

Restore, Boost and Prevent: The Economics for Recovering

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Economists excel at constrained optimization—from an individual who maximizes his satisfaction subject to budget constraint to a firm that maximizes its revenue subject to resource constraint, we have it all through elegant models. Yet, when it comes to providing answer to the most pressing situation of all, we just seem to not come up with any elegant solutions. It was expected that given our response to COVID-19, we would see a crash in economic activity, and

yet when the numbers are out, it seems the economists get entangled in their own constraints—vacillating between different ideologies. However, in times like these, perhaps going back to basics can work best.

To understand what needs to be done to get India back on track one needs to clearly understand the organization of Indian economy along with the constraints that are in place. What drives our economy is the informal sector, which works on informal arrangements, employing more than 90 of the labour force and one that doesn't immediately respond to macroeconomic policy announcements. Hence, in a federal structure like ours, to revive the economy, one needs to focus on individual decision makers, the State, the district, the household more than centralized policy interventions. Add to it the current constraint, a sharply falling economic output and an ever-steep increase of COVID-19 numbers, the constrained optimization is well defined—maximize output subject to the constraint that the COVID-19 spread is halted. How do we get there? There are three ingredients to it—restore, boost and prevent. Luckily for us, this is a situation where we do not have to wait for “other country experiences” to chart our path. Instead, understanding our own economy and the constraints will be immensely useful.

To restore the decentralized decision making the immediate starting point should be to clear the pending GST dues to the States and not trying to bypass a contractual obligation involving force majeure or Act of God. Not only repudiation of contractual obligation morally repugnant, especially when the economy needs confidence measurements and signals by the Government, it is bad Economics. States are not only responsible for keeping local economies afloat, they are the key nodal agencies for delivering welfare—for example, health, being the need of the hour. While individually State level GST collection data for the month of April and May, 2020 is yet to be made public, the economic slowdown would have differential impacts across States owing to their economic activity as well as lockdown intensities. Holding back the dues to States will aggravate the situation even further.

What needs to be boosted and how? While a significant portion of the current contraction is owing to lockdown, one cannot ignore the falling GDP growth rate over many quarters now. The one common prescription that was offered to the Government that still rings true, is the need to boost demand. Most of what was offered in the 20 lakh Crores is addressing supply side—enabling softer loans and hence an indirect way to boost demand. While this certainly is the most prudent strategy to maintain the Steady State, it is not when the economy is in a crisis. Thus, many continue to and still propose a Direct Benefit Transfer (DBT) to the account holders, at least to the bottom half of the pyramid. Of course, this would mean a higher Fiscal Deficit and even a possibility of rating downgrade. Rating downgrades will matter most when investors are evaluating different markets that are competing. Given an economic slowdown globally, even if we are assigned a downgraded more compared to others, in the immediate short run, it will have marginal effect. However, in the absence of any economic activity, our global competitiveness will fast erode. This is a bullet we must bite. Keeping the economy in any lockdown would mean far lower tax collection and eventually a deficit that will be destabilizing. However, opening activities would also mean a higher chance of COVID-19 spread. With daily new cases crossing 90,000 this isn't a constraint we can ignore.

While the responsibility of getting the economy back on track lies primarily with the State and Central Government, the responsibility preventing the COVID19 spread lies with the citizens. Strange, as it may sound, images of large social gatherings with individuals not using adequate protection is common place. It is not possible for any administration to monitor whether an individual is taking all the necessary precautions, however, economists for long has been adept at solving such moral hazard problems. So what can be the solution?

As and when the Government plans more DBT to accounts, can it be a Conditional transfer rather than the unconditional transfer we have been advocating so far? Evidence that targeted and conditional cash transfers give desirable outcomes is available in plenty. Conditional Cash Transfers promotes socially desirable outcomes by individuals when incentivized well. In our context, given that the beneficiary list is identified with most receiving DBTs, perhaps designing an additional incentive to the household of receiving a bi weekly transfer to their account if they do not contact COVID-19 will now keep the incentivize the citizens to be more careful. Together with frequent testing, one can prevent households from suppressing instances of COVID cases in the fear of losing the additional benefit. Simply put, if punishments were ineffective to enforce social distancing, perhaps incentives will. It is time that people are given spending power through DBTs, but with a condition that ties up with desirable “social behavior”.

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The article can be read online, [here](#).