

Don't Be Surprised If the Recovery Is Rapid

Gary S. Becker. Business Week. New York: October 22, 2001. , Iss. 3754; pg. 26.

The tragic loss of life and property from the September 11 terrorist attack has taken an enormous psychological toll, but will it severely damage the American and world economies? Although short-run economic damage is already obvious, the chances are excellent of long-term recovery to prior growth rates.

The possible pace of economic recovery from the attack can be gleaned from comparisons with major natural disasters, where recovery has generally been quick. John Stuart Mill, the great economist and philosopher, remarked in the 19th century: "What has so often excited wonder, the great rapidity with which countries recover from a state of devastation, the disappearance in a short time, of all traces of mischief done by earthquakes, floods, hurricanes, and the ravages of war." He recognized that knowledge and skills are the prime engine of economic growth and prosperity. Fortunately, America retains its vast supply of both.

The enormous earthquake that hit Kobe, Japan, in 1995 is an excellent illustration of Mill's conclusion because it was the most severe quake to strike a modern city. It destroyed more than 100,000 buildings, badly damaged many others, and left hundreds of thousands homeless. Over 6,000 persons lost their lives--about the same number as died on September 11, but that is a much larger fraction of the Japanese population. Despite predictions that Kobe's recovery would take a decade or longer, economist George Horwich of Purdue University has shown that the city had almost fully recovered after a little over a year. Most shops reopened rather quickly, and investments boomed.

The economic loss from September 11 is much smaller relative to the size of the U.S. economy than the damage from this earthquake. But uncertainty about future terrorism may make the economic recovery from this attack much slower and different from Kobe and other disaster areas. This is surely possible, although uncertainty is pervasive after major earthquakes and other disasters. For example, many Californians feared that the "big one" would come soon after a severe earthquake in 1989. Yet before long, the California economy fully recovered.

FORCE OF WILL. Moreover, terrorism, like other major crimes, can be reduced by appropriate public and private actions, whereas most natural disasters are beyond human control. The U.S. and Europe have already started to take various steps toward improved security that will add to confidence about safety and hasten the economy's return. The cost of a major increase in protection against terrorism is not trivial, but probably would not damage long-term economic prospects. For example, an additional 50,000 trained guards assigned to airports, flights, nuclear and water plants, and other sensitive facilities would cost less than \$3 billion annually.

Nevertheless, the U.S. economy, already in a downturn prior to the September 11 attack, may have been pushed into recession. Confidence has apparently oozed out of consumers

and investors. Measures of consumer confidence in the economy have fallen more sharply than at any time since the oil embargo in the 1970s and Iraq's invasion of Kuwait at the beginning of the 1990s. Pessimism and uncertainty about the future are reflected in the large drop in stock prices during the first week after markets reopened, although the markets recovered much of their losses during the following two weeks.

Airlines, hotels, and other industries that depend on travel have been particularly hard hit. Airline stocks declined by more than 40% between the close of Sept. 10 and that of Sept. 17, the first day of trading after the attack. By comparison, prices of airline stocks were down by less than 3% two days after a bomb destroyed the Pan Am flight from Lockerbie, Scotland, in 1988, and by under 7% after a TWA crash in 1996 that was erroneously blamed on a missile.

WAR DIVIDEND? Seat occupancy rates on flights within, and to and from, the U.S. plummeted during the first week after air travel resumed. Typically, airline traffic returns to normal within a few months after a major plane crash. Clearly, it will take longer after this devastating attack, but confidence about air safety has been growing, and traffic is steadily climbing toward pre-attack levels. The placing of federal marshals on many planes and additional security measures should help boost travel further.

The effect of the attacks on the overall economy will also be mitigated because the shifting of priorities toward greater safety from terrorism will help industries such as defense, intelligence, videoconferencing, and surveillance.

Moreover, many industries will benefit from the lower oil prices that should continue for a while, assuming no large-scale destruction of oil production capacity in the Middle East.

Obviously, psychological and other scars from the terrible events on September 11 will remain. But if future terrorism can be kept in check, the long-term development of the U.S. and world economies should not be permanently retarded.