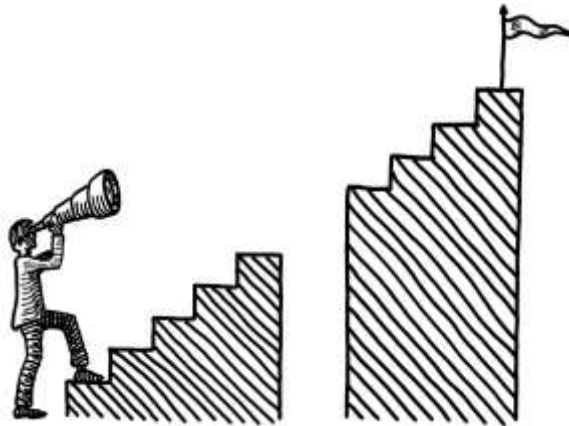


To save the economy, businesses need to social distance too

We need to think innovatively and take bold measures, such as foregoing EMI and rent payments to let the economy hibernate for three months. Here's why and how that will work



From cautious to bold steps

Covid-19 has brought the world to a halt casting a spell of doom over business. The impact of the great financial crisis of 2008, too, was expected to be highly devastating and prolonged. But the world recovered quickly. Contrary to past practice of using contractionary policies in crisis-hit countries, extensive use of expansionary policies reined during the 2008 crisis to buoy the buying sentiment. The current situation also warrants bold steps to stem the rot. Starting with baby steps like the complete waiver of minimum balance charges for savings bank accounts; free of charge cash withdrawals from any bank ATM; reduction in bank charges for digital trade transactions for all trade finance customers, the government has now come with bolder steps.

The RBI too began with cautious steps towards increasing liquidity in the market: The reduction in repo rate to 4.4 per cent; three months moratorium on payment of EMIs; reduction of CRR to 3 percent; conducting auctions of Targeted Long Term Repo Operations; and tweaking the Insolvency and Bankruptcy Code, which were largely seen as inadequate and off tangent. Such steps would be effective if one is sure that demand situations will remain strong after six months and firms will do roaring business thereafter. Alternatively, subdued demand during this period will increase the burden on firms to make payments and may result in increased NPAs. In order to boost to demand, a Rs 20 trillion package has been announced. However, the current crisis is that demand is down.

Supply shock turned into demand slump

Locked-down businesses have triggered pay cuts and job losses. A demand slump has set in and is expected to worsen. Since the supply shock is due to the lockdown, the lowering of interest rate,

increasing liquidity or deferring EMIs may be ineffective in restoring supply as well as consumer demand. Recall that demand has already been falling for quite some time. By the time the medical fraternity comes up with a cure and supply chains are restored, demand will have slumped further. Debts of government, companies and individuals would have risen. The inability to repay debts may lead to the closure of firms. Franklin Templeton has wound up six debt funds; many more cases may be seen in the future.

Saving demand through social distancing and ring fencing of businesses

Social distancing among humans has helped control the spread of Covid-19. Something similar is required for businesses too. Financial distress often leads to a contagion impact. One needs to keep companies insulated—ring fencing. Transactions connect companies. Since the revenue side of transactions are hit severely, cost side interventions are needed. This is where innovative and bold initiatives can do miracles. Companies face both fixed and variable costs. See, the variable costs for companies that went for total shutdown will be zero. For others too, it shouldn't be very high due to low capacity utilisation. Fixed costs include the payments of equated monthly instalments (EMIs), employees cost and rent. Let nobody pay rent or EMI. As that burden is gone, the financial health of the companies will not deteriorate to the extent if long-term slowdown seeps in. Nil or reduced working capital requirement will enable companies to continue paying salaries to employees. The household's buying sentiment may thus remain intact. As restrictions of lockdown are withdrawn, producers can cash on pent up demand and the economy can quickly come back to rails.

What about property owners who earn rent and banks who earn EMIs?

Property owners get relief through the exemption from paying EMIs. In a scenario where no EMI is to be paid, inflation and opportunity costs are low, foregoing rent should be manageable and better than default on rent payment in the situation of prolonged recession. By foregoing the EMIs, banks will have a problem in paying interest on customer deposits. We need to allow banks to not pay interest during this period. The interest income of customers may reduce but they will be better off than they would be in a long recession. Since the households and other lenders are not required to pay EMIs and rent, this loss of interest income is very likely to be bearable.

During a lockdown as well as severe slowdown, the opportunity cost of money should be negligible. Inflation too being negligible, thus there isn't a good case for charging interest. In adverse climatic conditions, when food availability is scarce, animals conserve energy by hibernating. Let the economy too, except for the essential goods and services, hibernate for the next three months. Liabilities will be minimised and balance sheets will not lose health to a large extent. Hungry to lap up the pent up demand seen after a period of social distancing, the economy could recover faster than expected.

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