Strategic Insight

Economic Costs to the United States Stemming From the 9/11 Attacks

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Introduction

Like all major disasters, natural or manmade, the terrorist attacks of September 11 resulted in a tragic loss of life and destruction of property, as well as short-term disruption of economic activity. In addition, because of the size and premeditated nature of the attack, there are likely to be more lasting effects in some industries and segments of the U.S. economy.

Conceptually, the economic costs to the United States stemming from the 9/11 terrorist attacks can be broken down into several categories, largely depending on their nature (direct and indirect) and on the time period examined (immediate, short-term, medium-term and long-term). Those costs that are short run and direct are clearly the easiest to identify and measure. Estimates covering longer periods of time and focused mainly on indirect costs require numerous assumptions concerning counterfactuals and hence are on less firm ground. Another area of controversy involves the anthrax scare following the attacks. The estimates below treat this as a separate event, although in some of the indirect cost estimates this factor may have had an influence.

Immediate and Short Term Direct Impacts

The September 11 attacks inflicted casualties and material damages on a far greater scale than any other terrorist aggression in recent history. Lower Manhattan lost approximately 30 percent of its office space and a number of businesses ceased to exist. Close to 200,000 jobs were destroyed or relocated out of New York City, at least temporarily. The destruction of physical assets was estimated in the national accounts to amount to $14 billion for private businesses, $1.5 billion for state and local government enterprises and $0.7 billion for federal enterprises. Rescue, cleanup and related costs have been estimated to amount to at least $11 billion for a total direct cost of $27.2 billion.

Immediate and Short Term Indirect Impacts

Immediately after the attacks, leading forecast services sharply revised downward their projections of economic activity. The consensus forecast for U.S. real GDP growth was instantly downgraded by 0.5 percentage points for 2001 and 1.2 percentage points for 2002. The implied projected cumulative loss in national income through the end of 2003 amounted to 5 percentage points of annual GDP, or half a trillion dollars.

With production disrupted in some areas (airlines) and consumers increasingly cautious, real GDP shrank in the third quarter of 2001. But in the fourth quarter, demand held up better than initially feared, and GDP increased. However, private sector fixed investment registered a steep decline, and inventories were slashed. Offsetting these forces, however, were household consumption, helped by falling energy prices, and government spending. Defense spending in particular grew by about 9.25% in real terms in the fourth quarter, at a seasonally adjusted annual rate.

Some sectors or firms actually witnessed an increase in demand, notably in the area of security and information technology. Still, while overall demand proved fairly resilient, a number of sectors were hit hard, with declining output and profits continuing into the mid-term.

Overall however the short-term adverse economic impact of the attacks was far less than feared initially, thanks in large part to good economic crisis management. The Federal Reserve, the Administration and Congress acted quickly to restore confidence, inject liquidity and provide resources to deal with the consequences of the attacks. The Federal Reserve by lowering the price of credit and temporarily providing vast amounts of liquidity helped safeguard the integrity of the financial system and saved many firms from bankruptcy.

Medium Term Impacts

Looking beyond the short term, the fact that the attack was premeditated and therefore could be repeated has had a significant impact on five main areas: (1) insurance; (2) airlines; (3) tourism and other industries associated with travel; (4) shipping; and (5) increased defense/security expenditures. In turn, developments in these areas have had a broader effect on wide areas of economic activity.

- *Insurance*. The losses from the terrorist attacks for the insurance industry (including reinsurance) are estimated at between $30 and $58 billion with the main uncertainty concerning liability insurance. By comparison the losses associated with Hurricane Andrew's 1992 damage in Florida came to around $21 billion. Even if the final cost is close to the lower estimate, insured losses in 2001 are likely to have been the highest ever.
  Following the attacks, most primary insurers have increased their premiums and curtailed or dropped altogether coverage for terrorism-related risk. The increases in insurance premiums have adversely affected several key industries. The strongest impact has been on aviation, but other sectors, including transportation, construction, and tourism and energy generation have also been affected. Overall it is estimated that commercial property and liability insurance rates have been raised by 30 percent on average.
- *Airlines*. The United States' airline industry was already in a weak financial position before the attacks with rising debt ratios and falling returns on investment. Even with cutbacks in service of the order of 20 percent and significant government support, airline passenger traffic has apparently remained below normal, 100,000 layoffs have been announced and employment in October and November fell by 81,000 (almost 8 percent). Equity valuations compared to the overall market illustrate these difficulties. The U.S. airline sector has lost around 20 percent of its relative value since September 10.
- *Tourism and Other Service Industries*. Other industries have also been badly affected, such as hotels, tourism, automobile rentals, travel agents, and civilian aircraft manufactures. For example, hotels have reported higher vacancy rates and employment in the sector as a whole fell by 58,000 (about 3 percent) in October and November. Relative equity values for hotels and leisure facilities are off by around 15 percent.
- *Shipping*. Shipping is an area where it is particularly hard to assess the impact of the terrorist attacks. The main problem is one of defining a credible counterfactual—i.e., what would the state of affairs been in the absence of 9/11? For example, in spite of new security requirements, six months following the attacks most available indices showed little evidence of an increase in shipping costs. Some rates had even declined. Maritime shipping rates increased by 5 to 10 percent on average in the two weeks following the attack, but that rise was soon reversed. Airfreight rates, on the other hand were bout 10 percent higher in late 2001 than before the attacks. Given the sharp deceleration of aggregate demand beginning in 2000 and the drop in fuel costs following the attacks, a steeper decline in freight costs should have occurred. The relative stability of freight rates, despite lower fuel costs and under-utilized shipping capacity would tend to suggest that underlying transportation costs may have increased as a result of the 9/11 attacks.
- *Increases in security and military spending*. The President has requested a significant increase in security-related programs in the context of the budget for FY2003. Additional spending of $48

billion was proposed for national defense (an increase of 14 percent from the previous year). In addition the President asked Congress for an appropriation of $38 billion for homeland security, compared to $20 billion spent in 2001. This seeks to improve the preparedness of first responders (fireman, police, and rescue workers), enhance defenses against biological attacks, secure borders and improve information sharing and includes $8 billion for domestic defense spending.

While it is too early to say with any precision, the medium term costs to the economy may be considerable. The shrinkage of terrorism related insurance coverage may have a detrimental impact on investment as lenders become wary of greater potential risks, although there is no strong evidence yet of such a pattern. While providing a much needed short-run stimulus to the economy, the increased levels of fiscal deficits stemming from the acceleration in defense expenditures may, in the medium-to-longer term, retard growth by increasing interest rates and thus reducing private capital formation and productivity.

Long Term Impacts

The main channel though which the continual threat of terrorism could affect the long term potential of the global economy is by raising transactions costs, resulting in a reduction in potential output. These costs can be broken down as follows:

- *Higher operating costs*. Businesses may experience higher operating costs owing to increased spending on security, higher insurance premiums and longer wait times for activities.
- *Higher levels of inventories*. Business may be required to hold larger inventories than previously, owing in part to less reliable air and rail transportation. There is anecdotal evidence from the auto industry that production was interrupted because components were not immediately available from suppliers after the September 11 attacks, owing to delays in shipments crossing the U.S.-Canada border.
- *Higher risk premium*. As a result of the attack, lenders' appetite for risk may decline, leading to higher risk premiums that may be passed on to businesses in the form of higher interest rates and lower equity prices, with an adverse effect on business investment, and a smaller capital stock.
- *Shift of resources away from the civilian labor force toward the military*. More resources may be diverted toward the military for use in the containment of terrorism. In addition, research and development (R&D) resources may be shifted way from productive activities towards the development of new devices to thwart terrorism (although such devices may have beneficial spillover effects elsewhere).
- *Shift away from globalization*. The attack may have effects on firms' investment decisions—in particular whether to invest domestically or abroad, in part because of potential disruption of cross-border flows of goods and assets. Costs for such transactions may rise owing to closer inspection of transactions and higher insurance premiums

While the immediate and short run impacts of the terrorist attacks were shown to be considerable, medium to longer term impacts are much more problematical. The Congressional Joint Economic Committee has compiled a comprehensive set of forecasts of the costs of terrorism. These studies vary based on assumptions about two key issues. The first is the extent to which transaction costs will increase—an issue that depends heavily upon whether further attacks occur, forcing high levels of constant vigilance, or whether September 11 turns out to be a relatively isolated incident, implying a smaller long-term change in behavior. The second is the degree to which any increase in transaction costs will disrupt economic activity.

For more topical analysis from the CCC, see our Strategic Insights section.

For related links, see our Homeland Security & Terrorism Resources.

Further Reading

John Helgerson, Chairman National Intelligence College, Global Trends and the Implications of the 11 September Attacks, January 22, 2002 (PDF)

Joint Economic Committee, Background Material on the Potential Economic Impacts of the Terrorist Attacks, September 21, 2001 (PDF)

University of Chicago Graduate School of Business, What's Next? The Economic Effects of September 11.

Alexander, Dean C., and Yonah Alexander, *Terrorism and Business: The Impact of September 11, 2001* (Ardsley, NY: Transnational Publishers, 2002).