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WILLIAM J. MCDONOUGH
PRESIDENT

April 18, 2002

The Honorable Carolyn B. Maloney
Ranking Member
Subcommittee on Domestic Monetary Policy,
Technology and Economic Growth
United States House of Representatives
2430 Rayburn House Office Building
Washington, DC 20515-3214

Dear Representative Maloney:

I am pleased to enclose our response to your letter of March 1, 2002, and the similar request of March 21, 2002, signed by you and ten of your colleagues. The attached document was prepared by staff of the Federal Reserve Bank of New York and addresses your questions in two sections. The first section analyzes the impact of the September 11 attack on the economy of New York City. The second section addresses concerns about the availability of emergency funds from FEMA and of bank and other credit to businesses and individuals affected by the September attack.

The destruction of the World Trade Center and damage to surrounding buildings and infrastructure imposed severe losses on the New York City economy. The losses include both the direct costs of property loss, cleanup, and loss of life and the related costs of lost employee and business income resulting from attack-related disruptions. Estimates of the costs of building replacement and repair and the costs of cleanup now range from $25 billion to $29 billion, with about $15 billion of that amount covered by insurance. Because of the speed of the cleanup, these estimates have declined from those made last fall. In addition, the death toll has proved to be about half of what was initially feared.

Estimates of the loss of income resulting from the September 11 attacks are far more difficult to make. One challenge is to disentangle the effects of the attack from the effects of the concurrent recession. Focusing on job losses and reduced income in the key affected sectors, which constitute the largest portion of the losses, we estimate that around $4.5 billion in lost income is attributable to the attack. This estimate of income losses is far below estimates that we would have made a few weeks after the attack.

We have had a number of helpful conversations with Ben Chevat of your staff concerning the effectiveness of federal government programs, especially FEMA, and the banking system in meeting the needs of all eligible businesses and households affected by the September 11 attack. To date, we have not identified any attack-related changes in financial institutions' lending policies and practices. Determining whether targeted assistance and credit flows from institutions are actually getting to those in need, however, would require detailed data and a case-by-case analysis that is best done through statistical sampling and surveys of the affected businesses and households. Several government agencies and the policy institutes that conduct surveys for them have the requisite expertise and experience to undertake this task.

We would be happy to answer any questions on the enclosed document. If you have further questions, please contact Christine Cumming, Executive Vice President and Director of Research, at 212-720-1830, or James Orr, Research Officer, at 212-720-5491.

Sincerely yours,

William J. McDonough
President

Enclosure

cc: The Honorable Maurice Hinchey
The Honorable Charles Rangel
The Honorable Jerrold Nadler
The Honorable Jose Serrano
The Honorable Nita Lowey
The Honorable Michael McNulty
The Honorable Gary Ackerman
The Honorable Edolphus Towns
The Honorable Major Owens
The Honorable Eliot Engel
The Honorable Alan Greenspan
Ms. Lynn S. Fox, Board of Governors
Ms. Michelle A. Smith, Board of Governors
Mr. Donald J. Winn, Board of Governors

This document summarizes the impact of the World Trade Center (WTC) attack on the New York City economy in its first section and, in the second, addresses issues relating to the availability of emergency funds and sources of credit to businesses and individuals affected by the attack.

IMPACT OF THE WTC ATTACK ON THE NEW YORK CITY ECONOMY: AN UPDATE

New data and developments over the past several months suggest that the initial estimates of the damage to the New York City and regional economy from the 9/11 attack were on the high side. Reports suggest that the uninsured expenses related to the cleanup and replacement/repair of buildings and infrastructure have declined to a range of $10 billion to $14 billion, and the death toll--while still appalling--has proven to be about half of what was initially feared. Moreover, while activity in the industries most immediately and severely affected by the attack—finance, travel and tourism, and retail--has not recovered to pre-attack levels, the pick up appears to be far quicker than in the scenarios sketched out in the weeks following the attack. Longer term, pressures to decentralize activities will remain a major concern for many firms located in the city. It remains critically important to repair infrastructure, improve security, and appropriately manage the city and state budget deficits in order to maintain the city and region's growth prospects. Many of the issues surrounding the impact of the attack on the city and region will be addressed in a volume of our *Economic Policy Review* planned for release in September 2002.

I. Revised Estimates of the Capital Destroyed or Damaged and the Lives Lost

Refinements to the estimates of the cleanup costs and the physical capital losses contained in the November 2001 report by the New York City Partnership and Chamber of Commerce have reduced these losses from about $35 billion to the range of $25 billion to $29 billion, before taking into account reimbursements from private insurance. News reports and analyses suggest that cleanup and site restoration will cost between $6 billion and $10 billion; replacing the World Trade Center (WTC) towers is estimated to cost $6.7 billion; repairing all other damaged buildings, the retail space, and the transportation, communications, and power infrastructure is estimated to cost $6 billion; and replacing destroyed technology and fixtures is estimated to cost $6.6 billion. Private insurance is expected to cover roughly $15 billion (assuming a determination that the WTC attack was two incidents), leaving $10 billion to $14 billion in uninsured physical losses—an amount equivalent to about 3.0% of annual Gross City Product.

Downward revisions to the estimates of the loss of human life put the value of the human capital losses at roughly $6 billion rather than $11 billion. Private insurance and victim compensation funds are anticipated to cover a substantial portion of these losses.

The attack reportedly displaced about 100,000 city workers. A tracking of former WTC tenants (tenantwise.com) indicates that the majority of firms have relocated their workers to other offices in the city, mainly in midtown Manhattan. About 18,000 workers reportedly left New York City, but many went to alternative locations in nearby New Jersey, and more than half of those plan to return to the city.

II. Employment and Income Impacts to Date

Our analysis of the aggregate and sectoral employment impacts of the attack suggests that the initial estimates of the output losses due to the attack were likely overstated. These earlier estimates were made in October and November, and more recent data provide a better perspective on the post-attack performance of key industries. Moreover, the outlook for a national economic recovery is significantly more promising today than it was in the immediate aftermath of the attack.

Aggregate employment impact

The attack accentuated the economic downturn that was already reducing employment in the city and region. The city entered a recession in January 2001, two months before the nation, and private-sector employment in the city had fallen by roughly 50,000 prior to September 11. Immediately following the attack, private-sector employment fell by another 50,000 and was down roughly 70,000 for the entire fourth quarter. Much of this job loss is likely linked to the WTC attack, as suggested by the spike in new unemployment insurance claims (UI) in New York State during October. However, the weakening economic conditions in the city and the nation suggest that job counts in the city would likely have declined even without the attack, though not nearly as much. New UI claims have recently settled down at roughly pre-attack levels, though the job count did fall by another 20,000 in the first two months of 2002. Looking ahead, the relatively swift recovery that is now expected at the national level--a development that was not clearly evident at the time of the attack--should improve conditions locally. Thus we expect the city and state to show a mild recovery in employment, most likely by midyear.

Sector impacts

The most immediate and severe effects of the attack were concentrated in the FIRE (finance, insurance, and real estate) sector, the travel and tourism sector, and the retail trade sector. The travel and tourism sector does not have a formal designation but is typically defined as a mix of service and retail trade industries. In our analysis, we combine the restaurant industry, which had the largest job losses among the city's retail industries following the attack, with the hotel, air transportation, and amusement and recreation industries and refer to them as the travel and tourism sector.

<u>FIRE</u>

The FIRE sector--the source of about 30 percent of total annual earnings in the city--was particularly hard hit. The New York Stock Exchange closed for four days, and numerous financial firms in the area surrounding the WTC were forced to find alternative locations. The attack compounded the weakening in the sector that was evident prior to 9/11. Employment had fallen by about 7,000 in the first nine months of the year and further layoffs had been announced. Reflecting these losses as well as the impact of the attack, this sector has yet to show signs of bottoming out. Adverse pre-attack employment trends appear to have reasserted themselves. FIRE employment fell in both New York City and New Jersey through February 2002, evidence of broad weakness in the sector throughout the region.

Employment in New York City's FIRE sector, according to the February numbers, was down by about 30,000 from its September level. To get a rough estimate of the earnings losses in this sector that can be attributed to the attack, we first take the likely trajectory of city employment in the sector prior to September 2001 and compare it with the actual level of employment in February 2002. The difference, 20,000, is a rough estimate of the loss of jobs due to the attack, both from the movement of workers to locations outside the city and from attack-related declines in financial activity in the city. Assuming that annual earnings per worker in the sector equal $150,000 (estimated average annual earnings of workers in Manhattan's financial sector) and that the job loss persists for one year, we estimate that the direct earnings loss associated with these job losses is on the order of $3.0 billion. This loss is below the estimated losses presented in the "best case" scenarios in earlier reports. Moreover, some of the city's loss in FIRE earnings, roughly $900 million, effectively becomes a gain for New Jersey.

The medium-term impact on the city of the post-attack relocation of FIRE sector firms will reflect the extent to which they return to city locations. The most recent data suggest that firms employing many of the displaced workers have returned or plan to return to the city, although about 6,000 workers, earning roughly $900 million annually, may remain in New Jersey. However, plans to move some of the operations of major financial firms in the city to New Jersey locations were already in place, and the attack may have sped up that relocation process. Nevertheless, the fact that the bulk of FIRE jobs have not left the region in the wake of the attack is a strong signal of the region's continued importance as a center of financial activity.

<u>Travel and Tourism</u>

New York City's travel and tourism sector was also significantly affected, although once again, losses have not been as severe as initially anticipated. We first estimate the trajectory of employment in this sector's chief industries--hotels, air transportation, restaurants, and amusement and recreation--prior to September 2001. Then, using employment data through February 2002, we look at the *actual* job loss occurring in each of these industries between September and the trough (which varies by industry). The difference between this job loss and the estimated "baseline" loss gives us our estimate of the attack's effect on employment in each of the city's travel and tourism industries. To gauge the earnings loss, we multiply the number of jobs lost by the estimated 2001 earnings per worker in each industry (actual 1999 County Business Patterns data, escalated by 10 percent), under the assumption that the differential job loss persists for a full year. Estimated losses for hotels, air transportation, restaurants, and recreation total at most 32,000 jobs and $1.2 billion in earnings.

- Hotels show an estimated loss of 6,000 jobs out of a total of 38,000; the annualized income loss is estimated at $210 million. All of the job loss appears to have occurred in October, with employment little changed in the four months since. Both occupancy rates and revenue per room have recovered noticeably in early 2002, suggesting that further job losses are unlikely.
- Air transportation shows an estimated loss of 11,000 out of 55,000 jobs; the annualized income loss estimated at $572 million. Substantial job losses were seen in October, November, and December, but employment leveled off in January and February.
- Restaurants show an estimated loss of 12,000 out of 165,000 jobs; the annualized income loss estimated at $252 million. Employment in this industry fell sharply in October but has actually edged up in the four months since. Much of the revenue loss was likely geographically concentrated. Restaurants in Lower Manhattan, including Chinatown, faced particularly severe declines in business in the weeks following the attack, which likely affected average hours worked in addition to employment. However, it appears that these disruptions were relatively short-lived.
- Amusement and recreation show an estimated loss of 3,000 out of 48,000 jobs; the annualized income loss estimated at $180 million. After declining in October and November, employment rebounded to pre-attack levels by January 2002 and leveled off in February.

Manufacturing

In addition to the FIRE and travel and tourism sectors, two of New York City's key manufacturing industries experienced disruptions as a result of the WTC attack. Although the disruptions produced virtually no incremental job loss, they did lead to an estimated earnings loss of $156 million:

- Apparel shed an estimated 3,000 jobs between August and December, but this loss was in line with preexisting trends (for example, over the twelve months leading up to the attack, employment fell by 8,400). As a result, there is no indication that this decline would have been significantly different if there had not been a terrorist attack. However, there were reported to be substantial *short-term* disruptions in Chinatown's garment industry that affected average hours worked, as opposed to employment. If *all* apparel workers in Manhattan had their hours (and weekly earnings) cut in half for a full two months following the attack, the total earnings loss would be an estimated $77 million.
- Printing and publishing, which also has a sizable presence in Lower Manhattan, shed an estimated 2,000 jobs in October. However, after adjusting for the preexisting downward trend, attack-related job losses appears to total roughly 1,000 in October, followed by some recovery in November. The estimated earnings loss would be $79 million.

Tax revenue impacts

The New York City Comptroller's initial estimate of the attack-related tax revenue losses to the city, on the order of $600 million in the fiscal year ending in June, appears reasonable; a similar amount is expected to be lost in the next fiscal year. The New York State budget officials' estimates of attack-related state tax revenue declines -- roughly $3 billion in the fiscal year that ended in March and another $6 billion in the current fiscal year, do not clearly distinguish the effects of the economic downturn from the effects of the attack.

III. Longer-term Prospects

The longer-term economic prospects for the city appear favorable. The city's industrial structure now contains numerous industries that are projected to see sharp job growth nationally throughout the decade. Despite a short-term budget deficit, city finances appear on a much sounder footing than in the dark days of the 1970s. Quality of life improvements throughout the 1990s and continuing domestic and international migration further support the expectation of economic vitality. And the benefits of the clustering of financial activity in the city and region will likely remain, as evidenced by the fact that most displaced financial firms to date have not strayed far from Wall Street.

Despite these favorable prospects, there are two key downside risks to a full recovery in New York City. Rising pressures on firms to decentralize operations in order to ensure business continuity have put a premium on quickly restoring the transportation, communications, and power infrastructure and on improving security against future attacks. And efforts to address the current budget deficits at both the city and state levels could entail policies that may lead to a long-term decline in the attractiveness of the city. A more immediate risk to the outlook for the city would be further weakening in the U.S. financial sector that would disproportionately affect New York City.

DISBURSEMENT OF EMERGENCY RELIEF FUNDS AND THE AVAILABILITY OF CREDIT TO BUSINESSES AND HOUSEHOLDS AFFECTED BY THE SEPTEMBER ATTACK

Disbursement of Emergency Funds

Representative Maloney's letter asked us to analyze which economic losses will be covered by the Federal Emergency Management Agency (FEMA) under the Stafford Act, if that is within our capacity. Unfortunately, the claim process under the Stafford Act and its implementing regulations is structured in a way that makes it very difficult to estimate accurately the value of successful claims from the broad economic data that are available to us. Accordingly, a useful estimate would require either gathering a substantial amount of new data through a survey or, more directly, reviewing the applications that have already been submitted to FEMA under the available programs, estimating the amounts that might be awarded to those applicants, and then adding the amounts that might be awarded to applicants who submit applications before the deadline (which itself may be extended in appropriate circumstances). Because we do not believe that, under either approach, we would be able to provide better information than is available from FEMA directly, we have chosen not to perform this task.

The Robert T. Stafford Disaster Relief and Emergency Assistance Act (42 U.S.C. §§ 5121-5206) provides federal assistance in response to a "major disaster" through a number of instrumentalities. For example, under Section 5170a, the President may direct any federal agency to use its resources in support of state and local assistance efforts or to provide technical and advisory assistance. In addition, there is authority for assistance with respect to hazard mitigation, repair of federal facilities, temporary housing, unemployment assistance, food coupons, food commodities, crisis counseling, emergency communications, and so on.

Federal assistance is primarily provided, however, through FEMA's Public Assistance and Individual Assistance programs. These programs require a presidential declaration of a major disaster; in the case of the September 11 events, four declarations by the President affirmed the fires and explosions resulting from the September 11 attack were a major disaster. The declarations authorized Public Assistance in the five boroughs, with the federal share at 100 percent; Individual Assistance in the five boroughs and an additional ten New York counties; and emergency protective measures (Category B) under the Public Assistance program for the parts of New York State not covered by the full Public Assistance program.

Grants under the Public Assistance program may be used by state and local governments in the defined area for debris clearance, emergency work to save lives and to protect improved property and public health and safety, and permanent work to restore an eligible facility on the basis of its predisaster design and current standards (44 CFR §§ 206.200 et seq.). The work must be performed within the time periods specified in the regulations (44 CFR §206.204). These time periods, however, may be extended in appropriate circumstances. The work must be required as a result of the major disaster, be located within the designated disaster area, and be the legal responsibility of the eligible applicant (44 CFR § 206.223). Actual and anticipated insurance recoveries must be deducted from otherwise eligible costs (44 CFR § 206.250). A private nonprofit organization that owns or operates an educational, utility, emergency, medical, or custodial care facility may also apply for a public assistance grant (44 CFR § 206.222). FEMA reports that 278 applicants have been determined to be eligible for Public Assistance reimbursements and $603 million has been obligated as of March 6, 2002 (http://www.fema.gov/diz01/d1391n68.htm). A press release from Senator Schumer states that FEMA expects city and state reimbursement to be in excess of $9 billion. (http://www.senate.gov/~schumer/-SchumerWebsite/pressroom/press_releases/PR00877.html).

Individual business assistance can be in the form of grants to individuals of up to $10,000 for disaster-related necessary expenses or serious needs (44 CFR § 206.131), temporary housing, mortgage and rental assistance, disaster unemployment assistance, crisis counseling, food stamps, and Small Business Administration loans (44 CFR §§ 206.141-.171). FEMA reports that more than $381 million has been distributed in assistance to households and business and more than 63,000 applications have been taken as of March 4, 2002 (http://www.fema.gov/diz01/d1391n66.htm).

The Stafford Act and its implementing regulations provide careful guidance on eligibility for, and the amount of, assistance available from the federal government. It would be extremely difficult to estimate the amount of assistance that will eventually be provided without essentially duplicating the process that FEMA and the other assistance agencies are carrying out. In these circumstances, it seems preferable to rely on FEMA's estimates of the amount of economic losses that it will cover.

Availability of Bank Loans

Representative Maloney's letter also asked whether bank lending standards had changed as a result of the terrorist attack. We have three primary sources of information. Our supervisory process brings us into close contact with large and small banks in the Second District. Our discussions with individual financial institutions in the Second District have not identified any specific attack-related changes in firms' lending practices to businesses and consumers. In addition, the Federal Reserve issued a press release on September 14 encouraging banks to work with customers affected by the attack, and suggested ways in which they could do so (http://www.federalreserve.gov/boarddocs/press/general/2001/200109142/default.htm). Bank Supervision officers informally provided the same encouragement through their contacts at the banks.

The Federal Reserve System also maintains consumer complaint offices at each Reserve Bank, as described in http://www.federalreserve.gov/pubs/complaints/ and http://app.newyorkfed.org/complaints/survey/Instructions.cfm; the other federal regulators and the New York State Banking Department have similar complaint offices. The program enables consumers who believe that a bank has been unfair or deceptive in its dealings, or has violated a law or regulation, to have their complaints reviewed and investigated by the appropriate federal banking agency. To date, in the Second District we have received no complaints from consumers that credit was denied for reasons related to the events of September 11.

Finally, each Federal Reserve District eight times a year conducts telephone interviews to elicit banks' views of lending conditions (the Senior Loan Officer Survey) and businesses' views of economic conditions. A regional analysis of financial and economic conditions is published along with a national summary in *Summary of Commentary on Current Economic Conditions by Federal Reserve District* (the Beige Book), available at http://www.federalreserve.gov/fomc/beigebook/. In the February Beige Book, the latest available, the report for the Second District indicated:

Bankers report continued tightening in credit standards for all types of loans. In particular, while none reported an easing of standards, roughly one in four bankers reported tighter standards on both nonresidential mortgages and commercial and industrial loans.

Bankers have told us through the Senior Loan Officer Survey that loan standards have been gradually firming since mid-1999. The firming of conditions for commercial and industrial (business) loans had intensified in the September survey, taken just prior to September 11, and again in October, but subsequently returned to its previous trend. We therefore see no lasting impact of the September 11 attack in the information gathered from the small and medium-size banks included in the panel for the Second District.

Further Thoughts on Availability of Emergency Funds and Bank Credit

In discussions with Ben Chevat of Representative Maloney's staff, we have learned that the questions on emergency funds and on bank credit in part reflect a concern that significant numbers of individual businesses and consumers may not have access to emergency funding or bank credit, even if adequate levels of overall funds and credit appear to be flowing into New York City. This line of inquiry involves not the aggregate flow of funds into New York City, but the experience of individual businesses and households in accessing and obtaining funding.

Loans, tax credits, and other forms of assistance have been committed to aid the many individuals and small businesses in Lower Manhattan adversely affected by the attack. An assessment of the effectiveness of this assistance requires information obtained from a statistically representative sample of the population and small businesses in the area. The information would be used to determine if eligible firms and individuals are aware of and are receiving assistance and if the aid is appropriately targeting their needs. Developing such information requires specialized expertise in survey design and interpretation. Organizations with capability and experience in program evaluation, such as the Census Bureau, or policy institutes that conduct research under contract from government agencies, would be most suited to carry out such an assessment.