# TO LOCKDOWN OR NOT? AN ECONOMIC PERSPECTIVE

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The handling and effectiveness of the lockdown depends on the healthcare system and testing capacity of the country, which has unfortunately been plagued by confusion itself amidst a debate, or rather indecisiveness as to whether we must lockdown the country or not, and if yes then to what extent. The COVID-19 pandemic is an existential threat to everyone. Representatives of the Pakistan Medical Association have advised the Federal Government to implement a strict lockdown to contain the local transmission of pandemic. This representation must be seriously considered as the number of healthcare resources, although not scarce as of now, may in the future become scarce if a large number of people get infected in Pakistan. Nevertheless, it may be noted majority of the Governments worldwide have been responding to this pandemic in light of the advice they receive from their medical practitioners, and our country must also adopt this best-practice. Moreover, some urge to prioritize health before the economy, the rationale behind such a demand being the ability of a country to revive/stimulate economic growth when this entire pandemic is over However, the flip side of the coin entails the damage a strict lockdown will cause to the Pakistani economy. Nevertheless, it is absolutely under this fix the Government finds itself in, as it eases the lockdown restrictions to maintain a balance between opening up businesses to run the economy and containing pandemic by enforcing certain Standard Operating Procedures ("SOPs").

A lockdown, till the virus curve flattens, seems like the only effective and rational option to avoid the spread of this fatal virus, as can be observed by strict lockdown measures taken by countries worldwide. As it has been noticed in many a country, including Pakistan, there is a direct correlation between removing lockdown restrictions and the transmission of the coronavirus, and the mortality rate. As of 7th May 2020, the number of confirmed cases and deaths due to Covid-19 stand at 23,214 and 544 respectively. One can argue that a unanimous strategy in terms of the lockdown should have been adopted from the very onset in order to refrain our healthcare system from being overburden, which it seems will now be so given the alarming rate at which the number of infections are rising.

The scale and magnitude of the economic damages caused by the pandemic is increasing as the days go by, making 2020 the worst ever year for Pakistan since it has pushed our economy into a state of recession. The multiple endogenous and exogenous shocks of the pandemic have paralyzed the manufacturing sector of Pakistan and has also affected the demand-side dynamics, disrupted supply chains resulting in deterioration of businesses. Practically speaking, it seems as if the private sector has gone under a "quarantine" and is about to collapse. The International Monetary Fund ("IMF") has projected Pakistan's GDP to shrink by 1.5% this year, which would be the first ever year since 1951-52 wherein Pakistan would oversee a negative growth in its GDP. This lowest ever negative GDP growth of Pakistan was last recorded in 1951-52. Currently, the economy was already facing consequences of monetary and fiscal tightening which deteriorated national output and hit private sector the hardest.

According to the Minister for Planning and Development, around 18 million or 27% of the total labor force of the country could be rendered jobless within the country due to the pandemic. Moreover, the effects of the pandemic will further worsen the country's fiscal position with an increase in expenditures and a tax gap of Rs. 1503 billion. It is therefore projected, that the country's fiscal deficit would be around 9 to 9.5% of GDP. Consequently, the recent impact of monetary easing will be neutralized if the pandemic persists in long run.

Based on the Income Distribution of Household Integrated Economy survey carried out in 2016, we had proposed a monetary lockdown strategy. The way forward, as suggested by us was:

## COST OF LOCKDOWN:

- A national population census was conducted in 2017, wherein, it was suggested that there were 32.21 million households at the time of the said census.
- The Income Distribution of Household Integrated Economy survey conducted in 2016, examining a sample of 24,238 households, categorized households in 5 quintiles based on their monthly income.

| | Q1 | Q2 | Q3 | Q4 | Q5 |
|---|---|---|---|---|---|
| Average Monthly Income | 19,742 | 23,826 | 28,020 | 33,668 | 60,451 |
| Average Monthly Income (inflation Adjusted) | 25,664 | 30,973 | 36,426 | 43,768 | 78,586 |
| Average Monthly Consumption - Normal | 18,500 | 22,874 | 26,702 | 31,337 | 52,906 |
| Inflation Adjusted Monthly Consumption - During Lockdown | 17,908 | 21,780 | 25,003 | 28,858 | 45,865 |
| % of Population | 15.66% | 17.50% | 19.18% | 21.60% | 26.06% |
| No. families out of total 32.21 million | 5,044,086 | 5,636,750 | 6,177,878 | 6,960,581 | 8,393,926 |
| No. of persons (6.45 per household as per census 2017) | 32,534,355 | 36,357,038 | 39,847,313 | 44,895,747 | 54,140,823 |
| Proposed limited assistance | 12,000 | 12,000 | 20,000 | 25,000 | 30,000 |

***Q1 and Q2 combined makes up 33.16% of total population***

- The compound inflation multiplier from 2017 to 2020, as per the data published by the Pakistan Bureau of Statistics ("PBS"), is 1.3.
- During the lockdown, there will be some reduction in the consumption pattern. We have incorporated such reductions in our monthly consumption calculations.
- These calculations have not incorporated sectors which are operating besides the lockdown, constituting 10% to 20% of the workforce.

| | Q1 | Q2 | Q3 | Q4 | Q5 |
|---|---|---|---|---|---|
| No. families out of the total of 32.21 million | 5,044,086 | 5,636,750 | 6,177,878 | 6,960,581 | 8,393,926 |
| Proposed Limited assistance | 12,000 | 12,000 | 20,000 | 25,000 | 30,000 |
| Total Assistance Required (Rs. Bln) | 60.52 | 67.64 | 123.55 | 174.0 | 251.81 |

- Based on the Income Distribution of Household Integrated Economy survey conducted in 2016 that categorized households in 5 quintiles based on their monthly income, we suggest that the lockdown assistance will accumulate to Rs.678 billion per month and can be stretched for two months for all the households of 32.21 million.
- The Ehsaas program will distribute Rs. 12,000 per family for Q1 and Q2 families. These disbursements should be enough for a complete lockdown scenario as Rs. 128 billion will be required for Q1 and Q2 families.
- For the remaining households, i.e. Q3, Q4 and Q5 households, approximately Rs. 550 billion will be required. These may partially be supported out of soft loans to employers, as announced by the State Bank of Pakistan ("SBP"). These soft loans should be provided markup free for 2 to 3 years and the limit should be equal to the monthly salary per employee, to pay salaries of the employees during the lock down period.
- Under the present state of recession and severe financial distress of the lockdown, policy makers must enforce a strict lockdown for two months to stop the spread of coronavirus outbreak.
- **The assistance of Rs. 678 billion may be provided through printing of new notes. It may be noted that since an amount to the tune of Rs. 128 Billion has already been budgeted for the purpose of financial assistance in the lockdown, an alternate could be printing of a net Rs. 550 billion worth monies. The increase in inflation due to printing of these notes will be insignificant, as the assistance will neither increase aggregate demand nor will it affect purchasing power of the people.**

## HOW TO MITIGATE THE LOCKDOWN?

**Here comes the most appealing question as to how Pakistan could avoid entering into a potential depression due to the severe consequences of the pandemic, and not repeat mistakes that were made during the Great Depression in the 1920s and 1930s. Businesses are facing a liquidity crunch, the demand has weakened, cost of doing business is still high and the danger of coronavirus spreading further is thumping the economy the hardest.**

The Great Depression, as we all know, started in August 1929. It wreaked havoc amongst the financial markets and caused the housing sector of the USA to collapse which resulted in a contraction in the US economy. This later transpired into the deepest depression across the globe. Federal officials were of the opinion that the money supply was sufficient, and interest rates were low during 1930s. As a result, this allowed the money supply to drop and did very little in averting the bankruptcies caused in the early 1930s. According to the US Census Bureau, the Real GDP of the USA contracted by 46% from $103.8 billion in 1929 to $56.2 billion in 1933, gross private investment dropped from $16.7 billion in 1929 to $1.7 billion in 1933 and exports of goods and services deteriorated significantly.

The US Federal Reserve believed that the contractionary policy was necessary and inevitable. Accordingly, the Federal Reserve failed to respond promptly and could not diagnose how deep the depression could penetrate the economy, even when the housing bubble got burst, and the banking system collapsed. Therefore, in hindsight, it can be deduced that the contractionary monetary policy pursued by FED was wrong and resulted in damaging the US economy, and later put the entire world into the infamous Great Depression.

As per **Mr. Ben Bernanke**, who served the US Federal Reserve System (hereafter "FED") in multiple roles during the Great Depression of 1930s, the biggest mistake committed was that not only did the FED pursue a monetary tightening but also made it too tight and too long. In this way, the FED actually allowed the prices to fall sharply which led to severe deflation. The unemployment rate reached to 25% in 1933 and it took around a decade for the economy to recover.

According to **Milton Friedman** and **Anna Schartz,** the FED observed flawed and unwise policies from 1929 to 1933. They claimed that "in order to increase the money supply in recession they had two effective tools; a) open-market operations which involves the purchase or sale of existing bonds; and b) The Discount rate. The FED had to reduce the discount rate and purchase bonds, which could have been used to support the banking system and both collectively increase the money supply." According to the **Oxford Review of the Economic Policy report**, the "FED policy caused the depression to deepen further".

The severity of the recession during the early 1920s was never discussed and recalled as Great Depression of 1930s, although the contraction in manufacturing, rise in unemployment and deflationary effects of 1920s were also immense. The World War I, 1918–20 flu pandemic, monetary tightening and the effects of a deflation wave pushed the economy into the Depression. Most of the economists believed that the FED had adopted an inappropriate contractionary monetary policy, and had to print money into the system, as during deflation the consumer spends less and starts hoarding cash, which further weakens the demand and deepens the recession. On the monetary side, the New York Fed had a record high rate of 7% by June 1920. With a severe decline in the US economy, the prices deflated significantly.
The outstanding stock of Federal Reserve's Notes in circulation stands at $1.799 trillion as of April 2020, according to the US FED reserve system website. The US FED has so far printed currency worth $84.129 billion (on an average) per annum from 2008 to April 2020, and it has only added inflation of 1.796% in US economy which is negligible.

| UNITED STATES MONEY SUPPLY VS INFLATION | | | | |
|---|---|---|---|---|
| Period | Currency in circulation (US $ bln) | | Difference per annum | Inflation (% ) |
| | Opening of currency | Closing of currency | | |
| 2008 | 817 | 878 | - | - |
| 2009 | 878 | 924 | 46.432 | -0.34 |
| 2010 | 924 | 979 | 55.075 | 1.64 |
| 2011 | 979 | 1,066 | 87.016 | 3.16 |
| 2012 | 1,066 | 1,157 | 90.289 | 2.07 |
| 2013 | 1,157 | 1,230 | 73.591 | 1.47 |
| 2014 | 1,230 | 1,327 | 96.412 | 1.62 |
| 2015 | 1,327 | 1,415 | 88.346 | 0.12 |
| 2016 | 1,415 | 1,499 | 84.311 | 1.26 |
| 2017 | 1,499 | 1,605 | 105.189 | 2.13 |
| 2018 | 1,605 | 1,707 | 102.348 | 2.44 |
| 2019 | 1,707 | 1,794 | 87.368 | 1.81 |
| 2020 | 1,794 | 1,887 | 93.176 | 2.12 |

**(Source: US Census Bureau)**

**In 2007, the FED printed $831 billion through "quantitative easing", to flush liquidity into the system, in order to avoid a Depression in the US economy. Later, this process is reversed when the economy begins to recover through reducing money supply accordingly. Resultantly, the inflationary impact due to the massive printing was negligible. Similarly, the FED has recently pumped in $2.2 trillion into the US Economy, which is technically printing money, to stimulate economic activities to avoid the effects of pandemic.**

**WAY FORWARD:**

The comparison of the money supply of Pakistan vs. the inflation during FY13 to FY18 is as follows:

| PAKISTAN MONEY SUPPLY VS INFLATION | | | | |
|---|---|---|---|---|
| Period | Currency in circulation (Rs in mln) | | Difference per annum | Inflation (% ) |
| | Opening of currency | Closing of currency | | |
| Jul 12-Jun 13 | 1,732,302 | 1,938,222 | - | - |
| Jul 13-Jun 14 | 1,938,222 | 2,177,873 | 239,650 | 8.62 |
| Jul 14-Jun 15 | 2,177,873 | 2,554,749 | 376,877 | 4.53 |
| Jul 15-Jun 16 | 2,554,749 | 3,333,784 | 779,035 | 2.86 |
| Jul 16-Jun 17 | 3,333,784 | 3,911,315 | 577,531 | 4.80 |
| Jul 17-Jun 18 | 3,911,315 | 4,387,828 | 476,513 | 4.70 |

**(Source: SBP, PBS)**

The SBP has, on average, printed Rs. 490 billion per annum from 2012-13 to April 2020 which has added only 5% inflation in the Pakistan economy, which is not too high. It is to be remembered that the 5% inflation was the result of expansionary policies pursued by the former regime during 2013-14 to 2017-18, during which the economy was in an expansionary phase and demand was higher. Pakistan's GDP growth was above 5% on average during 2016-17 to 2017-18.

| Pakistan Money Supply vs Inflation | | | | |
|---|---|---|---|---|
| Period | Currency in circulation (Rs in mln) | | Difference per annum | Inflation (% ) |
| | Opening of currency | Closing of currency | | |
| Jul 18-Jun 19 | 4,387,828 | 4,950,039 | 562,210 | 6.8 |
| Jul 19-Apr 20 | 4,950,039 | 5,879,299 | 929,260 | 11.22 |

**(Source: SBP, PBS)**

*The data above is the net currency in circulation from FY12 till April FY20.
*The 'distortion' is reported during last two year (July-18 to Apri-20). As per Pakistan's agreement with the IMF, the SBP will not advance loans to the Federal Government through printing of money. Overall, a 1% inflationary impact is witnessed as a result of Rs.490 billion worth printing of money.

**Therefore, Pakistan must print money to increase money supply to avoid deepening of the recession and to accelerate economic activities in the economy. Printing money and flushing liquidity into the system is the need of the hour, as it will increase spending, and will boost demand of the private sector. Through printing of monies, neither will inflation increase during the recession, nor will it affect the overall aggregate demand. Under the recession, the current interest rates are still quite high, and need to be reduced to 6%. In addition to this, the IMF agreement must be reconsidered, and structural issues of power must be resolved forthwith, in addition to cutting down the tax rates and clear all pending tax refunds, to further stimulate the economy and avoid deepening of the recession.**