

# THE COSTS OF TERRORISM AND OF COUNTERING TERRORISM

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## **Costs of Terrorism**

The economic costs imposed by the 9/11 attacks were not large in relation to the size of the US economy. Although business activity, and especially air travel, suffered setbacks, and some activities, particularly in the New York region, remain weakened after more than three years, the national economy recovered quickly, and within a year was again dominated by the trends and cyclical patterns in place prior to 9/11.

In contrast, countries or regions that experience persistent terrorism suffer significant economic losses from the decline in tourism and foreign direct investment, and from the adverse effects on forward-looking behavior. The Bank of Israel estimated that the country's 2002 GDP was down by between 3 and 3.8 per cent as a result of the second Intifada, which began in 2000. The initial negative impacts on economic activity were magnified as individuals began to translate the persistence of terrorist incidents into perceptions of a long-term decline in their income, and reduced their level of consumption, with negative multiplier effects. The relatively quick recovery in economic activity in the US may reflect a widespread perception that 9/11 was a single event and not part of a pattern likely to be repeated.

## **The Costs of Countering Terrorism**

Government and private spending on terrorism-related security in the US is expected to grow by between 100 and 200 per cent by the end of the decade. These outlays shift resources toward providing security and other services, such as insurance, but at the expense of activities that are likely to be more productive, as higher business costs are passed on to consumers and services such as education and health care suffer in government budgets. To the extent that these added security-related outlays reduce or even eliminate the threat of terrorist incidents, they can at best restore a status quo ante, but they do not, in general, provide the type of economic stimulation that is cumulative over time.

Tighter transport security increases the costs of travel and the costs associated with shipping goods, especially when time is factored in as a cost, an important consideration for firms that have adopted just-in-time inventory systems. A more difficult visa application process instituted in the aftermath of 9/11 made it harder for students and skilled workers to enter the US and led to an outcry from business and university leaders. While the process has been modified, this example illustrates the potential trade-off between security and economic efficiency. Thus, even when countries recover from specific terrorist incidents, they might still bear substantial costs, which tend to reduce their long-run growth potential.

## **Policies to Combat Terrorism**

### *The costs of bureaucracy*

It should not be assumed that increases in spending equate to, or even approximate, increases in effectiveness with respect to security-related problems. The US defense budget, for example, includes several large "legacy" weapons systems, such as the F-22 high-performance fighter aircraft, which was originally designed to counter

expected next-generation Soviet systems. With the breakup of the Soviet Union, this threat is not expected to materialize; yet the system remains and accounts for \$72 billion in expected future spending commitments. In another example, the US has still not created a single database of suspected terrorists, relying instead on lists from eight different agencies. This situation has persisted for more than a decade, since the first World Trade Center bombing in 1993, when the problem first received national attention, and for more than three years after 9/11, despite the fact that President Bush on several occasions publicly committed the government to creating a single, effective list.

At the same time, a number of programs that are more directly involved with counter-terrorist activities have had trouble securing adequate funding. One is the Cooperative Threat Reduction Program (popularly called Nunn-Lugar, after its sponsors in the Senate) designed to fund the securing of fissile materials within the former Soviet Union. While this effort to address the so-called “loose nukes” problem has run into a number of difficulties involving officials and institutions in the former Soviet Union, it has also been consistently funded at sub-optimal levels, and has received less than adequate support within the various US government bureaucracies.

### ***The costs of misplaced emphasis: the politics of fear***

Countering terrorism requires a wide range of tools: military and policing, politics and diplomacy, economic and social policy, etc. Yet frequently, it is the security aspect that is emphasized above all others. When an act of terrorism occurs, the response of governments is usually to first retaliate in kind, and then formulate a series of additional measures designed to punish and deter the perpetrators. This punish-ment/deterrence formula has an advantage in providing a sense of immediate gratification, as the shock of experiencing an attack is quickly followed by the satisfaction of inflicting punishment on those responsible. For a government, this conveys a sense of legitimacy, since it has done “something” to satisfy the citizenry’s desire for a visible response. However, there is considerable evidence that retaliatory behavior does not, in general, reduce the incidence of terrorist activity and may stimulate more activity by raising the political stakes.

The prevalence of retaliatory behavior by governments may be related to the politics of fear. For example, individuals appear to place a much higher priority on countering terrorism, in terms of their willingness to commit public resources and political capital, than they do on offsetting the risk of death, injury, or property damage from automobile accidents, even though the latter regularly produce far more casualties and impose far greater direct costs than the former. There are, of course, many differences between the two events. Perhaps the most important difference is that the possibility of being subject to terrorist attack invokes a considerable amount of fear and anger, which leads to a willingness to accept costs and policies that appear to be out of proportion to the potential benefits that they might produce.

An example of this phenomenon is the war in Iraq, where popular fear and anger fueled support for the Bush Administration’s war plans and its linking of Iraq to terrorism. Despite successful regime changes in Afghanistan and Iraq, terrorist organizations remain strong, continuing to recruit new members; and, according to experts across the political spectrum, the threat to the US and US interests and activities abroad is at least as great if not greater than previously.

### **Economic sources of terrorism: can aid help?**

Since 9/11, there has been extensive discussion and considerable research on possible links between economic deprivation and terrorism. A number of cross-section empirical studies have concluded that political variables,

such as the extent of civil liberties, carry far more weight than variables such as poverty and inequality in explaining the incidence of terrorism or the proclivity of individuals to engage in terrorist activity. At the same time, studies that look at changes in relative and absolute economic positions over time do find deprivation measures to be statistically significant in explaining the number of incidents or the propensity to engage in terrorist activities.

Such studies tend to provide a partial picture, in some cases a bit like studying the evolution and behavior of an industry by analyzing the motives behind the behavior of its labor force. At least of equal if not greater importance are the reasons behind the evolution of the firms that comprise the industry, and which help establish the incentives by which labor is recruited. To carry this analogy a bit further, terrorist acts are carried out by individuals but in the context of organizational objectives and resources, summarized, perhaps, by an epigram used by *The Economist* to lead an article, "Suicide bombing is a corporate activity."

Research on terrorist organizations suggests three lines of thinking that might help sharpen policy responses. The first is that terrorist organizations are rational in the sense that economists use that term, namely they respond to incentives and are constrained by their access to resources. Terrorist groups behave as if they are cost constrained, and therefore choose tactics they believe to be cost-effective. If the relative costs of one avenue of action are raised, or the perceived benefits change, timing and tactics can also change in response. Second, at least some terrorist organizations have adopted, and in some cases appear to have moved heavily towards, economic agendas. Terrorist groups, criminal organizations, and participants in civil wars - whatever their original motives - need sources of revenue and often become increasingly concerned with the business of making money. Third, some terrorist organizations establish and maintain their standing in host communities because they are successful in providing public goods, including security, in effect filling in gaps generated by the failures of other institutions, including markets and governments. Some terrorist groups are successful because they provide services to the population within which they reside.

Understanding how terrorist organizations behave may help formulate policies that place somewhat less emphasis on force, and more on influencing behavior. Thus, more resources devoted to disrupting terrorist financing mechanisms appear to have a significant potential payoff. Foreign aid devoted to supporting market mechanisms, strengthening security and expanding social service delivery would appear to be important in weakening the appeal of terrorist organizations.

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