

## Terrorism as a Trade Deterrant

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### Extended Abstract

The literature suggests that international terrorism may cause a reduction of international trade. Two earlier papers have addressed the topic of how terrorism affects trade specifically. Nitsch and Schumacher (2004) used a reduced-form cross-sectional gravity model to infer the impact of the product of two trading partners' total terror attacks (alternatively, they use an indicator variable which is unity if two countries experienced at least one terror attack). The data are based on a short time period, covering the years 1968-1979, and they use a country-pair's total (export-plus-import) trade rather than directed trade flows (i.e., imports or exports separately). They find that a doubling of a pair's terror attacks reduce total trade of the pair by 4%. The second paper which addresses the issue is by Blomberg and Hess (2006). They also use a standard gravity model augmented by terrorism. More specifically, their measure of terrorism is coded as an indicator variable which is unity if at least one terrorist event (and, alternatively, a general violence event including terrorism) is recorded for either country in a trading pair. In contrast to Nitsch and Schumacher (2004) they use annual panel data covering the period 1968-1999. Trade is defined as average (export-plus-import) trade between two partners. They identify a reduction in bilateral trade of 7.6% for a pair experiencing at least one terror incident.

We argue that the aforementioned work on the matter relied on data and methods which are not suited to answer the question at stake in a satisfactory manner. In particular, by using cross-section or annual bilateral trade data, this work did not allow a precise association of terrorism with outcome. Also, that work ignored general equilibrium repercussions of the effects. Finally, by using total or average bilateral (export-plus-import) trade flows, that work committed what Baldwin (2006) calls the silver-medal mistake. We utilize monthly bilateral trade flows to get a much finer-grained picture of the extent and timing of effects of international terrorism on trade flows. Moreover, we provide evidence based on structural model simulation about the effects of international terrorism on involved and third countries.

### References

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- Nitsch, V., Schumacher, D. (2004). Terrorism and International Trade: An Empirical Investigation, *European Journal of Political Economy* 20(2): 423-433.