

## Economic Lessons of Black Tuesday

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### **Article:**

The events of September 11 stunned and saddened the world. They also shook the American economy to its core. The initial economic effects of September 11 have been dramatic. The stock market fell sharply in the first week of trading after the attacks, travel industries are hemorrhaging jobs, and the consumer confidence that has bolstered the economy since the end of the dot-com boom is in full retreat.

And who can blame us consumers? First we watched in shock and horror as the details of the attacks unfolded, then we wept as heart-breaking human-interest stories were told and retold. Then we focused on the government's investigation into the attacks, and finally we swelled with pride as a new national unity arose.

But none of these activities involved buying stuff, except maybe American flags. Buying stuff is pretty much what an economy is all about.

There are now signs of a return to economic normalcy, and we're in a better position now than we were three weeks ago to assess what lies ahead. What economic lessons and insights have been made possible by the extraordinary events of September 11?

### **Economic Shocks**

Economists believe that "shocks" to the economy are often what start recessions. These shocks can take the form of droughts, credit crises, oil embargoes, or wars.

The attack on the World Trade Center and the Pentagon was the shock of shocks. In addition to the direct effects on the airline industry and the nation's transportation infrastructure, there will be indirect effects on the productivity of all industries that depend on quick and convenient transportation and shipping.

The U.S. and North Carolina economies had been beset with slow growth prior to September 11. At the federal level, gross domestic product grew at an annual rate of only 0.2 percent in the second quarter of 2001, which is just a hair's breadth above recession. Many forecasters predicted the economy to turn around without descending into negative territory, but the entire equation has now changed. We'll probably see a brief recession in late 2001 and early 2002.

Here in the Triad, we have even less breathing room and hence are more susceptible to economic shocks. From March to August of this year, the monthly Triad Business Index compiled by UNCG economist Don Jud fell three times, was unchanged twice, and rose slightly only once. The manufacturing recession continues across the country, and that hits especially hard in our manufacturing-intensive regional economy.

### **Consumer Psychology**

Much of our economic future will be determined by the psychological reactions of consumers to these nearly unprecedented events. Consumer psychology is relatively unfamiliar terrain to economists, because economic models are based on the concept of economic rationality.

In the context of economics, “rationality” doesn’t mean that people are sane, just that they tend to act in predictable ways. They buy more of a product when its price falls, they diversify their finances more when risks increase, and so on.

Economic rationality suggests that increased uncertainty about the future will lead people to cut back on big-ticket items like appliances and automobiles, at least for the time being. (This clearly isn’t a good sign for the home-furnishings industry, and it comes right when things were beginning to look up for next year.)

But economic rationality can do little to predict whether in the next few months people will sit at home and buy nothing for weeks on end, or go out and shop like crazy to escape their troubles. Or whether restaurants will be crowded because people are searching for substitutes for the vacations they don’t feel like taking, or empty because people are just staying home. To an economist, neither behavior is more rational than the other.

### **Gasoline = Bread + Milk**

Speaking of psychology, panic-buying of gasoline continues to be the national equivalent of North Carolinians’ pre-hurricane purchases of bread and milk, especially if the national consciousness is rocked by something in the Middle East.

In the days after the attacks there were reports of sporadic price spikes and hoarding by consumers. But oil and gasoline markets quickly returned to normal, and in fact gasoline prices have since fallen by a few cents.

### **Unreasonable Optimism**

Every disaster generates claims that the recovery from it will somehow spur the economy. We heard this in 1999 when Hurricane Floyd wreaked havoc on eastern North Carolina. The idea was that the construction industry would be helped by the need to rebuild, and that this would be good for the economy.

Of course, if hurricanes and earthquakes were actually good for the economy, then the only sensible policy would be to intentionally demolish our buildings, roads, and bridges from time to time.

But this view is persistent. A UNC-Chapel Hill economist recently predicted that while the national economy will shrink this quarter, it will soon rebound as lower Manhattan is cleaned up and rebuilt. Additional economic activity will be generated by the need to resupply those buildings with computers, telecommunications equipment, etc.

It is true that recovery efforts can serve as a kind of jobs program when the economy is doing especially badly, but nobody’s talking about a full-blown economic depression. It is also true that particular regions can benefit economically from rebuilding and recovery. Construction companies and office-equipment suppliers in New York and Washington will be helped by the increased demand for their products and services. But that effect will be relatively localized, in terms of both geography and the affected industries.

### **Good News for Some**

All news, good or bad, creates business opportunities for individual industries. Therefore, certain industries beyond the ones mentioned above will see their fortunes rise in our changed economy.

Obviously the war on international terrorism will be good for defense contractors. Some believe that increased demand by the military will help save the textile industry from being hit extra-hard by tough times in that industry. And our need to protect ourselves will benefit security firms and manufacturers of security cameras, metal detectors, and the like.

But some security measures will be smaller in scope. Did you think that everyone on the planet had a cellphone already? Apparently not, at least according to investors. After months of declining stock prices, the stocks of

cellphone makers like Nokia rose after September 11. Could it have been news reports of people making cellphone calls while trapped in the rubble or on hijacked airplanes?

### **A Brave New World in Airline Travel**

In contrast to the short-term and localized benefits of rebuilding, the changes in the airline industry will be pervasive and will be with us for years. The government will improve security across the board, but it will come at a cost. The time cost of airline travel will certainly rise, undoing decades of improvements. Flying may never again be as convenient as it has become in recent years.

Whether the monetary cost rises as well depends on whether new government security mandates are funded through airfare surcharges or through taxes on all Americans. No doubt it will be a combination of both. Some security measures will benefit all Americans, not just airline passengers, thereby justifying taxpayer funding.

But to the extent that ticket prices rise due to the costs of improved security measures, a monetary disincentive to fly will be added to the increased time costs.

There was a headline on the front page of the Triad Careers section in the September 23 *News & Record* that read: "Meetings: Are They Necessary?" The article focused on how to run an effective meeting, and it had nothing to do with terrorism. But the headline caught my eye. It's not uncommon for business people to jump on a plane and fly to another city for a single meeting. But now businesses will consider the increased costs and ask whether those face-to-face meetings are necessary. Look for increased demand for video-conferencing services and more "virtual meetings."

Amtrak tickets became a hot commodity when the airlines were grounded. Some commentators believe that the airlines' continuing woes will finally provide the impetus to invest in high-speed rail service, at least along the densely populated East Coast.

### **Perspective**

There are more important things than the economy to think about right now, but that doesn't mean the economy is unimportant. After all, its fundamental strength is what will finance the war on international terrorism, regardless of what form that war will take. And a strong economy helps us continue to express our national values of individual liberty and openness.