BROOKINGS

Forbes.com

Opinion | November 29, 2008

The Economic Cost of the Mumbai Tragedy

By: Arvind Panagariya

With the highly proficient National Security Guard commandos having killed the last of the terrorists holed up in the Taj Hotel in Mumbai, the question on everyone's mind is what effect the tragedy will have on the economy. Despite some clear differences between the Mumbai tragedy and the 9/11 New York calamity, the latter provides a good starting point for answering this question. The effects of the 9/11 events, now extensively studied and analyzed, may be considered at the local level on New York City and at the national level on the United States.

In the immediate aftermath of the 9/11 terrorist attacks, many analysts predicted significant permanent damage to the economy of the New York City. There is now virtual consensus, however, that the effects were smaller than initially predicted and were short-lived. A July 12, 2006, report by the Federal Reserve Bank of New York concluded that the economic effects of the terrorist attacks were sharp but short-lived and had largely disappeared by the end of 2002. According to the Federal Reserve report, New York City recovered from the 2001 recession--well under way at the time of the attacks--at least as fast as the rest of the country. Average incomes in the following four years rose faster for the city's residents than the rest of the nation.

At the national level, the Sept. 11 tragedy had no measurable effect. A 2002 study authored by Gail Makinen and published by the Congressional Research Service, observed that the initial fears that the event would have serious adverse effects on aggregate demand proved wrong. At the time of the attacks, the economy was in the third consecutive quarter of contraction. By the fourth quarter, growth had resumed. This strongly suggests that any adverse effects of the attacks on aggregate demand were truly short-lived and small in magnitude.

Several factors suggest that the effects of the Mumbai attacks, though devastating for far too many families at the personal level, will be less significant than those of 9/11 attacks. To begin with, the 9/11 attacks were the first ever by foreign terrorists on U.S. soil. They were perhaps also far more dramatic and took many more lives. As such, they left a deep psychological impact on a vast number of Americans, especially in New York. The Mumbai attacks are also more heinous and dramatic--and wider in scope--than anything Mumbai has witnessed previously. Yet they are not entirely new to Mumbai. Psychologically, Mumbai and India are better prepared to deal with such tragedies than the U.S. was immediately following 9/11. This makes the prospects of Mumbai bouncing back rapidly substantially better.

Indeed, I was surprised to learn from my former Columbia student Catherine Delain, who has been on a visit to India for the last three weeks, that she could arrive at Mumbai at 5 a.m. by train from Vadodara immediately following the night of the massacre at Victoria Terminus station, and, within an hour, could also take the train from the Terminus to Aurangabad.

Catherine could observe the signs of the vast tragedy strewn all over in the station and yet found, to her astonishment, that the railway staff was out there going about their jobs as if it were a normal day! And of course, flights into and out of Mumbai never stopped during the 60-plus hours of the clean-up operation.

Equally reassuring was the effect on the stock market. Following 9/11, the stock market in New York had to be closed down for almost a week. When the market opened on Sept. 17, the Dow Jones index, which had closed at 9,605 on Sept. 10, fell to 8,920. In Mumbai, markets opened on Friday (Nov. 28, 2008), after just a one-day break--with the tragedy still in progress. A day earlier, markets in Singapore and elsewhere had reacted negatively, with the rupee declining in value. Yet, the Sensex on the Bombay Stock Exchange rose 0.7% on Friday, reaching a two-week peak.

One further favorable point for India is that the market shock has come at a time when the economy is otherwise healthy. Despite the slowdown in the world economy, the average annual growth rate in India during April 1-Sept. 30, 2008, the first two quarters of financial year 2008-09, has been 7.75%. This is predictably down from the average rate of 9% during the preceding five financial years, but still sufficiently high to absorb the shock without significant effect. Indeed, any negative effects of the terrorist attacks nationally are likely to be indistinguishable from, and overwhelmed by, those of the global slowdown.

The key question from the national standpoint is whether the episode will have an adverse effect on foreign investment (both direct and portfolio). Judging from the reactions of foreigners who narrowly escaped the attacks, as broadcast on various television channels, it does not appear that they are about to run away from India. Indeed, my former student Catherine did not change her plan to return from Aurangabad to Mumbai even though she did not know whether the terrorist threat would be eliminated by the time she arrived there. The effect on foreign investment is likely to be, at worst, small and temporary.

In all likelihood, the large part of the measurable economic costs of the attacks will consist of: the cost of restoring the damaged structures of Hotel Taj, Hotel Oberoi and Nariman House; lost income earnings of those who lost their lives; expenditures on the care of those injured and suffering traumas due to lost family members; and increased expenditures on anti-terrorist measures and security precautions at such places and events as airports, train and bus stations, international cricket games and the forthcoming Commonwealth Games. A slight temporary drop in tourist activity and foreign investment may also occur.

A worthwhile investment for the government will be to urgently create a substantial national anti-terrorism force with commando units placed in all major cities to ensure rapid action in case of future attacks. Those fighting terrorism need to be better trained than the terrorists. The authority to tackle the crises must also be shifted entirely from the state administrations, which are often ill prepared and also ill informed about their limitations, to the national government. The government must also greatly improve its intelligence gathering capability. Prevention is a better remedy than cure.

AUTHOR

Arvind Panagariya

Nonresident Senior Fellow, Global Economy and Development