Some Economic Repercussions Of September 11

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Ray Stubblebine/Reuters

The September 11 attacks have had important economic and political effects on the entire world, beginning, of course, with the United States itself. Only a few days after the attacks, the UNAM Center for Research on North America organized a colloquium bringing together specialists from several institutions to analyze the situation and the social and political outlook for the United States from different points of view. This article was originally written for that colloquium to contribute to the analysis of the economic consequences of the attack, based on my profession and specialty (international economics) and on my having been an eyewitness to the New York events. Being there was not of enormous use, however, because, like many others on that day on the streets of Lower Manhattan, I could not immediately grasp the real magnitude of the damage nor the transcendence of what had happened; and an objective "reading" of what was going on was impossible. Therefore, the analysis and predictions that I have been able to present *a posteriori* is not based on that personal experience.

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Economic Repercussions

Although the attack was mainly symbolic (its objectives were the most important icons of U.S. economic, political and military power), it was undoubtedly the greatest damage ever caused by terrorists in terms of the loss of both human life and property.

Among the immediate repercussions were the virtual bankruptcy of the two airlines involved, which meant the layoff of 100,000 employees; and the plunge in both domestic and international tourism, with the corresponding effects on other airlines and the hotel and entertainment industries, particularly in New York. In the rest of the country there has been a clear drop in the use of commercial aviation out of the fear of further attacks. With this, several other airlines have encountered difficulties and have had to slash ticket prices, in some cases up to 80 percent.

Another more general repercussion has been the sharpening of the crisis in the U.S. economy because of the stock market decline. Stock market losses have been large and this has negative effects on the whole economy. It has meant a greater decrease than expected in production growth and economic activity in general for this year and will make for difficulties in activating the economy next year.

U.S. gross domestic product (GDP), which had grown 4.1 percent annually in recent years including 2000, only grew 1.3 percent in the first quarter and 0.3 percent in the second quarter. A negative growth rate is expected for the third quarter and the rest of this year. As a result, the U.S. economy could not grow at all or even report a negative growth rate for 2001 as a whole. This will have important consequences in other economies like Mexico's, tightly bound to the U.S. economy, but also in those of many other countries.

As a domestic expression of the heightened crisis, probably unemployment will rise, fiscal revenues will drop and the foreign deficit will increase, although inflation will most likely not be higher than predicted. In fact, the first impact was seen in the wave of lay-offs in sectors related mainly to air transportation and tourism. Tourism, so important to the United States, is among the hardest hit sectors. Both because of the drop in economic activity and fear among the population stemming from the attacks, the volume of domestic tourism and Americans traveling abroad has decreased significantly.

For the same reasons, income from tourism services abroad has also dropped significantly. This will be noted in the U.S. trade and services balance of payments, which had been positive in recent years, particularly in the tertiary sector. The trade deficit for goods is important and growing; even before the attacks, slower economic activity had caused a drop in the import of goods. This has meant that exporting countries with strong ties to the U.S. economy, like Mexico, have also suffered a drop in their economic activity and therefore demand fewer products of U.S. origin. The decline in trade was already being felt in the first quarter, but it sharpened after the attacks. For all these reasons, very probably the foreign trade balance will be negative for the year 2001 as a whole.

Recovery Policies

Apparently contrary to the dictates of free market policy, the U.S. government, the undoubted leader in globalization, immediately increased federal spending to deal with the effects of the attacks. Its first measure was a U.S.$15 billion federal subsidy to United Airlines and American Airlines to stave off bankruptcy. Another important measure was a U.S.$20 billion increase in federal subsidies to New York City. Federal military spending also climbed U.S.$40 billion, in addition to different kinds and amounts of spending on other items.

Increased military spending may stimulate demand in some specific branches of industry like arms and security-related electronic equipment production, but it has little general impact on the rest of the economy. The total additional sums spent come to less than one percent of GDP.

Another policy already being applied, though not very successfully, before the attacks was a reduction in interest rates. The Federal Reserve announced a few days after the attack that it was going to significantly lower the benchmark rate an additional two and a half points;[1] they hope this will be a greater stimulus to reactivating the economy than increased spending. The central idea is that when there is an inverse relationship between the interest rate and productive investment, a decrease in the former will stimulate an increase in the latter.

Additional measures to stimulate spending include a probable tax cut. Other economic policies such as greater restrictions on imports, especially from countries not recognized as friends during this stage of the conflict, are also to be expected.

Nevertheless, the most important damage has been to confidence. Just at the end of one of the United States' greatest periods of bonanza, a time of undoubted foreign policy successes, when the American way of life seemed to be the model for the world to follow, at the beginning of the year, signs of economic crisis appeared that were gravely accentuated by the effects of the terrorist attacks, with the loss of the public's trust in its institutions, given the insecurity people feel because they now realize their own vulnerability. It is not a matter of the specific damage done —which was very great and very painful— but of the loss of security and the feeling of invulnerability.

This makes for a political response to an economic crisis, a response that includes watching the borders more closely and restricting access, reducing imports for political reasons and, in general, closing what had already been a fairly closed economy (goods exports come to less than 10 percent of GDP). This makes it possible to predict that if there is a recovery by the second half of next year, as has been predicted, it will be based mainly on the domestic market if Americans can be brought to trust their institutions and particularly their economy again.

However, this will not be easy because investment and spending have not reacted favorably since the beginning of the year to reactivation policies via interest rates, and there is nothing to make us suppose that the situation has changed. The crisis may force economic policy makers to adopt more decided measures to stimulate the domestic market and avoid more lay-offs.

On a visit I made to New York's Twin Towers in the late 1970s, in the windows next to the souvenir shop on the top floor, I saw a picture of Keynes with a caption that read something like, "To the memory of John Maynard Keynes, the man who saved capitalism."

There is no doubt that it was the policies inspired in Keynes' work that made the recovery of the U.S. economy possible in the 1930s, when it was buried in the greatest crisis of its history. And with it, many other economies also came out of their depressions. It would be a good thing for the U.S. economy and others like our own if the memory of Keynes has not been lost with the Twin Towers. If it has been, there is something more, something very valuable, to be mourned, and recovery seems much more difficult without it. VM

NOTES

[1] The prime rate has dropped several times since then; at the close of this edition it was at 1.75%. [Editor's Note.]