washingtonpost.com

The Economics of Fear

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Wednesday, August 16, 2006; A13

This is an age of glaring contradictions. It's hard to ignore the great disconnect between the rise of terrorism and the relentless advance of the world economy. After Sept. 11, 2001, the reasonable fear was that terrorism and its nasty side effects -- more anxiety, uncertainty and security checks, and higher costs for moving people and cargo -- might cripple economic growth and frustrate the spread of globalization. It hasn't happened. Not yet, anyway.

To be sure, terrorism has exacted some steep costs. Airlines and tourism suffered after Sept. 11; in the wake of last week's foiled bomb plot, that could happen again. Spending for the war in Iraq was vastly underestimated. But terrorism's damage has paled before the larger effect, which is not much. It hasn't destroyed prosperity or cross-border flows of goods, money and people.

Since 2001 the world economy has expanded more than 20 percent. For the United States, the gain is almost 15 percent; for developing countries, more than 30 percent. World trade -- exports and imports -- has risen by more than 30 percent. Outstanding international debt securities have jumped almost 90 percent, to $13.6 trillion (through the third quarter of 2005).

We ought to ask why the economic fallout has been so muted -- and whether that could change. Could the backlash so feared five years ago unfold in the future?

One obvious explanation is that in the United States, there has been no second or third Sept. 11. Beyond that, economic resilience partly reflects human nature. People and businesses try to get back to normal. It's what they know best. For sheer physical damage, acts of nature often overshadow acts of terrorism. Michael Mussa of the Institute for International Economics notes that Hurricane Katrina hurt the economy more than Sept. 11.

Even when huge, terrorism's costs can get lost in a $13 trillion economy. At last count, Congress had committed $432 billion to the wars in Iraq and Afghanistan -- a far cry from informal estimates of $50 billion to $200 billion before the Iraq war. The Congressional Budget Office now projects that those costs could easily exceed $800 billion by 2016. A study by Linda Bilmes of Harvard and Joseph Stiglitz of Columbia puts the war's ultimate budget costs even higher, at a minimum of $1.1 trillion in present value. Still, this spending is a tiny share of all federal spending, estimated at $47 trillion from 2001 to 2016.

Similarly, skillful crisis management after Sept. 11 blunted terrorism's long-term effect on economic confidence. Some big banks lost their computer and communications systems; planes carrying checks were grounded. People might not have been able to cash checks; banks might have hoarded funds because they weren't receiving payments from other banks. But the Federal Reserve lent liberally to banks needing money ($46 billion on Sept. 12) and temporarily authorized checks to be credited before being cleared. Thus was averted a wider economic breakdown and a bigger blow to consumer psychology.

The result is that -- so far -- terrorism has been an economic blank. People regard attacks around the world (in London, Madrid, Bali) as isolated tragedies and not a cause to alter their buying habits. But that is not entirely reassuring. Even if consumer confidence remains unshaken, terrorism might threaten the world economy in other ways.

Every successful economic system requires a supporting political structure: rules, standards of behavior, ways of resolving conflicts. For years, the United States and its allies were bound together by political and economic alliances. But as Princeton historian Harold James notes, the war on terrorism -- mainly the war in Iraq -- has created divisions on political issues that make agreement on economic matters harder. Protectionism could depress economic growth if increasingly nationalistic countries retreat from global markets. The recent deadlock of the Doha round of trade talks is a suggestive example.

The larger threat involves the great disconnect: Countries are moving closer economically, depending on each other more for trade, raw materials (especially oil) and finance, but they're moving farther apart politically, disagreeing over goals, tactics and values. Historian Niall Ferguson of Harvard has pointed to a similar disconnect, before World War I, when European powers were highly integrated economically and increasingly hostile politically. But there was a chilling disregard for the contradiction. It's a grim analogy that suggests little cause for complacency.