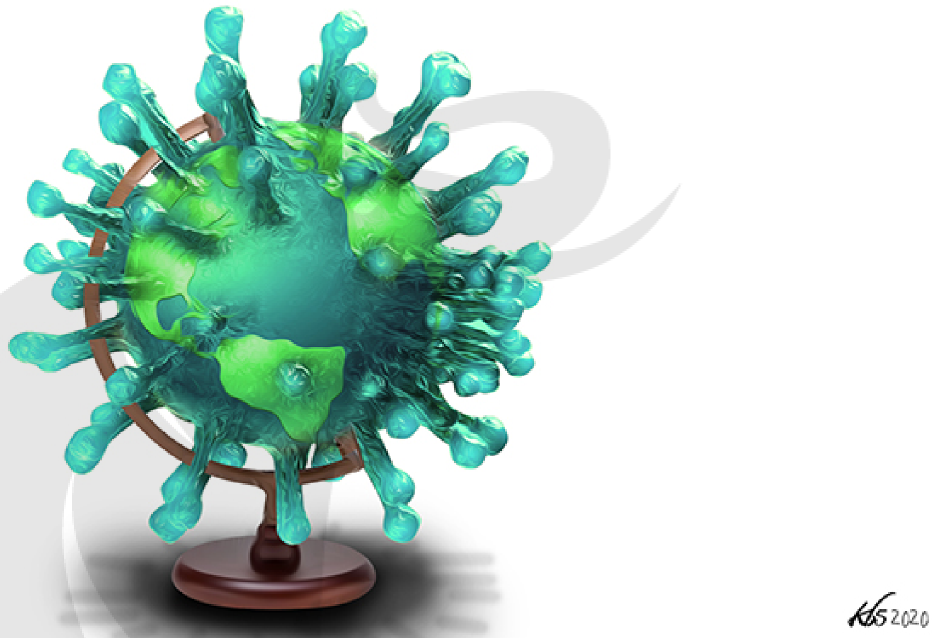
Notes on Leviathan, the Invisible Hand and Moral Sentiment in the Time of Coronavirus

By David Ndii



> *In the great chess-board of human society, every single piece has a principle of motion of its own*

I had an insightful, if disconcerting, engagement a couple of days ago on some of the thinking behind the COVID-19 resource mobilisation that is going on in the government. This was in connection with some proposals on how to tap into unconventional sources of private money, some of them admittedly quite innovative. It is not the substance of the proposals that is cause for alarm—in fact some of them are quite sensible and practical. It is the preoccupation with private money. My disquiet was reinforced by a source close to some of the captains of industry that have been appointed to a COVID-19 response task force. According to the source, it was intimated to them that the government was counting on substantial contributions from their respective companies.

I learned from Prof. Terry Ryan, a veteran treasury mandarin, and have taught public policy students over the years that policy priorities are understood, not from what is written, but by how three resources—political power, managerial time, and money, in that order—are allocated. That the government, at the top level, is preoccupied with private sector financing suggests two things. First, the government does not understand the magnitude of the response that is required. Second, there is no appreciation that the key challenge of responding to the COVID-19 economic shock is policy instruments, not funding. And that is a problem.

The US government's $2.2 trillion rescue package is over 10 per cent of GDP and close to half of the annual federal government budget. Canada's $75 billion relief package is 4.4 per cent of GDP and a third of the budget. The two quantums are not directly comparable because they have different public financial management (PFM) systems. If we benchmark with Canada whose PFM system is closer to ours, we are talking Sh440 billion if we go with the GDP ratio, and Sh750 billion going with the budget ratio. The most that private sector mobilisation can raise is a few billion shillings, if that; Sh2 billion at most by my reckoning, less than 0.5 per cent of the lower figure. The government is barking up the wrong tree.

In my open letter to President Uhuru Kenyatta, I proposed a lifeline fund in the order of one per cent of GDP, about Sh100 billion. Clearly, even this falls far short of the Canadian initiative. But as I make clear in the letter, the figure was not based on need but on what is financeable from a macroeconomic sustainability standpoint. Canada's budget deficit before the COVID-19 relief package was 1.2 per cent of GDP. The relief package will push it up to 5.6 per cent. Our budget deficit right now is about 7.5 per cent of GDP, and we were already in the early stages of a fiscal crisis before the COVID-19 crisis, with businesses crying out over pending bills and VAT refunds. A relief package like Canada's would push the deficit to 17 per cent of GDP. That, ordinarily, would be flirting with hyperinflation.

In macroeconomics parlance, we say that Canada had plenty of fiscal space. We have none. Hence my contention that the prudent thing to do is to switch rather than increase the borrowing we have already budgeted. The revised national government development budget for the year is Sh436 billion. The Exchequer had released Sh220 billion as at end of February, that is, with four months to go to the end of the financial year. This means that if we can freeze every national government development project, we can switch Sh200 billion to the COVID-19 response within the existing budget. My Sh100 billion Lifeline Fund proposal requires switching half of the budgeted amount, which I think is very realistic. As it is, the current spending rate projects an absorption of Sh330 billion by the end of the fiscal year, that is, Sh106 billion less than budgeted. The COVID-19 disruption is bound to slow budget absorption.

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It is important to point out that budget is not money in the bank as some people seem to think. It is the approved expenditure, that is, what ministries, departments and agencies (MDAs) are authorised to commit. Right now, all our development budget is deficit-financed, that is, funded by debt. As at end of February, the government had borrowed Sh378 billion against a budget target of Sh514 billion for the year, leaving a borrowing headroom of Sh136 billion. What I mean when I say that the government does not have a funding problem is that, once the spending decision is made and approved by parliament through a supplementary budget, the government will continue to borrow as normal and channel the money to the COVID-19 response instead of development projects.

It should be readily apparent that given the urgency and enormity of the challenge, running around scrapping for private sector charity is a misplaced diversionary preoccupation and a waste of valuable time. The orders of magnitude we should be talking about help to put into perspective the much ado about donor money, Sh10 billion or thereabouts so far. It is useful but nowhere near significant enough to warrant all the attention it is getting. By now, a serious government would have pushed a Sh150 billion-plus COVID-19 response supplementary budget through parliament.

We can now turn to my contention that it is policy instruments, not funding, that are the key challenge of responding to the COVID-19 economic shock.

Economics Nobel Laureate Paul Krugman delights in deploying the simplest models for penetrating insights into the most complex problems. In a blogpost titled Notes on coronacoma economics, Krugman posits that, "What we're experiencing is not a conventional recession brought on by a slump in aggregate demand". Instead, he postulates, "We're going into the economic equivalent of a medically induced coma, in which some brain functions are deliberately shut down to give the patient time to heal".

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To fix ideas, as we say in economics, Krugman deploys a stylised two-sector economy, consisting of a non-essentials (N) sector and an essentials (E) sector. Unlike a regular recession where policy intervention seeks to stimulate the whole economy, the coronavirus pandemic requires shutting down the N sector, while keeping the E sector working. But even after shutting it down, we need to replace incomes lost in the N sector, for two reasons. First, to keep the people alive. Second, to support the E sector with demand, so as to minimize the multiplier effect of the job losses in the N sector on the E sector, and spillovers into the financial sector that could bring the whole system tumbling down. Krugman posits that the correct policy instrument is a hybrid instrument he calls "disaster relief with a dash of stimulus". Readers of this column may recognise that this is akin to the Lifeline Fund proposed in my open letter to the president.

How to finance it? Krugman posits that the slowdown of the N sector will leave plenty of money on the table that would have been invested— think about all the approved and financed projects that have been put on hold. This money is available for the government to borrow to finance the COVID-19 response. Let me reiterate: funding is not the problem.

The US, like many other advanced countries, has public social security and other public social safety nets that can, and are, being deployed to achieve this. We don't. Another cautionary note is that the N and E sectors should not be taken literary. They don't exist as such in reality.

Two weeks ago, this columnist mused that "depending on how long this goes on, governments should start thinking in terms of wartime economic management". The IMF and others have since echoed the same call, prompting some people to compliment or be awed by this columnist's prescience.

As flattering as that might be, exceptional prescience was not required. John Maynard Keynes concludes his *magnus opus*, *The General Theory of Employment Interest and Money*, on the note that,

> [T]he ideas of economists and political philosophers, both when they are right and when they are wrong are more powerful than is commonly understood. Indeed, the world is ruled by little else. Practical men who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back.

And so it is. Adam Smith famously remarked that the market economy functions "as if by an invisible hand":

> Every individual . . . neither intends to promote the public interest, nor knows how much he is promoting it . . . he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention

But for all its virtues, there are occasions, times such as this, when the invisible hand is not fit for purpose. The market system is not wired to recognise essential and non-essential activities, only price signals. The market also does not respond to need, only to effective demand, that is, want backed by ability to pay.

At the onset of this crisis, a small supermarket chain caused uproar and moral outrage when one of its branches increased the price of hand sanitiser after observing a spike in demand (Krugman also talks of an "epidemic of price-gouging"). Even after the supermarket chain apologised profusely for "individual error" the authorities came down hard, and in an unprecedented consumer protection action, ordered the shop to trace and refund all buyers the difference between the normal and the inflated price. I am not certain that this directive is lawful, as there appears to have been no due process, but that is a matter for another day.

Market fundamentalists here and elsewhere have come out in support of price hikes of this nature as the proper working of the invisible hand, asserting that what the uninitiated see as price gouging is precisely the circuit breaker needed to prevent panicky and greedy people buying all the supply, the former to hoard, and the latter to resell at a profit. In this view, the branch store manager who hiked the price of sanitiser is cast as the unwitting agent of the invisible hand, compelled by his nose for a quick kill to do the greater good.

Adam Smith did not have such religious faith in the invisible hand, and in fact, much of his contribution to economic thought turns on trying to square markets and morality (unsurprisingly, seeing as he was professor of moral philosophy). His benevolent view of the invisible hand is not predicated on an angelic view of man, but on temperance of greed by "moral sentiment", that impulse which leads people to cultivate virtue. He had a dim view of businesspeople, maintaining that whenever and for whatever reason people in the same trade met, it would end up "in a conspiracy against the public, or in some other contrivance to raise prices".

Adam Smith's moral being was a person who cultivated justice, prudence and beneficence. Such a person would have asked themselves whether raising prices was morally upright, considering that the higher price would compel poor people desperate to protect themselves from harm to sacrifice food or another necessity. Thus Smith's moral being might have concluded that in the circumstances, rationing was a better allocation mechanism than price, seeing as no ordinarily person would buy ten sanitisers at a go, or three bales of toilet paper for that matter. Limiting each customer to two or three sanitisers was warranted.

An even more fundamental challenge is the propensity of the invisible hand to work as it is meant to, resulting in perverse, morally repugnant outcomes. We know that export horticulture has been completely disrupted. Floriculture employs more than 30,000 people, mostly low wage earners in Naivasha. The flower farms themselves are staring at business failure. Naivasha's second industry is tourism. In fact, both floriculture and the hotel establishments are on the same stretch of Moi South Road along the shores of Lake Naivasha. These two industries are the engine of the rest of the Naivasha economy. Once these paychecks stop coming, every other business, from the grocery shops, to boda bodas, petrol stations and supermarkets, will be affected. Naivasha may be looking at a socio-economic implosion in a matter of weeks. Once the flower farm and hotel paychecks stop, without income replacement, the invisible hand will signal a fall in demand and supply will adjust downward to the quantity commensurate with Naivasha's much diminished purchasing power, as opposed to the number of mouths Naivasha has to feed. Survival will turn on moral sentiment. Left to the invisible hand, they will starve.

Naivasha is not an island. Hospitality establishments are closing down—the Serena Group has closed ten lodges, Pride Inn has closed its Mombasa hotels, and in Nairobi, DusitD2 has closed, to name but that one. Given the trajectory of the pandemic we are observing, the best-case scenario is four to six months before the pandemic curve flattens globally. We do not know when the people from our COVID-19-devastated source markets will venture into leisure travel in large numbers again. The tourism-dependent economies—Mombasa, Diani, Malindi and elsewhere—are no islands either. In addition to sustaining livelihoods, they are a market for supplies of fresh foods from upcountry. If the big hotels are not in the market, it may not be worth their while for some traders to transport food there.

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Scarcity will drive up prices, which should elicit supply. Middle-men will be called out for price gouging. The government will be called upon to protect consumers. In as much as government intervention may become imperative, humility is required. We recall the spectacular failure of the dirigiste economic regimes of a few decades back. One week candles would be out of stock, but the market would be oversupplied with brown shoe polish. The following week, candles would be back, but only blue ones, and sugar could only be bought with tea leaves, salt, or a can of brown shoe polish. But people forget, and other generations who take twenty brands of toothpaste for granted are born. Governments will do well to proceed with an abundance of caution, and take heed of Adam Smith's much less remarked observation about *homo leviathansis,* government man:

> The man of system is often so enamoured with the supposed beauty of his own ideal plan of government, he seems to imagine that he can arrange the different members of a great society with as much ease as the hand arranges the different pieces upon a chess-board. He does not consider that in the great chess-board of human society, every single piece has a principle of motion of its own.

There is a view that we can disrupt the virus with a one-off lockdown of a few weeks—go into hibernation so to speak— and once we emerge, the curve will have flattened, and we will then go back to business as usual. This "silver bullet" view of lockdowns is little more than wishful, lazy thinking. As Stanford economics professor John Cochrane opines, the more likely scenario is "whack-a-mole"—as soon as we think it has subsided, it flares up in another corner of the world, triggering another containment cycle around the world. Epidemiologist Nelly Yatich offers a similar prognosis. She argues that an effective lockdown would have to be in place until a vaccine is found and administered on 60 per cent of the population, and that is still six months away at best. Alternatively, countries can adopt on and off lockdowns but that requires meticulous surveillance systems capable of picking up an increase in infections very quickly.

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These predictions may already be playing out. Singapore, one the first countries to bring infections under control, has announced another lockdown after registering an upsurge of cases whose source could not be traced, suggesting that there are people without symptoms within the community who are unknowingly passing the virus on to others who then develop symptoms. Put differently, it is now endemic. It is telling that only a week ago, the Singaporean government had said that a “nuclear option lockdown” was not on the cards, on the grounds that it would be too costly economically. Singapore’s economy is built on international trade. As Gillion Koh of the Institute of Policy Studies, a think tank at the Singapore National University’s Lee Kwan Yew School of Public Policy, observes, “Singapore’s survival and sustainability depends on borders being open and receiving goods as well as people. So the cost of locking down Singapore is very high, both for the economy and for sustaining daily life itself”.

Proponents of the “nuclear option” posit it as a moral imperative—lives above money. It’s a false dichotomy, and for three reasons. First, healthcare provision is an economic activity. It is not an island. It requires supplies and logistical services—medical and non-medical supplies, maintenance and financial services—and health workers need to meet their daily needs and social obligations. As the economy is disrupted so too will healthcare provision. Other diseases have not gone away. Already, patients with chronic illnesses are expressing fears about being crowded out of the healthcare system by social distancing and curfew. Preventive disruption of the economy must be weighed against how many existing patients’ lives will be put at risk, and whether the degraded economy will be able to service healthcare provision if the coronarivus epidemic does materialise. It is in anticipation of this unhappy trade-off that this column suggested weeks ago that African governments earmark coronavirus isolation hospitals and make contingency plans to evacuate them as and when needed. This advice, and much else, is clearly falling on deaf ears.

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Second, it has been pointed out *ad infinitum* that the vast majority of low-income people, particularly the urban poor, live day to day. Many have lost their incomes already. They are surviving on social support from family, friends and charity. It is not at all evident that the government is capable of mounting a safety net that would sustain half of Nairobi’s 4.5 million people for two weeks. Mounting a total lockdown has to be weighted against the risk of breakdown. Should the government be overwhelmed, it will be downhill from there. Self-preservation will become the government’s primary preoccupation. The coronavirus will have a field day.

Third, the economic dynamics of the pandemic are now, for all intents and purpose, delinked from the epidemiological. The coronavirus has become an economic terrorist. Such is its contagiousness that the only way to be sure not to get it is to be in complete isolation. Even a trip to replenish food supplies, face mask and all, is not risk-free. As long as the virus is lurking in our midst, self-preservation demands that people minimise social interaction and mobility to the extent that they are able.

And therein lies the rub. We do not need a lockdown for the economy to seize up. The instinct of self-preservation is sufficient, and this is already evident. With every day that goes by, there is less and less on the supermarket shelves. Many county governments have closed fresh produce markets. The fresh produce that is rotting in the farms means shortages for the remainder of the year because many farmers who are losing money simply won’t have the working capital to invest in another crop. The prudent thing for them to do is to hold on to the money they have to tide their families over the hard times ahead.

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All said, the lockdown question is not one of lives versus money. It is how many lives are at risk in each scenario. But above all, it is about getting it into our heads that complex problems do not have simple solutions. Simple solutions—especially ones that need to be propelled by manufactured consent through opinion polls and social media acclamation—can be relied upon to backfire. We need not trawl through the Jubilee administration's record in this regard at this time. Politicians who are raring to go back to their 2022 slugfests may want to consider looking for online side-hustles. Coronavirus is not a passing cloud.

"In the great chess-board of human society, every single piece has a principle of motion of its own". Men and women of the state realm, take heed.

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