Swine flu is a potential economic threat to US, but mostly to crowded cities and border areas

Roger Kubarych

- Blanket media coverage of a few hundred cases of an outbreak of a new strain of "swine flu" has virtually everybody a little worried, even economists. Recalling what happened during the SARS epidemic of 2002-3, when almost a tenth of the 8,450 people who caught the disease died, the obvious question is "Can it be worse this time?"
- Scientists don't know yet. But public health experts are concerned that without a vaccine, the swine flu virus will spread, as it already has in Mexico, the "ground zero" of the current epidemic. They urge common sense responses by the general public. The US Center for Disease Control has sought to put things in perspective by reminding everyone that in a typical year worldwide deaths from regular flu range from 250k to 500k, of which about 36k occur the United States, mainly to the elderly.
- Looking back, the SARS virus had a brief but definitely adverse impact on economic activity in the most heavily affected areas in Asia—China, Hong Kong, Taiwan, and Singapore—mostly through lower tourist revenues and shuttered firms. China suffered a GDP drop of 5% per annum in Q2 2003. The fall in GDP in Hong Kong was twice as large. The others endured an estimated cost of about 0.5% of GDP. The only major Western country that was hard hit was Canada, where 44 Canadians died of the disease. Economic losses were estimated to have been around CND 1.5 bn—important for the Toronto area but still only a tiny fraction of Canada's GDP.
- Even a relatively limited flu epidemic concentrated in major tourist centers will have economic and financial consequences for the affected areas: less income generation, lower tax receipts, and larger government financing needs, along with higher borrowing costs. At a time when the global economy is beset by a severe synchronized recession, anything that makes budget deficits worse for a country like Mexico (or for budget-strained New York City, for that matter) cannot help but worsen macroeconomic prospects.

Lessons from SARS

Studies have repeatedly shown that the general public and financial market participants alike suffer from "disaster myopia." They tend to underestimate the probability of infrequent but highly costly events, but then exaggerate the negative consequences when the disasters unfold. It is similar for natural disasters like earthquakes and hurricanes, as well as for purely man-made phenomena like punctured stock market or housing market bubbles. It is roughly similar for public health emergencies. They happen frequently enough that governments feel some sense of responsibility to prepare for them, but democratically-elected legislatures tend to starve public health agencies of resources necessary to assure timely and adequate responses. SARS didn't really change the calculation very much for most countries, but it is fair to say that Europe has done a better job than the North Americans in building up stockpiles of anti-viral medicines (for instance, Tamiflu) and to construct sufficient facilities to quarantine infected patients to prevent the spread of the virus. By contrast, emerging market countries have weak healthcare delivery systems, inadequate facilities for quarantining infected patients, and insufficient medical personnel. Some have, however, invested in substantial inventories of anti-virals, notably Mexico.

Tourism & travel are hurt badly

No one knows the probability of coming down with a dangerous virus on a visit to an infected area. So it is rational for people to cancel discretionary travel to such places when an outbreak is reported. Even business travelers will react with heightened caution, particularly in this day and age, when the main alternatives to face-to-face meeting—web-based meetings, as well as voice & video conference calls—are readily available at lower cost. Therefore, precautionary cancellations are to be expected. What's more, governments themselves weigh in with warnings. For instance, the US government has cautioned citizens to limit trips to Mexico, while the Europeans have issued warnings on optional travel to all of North America.

One of the reasons that the SARS outbreak in 2003 had such a minor impact on the vast majority of countries in which some individual cases of infection were identified is that it was quickly determined that SARS originated in China and neighboring countries and potential travelers were alerted. Had the Chinese government acted with greater alacrity in publicizing the presence of a new and more perilous virus as soon as the first cases were known to officials in November 2002, the epidemic may have been contained earlier. But it was contained as a result of firm actions by the local authorities of the affected areas (mandatory school and plant closings, postponed sports and entertainment events, and internal travel restrictions). A steep drop in tourism and overall travel naturally ensued. A recent World Bank study by Milan Brahmbhatt and Arindam Dutta reports statistics compiled by Chinese economists indicating that in the spring of 2003 businesses suffered a year-over-year loss of revenue from tourist attractions, exhibitions, and luxury hotels of around 80%, while travel agencies, airlines, railways, restaurants, retailers and taxis reported declines in revenue of 10-50%. Hong Kong businesses experienced similar or even greater losses.

Swine flu could have a bigger adverse economic impact than SARS

The swift uncovering of a new, deadly influenza virus and the mounting casualty toll has already set back travel. And the Mexicans are responding forcefully to limit the spread of the disease. Nevertheless, cases of recent travelers to Mexico coming down with the flu have been identified in several parts of the United States, as well as in Europe. The first death attributable to swine flu was reported this week in Texas. Health alerts have been posted, but no extraordinary measures have been taken, since the authorities do not want to deplete inventories of anti-virals, which must be taken under a strict regimen.

In some respects, scientists feel they are in a position to identify the exact DNA of the new virus. According to researchers, what took about a month of 24-hour laboratory efforts back in 2003 can now be accomplished in a day or two. Once the DNA can be identified, it is possible to determine relatively quickly whether a sick patient has the new swine flu variant, rather than some other strain of influenza. In addition, local hospitals and laboratories are better equipped to perform the tests. But there is still a primitive use of digital technology would allow thousands of test results to be processed electronically, cutting back on time-consuming paperwork.

However, the fact remains that the US and Mexico, neither of which was affected very much at all by the SARS epidemic, share an integrated geographic area, and the economies are closely linked. Tens of thousands of people cross the border every day, most legally, but many not. It would cause immense economic disruption to close the border in a futile effort to arrest the spread of the flu virus. Losses would quickly mount into the tens of billions of US dollars. The drop of income and tax revenues would strain the financial conditions of both Mexicans and Americans, as well as state and local governments. In short, it would take a lot more evidence of contagion than has been revealed so far to take such drastic measures. And the fact that outbreaks have already occurred in the US means that it may be too late.

Implications for financial markets

In emerging market countries, such as China or Mexico, agricultural areas are susceptible to the spread of disease from animals to humans, and vice versa. Even regular yearly influenza strains have their origin on farms. That is clearly the case with swine flu that developed in rural Mexico. But once the flu virus spreads, several cities and regions are particularly vulnerable to the economic costs of a major outbreak. They will tend to be densely populated, concentrated in service industries where businesses have a global clientele, and thus be highly dependent on reliable air transport. If they are also a major tourist destination, the vulnerabilities are compounded. That was proved conclusively during the SARS epidemic, where Hong

Kong and Singapore were severely harmed economically, and even in Toronto, where the relative costs were not large, but only because of swift action by the authorities to help bring the outbreak under control.

Along with major cities in California and Texas, especially San Diego, Los Angeles, and El Paso, swine flu does endanger the New York City area, too, not only in human terms, but also in economic and financial terms. Schools have been closed where the outbreak has already been significant. If the virus starts to infect large numbers of people throughout the city, businesses will have to close or shift work to affiliates elsewhere. Tourism will of course shrink, impacting hotels, restaurants, theaters, Broadway shows, museums, and other attractions. Retailing will clearly suffer. The resulting loss of tax revenue will strain New York City's already strained fiscal position. The threat of enlarged financing needs will lead to a sell-off in the municipal bond market and higher interest costs.

It is exceedingly unlikely that the swine flu epidemic will become widespread enough to have a substantial macroeconomic impact on the US economy as whole. The vast US geography will tend to limit the outbreak to a few exposed large cities. But it certainly will make it more difficult for the US to pull out of recession with a robust recovery.

April 30, 2009

The author is chief US economist, UniCredit Group Research, and Henry Kaufman Adjunct Fellow for International Economics and Finance, Council on Foreign Relations. This note is reprinted with permission of the author.