

Paris terror attack: Economic cost

T.K. JAYARAMAN

Another terror attack, with incalculable human cost but at quantifiable economic cost!

The Institute for Economics and Peace (IEP) specializes in this area. They estimate costs of terror attacks by issuing annual Global Terrorism Index, along with other indices such as Global and National Peace Indices.

The IEP just released the report on terror attack costs of 2014. One has to wait for 2016 Report from IEP for the last week Paris terror attack.

Long-run costs

The latest IEP Report places economic costs of 2014 terror attacks at US\$ 53 billion. This is slightly higher than US\$ 51.5 billion estimated for the 9/11 attack on Twin Towers in New York in 2001.

The costs in the immediate aftermath of terror attacks are known as short-run costs. They are reflected in stock market losses.

The Paris attack of Friday, November 13 wiped off 2 billion Euros in hotel and travel stocks. Further, tourist consumption of luxury brands plunged triggering stock market losses for Christian Dior, Hermes International and the like.

Tourism contributes 7.5% of France's national income.

As the week-end was adequate for ingesting the bad news, markets returned to normalcy. The resilience is based on the conviction that these attacks are only isolated incidents.

On Wednesday, US Federal Reserve Richmond President Jeffrey Lacker observed economic impact of the Paris terror attacks would be temporary:

"We've been through episodes like this before in which some disruption of a certain geopolitical or military nature affects things. For a time people can get cautious and pull back a little bit. These tend to be transitory."

Short term impacts

Elvis Picardo writing for Investopedia recalls the March 12, 1993, (a Friday again) attack on Bombay Stock Exchange (BSE). He was working then as a currency trader in a bank next to BSE. The first bomb explosion in BSE's basement car parking was followed by series of attacks in the city's various crowded markets. So too, the November 26, 2008 attack on Mumbai's iconic Taj Hotel was also a well coordinated attack, much like Paris attack.

Picardo narrates how fast Mumbai recovered. The week-end was sufficient to cool off nerves. On Monday, businesses opened as usual.

The 9/11 attack of 2001 on New York's Twin Towers in the world's richest was the biggest shock of the world, as it stepped into the new Millennium.

Students of monetary economics would recall how exchange rates react to situations of these kinds when investor confidence is shattered. Funds are pulled out in seconds in the present globalised world of capital mobility. Instead of the much expected stability in exchange rates due to embracing flexible exchange rates we have today greater volatility in exchange rates than ever before. Any bit of bad news, coups, terror attacks or natural disasters are sufficient to rattle stock markets and contribute to capital outflows to safer havens.

Reaction time

A Bloomberg study documents the reaction time of stock markets for return to normalcy. For political incidents, the gap is longer. In the case of Pearl Harbour (1941), the S&P Price recovery took 308 days.

In the case of terror attacks, reaction time following the 9/11 of 2001 was 31 days, London Subway bombing: 4 days; and Madrid bombing: 20 days.

In the case of natural disasters, reaction following the Japanese Tsunami of 2011 was 14 days; and the manmade disaster, OPEC Oil Embargo of 1973: 3 days.

The IEP economic cost estimates are conservative. They do not include the increased number of security guards, higher insurance premium or rise in airport security check costs and a host of other prevention measures.

IMF study

Two IMF economists, Barry Johnson and Oana Nedelescu in their 2005 paper: "Impact of Terrorism on Financial Markets" splits total costs into two categories: direct and indirect.

The direct economic cost, being short-run costs, include destruction of life and property, response from emergency and medical service providers, rehabilitation of infrastructure and temporary reliefs measures.

Indirect costs are long-term costs. They include losses resulting from fall in investor confidence and consumer spending, besides introduction of airport security measures.

The New York Times recent survey provides cost estimates (in US\$ billion) of 9/11 attack:

- Physical damage and human toll: 55
- Economic impact: 123 (business interruption: 23 and reduced air travel 100)
- Homeland security and Border Control: 589
- War funding: 1,649
- War veteran medical care costs: 867
- Total: US \$ 3.3 trillion

Costs of Paris Attack

A number of EU countries are ready to restrict mobility of people. Imposing restrictions on the Schengen Agreement, which guarantees free movement within EU, will be a blow to the spirit of the single economic space. Restricting labour mobility will result in productivity losses. Total cost will exceed the cost of 9/11 terror attack.

That will pose a dilemma before EU!