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Covid and Social Distancing with a Heterogenous Population

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Covid and Social Distancing with a Heterogenous Population^{*}

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Abstract

Motivated by the Covid-19 epidemic, we analyse a SIR model of an epidemic but with endogenous social distancing, and calibrate it to UK data to study various hypothetical scenarios of government intervention regarding social distancing. We explicitly take into account that (a) there is heterogeneity in the population in terms of infection-induced fatality rates and thereby private decisions on social distancing, and that (b), due to limited resources available for health services, mortality rates may depend on the stock of infected people who become seriously ill because of the infection. Simulations based on our calibrated model suggest that lockdown policies that shut down some of the essential sectors have a stronger impact on the death toll than on the evolution of infections and the level of "herd immunity" compared to policies that shut down non-essential sectors, and vice versa. Finally, there might not be an after-wave after lockdown policies that shut down some of the essential sectors are lifted.

JEL: C61, C72, C73, H41, I12, I18 Keywords: COVID-19, Epidemiology, SIR model, Social Distancing, Externalities

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1 Introduction

One of the most commonly used epidemiological models for the understanding of the current coronavirus epidemic is the SIR model (Kermack and McKendrick, 1927, Anderson et. al., 1992) and its related extensions. However, this framework does not take into account that (a) individuals make decisions on their own social distancing even in the absence of government interventions, and (b) people may respond behaviourally to government interventions that aim at influencing the evolution of the current epidemic. The reason for the latter is that how the infection evolves will affect the probability a susceptible person will get infected and – when resources available for the effective care of the seriously ill are limited – the probability of dying because of an infection; both probabilities will influence the scope for social distancing. Therefore, decisions on social distancing will naturally depend, among others, on personal health conditions and any underlying health risk factors to develop a serious disease because of an infection. Ignoring this may be an important shortcoming of the typical epidemiological model because the mean contact rate, which influences the speed of transmission and is typically assumed to be exogenous and constant, might actually change over time or following a change in government policy. In this paper we build a model that addresses this shortcoming in a simple variant of the basic SIR model. We also calibrate our model to UK data on reported deaths, and use it to study various hypothetical scenarios of government intervention on social distancing. The aim if this exercise is to highlight in the simplest possible manner how economics modelling could be integrated in epidemiological models to help us improve our understanding of the course of an epidemic and to plan effective control strategies. By focusing on a simple variant of the SIR model, the hope is to make in a stark manner the case for the need of more sophisticated and elaborate approaches that combine economic and epidemiological modelling techniques in order to increase the predictive power of the models used to guide policies such as lockdowns.

Social distancing refers to the adoption of a behaviour by individuals that reduces their risk of becoming infected. Examples are: limiting contact with other individuals or reducing the transmission risk during each contact. In our work, social distancing is modeled as a reduction in the proportion of all possible contacts a person can have. Social distancing incurs a cost in terms of isolation, distancing and alienating from friends and family, convenience, productivity, income e.t.c. As a result, individuals will only adopt (more) social distancing when there is a specific incentive to do so. Such incentives may include the risk of death or the financial and health costs a person may face when infected. Moreover, typically, there is heterogeneity in the incentives to exert social distancing; for example, due to different fatality rates across individuals with different health conditions. Our model allows us to study the different incentives to exert social distancing in the various segments of the population, and understand how these may change over the course of an epidemic. Typically individuals that are of high risk to develop a serious illness when infected and eventually die will abstain more from social interactions than the rest of the population. Social distancing of all individuals is increasing with the level of infection, reaches a peak and then decreases with the level of infection. As a result the mean contact rate, which is typically assumed to be constant in the standard epidemiological models, has a U shape. In fact, our model predicts that social distancing will start taking place before any lockdown restrictions are introduced, which is consistent with recent evidence.¹

¹See Maloney and Taskin (2020). For related suggestive evidence based on UK mobility data from Apple, see

Crucially, however, social distancing decisions produce a positive externality as the higher the investment in social distancing the lower the rate of infection in the wider population is. Consequently, government intervention will typically be required in order to induce more social distancing. Motivated by this, our paper contributes also to the understanding of the effects on the epidemics of government intervention in relation to social distancing by studying various lockdown episodes in terms of their impact on the evolution of the infection and death toll, and whether they are followed by a major afterwave or not. Importantly, the lockdown policies we focus are not of first-best nature. That is, we do not investigate the solution to the optimal design problem that determines the optimal from the point of view of the society social distancing. The reason is that, despite its inherent theoretical interest, a full implementation of the optimal social distancing in large and modern societies would require massive administrative costs in terms of policing and fine-tuning social interactions along several dimensions on a daily basis. We, therefore, choose to focus on "second-best" lockdown policies and their effects on the evolution of the epidemic.

We achieve this by calibrating our model to UK data on reported deaths from the recent coronavirus epidemic,² using also existing estimates of epidemiological model parameters that represent the basic reproduction number, the length of the infectious period, and the length of the time from the onset of the infection to death.

We show that the predicted evolution of the epidemic is significantly different when social distancing is endogenous than when the mean contact rate is exogenously given. Our simulations suggest that the death toll under endogenous social distancing is about one third of that under exogenous social distancing. Moreover, the mean contact rate is not constant, but has a U-shape over the course of the epidemic when equilibrium social distancing is explicitly taken into account. Furthermore, under endogenous social distancing the predicted infection peak is less than half of, and the total exposure to the infection is a quarter less than, what is predicted under exogenous social distancing

Second, our model with endogenous social distancing predicts that by the date of the first reported death 0.009% of the UK population would have already been infected with the virus.³ In addition, the current epidemic wave in the UK would last around six months in the absence of government intervention. Third, our numerical analysis suggests that the peak of the mortality rate in UK would have occurred around mid April in the absence of government intervention, but with a significant death toll by the end of the epidemic.

Regarding the effects of various scenarios of government intervention on social distancing, our results suggest that the length of a lockdown that imposes a minimal degree of social distancing (e.g. by shutting down non-essential sectors such as services) has a significant effect on the death toll, and the "flattening of the curve", but also on the behavioural responses of low-risk individuals when such policies are lifted. These behavioural responses, in turn, could contribute to an afterwave. Furthermore, our numerical analysis indicates that a government intervention that increases the maximal degree of social distancing (e.g. by forcing some of the less essential sectors such as schools and parts of the food industry to close down or reduce their operations) has a significant negative

 $^{^{2}}$ Similar data is available for several other countries and therefore our exercise could be applied to more countries as well.

³The corresponding number in Lourenço et. al. (2020) is 0.08%.

impact on the cumulative count of deaths but not on the evolution of infections and herd immunity. Furthermore, our results suggest that a government intervention that increases the maximal degree of social distancing might not be followed by a second wave once the lockdown restrictions are lifted due to the social distancing behaviour of the susceptible to infection individuals.

To understand the latter, observe first that in the SIR model there is no after-wave when the mean contact rate times the proportion in the population of the susceptible to infection individuals times the basic reproduction number is (weakly) lower than one. This condition forms the basis of arguments in favour of strict lockdowns (a low mean contact rate) or of high herd immunity (a low pool of susceptible individuals) or of testing-and-tracing (a low basic reproduction number) to avoid a second wave of the infection. However, as we argue in this paper, the mean contact rate is endogenous and depends on the evolution of the epidemic. According to the simulated lockdown policies, the equilibrium mean contact rate is around 0.6 during the intervention period. With a basic reproduction number of 2.25 (used for instance in Lourenço et. al., 2020) this implies that there will be no second wave when the simulated lockdowns are lifted if the proportion in the population that has been exposed to the infection (and are no longer susceptible) is at least equal to around 26%. This is way lower than the level of herd immunity normally thought to be sufficient for the prevention of a second wave. In our calibrated model, the equilibrium proportion of exposed people at the instant the simulated lockdowns are lifted is around 38%, and so there is no after-wave.

Finally, we identify a policy mix that consists of increasing both the minimal and maximal degree of social distancing on the day of the UK lockdown and leads to a similar death toll to the UK one at the time of writing these lines, and study its impact on the evolution of the epidemic, including the after-wave that would emerge if this mix was lifted six weeks after its introduction. The result of this policy intervention is a significant flattening of the curve, followed by a sizeable second wave.

Related Literature: SIR models have been used extensively in mathematical epidemiology. Such models are particularly relevant for the study of epidemics such as the current SARS-CoV-2 because they assume that individuals become infectious as soon as they get infected and that recovered people do not get infectious again, which is a good first approximation of what is currently agreed by many experts to be the leading hypotheses for Covid-19. For, instance, it has been used in Lourenco et. al. (2020), a study which found itself in the public spotlight recently.⁴ Our model, extends that work by (a) allowing for fatality rates of individuals who are at high risk of developing severe illness when infected to depend on the stock of infected people who become seriously ill because of the infection, and (b) bringing private decisions on social distancing and equilibrium analysis at centre stage. Epidemiological models have also been used recently to discuss various issues on epidemics from a macroeconomics point of view.⁵ In all these papers, individuals do not choose their social distancing. Eichenbaum et. al. (2020) and Krueger et.al. (2020) study a macroeconomic version of the SIR model, where people choose to consume goods that require less social contact, and report that such behaviour can lead to a substantial mitigation of the economic and human costs of the current coronavirus crisis. Closer to our work is Reluga (2010), and the independent works by Farboodi et. al. (2020), Keppo et. al. (2020) and Toxyaerd (2020), who analyse a SIR model with endogenous social distancing.⁶ In

 $^{^{4\}mbox{\tiny "Coronavirus}}$ may have infected half of UK population — Oxford study", Financial Times, 24 March 2020, https://www.ft.com/content/5ff6469a-6dd8-11ea-89df-41bea055720b

⁵See, for instance, Kaplan et.al. (2020), Alvarez et. al. (2020), Glover et.al. (2020), Bodenstein et.al. (2020).

 $^{^{6}}$ For more related literature, see the excellent discussion in Toxvaerd (2020). Galanis (2020) study in a static model

contrast to our work, all these papers feature models with no heterogeneity in the population with respect to mortality rates. Moreover, in contrast to our work, Reluga (2010) and Toxvared (2020) deploy linear costs of social distancing and do not analyse government interventions regarding social distancing.⁷ Keppo et. al. (2020), on the other hand, deploy non-linear costs and discuss various lockdown policies, but, in contrast to our work, they assume that the cost from getting infected is constant over time. Our work differs also from Reluga (2010) and Toxvaerd (2020) in that they do not calibrate their models. Keppo et.al. (2020) and Farboodi et. al. (2020) differ also from our work in that they assume that people do not know if they are infectious. Furthermore, when Farboodi et. al. (2020) calibrate their model they assume that the mortality rate is constant, while we maintain throughout that the mortality rate of people who develop a serious illness from infection depends on the level of infections, thus capturing limited resources for critical care.⁸

The organisation of the paper is as follows. In the next section we develop the model, while in Sections 3 and 4 we discuss equilibrium social distancing and welfare-improving government intervention on social distancing. In Section 5 we calibrate our model to UK data on reported deaths. There, we compare the predictions of our equilibrium model with those of a SIR model where social distancing is exogenous and with those of a SIR model where social distancing is endogenous but there is no heterogeneity in mortality rates. We also study the implications for the evolution of the epidemic of various government interventions that implement higher social distancing than the equilibrium one for a given number of periods. Finally we conclude and point to possible extensions of our model and directions for future research.

2 The Model

2.1 The standard SIR model

Let N be the population size, which is assumed to be a very large number. We assume that the epidemic is fast relative to the demographic process, and so the population size N is treated as constant. We also assume that individuals become infectious as soon as they get infected, a modeling assumption which seems to be roughly consistent with existing evidence for COVID-19. Denote by t_0 the instant when the epidemic starts (the "introduction time").

the potential to use social proximity, and within-group random testing and anonymous notification of positive cases as a tool to induce social distancing.

⁷See, however, Rowthorn and Toxvaerd (2017) for a problem of managing an infection in an SIS model (where recovered can become infected again) with homogenous population and no risk of infection-induced mortality. Toxvaerd (2019) also study private social distancing and the planner's problem in a SIS model.

⁸Alvarez et. al. (2020) calibrate their model of the optimal design of a lockdown within a SIR framework, in which, however, there is no heterogeneity in mortality rates and the government directly controls the contact rates in the population. Acemoglou et. al. (2020) generalise Alvarez et. al. (2020) by introducing heterogeneity between age groups with respect to infectiousness, need for critical care, mortality, and contact rates. They show that *optimal* policies differentially targeting age groups significantly outperform optimal uniform policies, and most of the gains can be realized by having stricter lockdown policies on the oldest group. These papers use data on both deaths and reported cases, while we use only data on deaths. The reason for our choice is that arguably reported cases are less accurate than reported deaths due to the lack of extensive testing and the heterogeneity in intensity of symptoms that led to many mild cases going unreported, especially in UK. Moreover, while we focus on the first 14 days of the epidemic (based on reported deaths) to avoid contamination by mitigation strategies that were implemented after that time, Alvarez et. al. (2020) use observations for the first 25 days after reported cases have been at least 100, and Acemoglou et. al. (2020) use deaths reported on April 11 and cases reported 18 days earlier.

Let S be the proportion of the population that is susceptible to infection, I the proportion of the population that is infected and infectious, and R the proportion of the population that are no longer infectious. Denote also with Z the proportion of the population that have been exposed to the infection and therefore are no longer available for infection.⁹ That is,

$$Z = I + R = 1 - S \tag{1}$$

Let β be the mean number of infections per unit of time if every person was susceptible and has been in contact with an infectious person. This is the rate of transmission of the infection, or the probability of an infection developing from a match between a susceptible and an infectious person. Denote with σ the rate with which the typical infectious individual becomes non-infectious. Thus, $\frac{1}{\sigma}$ is the length of the infectious period (ie. the mean time until recovery or hospitalisation due to the development of a serious disease) per infectious individual. These two parameters are exogenous. We therefore have that the mean number of infections directly generated by one case if all individuals were susceptible and come in contact with the infected person (i.e. the basic reproduction number) is equal to

$$\mathscr{R}_0 = \frac{\beta}{\sigma} \tag{2}$$

 \mathscr{R}_0 measures the maximum reproductive potential for an infectious disease (at the beginning of the epidemic).

Note that under homogenous mixing of the population, I is the probability with which a susceptible individual comes in contact with a non-infectious person. Allowing, instead, for non-homogenous but random matching, let γ be the proportion of the infectious population with which a susceptible person comes in contact (or the probability with which a susceptible person comes in contact with an infectious person). We will refer to it as the mean contact rate. The two differential equations that determine Sand I are thus:

$$\frac{dS}{dt} = -\beta\gamma SI\tag{3}$$

$$\frac{dI}{dt} = \beta \gamma S I - \sigma I \tag{4}$$

with initial values $S(t_0) = S_0 \in (0, 1)$ and $I(t_0) = I_0 = 1 - S_0$. Note that (1) implies that

$$\frac{dZ}{dt} = \beta \gamma SI \tag{5}$$

with initial value $Z(t_0) = Z_0 = 1 - S_0 \in (0, 1)$. In this model, an epidemic with increasing number of infections initially starts when $\mathscr{R}_0 \gamma S_0 > 1$, otherwise infections drop below their initial level from t_0 onwards and vanish over time. We will focus hereafter on the more interesting case where infections increase initially, noting however that in our model with endogenous social distancing the mean contact rate may be time-varying.

 $^{^{9}}$ Evidence so far indicates that for SARS-CoV-2, individuals who get infected are immune to future infection by the same strain, which supports our modeling assumption (when it comes to the SARS-CoV-2 epidemic) that susceptible, infectious and recovered individuals comprise the whole population.

Hereafter, we will refer to $\beta\gamma S$ as the rate of infection, $\beta\gamma SI$ as the aggregate rate of transmission, and $\beta\gamma S - \sigma$ as the spread of infection. Denote also with $\overline{I}(\gamma)$ the peak (i.e. the highest level) of the infection given the proportion γ of the infectious population with which a susceptible person comes in contact. This is equal to¹⁰

$$\overline{I}(\gamma) = 1 - \frac{1}{\gamma \mathscr{R}_0} [1 + \log(\gamma \mathscr{R}_0 S_0)]$$

We note here the dependence of the infection peak $\overline{I}(\gamma)$ on γ , which in general will depend on social distancing decisions. Therefore, the peak of infection will in general be different under endogenous social distancing decisions.

2.2 The SIR model with heterogeneity in infection-induced mortality rates

The SIR model can also be extended to incorporate heterogeneity in infection-induced mortality rates at the population. Following Lourenço et. al. (2020), we assume that there are two types of individuals. There are those who belong to a "high-risk" group (e.g. old people, with asthma and other respiratory conditions e.t.c.), for whom getting infected leads with probability θ to a critical, and ultimately fatal, illness. We refer to these individuals as the high-risk individuals. Let ψ denote the exogenously given delay between the time of infection and the time of death for a high-risk person who develops a critical illness from infection.¹¹ The number of the high-risk individuals is a proportion ρ of the population. The rest of the population, hereafter referred to as the low-risk individuals, will not die when infected. We will indicate risk-types with the index i = L, H, where L stands for the low-risk and H for the high-risk type.¹² Denote the cumulative count of deceased ψ periods ahead as a proportion of the population by Λ .

We extend the model in Lourenço et. al. (2020) in two ways. First, by assuming that the mortality rate θ is increasing with the share in the population of the infectious individuals who become seriously ill when infected, i.e.

$$\theta = F(\rho I)$$

where $F : [0, 1] \to (0, 1)$ is a (weakly) increasing function such that $F(0) \in (0, 1)$. This assumption captures an environment where resources for the effective health care of the infected are limited and thereby health services get stretched (and even overwhelmed) when the demands for intensive care are high.¹³ We also assume that F is convex for low levels of ρI to capture capacity constraints (such as a limited number of ICUs) in a smooth way.¹⁴

¹⁰In the standard SIR model we have that $S_t = S_0 e^{-\frac{\beta\gamma}{\sigma}(S_0 + I_0 - S_t - I_t)}$. The infection peak occurs when $S_t = \frac{\sigma}{\beta\gamma}$. using this in the previous equation together with $S_0 + I_0 = 1$ and the definition of \mathscr{R}_0 gives the condition for $\overline{I}(\gamma)$.

¹¹An alternative modeling choice would be to assume that high-risk individuals who develop a critical illness from infection die at a constant rate. We have, however, chosen to maintain the above modeling assumption in Lourenço et. al. (2020) of an exogenous delay between the time of infection and the time of death to facilitate comparability and highlight the implications of introducing endogenous social distancing in an established epidemiological model for understanding the Covid-19 crisis.

 $^{^{12}}$ Evidence so far indicates that for SARS-CoV-2, the vast majority of infected individuals who die have had underlying health problems that were exacerbated due to the infection, and so our assumption that individuals who are not "high-risk" do not die due to the infection seems to be a good modeling approximation of the SARS-CoV-2 epidemic.

¹³Therefore, our model can also be used to study government interventions whereby more resources are channelled to health care services and as a result F(.) decreases for any given ρI . However, as our focus is on social distancing, we leave such an analysis for another paper.

¹⁴See, for instance, Kaplan et. al (2020) and Glover et. al. (2020) for alternative ways to introduce capacity constraints

We further extend the model in Lourenço et. al. (2020) by allowing for different probabilities of coming in contact with an infectious person for high-risk and for low-risk individuals. Denote with n^i the probability with which a susceptible person of risk-type i = L, H, comes in contact with an infectious person. We then have that

$$\frac{d\Lambda}{dt} = F(\rho I)\rho n^H \beta S I \tag{6}$$

with $\Lambda(t_0) = F(\rho I_0)\rho I_0$. To understand this law-of-motion, we note that $\rho\beta SI$ represents the new infections (as a proportion of the population) in the current instant among the high-risk susceptible individuals, had this type of individuals been in contact with all the infectious people in the population. However, high-risk susceptible individuals come in contact with other people at a rate n^H . Therefore, $F(\rho I)\rho n^H\beta SI$ is the increase in deaths (as a proportion of the population) in the current instant, all coming from the part of the susceptible population which is of high risk. Note that when every individual meets with everyone else (Lourenço et. al., 2020), we have that $n^H = 1$ and $\gamma = 1$. Here, however, due to endogenous social distancing, we may have that in equilibrium $n^H < 1$ and, thereby, $\gamma < 1$.

In this version of the SIR model (see Figure 1), the pool S includes all the $(1 - \rho)S$ low-risk susceptible individuals (S^L) and all the ρS high-risk susceptible individuals (S^H) ; the pool I includes all the $(1 - \rho)I$ low-risk individuals (I^L) who become infectious (at a rate $n^L\beta$), all the $(1 - \theta)\rho I$ high-risk individuals who become infectious (at a rate $(1 - \theta)n^H\beta$) but survive the infection (I^H) , as well as the $\theta\rho I$ high-risk individuals who become infectious (at a rate $\theta n^H\beta$) but become terminally ill and die in ψ periods (Λ_I) . Moreover, the pool R includes all the $(1 - \rho)R$ low-risk individuals (R^L) who recover (at a rate σ), the $(1 - \theta)\rho R$ high-risk individuals (R^H) who survive the infection and recover (at a rate σ) as well as the $\theta\rho R$ high-risk individuals who become terminally ill and die in ψ periods but become non-infectious (at a rate σ) due to hospitalisation (Λ_R) . All the high risk-individuals who became infected and will die in ψ periods are in the pool $\Lambda = \Lambda_I + \Lambda_R$, whether they are infectious or not. More details on this version of the SIR model are given in the Appendix.

The above model could be extended in a number of ways to allow for further heterogeneity in the population. For instance there could be heterogeneity in the transmission rates based on the risk type, or in the recovery rates based on the risk type and whether an individual has developed a critical illness.¹⁵There could also be heterogeneity within the group of high-risk individuals regarding the delay from the time of the onset of the illness to the time of death. We choose to abstain from such heterogeneity for two reasons. First, there is not enough evidence on the degree of such heterogeneity that we can use to guide our modeling assumptions and associated calibration. Therefore, we choose to be agnostic on such heterogeneity and focus only on the heterogeneity with respect to infection-induced mortality as in Lourenço et. al., (2020). Second, we want to focus on understanding how the novel economic part of our model affects the predictions of the SIR model and its related variants, and so we choose to keep the details of the epidemiological model as simple as possible to facilitate comparability with existing models. Introducing more heterogeneity would be interesting from a theoretical point of

that allow for a kink at the point when the capacity constraint binds.

 $^{^{15}}$ See Acemoglou et. al. (2020) for a model with such heterogeneity, but where individuals do not choose their own social distancing.



Figure 1: States and Flows in the SIR model with heterogenous infection-induced mortality rates

view and might also improve the predictive power of the model, but would not allow us to highlight the added value of our contribution in a clear and stark manner.

We leave this section by defining the 'effective reproduction number' as $\gamma \times \mathscr{R}_0 \times S$. This is the number of infections produced by an infectious person. Recalling (4) and using the definition of \mathscr{R}_0 , we note that if the effective reproduction number is greater than one, then infections will grow initially given the prevailing herd immunity, 1 - S. As infections grow, the pool of susceptible individuals becomes smaller, the effective reproduction number eventually drops below one and infections start decreasing, vanishing towards the end of the epidemic.

2.3 Incorporating social distancing in the SIR model

In our model, we also allow for endogenous social distancing. Individuals are recipients of state- and risk-type-contingent flow utilities over time. Thus, their expected utility depends on the probability of getting infected, which, in turn, depends on their social distancing choices and the level of infectiousness.

In more detail, each individual of risk type i = L, H, is assumed to be a recipient of a utility flow which depends on the state she/he is at and her/his risk-type. The states are Susceptible, Infected and Recovered. Given any state, the flow utilities are (weakly) higher for low-risk individuals. Given any risk type, the flow utility in the Susceptible state is (weakly) higher than the flow utility in the Recovered state, and the flow utility in the latter state is (weakly) higher than the flow utility in the Infected state. We assume that risk- and state-dependent flow utilities are constant.¹⁶ The transition

 $^{^{16}}$ In principle, the flow economic costs faced by infected individuals may not be time-invariant. This would for instance be the case in the presence of imperfect capital markets. For our paper, we implicitly assume that there are no capital market imperfections. We also assume that the economy is at a steady state when it is hit by the epidemic, and that the proportion of the government budget devoted to the support of the economy during adverse environmental/health aggregate shocks is sufficient for insulating the economy from any medium- and long-run consequences of such shocks.

rate between the Susceptible state and the Infected state for any individual is equal to βS times the individual's contact rate. The latter is (partly) controlled by the given individual.

Specifically, every individual pays a cost associated with social distancing in exchange for a reduction in their own risk of becoming infected. Each individual is very small relative to the rest of the population. Therefore, each individual takes the levels of infection and susceptibility, S and I, and their evolution, to be exogenously given and out of their control. Individuals take also as given and outside their control the mean contact rate in the population. In equilibrium, the anticipated (statedependent) mean contact rate in the population is equal to the actual mean contact rate implied by individuals' equilibrium decisions.

Following the existing literature, we assume that any societal motivation for social distancing is small relative to the marginal cost of exercising social distancing. A direct implication of this assumption is that infectious individuals do not exercise social distancing, and thus the burden of social distancing falls with the non-exposed individuals. Given this assumption, and in order to simplify notation, we assume hereafter that there is no societal motivation for social distancing. We also assume that the instance of becoming infectious coincides with the onset of symptoms. As a result, no infectious individual mistakenly behaves like a non-exposed one. While recognising that both these assumptions may be restrictive,¹⁷ we also note that relaxing them will reduce further the equilibrium rate of infection and make it potentially more responsive to second-best lockdown policies. Therefore, despite the fact that relaxing these two assumptions might potentially generate new insights in addition to the novel insights our paper produces, the main message of our work might even be strengthened after relaxing these two assumptions. We leave such an extension for future work.

We also assume that individuals know their risk type (i.e. whether they are old or have underlying respiratory problems). In reality, there can be cases where some people do not know whether they are of low- or high-risk type.¹⁸ However, we conjecture that this type of individuals will only be a very small percentage in the population, with most people having a strong indication of whether they have an underlying condition that would classify them as high-risk types in our model's lingo. Therefore, ignoring this group of individuals might not be with much loss of generality.

Except their risk-type, individuals are identical to each other in any other aspect. As a result, all susceptible individuals of the same risk-type choose the same social distancing.

We formulate the social distancing problem of each non-exposed (i.e. being at the Susceptible state) individual as one where she/he chooses (through altering social behaviour) the probability with which she/he severs a contact (or, equivalently, the proportion of all the contacts she/he severs).¹⁹ We

Assuming that the epidemic is fast relative to the evolution of the economy allows us then to treat the income earned and consumption under each state as constant over the duration of the epidemic. As a result, the flow utilities can be treated as constant over time. An interesting extension of our model, which we leave for future work, would be to study the implications for social distancing, and hence the evolution of the epidemic, of various capital market imperfections and limitations in the ability of governments to borrow/tax to insulate the economy.

¹⁷Similar assumptions are used in Raluga (2010) and Toxvaerd (2020).

 $^{^{18}}$ Uncertainty over own risk type would make susceptible individuals exerting more social distancing than the low-risk individuals in our model, but less social distancing than the high-risk individuals in our model.

¹⁹For an investment towards social distancing c, we have that only d(c) proportion of feasible contacts survive, where d(c) is a decreasing and convex function (see also Reluga (2010)). Denoting with δ , the proportion of feasible contacts a person severs, and setting $1 - \delta = d(c)$ allows us to define the cost of inducing a reduction δ in the probability of a contact taking place as $d^{-1}(1-\delta)$. For instance, if $d(c) = \frac{1}{1+mc}$, m > 0, then the cost of inducing a reduction equal to δ is $m^{-1}\frac{\delta}{1-\delta}$. If, as another example, $d(c) = 1 - \sqrt{2mc}, m > 0$, then the cost of inducing a reduction equal to δ is $m^{-1}\frac{\delta^2}{2}$.

denote by δ_i the percentage of potential contacts a susceptible individual of risk type i = L, H, severs by exercising social distancing. That is, $n^i = 1 - \delta_i$.

We show in the Appendix that every non-exposed individual of risk-type i solves, in effect, the following problem:

$$\max_{\delta_i \in [\underline{\delta}, \overline{\delta}]} \delta_i \beta I C_i - \frac{\delta_i^2}{2}$$

where C_i is defined as the *expected net present value* (ENPV) of the cost from getting infected in the next instant, and $\delta_i\beta I$ is the probability of getting infected in the next instant given current social distancing δ_i . All individuals take βIC_i to be outside their control. The cost C_i takes a different form for different risk types, and will be discussed further shortly. Note that we postulate that social distancing may face exogenous bounds $0 \leq \underline{\delta} \leq \overline{\delta} \leq 1$. For instance, $\underline{\delta} > 0$ can capture a government intervention that enforces a minimum level of distancing. $\overline{\delta} < 1$, on the other hand, may be the case because people may need to interact with other people from their network for essential shopping, getting help, catering for their pets or other family members in need etc. Related, some people may have to go to work either because they are essential workers or because they face pressure from employers. The latter raises another avenue for government intervention towards enabling more social distancing. We will refer to $\underline{\delta}$ as the minimal (degree of) social distancing, and to $\overline{\delta}$ as the maximal (degree of) social distancing.

Before we move to the discussion of the equilibrium, we note that the above decision problem could potentially be extended in several ways. For instance, there could be heterogeneity with respect to the cost of social distancing; high-risk individuals might face a lower cost of social distancing if they are retired or are under care. Such a model would lead to even lower social distancing for the group with the higher cost from social distancing compared to the group with the lower cost from social distancing. There could also be heterogeneity in terms of the maximal social distancing people can exercise; high-risk individuals might face a higher upper bound because they may not work anyway or because the have arranged care. Such a model would lead to even higher social distancing on the part of high-risk individuals.²⁰ Moreover, observe that the above problem would also describe individual decision-making in a population where people do not know their risk type, but the population consists of two groups with different beliefs about the likelihood that they are of high or low risk. In such a model, the subscript i would indicate the group in terms of these beliefs and C_i would also take into account the uncertainty from the point of view of individuals about their risk type. We choose to abstain from such very interesting and plausible types of (additional) heterogeneity, as well as from other possible extensions (see the Conclusions), because we want to focus on understanding how the novel economic part of our model affects the predictions of the SIR model and its related variants. Therefore, we choose to keep the details of the economic part of our model as simple as possible in order to facilitate comparability, and emphasise our contribution in a clear and focused manner. By doing so, we hope to make the case for the scope of future research that constructs even more elaborate models with potentially higher predictive power.

We now turn to the discussion of equilibrium. Consider, first, the non-exposed low-risk individuals.

 $^{^{20}}$ Such a model would also allow the study of targeted "second-best" lockdown policies such as those restricting social distancing of high-risk individuals only. See Acemoglou et.al. (2020) for a study of targeted first-best lockdown policies, i.e. under the assumption that the planner can control directly the social distancing of different groups.

Every such individual faces the same expected net present value of the cost from getting infected, denoted by K_L , i.e. $C_L = K_L$, where K_L is determined by the law-of-motion (12) stated shortly. It follows that in equilibrium every susceptible low-risk individual chooses the same level of social distancing which is equal to

$$\delta_L = \delta_L^*(K_L, I) \equiv \max\{\underline{\delta}, \min\{\beta I K_L, \overline{\delta}\}\}$$
(7)

To understand this note that δ_L is the marginal cost and $\beta I K_L$ is the marginal benefit from social distancing. The marginal benefit and, thereby, the chosen social distancing by low-risk individuals is, as intuition would suggest, increasing in the infection rate βI and the cost of getting infected, K_L .

Turning to the non-exposed high-risk individuals, every such individual faces the same expected net present value of the cost from getting infected but surviving the infection, denoted by K_H and determined by the law-of-motion (13) stated shortly. We assume hereafter that the difference between the flow utilities of low- and the flow utilities of high-risk individuals under the Infected and under the Recovered state are high enough so that $K_H > K_L$. In addition to the cost from getting infected, K_H , high-risk individuals face also an additional cost from being critically ill and eventually dying (ψ periods ahead), denoted by \overline{K} in present value terms and assumed to be positive. We show in the Appendix that this cost is constant. We, therefore, have that the expected net present value of the cost from getting infected faced by susceptible high-risk individuals C_H is equal to $K_H + F(\rho I)\overline{K}$. We assume that the the cost from dying, \overline{K} , is finite.²¹ We thus have that susceptible high-risk individuals choose

$$\delta_H = \delta_H^*(K_H, I) \equiv \max\{\underline{\delta}, \min\{\beta I[K_H + F(\rho I)\overline{K}], \overline{\delta}\}\}$$
(8)

for any given level of infection I. To understand this recall that δ_H is the marginal cost and that $\beta I[K_H + F(\rho I)\overline{K}]$ is the marginal benefit from social distancing. The marginal benefit and, thereby, the social distancing by high-risk individuals is, as intuition would suggest, increasing in the transmission rate β , the level of infectiousness I, the cost of dying \overline{K} and the cost of getting infected but surviving the infection K_H . Observe that

$$\delta_H^*(K_H, I) \ge \delta_L^*(K_L, I)$$

due to $F(\rho I) \ge F(0) > 0$, $K_H > K_L$ and $\overline{K} > 0$.

Furthermore, we have that in equilibrium:

$$n^i = 1 - \delta_i^*(K_i, I)$$

for any i = L, H, and

$$\gamma = \gamma(K_L, K_H, I) \equiv (1 - \rho) \left(1 - \delta_L^*(K_L, I)\right) + \rho(1 - \delta_H^*(K_H, I))$$

Clearly, then, the evolution of the equilibrium social distancing will depend on the evolution of the epidemic as well as the evolution of the costs from getting infected and surviving the infection K_i .

 $^{^{21}}$ For a recent treatment of the economic cost of death see Kniesner and Viscusi, 2020. For a collection of estimates of the *economic* value of life used in various cost-benefit policy studies see https://en.wikipedia.org/wiki/Value_of_life.

3 The equilibrium SIR model

In equilibrium, the two differential equations above that determine Z and I become:

$$\frac{dZ}{dt} = \left[(1-\rho) \left(1 - \delta_L^*(K_L, I) \right) + \rho (1 - \delta_H^*(K_H, I)] \beta (1-Z) I \right]$$
(9)

$$\frac{dI}{dt} = \{ [(1-\rho)(1-\delta_L^*(K_L,I)) + \rho(1-\delta_H^*(K_H,I))] \beta(1-Z) - \sigma \} I$$
(10)

with initial values $Z(t_0) = I_0$ and $I(t_0) = I_0 \in (0, 1)$.

In addition, we have that the law-of-motion for the cumulative number of deaths at time $t + \psi$ is equal to

$$\frac{d\Lambda}{dt} = F(\rho I)\rho(1 - \delta_H^*(K_H, I))\beta(1 - Z)I$$
(11)

with initial value

 $\Lambda(t_0) = F(\rho I_0)\rho I_0$

This law-of-motion will be used for the calibration of our model to UK data on reported deaths.

Finally, we show in the Appendix that the laws-of-motion that govern the evolution over time of the costs from getting infected and surviving the infection are

$$\frac{\partial K_L}{\partial t} = \phi^L + \xi K_L + [1 - \delta_L^*(K_L, I)]\beta I K_L + \frac{(\delta_L^*(K_L, I))^2}{2}$$
(12)

and

$$\frac{\partial K_H}{\partial t} = \phi^H + \xi K_H + [1 - \delta^*_H(K_H, I)]\beta I[K_H + F(\rho I)\overline{K}] + \frac{(\delta^*_H(K_H, I))^2}{2}$$
(13)

where ξ denotes the discount rate, and ϕ^i is a constant which depends on the discount rate, the recovery rate, and the flow utilities for an individual of risk type i = L, H when susceptible, infectious but surviving the infection, and recovered. Let $K_{i0}, i = L, H$, denote the initial costs from getting infected and surviving the infection. These are endogenously determined to ensure convergence to a steady state.

Note that, with $\underline{\delta} = 0$, $I_0 > 0$ and $S_0 > \frac{1}{\gamma(K_{L0}, K_{H0})R_0}$, in any steady state with finite costs from infection while surviving the infection, denoted by K_L^* and K_H^* , and with the level of infection be equal to zero, we have zero social distancing from all individuals. Consequently, in any such steady state, we have $K_i^* = \frac{-\phi^i}{\xi}$ for all i = L, H. In such equilibrium, the pool of infected increases over time until it reaches an endogenously determined peak at which time the number of exposed individuals is high enough for the spread of infection to become negative and infections start decreasing all the way to zero. Interestingly, we note that infections will peak quicker than in the absence of social distancing as now a increase in infections raises social distancing as well (at least initially) reinforcing the standard effect on the rate of infection of a lower pool of susceptible people. Similarly when $\underline{\delta} > 0$; the only difference in this case is that the steady-state values of the costs from getting infected and surviving the infections are appropriately modified to ensure that $\frac{\partial K_i}{\partial t} = 0$ for all i = L, H.

Unfortunately, deriving an analytic solution for the system of highly non-linear ODEs (9)-(13) is very difficult and we have to resort to numerical solutions. These solutions will depend on the parameter choices. Existing estimates and the calibration of our model to data on reported coronavirus-related deaths in UK will guide our selection of the model parameters. Before we do so in Section 5, we discuss next various scenarios of government intervention.

4 Government intervention

In our context, with convex costs from social distancing, we can think of an increase in maximal social distancing as capturing the shutting down of some of the essential sectors of the economy or reducing their operations. In addition we can think of an increase in minimal social distancing as capturing the shutting down of some of the less essentials sectors or limiting their operations.

An increase in maximal social distancing $\overline{\delta}$ is more likely to decrease (close to the peak the epidemic) the rate of infection among the high-risk individuals, $\rho(1 - (\delta_H^*(K_H, I))\beta(1-Z))$, for any given *infection* capacity $\beta(1-Z)$, than the rate of infection among the low-risk individuals. This has a number of implications. First, the decrease in the rate of infection among high-risk individuals reduces the number of future deaths (recall (11)). This reduction comes both through a direct reduction in the infection rate among high-risk individuals (for given fatality rate) and through a reduction in the future mortality rates (for given future infection rates among high-risk individuals). These effects emphasise the importance of government interventions that increase social distancing from high-risk people in terms of reducing the count of fatalities. Second, the decrease in the mean rate of infection due to an increase in $\overline{\delta}$ reduces the flow of infection $\frac{dI}{dt}$, but it also reduces the flow of exposure to the infection $\frac{dZ}{dt}$ and thereby the dampening effects of new infections on the future flow of infection (i.e. the 1-Zterm in (10) after recalling (9)). Therefore, increasing social distancing from high-risk individuals (at the start of the epidemic) has an ambiguous effect on the *duration* of the infection, with the net effect depending on the primitive factors of the infection such as the relative sizes of ρ, β and σ . We will discuss this further in our quantitative analysis in the next section.

Note next that private decisions on social distancing produce an externality due to the fact that individuals do not internalise that their social distancing decisions have an effect on the mean contact rate and thereby on the evolution of the epidemic over time. Therefore, individuals do not take into account that an increase in their social distancing reduces the future risk of infections and future probability of death faced by other individuals. This externality is positive, and will be the dominant one if the cost from dying \overline{K} is sufficiently high. As a result, optimal (from the point of view of a Utilitarian planner) distancing is (weakly) higher than that chosen by susceptible individuals themselves. See the Appendix for the details.

Importantly, despite its inherent theoretical interest, a full implementation of the optimal social distancing in large and modern societies would require massive administrative costs in terms of policing and fine-tuning social interactions along several dimensions on a daily basis. We, therefore, choose to focus hereafter on "second-best" lockdown policies and their effects on the evolution of the epidemic. There are potentially many ways with which to model enforceability of social distancing restriction. In any case, with imperfect enforcement of social distancing, it is very likely that the government would only be able to enforce a (piece-wise) constant level of social distancing which is (weakly) lower than the optimal from the point of view of the society social distancing. For this reason, we assume hereafter

that the *enforceable* level of social distancing (a) can only change in a piece-wise manner, (b) can be enforced in the form of setting the minimal social distancing $\underline{\delta}$ to be equal to the enforceable level of social distancing, and (c) is (weakly) higher than that chosen by individuals themselves. Therefore, a government intervention in the form of raising the *minimal* social distancing $\underline{\delta}$ (marginally) above zero for a given period could be justified as a second-best externality-correction measure.

An increase in the minimal social distancing δ is more likely to decrease (at the start of the epidemic) the rate of infection among low-risk individuals $(1-\rho)(1-(\delta_L^*(K_L,I))\beta(1-Z))$ in every period, for any given infection capacity $\beta(1-Z)$, than the rate of infection of high-risk individuals.²² This has a number of consequences. First, it reduces the number of future deaths. This reduction comes indirectly through the lowering of the mean contact rate and thereby the relief of health services and the associated reduction in the mortality rates among high-risk individuals in the future. This novel effect highlights the significance of government interventions that increase social distancing from low-risk individuals in terms of reducing the count of fatalities. Second, the decrease in the mean rate of infection due to an increase in $\underline{\delta}$ reduces the flow of infection $\frac{dI}{dt}$, but it also reduces the flow of exposure to the infection $\frac{dZ}{dt}$ and thereby the dampening effects of new infections on the future flow of infection. Therefore, increasing social distancing from low-risk individuals also has an ambiguous effect on the *duration* of the infection, with the net effect depending on the primitive factors of the infection such as the relative sizes of ρ , β and σ . We will discuss this further in our quantitative analysis in the next section, when we will use the above law-of-motions to calibrate our model and study the implications of various scenarios of government intervention that induce social distancing which is over and above those that individuals would have chosen by themselves for a given period.

An important issue in all these partial lockdown scenarios is whether there will be an after-wave once the lockdown policies are lifted. The effective reproduction number at the time lockdowns are lifted tells us whether there will be a second wave or not. Specifically, denoting with τ the time of lifting the lockdown policies, we have that a second wave will emerge if and only if the effective reproduction number at time τ is higher than one, i.e. $\gamma(K_{L\tau}, K_{H\tau})S_{\tau}\mathscr{R}_0 > 1$.

5 Quantitative Analysis

We calibrate the above model to daily UK data on reported deaths from the recent coronavirus epidemic, using also existing estimates of epidemiological model parameters that represent the basic reproduction number, the length of the infectious period, and the length of the time from the onset of the infection to death.

Specifically, we set the daily discount rate at $\xi = 0.05/365$ to be consistent with a 5% annual interest rate, and N = 66.87M. In the basic calibration, we use the following estimates: $\Re_0 = 2.25$, $1/\sigma = 4.5$, $\psi = 17.^{23}$ We also use $\beta = \Re_0 \sigma$. We set the introduction date to be $t_0 = \tau_1 - \psi$, where τ_1

 $^{^{22}}$ Note here that if the government can enforce the minimal degree of social distancing to every individual, then infectious people will also be forced to exercise the minimal degree of social distancing. In this case, the rates of infection need to be multiplied by $(1 - \underline{\delta})$ as only $(1 - \underline{\delta})$ proportion of the infectious people may come in contact with susceptible individuals.

²³Kucharski et. al. (2020) report a median estimate of $\mathscr{R}_0 = 2.35$ and Wu et. al. (2020) report an estimate of $\mathscr{R}_0 = 2.2$. Given these estimates, we will also check how our calibration results change when $\mathscr{R}_0 = 2.22$ and $\mathscr{R}_0 = 2.35$. Lourenço et. al. (2020) report and use an estimate of $\psi = 17$, stating that this estimate for ψ includes the incubation period as well. Linton et al. (2020), report that the mean time to death from the onset of disease is 15 and the mean

is the date in the data when the first death was reported.²⁴Furthermore, we postulate that

$$F(w) = \min\{\theta_0^{1-kw}, \overline{p}\}, \qquad \theta_0 \le \overline{p} \le 1$$

Observe that this formulation incorporates the special case of a constant mortality rate when k = 0. Instead, when k > 0, the mortality rate is an increasing and initially convex function of w. Under this formulation, a low (but positive) k captures (in a smooth way) a capacity constraint (in critical care) that becomes an issue only for high w's, while a high k would capture a capacity constraint that binds early in the epidemic. As we will see below, the calibrated value for k turns out to be large justifying our approach to endogenise the mortality rate of the high-risk individuals in the SIR model with heterogeneity in the infection-induced mortality rates used in Lourence et. al. (2020).

In addition, we set $\overline{\delta} = 0.7$, so that $1 - \overline{\delta}$ is roughly equal to the share of GDP of essential sectors such as health, government, retail, utilities, and food manufacturing, which continue to operate even in extreme scenarios (see also Alvarez et.al (2020)). We also set $\underline{\delta} = 0$ to capture an environment without intervention.

We assume logarithmic utility and normalise units by setting the flow utility of all susceptible people to be equal to zero, regardless of their risk type. Therefore, the benchmark consumption of all susceptible individuals in our model is normalised to one, and hence all model units are measured in daily consumption per capita terms. We also set $\overline{K} = 108$ which is consistent with a statistical value of life of 127.5 times the annual consumption per capita. To see how a statistical value of life of 127.5 times the annual consumption per capita implies $\overline{K} = 108$, let first P be the extra cost of dying in terms of current annual consumption per capita. We identify a statistical value of life SVL with the shadow cost of dying (in the absence of an epidemic), which consists of the NPV of one unit of annual per capita consumption (with r annual discount rate) plus the extra cost of dying P, i.e. equal to $\frac{1}{r} + P$. With SVL = 127.5 and r = 0.05, we have P = 107.5. Next, note that a cost P is equivalent to paying daily a constant stream of ξP . Given that \overline{K} is the NPV of the extra cost of dying (in ψ periods) in utility terms, and utility is logarithmic, we can think of \overline{K} as being equal to $\overline{K} = \frac{\log(1)}{\xi} - \frac{\log(1-\xi P)}{\xi}$. Using P = 107.5 and $\xi = 0.05/365$ gives $\overline{K} = 108$. Observe now that a statistical value of life of 127.5 times the annual consumption per capita is equal to the average of the value of 30 times the annual consumption per capita found by Hall et.al. (2020) and used in Alvarez et.al (2020) and the value of 225 times the annual consumption per capita found by Kniesner and Viscusi (2020).²⁵

incubation period is 5.3. (see their Table 1). Given these estimates, we will also derive calibration results for the cases $\psi = 15$ and $\psi = 20$. Lourenço et. al. (2020) also report and use an estimate of $1/\sigma = 4.5$. We will also conduct sensitivity analysis by using $\sigma = 0.18$ and $\sigma = 0.20$.

 $^{^{24}}$ To be more precise, the introduction date thus found is 18/2/2020. There were only 9 reported cases during the 18 days *prior* to the introduction date and no newly reported cases on the introduction date. From these 9 reported cases, the first 2 were on 31/1/2020, the next one on 7/2/2020, with 5 more on 10/2. The last reported case prior to the introduction date was on 12/2/2020 and no other case was reported until 24/2/2020. Of course, most probably not all cases are reported as symptoms can be similar to flu. Moreover, in reality there is heterogeneity in the time of delay from the onset of illness to death and in the incubation period. In fact, Linton et al. (2020), find that the time of delay from the onset of illness to death follows a lognormal distribution with mean 15 and standard deviation 6.9, while the incubation period follows a lognormal distribution with mean 5.3 and standard deviation 3.2, Taking into account of such heterogeneity is left for future work.

²⁵Farboodi et.al. (2020) uses, in terms of our notation, $\xi P = 0.011$ and thereby $\overline{K} = 80$. Estimates of the statistical value of life are typically attained under the assumptions of no epidemic and a constant mortality rate. In our model, however, we have an endogenous probability of dying (after ψ periods) which depends on the level of infection. Moreover, the flow utility (in consumption-equivalent units) of infected and recovered individuals are typically (weakly) lower than

Finally, we calibrate the remaining parameters by minimising the squared sum of the residuals (expressed in proportional terms) between cumulative deaths in our model, implied by (11), and those in UK data.²⁶

Given the integer nature of our data, matching all data points is futile especially when there is a significant jump in values (in proportionate terms). To deal with this we weight the residuals (in proportional terms) between our model-generated counts of cumulative deaths and the actual data by using the following procedure. First, we attempt to calibrate the model by assigning weight one on each residual. This typically produces results with large residuals for the fifth and eighth data points. The reason is that both data points are associated with an increase in the number of cumulative deaths which is more than 200%, something that the model cannot match. In fact, in attempting to reduce these large residuals, the model was not fitting well the other moments as well. Motivated by this, in the second step we assign weight zero on the two largest residuals. Calibration with this weight profile typically produces larger residuals for the two "ignored" data points than the uniform weight rule but much better approximation of the other data points.

5.1 The equilibrium SIR case

Next, we calibrate the equilibrium SIR model. The remaining to be calibrated parameters are ρ , θ_0 , k, \bar{p} , ϕ_L , ϕ_H , $K_{L,0}$, $K_{H,0}$ and I_0 . We find $\rho = 0.1828$, $\theta_0 = 0.1974$, k = 1091332, $\bar{p} = 0.4333$, $I_0 = 38/N$, $\phi_L = -0.0025$, $\phi_H = -2.9925$, $K_{L,0} = 5.58$, $K_{H,0} = 14513$. Observe that $0 < \rho < 1$, and so the data on UK deaths suggest that the postulated heterogeneity is empirically plausible. In the next subsection, we discuss the benchmark case of no heterogeneity.

Figure 2 shows reported and model generated counts of cumulative deaths (log10 transformed). Ignoring the residuals for the two dates when the proportional increase in deaths was more than 200%, we have that the absolute residuals in proportional terms are below 6.2% for the first four and last six dates. For the remaining two dates the model predicts only one count of cumulative deaths more than the actual death toll of nine deaths on 12/03/2020 and predicts only one count of cumulative deaths less than the actual death toll of seven on 11/03/2020.

This model predicts a very high death toll of 1,406,630 deaths in the absence of a government intervention. It also predicts that by the end of the epidemic 60.9% of the UK population would have been exposed to the virus, and that infections reach their peak of 7.57% of the UK population by the 19th of April. Moreover, this model predicts that by the date of the first reported death 0.009% would have already been infected with the virus. This last number is noticeably lower than the prediction of 0.08% in Lourenço et. al. (2020). Interestingly, our model also predicts that the current epidemic

that of susceptible individuals. We assume here that the duration of the epidemic is small enough, so that the implied cost of death from existing estimates of the statistical value of life remains a good approximation of the extra cost of death in our model. Note, however, that we will also perform sensitivity analysis using lower as well as higher values for the cost of death within the range [10, 208] implied by the range of statistical values of life [30, 225] and an annual discount rate 5%.

 $^{^{26}}$ A time series was obtained from the John Hopkins University Centre for Systems Science and Engineering COVID-19 GitHub repository. Available: at https://github.com/CSSEGISandData/COVID-19. Following Lourenco et. al. (2020), we trimmed the data to the first fourteen days of death counts above zero until 19/03/2020 (06/03/2020 to 19/03/2020) to include only the initial increase free of effects from local control measures to avoid contamination by mitigation strategies that were implemented after that time. The data was accessed on 04/04/2020 the first time. UK data was updated on 31/04/2020 and was accessed on 01/05/2020. This version of the paper uses the updated data.



Figure 2: The model fit

wave in the UK would last for around six months and a mean case fatality rate of around 7.84% over the duration of the epidemic.

The equilibrium model generates also endogenous social distancing on the part of susceptible individuals. In the calibrated model, the endogenous mean contact rate is 0.8138. As Figure 3 shows, high-risk individuals exercise maximal social distancing around the infection peak, and certainly before the announcement of the UK lockdown on the evening of the 23rd of March. High-risk individuals exercise a much stricter social distancing than low-risk individuals, reaching maximal social distancing before the infection peaks and maintaining it after the infection peaks. Social distancing of low-risk individuals is increasing with the level of infection, reaches a peak and then decreases with the level of infection. The mean contact rate has a U-shape for most part of the epidemic emphasising further the importance of incorporating endogenous social distancing in the SIR model (which assumes that the mean contact rate is constant throughout the epidemic).²⁷

Figure 4 contrasts social distancing by the various risk types against one of its determinants; namely, the level of infections. Interestingly, the peak of low-risk individuals' social distancing is after the peak of infection. To understand this, note that, as we have already mentioned when discussing the equilibrium, social distancing is (weakly) increasing with the level of infection while keeping constant

²⁷The calibration results are very similar when we assume that the mortality rate is given by the logistic function $F(w) = \frac{\overline{p}}{1+e^{-k(w-x)}}$: $x = 9.4/10^8$, $k = 1.1976 \times 10^7$, $\rho = 0.1527$, $\overline{p} = 0.5239$ and $I_0 = 37/N$, and $\phi_L = -0.0028$, $\phi_H = -2.9175$, $K_{L,0} = 6.4035$, $K_{H,0} = 14171$. Moreover, the peak date is on the 17th of April, the peak level of infection is 7.35%, the proportion in the population of infected by the date the first death was reported is 0.009%, the duration of the epidemic is about 6 months, the level of exposure at the end of the epidemic is 60.62%, and the total number of deaths is around 1.4M. Finally, the mean case fatality rate is around 7.92% over the duration of the epidemic, and the mean contact rate is 0.8208.



Figure 3: Equilibrium social distancing and the mean contact rate

the ENPV of the cost from getting infected. Moreover, social distancing is increasing with the ENPV of the cost from getting infected while keeping constant the level of infection. However, the ENPV of the cost from getting infected and the level of infection may not move in sync during the epidemic. To see why this is the case, recall (12). Using the envelope theorem, we can see that an increase in infections leads to an increase in the cost in the next instance of from getting infected. Observe, however, that how this cost evolves over time depends also on its current value and the flow utilities from in the Infected and Recovered states, as captured by the term $\phi_L + \xi K_L$. This term can be positive for high levels of K_L . In fact, Figure 4 highlights that in the calibrated model this is indeed the case at the infection peak, making low-risk individuals' social distancing being increasing on the date of the infection peak and for some time after.

Next we check how the predictions about the epidemic and social distancing (captured by the equilibrium mean contact rate) change when we consider alternative values for \overline{K} , \mathscr{R}_0 (equivalently, β), σ and ψ . For all the reported alternative values, the duration of the current UK epidemic would have be around 6 months in the absence of government intervention. Moreover, the mean fatality rate is around 0.795. Different times from the onset of infection to death – for instance, $\psi = 15, 20$ – lead to similar predictions for the fraction in the population of high-risk individuals, the peak level of infection, the death toll and total exposure to the virus as well as the initial level of infection and the number of cases when the first death was reported. The only difference is in the peak date, with $\psi = 15$ predicting 22nd of April, and $\psi = 20$ predicting 16th of April.²⁸ Table 1 reports the findings for alternative values for \overline{K} , \mathscr{R}_0 and σ (parameters that are not stated in the heading of a column stay

²⁸Details are available upon request.



Figure 4: Equilibrium social distancing against infections

the same as in the basic calibration):

We note the reduction in the infection peak, the total exposure at the end of the epidemic, the death toll and the predicted level of infections on the date the first death was reported as the transition rate from the Infectious to Recovered state increases. The reason is that faced with a lower duration of the infection and thereby lower infectiousness of the virus (recall that \mathscr{R}_0 decreases as σ increases), low-risk individuals respond with lower social distancing (which increases the mean contact rate).

Observe also that as the economic cost of death increases, the death toll, total exposure, the infection peak and the mean contact rate have a U-shape, whereas the predicted level of infections on the introduction date and on the date the first death was reported, as well as the date of the infection peak have an inverted U-shape. The reason is that high-risk individuals now take relatively more

	$\sigma = 0.2$	$\sigma = 0.18$	$\Re_0 = 2.30$	$\mathscr{R}_0 = 2.22$	$\overline{K} = 130$	$\overline{K} = 80$
Mean contact rate	0.7778	0.7413	0.8691	0.8667	0.856	0.8632
Infection peak	10.38%	11.11%	8.92%	9.24%	9.14%	9.25%
Peak date	22 April	19 April	11 April	16 April	16 April	16 April
Death toll	1.6M	1.78M	1.48M	1.43M	1.44M	1.45M
Total exposure	67.31%	68.23%	65.03%	65.19%	64.91%	65.24%
Initial infection pool	30	28	32	39	35	35
Infections by 6 March	0.0088%	0.01%	0.0092%	0.0086%	0.0084%	0.0086%

Table 1: Sensitivity analysis

precautions at the early stages of the infection, before they start taking relatively fewer precautions as the infection evolves and the mean contact rate drops.

Note also that an increase in the basic reproduction number implies a higher transmission rate but, also, higher social distancing as an increase in infectiousness leads to a higher probability of getting infected. The net result on the various dimensions of the epidemic will depend on the relative strength of these two effects. The end result in these simulations is a higher predicted level of infections on the date the first death was reported and a lower level of initial infections. The reported results in Table 1 also suggest that the death toll, the infection peak, total exposure and mean contact rate have a U-shape, whereas the date of the infection peak has an inverted U-shape, as the basic reproduction number increases.²⁹

5.2 Comparison with some benchmark cases

5.2.1 Exogenous distancing

We start with the case of the epidemiological version of the SIR where social distancing is treated as the same for all individuals and independent of the epidemic, say some fixed δ , in which case the mean contact rate is $\gamma = 1 - \delta$ and the contact rate of high-risk individuals is $\rho(1-\delta)$. This benchmark model is, in effect, a generalisation of the one studied in Lourenço et. al. (2020) who assume that the mortality rate is exogenous, and that there is zero social distancing. In effect, the proportion in the population of the high-risk individuals Lourenço et. al. (2020) is equal (in terms of our notation) to $\rho(1-\delta)$. Here, however, we allow for δ to be positive. Importantly, also, δ is calibrated from the data together with the rest of the model parameters.³⁰ We find $\delta = 0.0913$, $\rho = 0.142$, $\theta_0 = 0.09$, k = 636016, $\bar{p} = 0.5632$ and $I_0 = 78/N$. Interestingly, $\rho(1-\delta) = 0.129$, which is significantly higher than the proportion in the population of the high-risk individuals found in Lourenço et. al. (2020) under the assumption of exogenous mortality rate.

As our model above this benchmark model predicts that the current epidemic wave in the UK would last for around six months.. However, it also predicts a total number of deaths of about 4,33M in the absence of a government intervention, and infections reaching their peak of 16.11% of the UK population by 17th of April. It also predicts that by the end of the epidemic 80.85% of the UK population would have been exposed to the virus. Our model with endogenous social distancing predicts one third less, about half less, two days later, and one quarter less of these findings, respectively. In addition, this benchmark model predicts that by the date of the first reported death 0.011% would have already been infected with the virus. The latter is around 86% lower than the number found in Lourenço et. al. (2020), and 22% higher than the number we found above under endogenous social distancing. Moreover, it predicts a mean case fatality rate of 6.78% which is about one percent below the one predicted by the calibrated model with endogenous social distancing.

 $^{^{29}}$ For completeness, we also note here that the calibrated fraction in the population of the high-risk individuals, starting from the left column, is 0.275, 0.302, 0.063, 0.109, 0.123, 0.108.

 $^{^{30}}$ Ignoring the residuals for the two dates when the proportional increase in deaths was more than 200%, we have that the absolute residuals in proportional terms are below 5% for the first four, the sixth and the last three dates. For the remaining four dates the residuals in proportionate terms are below 14%.

5.2.2 No heterogeneity in mortality rates

In this section we want to compare our main calibration results with those under the alternative assumption that there is no heterogeneity in mortality rates. We should emphasise here that, as we have seen above, the calibrated value of ρ when we allow it to take any value between zero and one is indeed positive but less than one justifying our focus on heterogeneity in terms of underlying health conditions and how they may lead to a death from infection.

Given that in the data there are deaths, to give the best chance to the benchmark model with no heterogeneity, we assume that in this model all individuals face a risk of developing a serious disease from infection and die after ψ periods, i.e. $\rho = 1$. This benchmark model is, in effect, a generalisation of Toxyaerd (2020) that allows for endogenous mortality.³¹

We find $\theta_0 = 0.0336$, k = 98139, $\bar{p} = 0.8$ and $I_0 = 38/N$. This benchmark model predicts a mean case fatality rate of 7.88% which is very similar to the one predicted by the calibrated model with heterogeneity. However, this benchmark model would massively under-predict, compared to the model with heterogeneity, the death toll, the infection peak and total exposure in the absence of a government intervention, predicting a total number of deaths of about 12,000, that infections reach their peak of 0.0075% of the UK population by 14th of May, and that by the end of the epidemic only 0.25% of the UK population would have been exposed to the virus. In addition, this benchmark model predicts that by the date of the first reported death 0.0065% would have already been infected with the virus. The latter is around 28% lower than the number we found earlier under heterogeneity. Finally, in this model, the endogenous mean contact rate is 0.5056 which is around 38% lower than the mean contact rate under heterogeneity. The reason for these discrepancies is that in an homogenous population where everyone is at risk of dying from infection, everyone exercises a high degree of social distancing. Interestingly, however, no one exercises the maximal degree of social distancing. The reason is that when everyone else is expected to exercise high social distancing the chances of getting infected are low and so it is not optimal to exercise maximal social distancing; this explains why the mean contact rate is lower than the mean contact rate of the high-risk individuals in the model with heterogeneity.

5.3 Partial lockdowns in the equilibrium SIR model

In what follows, we examine the effects on the main predictions of our model of various scenarios of government intervention regarding social distancing. To fix ideas, we assume that the measures are implemented on the 24th of March, i.e. the first day of the UK lockdown as announced by the UK government at 8pm of the 23rd of March, and are lifted on a specific date at least 5 weeks after the the 24th of March. We examine the case where both dates were not known on the introduction date. We also assume that, on the date the lockdown was announced, the lockdown was unanticipated, whereas the date the lockdown is lifted was anticipated.³²

First, we run the case where the government enforces a minimal level of social distancing whereby *all* individuals cut at least 40% of their contacts until the 30th of April (inclusive). Under such regime,

³¹In Toxvaerd (2020) there is no mortality. To compare our model with the one there we would have to set $\rho = 0$, which would however predict zero deaths throughout the epidemic.

 $^{^{32}}$ In reality, the situation is somewhere between with individuals having (some) imperfect information on either of the two dates. We leave it for future work to appropriately modify our model to incorporate imperfect information on the part of individuals regarding government intervention on social distancing.



Figure 5: Social distancing under minimal social distancing of $\delta = 0.4$ until 30 April

low-risk susceptible individuals are forced to choose $\delta_L^* = 0.4$ throughout the intervention period, while the behaviour of high-risk susceptible individuals is largely unaffected.³³ All infectious individuals are also forced to cut 40% of their contacts. In this scenario, where infectious people are also forced to exercise the minimal social distancing, the mean contact rate is, with some abuse of notation, equal to $\gamma(1-0.4)$. Figure 5 shows the social distancing of susceptible individuals depending on their risk type under this partial lockdown policy. Similar patterns of social distancing are found for longer periods of such social distancing restrictions.

We find that under such an intervention the death toll is reduced by around 7,000, a 0.05% reduction compared to the death toll under no intervention. We also find that under such intervention 60.1% of the UK population would have been exposed to the virus by the end of the epidemic, which is only 0.8% lower than the total exposure by the end of the epidemic without intervention. Finally, infections would have reached their peak of 6.5% by the 18th of May, which are lower by 1.1% and almost a month later, respectively, compared to the no intervention case. Enforcing minimal level of social distancing at $\delta = 0.5$ would have been reduced by almost 17.5%, the total exposure would have been 8.5% lower, while the infection peak would have been about 2% lower and reached by more than two months later.

Extending the lockdown of non-essential sectors and thereby the minimal level of social distancing after the 30th of April would increase the impact of this type of lockdown policies. For instance,

³³The highest degree of social distancing low-risk susceptible individuals would choose in the absence of government intervention would be 0.336. We have also run the case when the government enforces a minimal level of social distancing whereby individuals cut at least 34% of their contacts until the 30th of April (inclusive). Under such regime, infectious and low-risk susceptible individuals are forced to choose $\delta_L^* = 0.34$ throughout the intervention period. We find that such an intervention would only have a small effect in the infection peak, level of exposure and death toll. It would also delay the infection peak by a month.



Figure 6: Infections under no intervention and minimal social distancing of $\underline{\delta} = 0.4$ until 30 April or 30 May

keeping the minimal level of social distancing at $\underline{\delta} = 0.4$ until the 30th of May (inclusive) would have as an effect that the death toll would have been reduced by almost 6%, the total exposure would have been 4.2% lower, and the infection peak would have been 3.2% lower and reached by about two months later compared to the case of no intervention. Figures 6-8 contrast the infections, exposure and the death toll under no intervention, and under minimal social distancing of $\underline{\delta} = 0.4$ until the 30th of April and until the 30th of May. Figures 5 and 6 together highlight the impact the social distancing decisions of the low-risk susceptible individuals have on the evolution of the epidemic: as soon as the lockdown measures in question are lifted there is an after-wave due to low-risk susceptible individuals decreasing drastically the frequency of their interactions as soon as the lockdown is lifted.

Finally we derive the epidemic under several alternatives values for the maximal level of social distancing, $\overline{\delta} = 0.71, 0.72, ..., 0.99, 1$. This type of intervention does not affect the behaviour of infectious individuals. Under all these cases the behaviour of the low-risk susceptible individuals remains largely unchanged.³⁴ Since they are the vast majority of susceptible individuals in the calibrated economy, it thus should not be a surprise that we find that such intervention has a very small impact on the pools of infectious and susceptible individuals.³⁵ A consequence of this is that in the calibrated economy there is no after-wave when these lockdown policies are lifted, simply because the endogenous mean

 $^{^{34}}$ To be precise their social distancing increases somewhat once the intervention stops because the risk of getting infected is somewhat lower at that point due to the high-risk individuals being more cautious during the intervention period.

³⁵For instance, for the cases of $\overline{\delta} = 0.7, 0.8, 0.9$, the peak infection is 7.58%, 7.21%, 6.85%, respectively, the dates of the peak are 19th, 20th and 21st of April, respectively, and the proportion in the population of the exposed individuals at the end of the epidemic is 60.89%, 60.61%, 60.38%, respectively.



Figure 7: Exposure under no intervention and minimal social distancing of $\underline{\delta} = 0.4$ until 30 April or 30 May



Figure 8: Cumulative deaths under no intervention and minimal social distancing of $\underline{\delta}=0.4$ until 30 April or 30 May



Figure 9: Social distancing under maximal social distancing of $\underline{\delta} = 0.8$ until 30 April

contact rate is small enough so that the effective reproduction number is less than one when these lockdown policies are lifted.

However, such intervention enables the high-risk susceptible individuals to increase their social distancing during the intervention period up to the new maximal level. Figure 9 depicts social distancing by susceptible individuals when $\overline{\delta} = 0.8$. Therefore, such intervention has a significant impact on the death toll of the current UK epidemic. At the extreme when the whole economy is shut down (i.e. $\overline{\delta} = 1$) until the 30th of April, the death toll is reduced by 888, 884 (around 63%) compared to the case of no government intervention. When maximal social distancing increases to $\overline{\delta} = 0.9$ until the 30th of April, the death toll is, instead, reduced by around 619, 650 (around 44% compared to the case of no government intervention. As another case, consider when the maximal social distancing increases to $\overline{\delta} = 0.8$ until the 30th of April. In this case, the death toll is reduced by around 322, 400 (around 23% compared to the case of no government intervention.

Furthermore, interventions of this type that last between 5 and 8 weeks have almost identical effects on the pools of infectious and susceptible individuals. The reason here is that high-risk susceptible individuals already exercise the maximal degree of social distancing before the start of the lockdown period and maintain maximal social distancing well beyond the end of an 8-week lockdown period. However, interventions that last between 5 and 8 weeks do differ in terms of the size of the negative effect they have on the death toll. For instance, extending the intervention until the 30th of May would reduce the death toll by 961,780 (around 63%) compared to the case of no government intervention. Figure 10 depicts the death toll when the maximal social distancing increases to $\overline{\delta} = 0.8$ until the 30th of April and until the 30th of May.



Figure 10: Death toll under no intervention and maximal social distancing of $\underline{\delta} = 0.8$ until 30 April and until 30 May

Most of the calibrated models above predict a very high number of deaths compared to what we observe. However, our model can match observed numbers to a good degree with the appropriate choice of minimal and maximal social distancing. At the time of writing these lines (7 May 2020) the number of deaths was between 32,000 and 33,000, with the UK (partial) lockdown still being in place, and talks in the news about lifting some of the lockdown measures start appearing in mainstream newspapers.³⁶ We have checked some indicative levels of $\underline{\delta}$ and $\overline{\delta}$ in an attempt to match the aforementioned death toll. It turns out that setting $\underline{\delta} = 0.355$ and $\overline{\delta} = 0.72$ produces a death toll on the 7th of May between 32,000 and 33,000. Therefore, our model can predict the observed data to a good degree.³⁷ With such lockdown policies, infectious individuals cut down their contacts by 3.55%. Moreover, the pattern of social distancing by susceptible individuals is similar to the one depicted in Figure 5 because the low-risk individuals are a significant majority of susceptible people in the calibrated population. Figures 11 and 12 depict the evolution of infections and total exposure under the lockdown policy that enforces $\underline{\delta} = 0.355$ and $\overline{\delta} = 0.72$, contrasting them with their counterparts under no intervention.

 $[\]frac{^{36}\text{See, for instance, the following article in the Independent: \ https://www.independent.co.uk/news/uk/politics/coronavirus-uk-lockdown-measures-lift-announcement-boris-johnson-news-a9501441.html$

 $^{^{37}}$ Increasing the maximal degree of social distancing over 70% would enable matching the observed death toll by using a lower minimal degree of social distancing than 37.5%.



Figure 11: Infections under no intervention and combined intervention of $\underline{\delta} = 0.355$ and $\overline{\delta} = 0.72$ until 30 May



Figure 12: Infections under no intervention and combined intervention of $\underline{\delta} = 0.355$ and $\overline{\delta} = 0.72$ until 30 May

6 Conclusions

Motivated by the current coronavirus epidemic, we have analysed a SIR model of an epidemic but with endogenous social distancing. We have calibrated the model to UK data on reported deaths prior to the introduction of the UK lockdown to study various hypothetical scenarios of government intervention regarding social distancing. We have explicitly taken into account that there is heterogeneity among the population in terms of infection-induced fatality rates and thereby private decisions on social distancing, and that, due to limited resources available for health services, mortality rates may depend on the stock of infected people who become seriously ill because of the infection.

We show that the predicted evolution of the epidemic is significantly different when social distancing is endogenous than when the mean contact rate is exogenously given. For instance, the death toll and total exposure under endogenous social distancing is one third of and one quarter less than that under exogenous social distancing. Furthermore, under endogenous social distancing, the predicted infection peak is lower by 1% of the UK population. Our model predicts that by the date of the first reported death around 0.009% of the UK population would have already been infected with the virus, and that the current epidemic wave in the UK would last around six months in the absence of government intervention. Our numerical analysis also suggests that the peak of the mortality rate in UK would have occurred mid April in the absence of government intervention, but with a significant death toll by the end of the epidemic. Regarding the effects of various scenarios of government intervention on social distancing, our results suggest that the length of a lockdown that imposes a minimal degree of social distancing has a significant effect on the death toll, and the "flattening of the curve", but also on the behavioural responses of low-risk. These responses may lead to an after-wave. Furthermore, our numerical analysis indicates that a government intervention that increases the maximal minimal degree of social distancing has a significant negative impact on the cumulative count of deaths but not on the evolution of infections and herd immunity. The latter implies that such a government intervention might not be followed by an after-wave once lockdown restrictions are lifted.

Our approach could also be used for the study of the Covid-19 epidemic in other countries where there is data on deaths. Our methodology could also be extended for the study of other epidemics by modifying the underlying epidemiological model appropriately.

An interesting extension of the epidemiological side of our model would be to allow for a period when infected individuals can be infectious but asymptomatic as well as for an incubation period during which infected people are asymptomatic and non-infectious, as these changes are expected to have an impact on social distancing decisions and thereby the evolution of the epidemic. Another interesting extension of our model would be to introduce heterogeneity in the time of delay from the onset of the infection to death as well as in the recovery rate from being infectious to not contributing to the spread of the infection.

In reality, individuals may not be certain about the fundamental epidemiological parameters such as the recovery and the transmission rate, or about the level of infections. In all these cases, decisionmaking would be taking place under uncertainty about the risks of social distancing. In such an environment, high-risk susceptible individuals might exercise a lower degree of social distancing. Lossaversion could also make even low-risk susceptible individuals to exercise a significant degree of social distancing. Similar behavioural changes could also be observed in a model where people do not know their risk type but the population consists of two groups with different beliefs on the likelihood that they are of high or low risk. These are all interesting extensions of the economic side of our model.

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8 Appendix

8.1 The SIR with heterogeneity in infection-induced mortality rates

Let $n^i, i = L, H$, be the probability a susceptible individual of risk-type i (L for low, H for high) comes in contact with an infectious person. Let I^i be the proportion in the population of infectious individuals of risk-type i who will not die. Let S^i be the proportion in the population of susceptible individuals of risk-type i. Let R^i be the proportion in the population of exposed and non-infectious individuals of risk-type i who will not die. Let Λ_I be the proportion in the population of infectious individuals of risk-type i who will not die. Let Λ_I be the proportion in the population of infectious individuals of high risk who will die (in ψ periods). Let Λ_R be the proportion in the population of exposed individuals of high risk who will die (in ψ periods) but are non-infectious due to hospitalisation.

There is the standard infection flow from S^L to I^L at rate $n^L\beta I$ and from S^H to I^H at rate $(1-\theta)n^H\beta I$. These rates differ from the standard ones to accommodate for the respective contact probabilities $n^i, i = L, H$, and that only a fraction of high-risk individuals survive the infection. There are also the standard flows from I^L to R^L and from I^H to R^H , at rate σ , of recovered individuals. In our model, however, there are additional flows. There is a flow from S^H to Λ_I of the share of the population that is of high risk, becomes infectious and will die (in ψ periods), at a rate $\theta n^H\beta I$. There is also a flow from Λ_I to Λ_R at a rate σ ; this is the share of the population that is of high risk, will die (in ψ periods) and become non-infectious due to hospitalisation. The epidemic is then described by the following laws-of-motion:

$$\frac{dI^L}{dt} = n^L \beta S^L I - \sigma I^L \tag{14}$$

$$\frac{dI^{H}}{dt} = (1-\theta)n^{H}\beta S^{H}I - \sigma I^{H}$$
(15)

$$\frac{d\Lambda_I}{dt} = \theta n^H \beta S^H I - \sigma \Lambda_I \tag{16}$$

$$\frac{d\Lambda_R}{dt} = \sigma\Lambda_I \tag{17}$$

$$\frac{dS^L}{dt} = -n^L \beta S^L I \tag{18}$$

$$\frac{dS^H}{dt} = -n^H \beta S^H I \tag{19}$$

$$\frac{dR^L}{dt} = \sigma I^L \tag{20}$$

$$\frac{dR^H}{dt} = \sigma I^H \tag{21}$$

with initial values $I^{L}(t_{0}) = (1 - \rho)I_{0}, I^{H}(t_{0}) = (1 - \theta)\rho I_{0}, \Lambda_{I}(t_{0}) = \theta \rho I_{0}, \Lambda_{R}(t_{0}) = 0, S^{L}(t_{0}) = (1 - \rho)S_{0}, S^{H}(t_{0}) = \rho S_{0}, R^{L}(t_{0}) = R^{H}(t_{0}) = 0.$

Let now $\gamma = n^L(1-\rho) + n^H\rho$, $I = I^L + I^H + \Lambda_I$, $I^L = (1-\rho)I$, $I^H = \rho(1-\theta)I$, $S^L = (1-\rho)S$, $S^H = \rho S R^L = (1-\rho)R$, $R^H = \rho(1-\theta)R$, $R = R^L + R^H + \Lambda_R$, and $\Lambda = \Lambda_I + \Lambda_R$ and Z = I + R = 1 - S. *I* is the proportion in the population of infectious individuals of any type, which includes those who will die (after ψ periods) and are not hospitalised and hence are still infectious, Λ_I . *S* is the proportion in the population of susceptible people of any risk type. *R* is the proportion in the population of non-infectious individuals of any risk type, which includes those who will die (after ψ periods) and are hospitalised and so are non-infectious, Λ_R . Finally, *Z* is the proportion in the population of the exposed individuals whether they are infectious or not, which includes also those who will die (after ψ periods). It follows from the above laws-of-motion that:

$$\frac{dI}{dt} = \gamma\beta SI - \sigma I \tag{22}$$

$$\frac{dS}{dt} = -\gamma\beta SI = -\frac{dZ}{dt} \tag{23}$$

$$\frac{dR}{dt} = \sigma I \tag{24}$$

with initial values $I(t_0) = I_0 \in (0, 1)$, $S(t_0) = S_0 = 1 - I_0 = 1 - Z(t_0) \in (0, 1)$ and $R(t_0) = 0$. These are as in the standard SIR model. Note also that here we have a law-of-motion for deaths:

$$\frac{d\Lambda}{dt} = \theta n^H \rho \beta S I \tag{25}$$

with $\Lambda^{\psi}(t_0) = \theta \rho I_0$.

8.2 NPVs of being at the susceptible and infectious states

Let the flow utility from being infectious and of low risk be v_I^L , the flow utility from being infectious and of high risk be v_I^H , the flow utility from being non-exposed and of low risk be v_S^L , the flow utility from being non-exposed and of high risk be v_S^H , the flow utility of being exposed and recovered and of low risk be v_R^L , and the flow utility of being exposed and recovered and of high risk be v_R^L . Assume that

$$v_S^i \ge v_R^i \ge v_I^i \quad i = L, H$$

and

$$v_j^L \ge v_j^H, \quad j = S, R, I$$

Given that Recovered is an absorbing state, we have that the NPV of being recovered and of risk-type $i = L, H, V_R^i$, is equal to

$$V_R^i = \frac{v_R^i}{\xi}$$

Consider next an interval [t, t + dt) with dt very small. We have that the NPV of being infectious and of low risk at time t, V_I^L is equal to

$$V_I^L = v_I^L dt + [1 - \sigma dt] e^{-\xi dt} V_I^L + \sigma dt e^{-\xi dt} V_R^L$$

Using the approximation $e^y = 1 + y + \frac{y^2}{2} + \frac{y^3}{6} + \frac{y^4}{24} + \dots + \frac{y^n}{n!} + \dots$ we have that

$$V_{I}^{L}(1+\xi dt) = v_{I}^{L}dt + (1-\sigma dt)V_{I}^{L} + \sigma dtV_{R}^{L} + o^{L}(dt)$$

where

$$o^{L}(dt) = v_{I}^{L}dt\{\xi dt + \frac{(\xi dt)^{2}}{2} + \frac{(\xi dt)^{3}}{6} + \dots\} - V_{I}^{L}\{\frac{(\xi dt)^{2}}{2} + \frac{(\xi dt)^{3}}{6} + \dots\}$$

Canceling terms, rearranging, dividing by dt, then taking the limit as $dt \to 0$ and using the above equation for V_R , we derive that

$$V_I^L = \frac{v_I^L + \sigma \frac{v_R^L}{\xi}}{\xi + \sigma} \le \frac{v_R^L}{\xi} = V_R^I$$

The NPV of being infectious at time t and of high risk but surviving the infection, V_I^H , is equal to

$$V_I^H = v_I^H dt + [1 - \sigma dt] e^{-\xi dt} V_I^H + \sigma dt e^{-\xi dt} V_R^H$$

Using similar steps to the ones above, we have that

$$V_I^H = \frac{v_I^H + \sigma \frac{v_R^H}{\xi}}{\xi + \sigma} \le \frac{v_R^H}{\xi} = V_R^H$$

Finally, let V_D be the NPV of being infected in period t', and of high risk and dying in period $t' + \psi$. With a constant utility flow in the first ψ periods (which includes any disutility due to the anticipation of death), V_D is constant.

8.3 Non-cooperative social distancing by susceptible individuals

Consider an interval [t, t + dt) and an individual of risk type i = L, H, who is susceptible at instant t and chooses the probability n^i , with which they get in contact with each and every of the other individuals in the population, while taking as given the mortality rate for high-risk individuals, $F(\rho I)$, the transmission rate, β , and the stocks of infection I and susceptibility S.

Recall that $n^L \beta I$ is the probability of a low-risk individual getting infected, and that $n^H \beta I$ is the probability of a high-risk individual getting infected. Recall also that a high-risk individual becomes

critically ill with probability $F(\rho I)$ after being infected. Thus, $F(\rho I)n^H\beta I$ is the transition rate from the state of being susceptible and of high risk to the state of being critically ill and eventually dying. Let $W^L = V_I^L$ and $W^H = [1 - F(\rho I)]V_I^H + F(\rho I)V_D$ be the expected NPVs of low- and high-risk susceptible individuals, respectively, from being infected.

The best NPV that can be obtained at any time t from being susceptible and of risk-type i given the level of infection I and susceptibility S, denoted by $V_S^i(I,S)$, is equal to

$$V_{S}^{i}(I,S) = \max_{\underline{n} \le n \le \overline{n}} \{ [v_{S}^{i} - \frac{(1-n)^{2}}{2}] dt + (1-n\beta I dt) e^{-\xi dt} V_{S}^{i}(I + \frac{dI}{dt} dt, S + \frac{dS}{dt} dt) + n\beta I dt e^{-\xi dt} W^{i} \}$$

Note that, with dt being very small, we have

$$\begin{split} V_{S}^{i}(I + \frac{dI}{dt}dt, S + \frac{dS}{dt}dt) &= V_{S}^{i}(I, S) + \frac{\partial V_{S}^{i}(I, S)}{\partial I}\frac{dI}{dt}dt + \frac{\partial V_{S}^{i}(I, S)}{\partial S}\frac{dS}{dt}dt \\ &= V_{S}^{i}(I, S) + \frac{\partial V_{S}^{i}(I, S)}{\partial I}I[\beta\gamma S - \sigma]dt - \frac{\partial V_{S}^{i}(I, S)}{\partial S}\beta\gamma SI \end{split}$$

Using similar steps to the ones above, we then have that

$$\xi V_S^i(I,S) = \max_{\underline{n} \le n \le \overline{n}} \{ v_S^i - \frac{(1-n)^2}{2} - n\beta I V_S^i(I,S) + n\beta I W^i + \frac{\partial V_S^i(I,S)}{\partial I} I[\beta\gamma S - \sigma] - \frac{\partial V_S^i(I,S)}{\partial S} \beta\gamma SI \}$$
(26)

where γ, I, S and W^i are taken as given.

Let $\delta = 1 - n$. It follows that social distancing of risk-type *i* individuals given the states *S* and *I* solves the following problem:

$$\max_{0 \le \delta \le \overline{\delta}} \{\delta \beta I [V_S^i - W^i] - \frac{\delta^2}{2}\}$$
(27)

Let $\delta^i(V_S^i, W^i, I)$ denote the solution of the above maximisation problem. We then have that the social distancing in equilibrium of risk-type *i* individuals given the states *S* and *I* is given by

$$\delta^{i}(V_{S}^{i}, W^{i}, I) = \min\{\max\{\beta I[V_{S}^{i} - W^{i}], \underline{\delta}\}, \overline{\delta}\}$$

and

$$\frac{dV_S^i}{dt} = \{\xi + [1 - \delta^i(V_S^i, W^i, I)]\beta I\}V_S^i - v_S^L + \frac{(\delta^i(V_S^i, W^i, I))^2}{2} - [1 - \delta^i(V_S^i, W^i, I)]\beta IW^i\}$$

where the first condition is the necessary condition of the above maximisation problem (27) and the second condition is equation (26) rearranged, after using the definition of $\delta^i(V_S^i, I)$ and that

$$\frac{dV_S^L}{dt} = \frac{\partial V_S^i(I,S)}{\partial I}\frac{dI}{dt} + \frac{\partial V_S^i(I,S)}{\partial S}\frac{dS}{dt} = \beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial I}I[\beta\gamma S - \sigma] - \frac{\partial V_S^i(I,S)}{\partial S}\beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial S}\frac{dS}{dt} = \beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial I}I[\beta\gamma S - \sigma] - \frac{\partial V_S^i(I,S)}{\partial S}\beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial S}\frac{dS}{dt} = \beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial I}I[\beta\gamma S - \sigma] - \frac{\partial V_S^i(I,S)}{\partial S}\beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial S}\frac{dS}{dt} = \beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial I}I[\beta\gamma S - \sigma] - \frac{\partial V_S^i(I,S)}{\partial S}\beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial S}\frac{dS}{dt} = \beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial I}I[\beta\gamma S - \sigma] - \frac{\partial V_S^i(I,S)}{\partial S}\beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial S}\frac{dS}{dt} = \beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial I}I[\beta\gamma S - \sigma] - \frac{\partial V_S^i(I,S)}{\partial S}\beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial S}\frac{dS}{dt} = \beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial I}I[\beta\gamma S - \sigma] - \frac{\partial V_S^i(I,S)}{\partial S}\beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial S}\frac{dS}{dt} = \beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial I}I[\beta\gamma S - \sigma] - \frac{\partial V_S^i(I,S)}{\partial S}\beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial S}\beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial S}\frac{dS}{dt} = \beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial I}I[\beta\gamma S - \sigma] - \frac{\partial V_S^i(I,S)}{\partial S}\beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial S}\beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial S}\frac{dS}{dt} = \beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial I}I[\beta\gamma S - \sigma] - \frac{\partial V_S^i(I,S)}{\partial S}\beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial I}\frac{dS}{\partial I}\frac{dS}{dt} = \beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial I}I[\beta\gamma S - \sigma] - \frac{\partial V_S^i(I,S)}{\partial S}\beta\gamma SI\frac{\partial V_S^i(I,S)}{\partial I}\frac{dS}{\partial I}\frac{dS}{dt}$$

We can then derive the problem of susceptible individuals as stated in the main text by setting:

$$C_{L} \equiv K_{L} = V_{S}^{L} - W^{L} = V_{S}^{L} - V_{I}^{L} = V_{S}^{L} - \frac{v_{I}^{L} + \sigma \frac{v_{R}^{L}}{\xi}}{\xi + \sigma}$$

$$K_H = V_S^H - V_I^H = V_S^H - \frac{v_I^H + \sigma \frac{v_R^H}{\xi}}{\xi + \sigma}$$

and

$$\overline{K} = V_I^H - V_D = \frac{v_I^H + \sigma \frac{v_R^H}{\xi}}{\xi + \sigma} - V_D$$

and so

$$C_H \equiv K_H + F(\Theta)\overline{K} = V_S^H - W^H = V_S^H - V_I^H + F(\Theta)[V_I^H - V_D]$$

Note that $\overline{K} > 0$ if V_D is small enough, which is assumed to be the case. We also assume that $v_I^L + \sigma \frac{v_R^L}{\xi}$ (for given σ and ξ) is sufficiently higher than $v_I^H + \sigma \frac{v_R^H}{\xi}$ so that $K_L < K_H$.

Finally, note that social distancing by high-risk individuals depends on the mortality rate, which depends on level of infection. After using the above definitions, the equilibrium social distancing distancing $(\delta_L^*(K_L, I), \delta_H^*(K_H, I))$ is given by:

$$\delta_L^*(K_L, I) = \min\{\max\{\beta I K_L, \underline{\delta}\}, \overline{\delta}\}$$
$$\delta_H^*(K_H, I) = \min\{\max\{\beta I [K_H + F(\rho I) \overline{K}], \underline{\delta}\}, \overline{\delta}\}$$

where K_L and K_H evolve over time according to the following system of ODEs (given a path of I).

$$\frac{\partial K_L}{\partial t} = \frac{dV_S^L}{dt} = \{\xi + [1 - \delta_L^*(K_L, I)]\beta I\}[K_L + V_I^L] - v_S^L + \frac{(\delta_L^*(K_L, I))^2}{2} - [1 - \delta_L^*(K_L, I)]\beta IV_I^L$$
$$= \xi[K_L + V_I^L] + [1 - \delta_L^*(K_L, I)]\beta IK_L - v_S^L + \frac{(\delta_L^*(K_L, I))^2}{2}$$
$$\frac{\partial K_H}{\partial K_H} = \frac{dV_S^H}{\partial K_S} = \{\xi + [1 - \delta_L^*(K_H, I)]\beta I\}[K_H + V_H^H] = v_S^H + \frac{(\delta_H^*(K_H, I))^2}{2}$$

and

$$\begin{aligned} \frac{\partial K_H}{\partial t} &= \frac{dV_S^H}{dt} = \{\xi + [1 - \delta_H^*(K_H, I)]\beta I\} [K_H + V_I^H] - v_S^H + \frac{(\delta_H^*(K_H, I))^2}{2} \\ &- [1 - \delta_H^*(K_H, I)]\beta I [V_I^H - F(\rho I)\overline{K}] \\ &= \xi [K_H + V_I^H] + [1 - \delta_H^*(K_H, I)]\beta I [K_H + F(\rho I)\overline{K}] - v_S^H + \frac{(\delta_H^*(K_H, I))^2}{2} \end{aligned}$$

The above ODEs become the laws-of-motion stated in the main text after setting $\phi^i = \xi V_I^i - v_S^i$, i = L, H. Note that $\phi^i \leq 0$.

For the calibrations, we set $v_S^L = v_S^H = v_S$ and normalise units by setting $v_S = 0$. This implies that $v_I^i \leq v_R^i \leq v_S \leq 0$ and

$$\phi^H = \frac{\xi v_I^H + \sigma v_R^H}{\xi + \sigma} \le \phi^L = \frac{\xi v_I^L + \sigma v_R^L}{\xi + \sigma} \le v_S = 0$$

Note also that

$$V_D = \frac{\phi^H}{\xi} - \overline{K} < 0$$

Finally note that with logarithmic utility, and denoting with c_j^i , i = L, H, j = S, I, R, the state- and risk-type dependent consumption, we can define consumption-equivalent units c^i , i = L, H, and c_D , and a proportionate payment stream p such that $\phi^i = log((c_I^i)^{\frac{\xi}{\xi+\sigma}}(c_R^i)^{\frac{\sigma}{\xi+\sigma}}) = log(c^i)$ and

 $V_D = \frac{\log(c_D)}{\xi} = \frac{\log(c^H(1-p))}{\xi}$. Therefore, we can express \overline{K} as

$$\overline{K} = \frac{\log(c^H) - \log(c^H(1-p))}{\xi} = \frac{\log(1) - \log(1-p)}{\xi} = \frac{-\log(1-p)}{\xi}$$

8.4 Optimal social distancing of susceptible individuals

Here we solve the problem of finding the optimal from the point of view of the society social distancing of susceptible individuals from a period t_g onwards, while taking into account the implications for aggregate infections. Specifically, we find the social distancing profile of susceptible individuals that maximises total welfare in the economy. To ease exposition, we assume without loss of generality that infectious individuals do not exercise any social distancing.

Recall that $n^L \beta I$ is the probability of a low-risk individual getting infected, and that $n^H \beta I$ is the probability of a high-risk individual getting infected. Recall also that a high-risk individual becomes critically ill with probability $F(\rho I)$ after being infected. Thus, $F(\rho I)n^H\beta I$ is the transition rate from the state of being susceptible and of high risk to the state of being critically ill and eventually dying. Recall also from the previous subsection in this appendix the definition that $W^L = V_I^L$ and $W^H = [1 - F(\rho I)]V_I^H + F(\rho I)V_D$.

Let also $V_R = (1 - \rho)V_R^H + \rho V_R^H$ and $V_I = (1 - \rho)V_I^H + \rho V_I^H$. Using the results in the previous subsection in this appendix, we have that $V_R - V_I \ge 0$ and that V_R and V_I are constants. Let also $\gamma(n^L, n^H) = (1 - \rho)n^L + \rho n^H$. Given the constants V_R and V_I and the levels of infection and susceptibility I and S, define here with some abuse of notation the NPV of susceptible people that is obtained by optimal social distancing.

Given the levels of infection I and susceptibility S at instant $t \ge t_g$, the government chooses the probabilities (n^L, n^H) , with which low-risk and high-risk susceptible individuals, respectively, get in contact with each and every of the other individuals in the population, while taking into account how these probabilities affect the mortality rate for high-risk individuals, $F(\rho I)$, and the evolution of the population shares of infectious and susceptible people. With some abuse of notation, let $\tilde{V}_S^i(n^L, n^H, S, I)$ be the NPV of a susceptible individual of risk type i = L, H, given the levels of infection I and susceptibility S, and the social distancing profile (n^L, n^H) at instant t. We then have that optimal distancing solves the following problem:

$$\max_{1-\overline{\delta} \le n^L, n^H \le 1-\underline{\delta}} \{ [1-S-I] V_R + I V_I + S[(1-\rho) \widetilde{V}_S^L(n^L, n^H, S, I) + \rho \widetilde{V}_S^H(n^L, n^H, S, I)] \}$$

Clearly, then, optimal social distancing solves also the following problem:

$$\max_{1-\overline{\delta} \le n^L, n^H \le 1-\underline{\delta}} \{ (1-\rho) \widetilde{V}_S^L(n^L, n^H, S, I) + \rho \widetilde{V}_S^H(n^L, n^H, S, I) \}$$

Let $V_S^i(I, S)$ be the NPV for a susceptible individual of risk type i = L, H, evaluated at the optimum social distancing profile. Let $V_S(I, S) = (1 - \rho)V_S^L(I, S) + \rho V_S^L(I, S)$, and note that $V_S(I, S)$ is the value function of the above maximisation problem.

Consider now an interval [t, t + dt), with $t \ge t_g$ and dt very small. We thus have that

$$\begin{split} V_{S}(I,S) = \\ \max_{1-\bar{\delta} \leq n^{L}, n^{H} \leq 1-\underline{\delta}} \{ (1-\rho) \{ [v_{S}^{L} - \frac{(1-n^{L})^{2}}{2}] dt + n^{L}\beta I dt e^{-\xi dt} V_{I}^{L} + \\ + (1-n^{L}\beta I dt) e^{-\xi dt} V_{S}^{L} (I + \frac{dI}{dt} dt, S + \frac{dS}{dt} dt) \} + \\ + \rho \{ [v_{S}^{H} - \frac{(1-n^{H})^{2}}{2}] dt + n^{H}\beta I dt e^{-\xi dt} [V_{I}^{H} - F(\rho I) [V_{I}^{H} - V_{D}]] + \\ + (1-n^{H}\beta I dt) e^{-\xi dt} V_{S}^{H} (I + \frac{dI}{dt} dt, S + \frac{dS}{dt} dt) \} \} \end{split}$$

given the laws-of-motion $\frac{dI}{dt}, \frac{dS}{dt}$. Note that, with dt being very small, we have

$$V_{S}^{i}(I + \frac{dI}{dt}dt, S + \frac{dS}{dt}dt) = V_{S}^{i}(I, S) + \frac{\partial V_{S}^{i}(I, S)}{\partial I}I[\beta\gamma(n^{L}, n^{H})S - \sigma]dt + \frac{\partial V_{S}^{i}(I, S)}{\partial S}\beta\gamma(n^{L}, n^{H})SIdt$$

Using similar steps to the ones in the previous subsection in this appendix, we have that

$$\begin{split} \xi V_S(I,S) = \\ & \max_{1-\overline{\delta} \leq n^L, n^H \leq 1-\underline{\delta}} \{(1-\rho)\{[v_S^L - \frac{(1-n^L)^2}{2}] + n^L \beta I[V_I^L - V_S^L(I,S)] + \\ & + \frac{\partial V_S^L(I,S)}{\partial I} I[\beta \gamma(n^L,n^H)S - \sigma] + \frac{\partial V_S^L(I,S)}{\partial S} \beta \gamma(n^L,n^H)SI\} + \\ & + \rho\{[v_S^H - \frac{(1-n^H)^2}{2}] + n^H \beta I[[V_I^H - V_S^H(I,S)] - F(\rho I)[V_I^H - V_D]] \\ & + \frac{\partial V_S^H(I,S)}{\partial I} I[\beta \gamma(n^L,n^H)S - \sigma] + \frac{\partial V_S^{iH}(I,S)}{\partial S} \beta \gamma(n^L,n^H)SI\} \} \end{split}$$

Clearly then, after letting $\delta_i = 1 - n^i$, i = L, H, and recalling the definition of \overline{K} from the previous subsection in this appendix, the government solves, in effect, the following problem:

$$\max_{1-\overline{\delta} \le n^L, n^H \le 1-\underline{\delta}} \{ (1-\rho) \{ \delta_L \beta I[V_S^L(I,S) - V_I^L] - \frac{(\delta_L)^2}{2} \} + \\ + \rho \{ \beta I \{ \delta_H[V_S^H(I,S) - V_I^H] - (1-\delta_H)F(\rho I)\overline{K} \} - \frac{(\delta_H)^2}{2} \} + \\ + \beta \gamma ((1-\delta_L), (1-\delta_H))SI\{(1-\rho)[\frac{\partial V_S^L(I,S)}{\partial I} + \frac{\partial V_S^L(I,S)}{\partial S}] + \rho [\frac{\partial V_S^H(I,S)}{\partial I} + \frac{\partial V_S^H(I,S)}{\partial S}] \} \}$$

Therefore, compared to the problem solved by susceptible individuals, the government internalises the externalities generated by the social distancing of each risk-type through the impact of social distancing on the mean contact rate and thereby on the mortality rate and the evolution of the epidemic.

8.4.1 Solving for the optimal social distancing

Let

$$DV_S(I,S) \equiv (1-\rho)\left[\frac{\partial V_S^L(I,S)}{\partial I} + \frac{\partial V_S^L(I,S)}{\partial S}\right] + \rho\left[\frac{\partial V_S^H(I,S)}{\partial I} + \frac{\partial V_S^H(I,S)}{\partial S}\right]$$

The necessary conditions of the above maximisation problem are:

$$\beta I[V_S^L(I,S) - V_I^L] - \delta_L = \beta SIDV_S(I,S)$$

and

$$\beta I\{[V_S^H(I,S) - V_I^H] + F(\beta \gamma(n^L, n^H)SI)\overline{K}\} - \delta_H = \beta SIDV_S(I,S)$$

Note that individuals do not internalise the effect of their decisions on the evolution of the epidemic either. An increase in current social distancing (of any given individual) reduces the new infections and thereby it reduces the future population share of infectious people while it increases the future population share of the susceptible part of the population. These changes have the following implications.

First, a decrease in the level of infection decreases the expected net present value of the cost of infection. It also decreases the new infections, and thereby the future level of infection and hence the future expected net present values of the cost of infection, and so on. These effects push towards $DV_S(I,S) > 0$. However, note also that a decrease in the level of infection also decreases mortality rates and therefore the expected cost from dying. This effect pushes towards $DV_S(I,S) < 0$. Second, an increase in the level of susceptibility increases the new infections and hence the future level of infection and thereby the expected net present value of the cost of infection in the future. These effects push towards $DV_S(I,S) > 0$. Therefore, the overall welfare effect of changes in the evolution of the epidemic and thereby the associated externality of social distancing, as captured by the term $DV_S(I,S)$, cannot be signed without further restrictions on the primitives of the model.

We assume that \overline{K} is high enough to ensure that the positive externality via the effect of social distancing on the mortality rate (ψ periods ahead) dominates, i.e.

$$\beta SIDV_S(I,S) < 0$$

and so the overall externality generated by social distancing is positive. It follows directly (from the first two optimality conditions) that the optimal social distancing is (weakly) higher than private choices,³⁸ with optimal social distancing from high-risk individuals being higher than that from low-risk individuals.

 $^{^{38}}$ Optimal social distancing will coincide with private decisions if individuals choose the maximal social distancing, but not otherwise.

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