum wage will be phased in over time, giving small businesses plenty of time to adapt. Raising the wages of the lowest paid workers in America can unlock billions of dollars of consumer spending that could be used to fuel demand for the essential goods and services small businesses provide. With greater revenue coming in, entrepreneurs can not only pay their employees higher wages (which will increase productivity and retention), but also invest in new equipment, expand their operations, and grow their business." <https://www.finance.senate.gov/imo/media/doc/Dr%20Janet%20Yellen%20Senate%20Finance%20Committee%20QFRs%2001%2021%202021.pdf>

²⁸ <https://www.cnn.com/2020/12/11/majority-of-americans-are-living-paycheck-to-paycheck-since-covid-hit.html>

²⁹ <https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2017/10/financial-shocks-put-retirement-security-at-risk>