

**The Nexus of Terrorism & WMDs: Developing a Consensus**  
*How could a Leaders' Level G20 make a difference?*

The second category consists of the budget cost of government responses to terrorism: money spent on national defense and homeland security in an attempt to block or forestall future terrorist attacks. In principle this is easy to measure; in practice, we face the problem that people sharply disagree about what portion of increased defense spending is really a response to terrorism.

The third category is the subtlest: it's the cost imposed by the way people respond to fears of terrorism. This includes relatively concrete costs, such as the value of extra time spent waiting in line to pass through airport security, but also more diffuse costs, such as the "friction" imposed on global supply chains by increased fears about the security of cargo.

### *Direct economic costs*

The 9/11 attacks were, from the terrorists' point of view, as successful as an attack not aided by weapons of mass destruction can get: because of the collapse of the World Trade Center, lightly armed terrorists inflicted huge losses of life and large property damage. Nonetheless, from the point of view of the U.S. economy, the direct costs did not bulk very large.

A report by the Comptroller of the C

The comptroller's office also made a rather cold-blooded estimate of the economic side of human loss, calculating the likely future earnings of those killed in the attack; this adds a further \$8.7 billion in losses, plus \$0.9 billion in lost earnings due to disability and trauma among survivors.

According to the report, New York City suffered further large economic losses because of the diversion of business away from the city to other locations. As I'll explain below, however, most of this does not represent a net economic loss to the nation.

The point of the comparison with Kobe and other natural disasters is not to belittle the

The obvious, but perhaps unanswerable, question is to what extent this additional security spending should be viewed as a response to terrorism, as opposed to a political program enabled by terrorism. Not to put too fine a point on it: the Iraq war, which seems likely to absorb about 0.6 percent of America's GDP for the foreseeable future, clearly wouldn't have happened without 9/11. But was it in any meaningful sense a response to 9/11?

Anyway, the costs of defense and homeland security spending are the main easily measurable economic impact of terrorism. This is also true in countries where the terrorist threat is much more pervasive. In Israel, the direct damage



risks may be misleading indicators of the losses to society as a whole. Spanish estimates suggest that the Basque region is about 10 percent poorer than it would be in the absence of ETA; Eckstein and Tsiddon suggest a similar figure for Israel. But most of these losses aren't net losses to the world economy, or to large economic regions like the EU or the US.

The net cost to the world economy comes from the fact that people and businesses whose decisions are affected by terrorism choose alternatives that would otherwise be regarded as less desirable. To put a trivial spin on it: when a tourist decides to hear country music in Branson rather than see *The Producers* in New York, the cost to the U.S. economy is the extra he or she would have been willing to pay to see the metropolitan production.

The point is that on an economy-wide basis – except for small economies like that of Israel – the costs of behavioral responses to terrorism at current levels are probably fairly small, almost surely less than 1 percent of GDP.

One question for this conference is whether developing countries fall into the category of economies that suffer substantial losses, despite relatively small effects at the level of the world economy. I haven't been able to come up with evidence on this, but hope that participants will have something useful to say.

### ***Policy implications***

There do not seem to be strong policy implications from this quick and dirty analysis, except as follows: the biggest economic costs of terrorism right now seem to be those arising from government spending actually or ostensibly aimed at fighting terrorism. The natural question would be whether some form of international cooperation and consultation can reduce these costs.

Table 1: U.S. National Security Spending, Broadly Defined, as % of GDP (fiscal years)

2001	3.4
2002	4.3
2003	4.8
2004	4.7

Table 2: US productivity growth, % (calendar years)

2000	2.8
2001	2.5
2002	4.4
2003	4.4

## REFERENCES

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