

# CRS Report for Congress

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## 9/11 Terrorism: Global Economic Costs

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### Summary

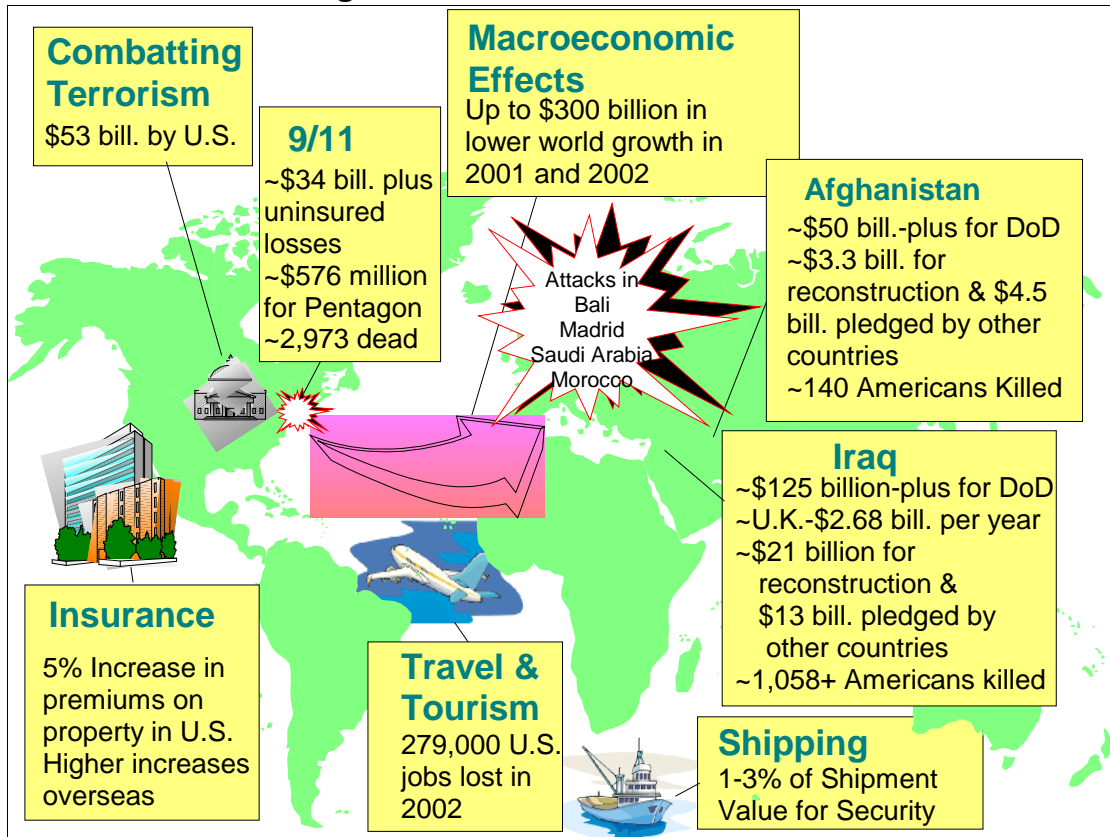
The 9/11 attacks were part of Al Qaeda's strategy to disrupt Western economies and impose both direct and secondary costs on the United States and other nations. The immediate costs were the physical damage, loss of lives and earnings, slower world economic growth, and capital losses on stock markets. Indirect costs include higher insurance and shipping fees, diversion of time and resources away from enhancing productivity to protecting and insuring property, public loss of confidence, and reduced demand for travel and tourism. In a broader sense, the 9/11 attacks led to the invasions and occupations of Afghanistan and Iraq (and the Global War on Terrorism) and perhaps emboldened terrorists to attack in Bali, Spain, Morocco, and Saudi Arabia. A policy question for Congress is how to evaluate the costs and benefits of further spending to counter terrorism and its economic impact. This report will be updated periodically.

A strategy of Al Qaeda is to hurt the Western world by attacking economic nodes and avenues of commerce. Osama Bin Laden has pegged the cost of the 9/11 attacks on the U.S. economy at \$1 trillion.<sup>1</sup> This attack, along with the Bali bombings in Indonesia and the Madrid train bombing, was aimed partly at taking down the global economic system and inspiring recruits by demonstrating that Al Qaeda's terror attacks could cause significant damage and to raise fear levels that would cause governments, businesses, and individuals to change the way they behave in everyday life. This fits into aim of Al Qaeda to destroy Western powers by exhausting them in much the same manner that the resistance did after the USSR's invasion of Afghanistan or the United States did to Russia in the Cold War. In each case, the prolonged war ended as much from economic exhaustion as from military victories. The purpose of this report is to briefly survey the global economic costs of 9/11. Details of the effects of 9/11 and terrorism on the U.S. and world economies are also addressed in other CRS reports and various studies.<sup>2</sup>

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<sup>1</sup> Sept 11 Strikes Cost US One-trillion Dollars: Laden. rediff.com. December 28, 2001.

<sup>2</sup> See, for example, CRS Report RL31617, *The Economic Effects of 9/11: A Retrospective Assessment*; CRS Report RL31733, *Port and Maritime Security: Background and Issues for Congress*; CRS Report RL32022, *Air Cargo Security*; U.S. Congress, Joint Economic Committee, *The Economic Costs of Terrorism*, May 2002.

**Figure 1. Economic Costs of 9/11**

The global costs of terrorism — particularly 9/11 — are a policy concern for Congress, not only because imposing such costs is part of Al Qaeda’s strategy, but because, in certain cases, Congress provides the funds to cover those costs. H.R. 10 (Hastert) and S. 2845 (Collin/Lieberman) both touch on many of these issues. This “economic warfare” also may affect U.S. economic growth and productivity, cause financial instability in other countries, and hamper international trade and capital flows. The policy issues for Congress center on how much more security to fund, actions to be taken to sustain world economic growth (particularly in the nations cooperating in the anti-terrorism effort), how to maintain the integrity and security of the American and global economy, and how to expedite trade flows and business activity hampered by increased security procedures.

The 9/11 terrorist attacks affected the world economy at different levels depending on how the attacks are viewed. (See **Figure 1**.) First, they can be seen as a one-time event along with its accompanying aftermath, much like a hurricane or other natural disaster. The impact of the attacks within this framework is direct and primarily physical. Lives lost and property damage usually is confined to the immediate area of attack. Repercussion from the attack then may cause an economic shock wave that is transmitted around the world through financial markets, trade, and levels of confidence. In the 9/11 case, the costs begin with the approximately \$34 billion in insured losses (covering part of the \$21.6 billion in capital losses for buildings and infrastructure), \$576 million for rebuilding the Pentagon, and \$7 billion for official victim compensation (covering claims

for 2,973 killed as well as some of the \$7.8 billion in lifetime earnings lost by 2,780 New York workers).<sup>3</sup>

Second, the 9/11 attacks (combined with subsequent terrorist incidents) caused a *gestalt* shift in public perceptions of the threat to their security and their vulnerability to terrorist activity. This heightened the need for security, required greater government expenditures to counter terrorism, and fundamentally altered how companies conduct business and people pursue life. It affected everything from airline security checks to the organization of government and from terrorism insurance coverage to sales of duct tape. Responding to the need for greater security increases direct cash outlays, expenditures that may reduce (or not add to) productivity, as governments and businesses spend more on guarding lives and property rather than investing in research, technology, and new equipment. The global costs of this shift in perceptions of threat are dispersed, varied, and, in many cases, difficult to quantify. Some costs, such as those for terrorism insurance and airport security, may be calculated, but the costs of human anxiety, incursions on civil liberties, and personal responses to escalated threat levels are elusive.

Third, the 9/11 attacks also can be viewed as the defining event that transformed the U.S. counter terror effort from law-enforcement actions and limited military retaliation to a global war on terror. In this context, 9/11 triggered a series of government actions — to include the invasions and occupations of Afghanistan and Iraq (despite the apparent lack of direct connection between Iraq and the 9/11 attacks). Estimates of the economic impact of 9/11, in this case, become the costs, both in budgetary outlays and in human life, of the Global War on Terrorism.

## Macroeconomic Effects

Following the terrorist attacks, the already weak international economy was weakened further. The aftershocks of 9/11 were felt immediately in foreign equity markets, in tourism and travel, in consumer attitudes, and in temporary capital flight from the United States. Central banking authorities worldwide reacted by injecting liquidity into their financial systems. Still, the downturn in business conditions became more generalized and most of the world dropped into a synchronous recession — from 4.1% world economic growth in 2000 to 1.4% in 2001 (a growth rate of less than 2% for the world is considered to be recessionary). By late 2002, aggressive reflationary fiscal and monetary policy in the United States and a booming Chinese economy led the recovery.

As shown in **Figure 2**, the 2001 recession turned into a weak economic recovery with world growth of 1.9% in 2002 and 2.7% in 2003 — still anemic when compared with the growth rate of 2.3% in 1998 during the worst of the Asian financial crisis. For 2004, the recovery picked up speed and its strength broadened with growth at 4%, even though by mid-2004, the world was hit with petroleum prices exceeding \$40 per barrel

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<sup>3</sup> Bram, Jason, James Orr, and Carol Rapaport. Measuring the Effects of the September 11 Attack on New York City. *FRBNY Economic Policy Review*, November 2002. P. 12. Congressional Research Service Report RL31716, *Homeland Security: 9/11 Victim Relief Funds*. Office of the Secretary of Defense. *The Renovation of the Pentagon*, March 1, 2002.

of which \$6 to \$10 was a “security premium” caused primarily by instability and uncertainty in the Middle East. Still, in most markets, there appeared to be a general dissipation of geopolitical concerns and a steady decline in post-9/11 terrorism fears.<sup>4</sup>

How much did 9/11 bring down world growth rates? Prior to 9/11, a major econometric forecasting firm expected real GDP for the world (185 countries) to grow at 2.8% in 2001 and 3.1% in 2002.<sup>5</sup> After 9/11, world GDP actually grew by 1.4% in 2001 and 1.9% in 2002. In the aftermath of 9/11, therefore, actual growth came in at approximately 1

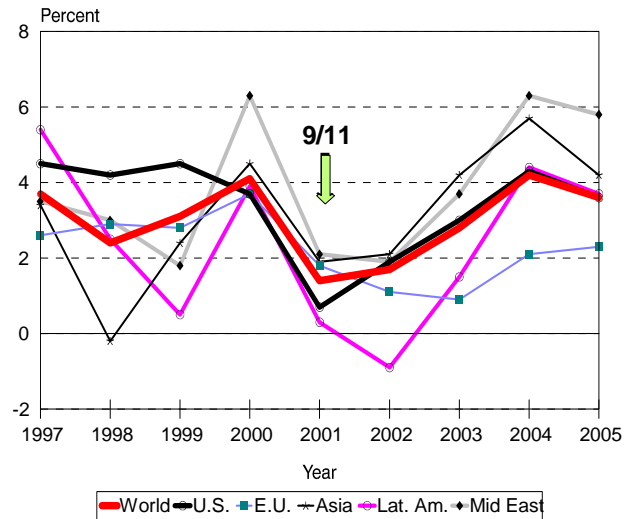
percentage point below expectations. Not all of this, of course, can be attributed to 9/11, but a 1 percentage point decline in global GDP amounted to about \$300 billion less in world production and income in 2002.<sup>6</sup> Subsequent terrorist attacks also have affected economic growth abroad. An Australian study pointed out the negative macroeconomic consequences of terrorism for developing nations because of reduced trade, investments, and tourism. The 2002 Bali bombings reduced Indonesia’s growth rate by an estimated 1 percentage point.<sup>7</sup>

September 11 also marked the end of an era. In the United States, it wiped out the lingering euphoria from the roaring 1990s and replaced it with a cloud of uncertainty and lowered expectations of growth. This had a major effect on equity markets worldwide. In the United Kingdom, Germany, France, Canada, and Japan, equity values, after initially recovering from the 9/11 shock, subsequently fell, and in September 2002, generally were below the lowest values recorded in the immediate aftermath of 9/11. The loss in market capitalization on U.S. exchanges in September 2001 was \$1.7 billion by one estimate.<sup>8</sup>

## Budgetary Effects

For the United States, the budgetary impact of 9/11 has become intertwined with that for subsequent terrorist activity and the general war on terror. According to the Office of

**Figure 2. Real Economic Growth Rates for the World and Regions, 1997-2005**



Source: Data and forecasts from Global Insight

<sup>4</sup> Global Insight. “World, Current Situation.” Sept. 3, 2004. Cambridge Energy Associates.

<sup>5</sup> DRI-WEFA (a Global Insight Company), The World Outlook, 2001/2nd Quarter.

<sup>6</sup> Some of the costs of 9/11 diminish GDP (lost work time), while others (rebuilding, government expenditures) increase GDP. Reduced growth rates, therefore, may double count other costs.

<sup>7</sup> Australia, Department of Foreign Affairs and Trade. *Combating Terrorism in the Transport Sector, Economic Costs and Benefits*. 2004.

<sup>8</sup> Navarro, P. and A. Spencer. “September 11, 2001: Assessing the Costs of Terrorism.” *The Milken Institute Review*, 4<sup>th</sup> Quarter 2001. p. 22.

Management and Budget, for FY2004, the Administration requested \$52.7 billion for funding to combat terrorism. This was 83% more than the \$28.8 billion enacted in FY2002. Fourteen agencies had requested more than double their FY2002 level. The largest increases were for Homeland Security (\$23.9 billion) and Defense (\$15.2 billion).<sup>9</sup> Including the FY2004 Supplemental Request, Defense has received \$51.7 billion for Operation Enduring Freedom in Afghanistan and \$100.1 billion for Operation Iraqi Freedom.<sup>10</sup> The FY2005 supplemental for \$25 billion is for both operations. For reconstruction in Afghanistan, the United States has provided \$3.3 billion, and other nations have pledged \$4.5 billion. For reconstruction in Iraq, the United States has committed \$20.9 billion, and other nations have pledged \$14.4 billion.<sup>11</sup>

In a 2002 study on the economic consequences of terrorism, the Organisation for Economic Cooperation and Development pointed out the trend toward stepped-up security spending among the industrialized OECD nations. The OECD has not yet published data for 2003 and budgets for 2004, but in 2001 and 2002, defense expenditures were increasing worldwide. In U.S. dollars, defense expenditures in 2001 and 2002 were, respectively, \$464 and \$515 billion for NATO, \$22 and \$24 billion for non-NATO Europe, \$44 and \$48 billion for Russia, and \$133 and \$141 billion for East Asia and Australasia.<sup>12</sup> It is not clear how much of this increase in defense expenditures is for security or how much is being spent on more homeland security in non-defense budgets in other nations.

## **Increased Costs of Commerce and Reduced Travel**

Another channel of effect from 9/11 is increased private sector costs arising from a heightened perception of the threat from terrorism and the increased probability of and costs of such attacks should they occur. Some of this is reflected in rising insurance costs, enhanced measures to ensure security of shipments, and in reduced travel and tourism. What cannot be measured is the decrease in productivity by individuals arising from lost time, greater hassles, and general anxiety caused by the new security environment. In Europe, 36% of companies recently surveyed expected terrorists to deliberately target their organization or staff — 93% believed that the war in Iraq had increased that threat. Yet the survey found that 77% of organizations spend less than two percent of their global revenues on security.<sup>13</sup>

Following 9/11, in the United States, terrorism insurance for property virtually disappeared or prices soared. In 2002, prices moderated, particularly after Congress passed the Terrorism Risk Insurance Act. With this federal backstopping of insurance

<sup>9</sup> U.S. Office of Management and Budget. *2003 Report to Congress on Combating Terrorism*. September 2003.

<sup>10</sup> CRS Report RS21644, *Defense Funding by Mission for Iraq, Afghanistan, and Homeland Security: Issues and Implications*.

<sup>11</sup> CRS Report RL31833, *Iraq: Recent Developments in Reconstruction Assistance*.

<sup>12</sup> International Institute for Strategic Studies. *The Military Balance: 2003-2004*. Oxford University Press. pp. 335ff.

<sup>13</sup> Rand Europe. *Businesses Indicate Significant Growth in Fear of Terrorist Attacks, Study Shows*. [<http://www.rand.org/news/press.04/05.10.html>]

claims in the United States through 2005, about 4.36% of premiums on property are to cover terrorism risks.<sup>14</sup> In Europe, following 9/11, commercial property and liability insurance rates rose by about 30% on average, with “target” structures (e.g. chemical and power plants, iconic office buildings) showing steeper increases. In response to rising insurance rates for aviation insurance, the European Union took measures that allowed Member States either to pay insurance premiums linked to the “risk of war and terrorism” for their airline companies or to grant them a State guarantee against such risk. Industry experts expect security-inspired measures to amount to between 1 and 3 % of the value of shipments.<sup>15</sup>

The travel and tourism industry was hit particularly hard by 9/11 and subsequent terrorism but also by the SARS outbreak and recession. Although most of the funds not spent on travel and tourism is spent elsewhere, the adjustment costs for the industry and economy can be significant. U.S. exports of travel services (foreign tourists visiting the United States) dropped by 12% in 2001 and 4% in 2002. Employment in U.S. industries related to travel and tourism in 2002 was down by 270,000 persons from 2001.<sup>16</sup> Despite government assistance (\$15 billion emergency assistance package in 2001), several airlines have declared bankruptcy. Colleges report that new security procedures are reducing foreign student applications and lengthening wait times for visas.<sup>17</sup>

## Conclusion

The immediate costs and subsequent economic effects of 9/11 are large and varied, but they still are small when compared with global GDP in excess of \$40 trillion. For U.S. policymakers, a central question is how much to spend on preventing another 9/11-type attack. Several approaches exist for addressing this question. One is to compare expenditures (costs) with potential benefits (damage not sustained) and to ensure that costs are commensurate with benefits. Both the government and private sector share the costs — governments take actions to reduce the probability of terrorist attacks in general, while the private sector protects (or insures against the loss of ) specific private property. The problem with this approach is that the psychological and political repercussions from 9/11 were so large that many people feel that another 9/11 should be prevented at all costs. Also, the prospect of a nuclear attack by terrorists raises the “benefit” of prevention considerably. A second approach is to see what companies spend on security for their operations. It appears that businesses are spending about 2% of their revenues and 1-3% of the value of cargo in shipment on security. Two percent of the \$11.7 trillion U.S. GDP amounts to \$234 billion. A third approach is to examine the opportunity cost of budgeting for security. The cost to the nation of funding for homeland security, for example, is what is given up by not funding other national programs — such as health care or transportation.

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<sup>14</sup> Insurance Information Institute. See also CRS Report RS21444, *The Terrorism Risk Insurance Act of 2002: A Summary of Provisions*.

<sup>15</sup> OECD, *op.cit.*, p. 18-19.

<sup>16</sup> See CRS Report RL32016, *The Tourism Industry and Economic Issues Affecting It*.

<sup>17</sup> Institute of International Education. *Open Doors, 2003*.