Terrorism and Its Impact on the Cost of Debt

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The author extends the literature on the costs of terrorism by examining its long-term impact on financial markets, an underdeveloped strand of research within the terrorism construct. Specifically, the author looks at its effect on sovereign risk, which forms the basis of the cost of debt in affected countries, postulating that it results in a lower credit rating and that this impact is more pronounced in developing vs. developed nations. In operationalizing the risk of terrorism, the author utilizes the Institute for Economics and Peace’s Global Terrorism Index for the first time, the most comprehensive index constructed to date which incorporates both the economic and social dimensions of terrorism and is based on the Global Terrorism Database, the world’s largest source of such data. The results of the study support the hypothesis that terrorism results in a higher cost of debt for sovereigns and by extension, firms in impacted countries, and that this effect is more pronounced in developing vs. developed economies.