



Hazards rooted in Sept. 11 Long-term loss of liquidity, market elasticity

**by Linden Blue and Herbert London
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With the financial meltdown in full force across the globe, finger-pointing for the problem has become a national preoccupation. Easy credit, low interest rates, mismanagement and political interference are often mentioned as culprits.

Overlooked in this heated debate, however, is Sept. 11, 2001, the day the Earth shook with horror. In addition to the more than 2,800 people who lost their lives on that fateful day, the world economy took a financial hit that accumulated to somewhere between \$1 trillion and \$3 trillion. By contrast, the terror operation cost about \$200,000, a destructive leverage of at least 5 million to 1.

It is largely unrecognized by partisan historiography that former President George W. Bush inherited an economy in recession, which was improving modestly before Sept. 11. The shock of the terror on that day sent the world into a recessionary mode because it displayed the destructive leverage the terrorists commanded at will.

If the "shoe bomber," Richard Reid, had been successful, world airline travel would have been shocked into paralysis, further damaging global commerce. Likewise, a whole host of similar problems have been avoided by sophisticated intelligence in many parts of the world. Even so, the threat of another Sept. 11, or Bali or London or Madrid attack, has been lurking in the shadows capable of inflicting huge economic shocks.

For several days if not weeks after Sept. 11 the economy was paralyzed. Post-traumatic syndrome seemed to be a national problem. Mr. Bush sought to rouse the American people by suggesting they go to their malls and shop. "Don't give the terrorists a victory" was his admonition. And the fear - which was prolonged by the concern of additional attacks - did result in an economic downturn for the last quarter of 2001 and the first quarter of 2002.

Fortunately that downturn was short. Mr. Bush's positive rhetoric focused American minds on the importance of shaking off the trauma. It also reminded us that there are positive aspects of American freedoms, including our free economy.

So, to some degree, the Bush tax cuts were designed to offset the negative economic consequences of Sept. 11. In many respects, these tax cuts and Mr. Bush's spirited response

to Sept. 11 generated economic activity, notwithstanding the "security tax" imposed on productivity and other increased transactional costs.

But that wasn't the end of it. The post-Sept. 11 trauma in the Middle East and fragile world economies reliant on oil inexorably put pressure on world oil supplies. U.S. failures to develop offshore oil resources and other non-oil and non-gas energy increased pressure on oil prices. These pressures climaxed with oil at \$140 a barrel and caused the transfer of about \$7 billion a day in liquidity from industrial economies to oil-producing nations.

While the diminished fortunes of the dollar accounted for much of the rise in price, the instabilities highlighted by Sept. 11 were major contributing factors. The combined effect of the huge transfer of world cash-flows to oil-producing nations was a serious drain on industrialized nations' liquidity that deprived markets of elasticity - i.e., the ability to absorb housing and other debt bubbles. This, combined with Sarbanes-Oxley, generated governmental regulation like "mark to market" that helped establish the downward economic spiral we now are in.

Needless to say, there were tactical errors by the Federal Reserve, including inconclusive signals about interest rates, but in the end this was a trifling matter compared to the effect of Sept. 11.

Yet it is curious that this seemingly obvious point was not made by the Bush administration, nor was it raised during the recent presidential campaign. In fact, had this issue been addressed, it would have moderated the Obama claim that economic exigency was due to the bungling of the Bush economic team.

Obviously fairness and political strategy are words that should not be employed in the same sentence. Moreover, the Bush team failed to communicate this strategic point. It might have been reasonable for the former president to note that with the chilling economic effect of Sept. 11, his policies were designed to counter the loss of confidence in the markets. Here was a genuine stimulus package that worked for almost seven years.

Our suspicion is that Mr. Bush will not get any credit for his actions, although historians may be obliged at least to record his initiatives accurately.

With reasonable intentions in mind, Mr. Bush acted and he acted firmly and decisively. It didn't turn out quite as he anticipated; but a seven-year run of continued economic growth is nothing to sneeze at.

What turns out to be most noteworthy is that the events that preceded the economic downturn have been ignored or forgotten. Only eight years after Sept. 11, the nation seems to suffer from historical amnesia.

Perhaps history is little more than a dream from which we will awaken. In this case, the dream has real consequences for the nation and our future. Perhaps it is time we reflected on some

of the root causes of our economic problems and what we can do to correct them without the government pushing us once again in directions that may be counterproductive.

Linden Blue is vice chairman of General Atomics, and Herbert London is president of the Hudson Institute and a The Harbour League trustee.

