

On the Economics of Terrorism

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Within a week, I added my voice to the clamor of voices debating the events of 11 September 2001. I made two sets of comments then, and they are essentially unchanged now. Many of my thoughts and predictions turned out to be right on the mark. The first set of comments pertained to the economic impact of the terror attack; the second, more unusual, referred to what economists call the “economics of terrorism.”

With regard to the first topic, I made two points. First, while the gruesome reality is that thousands died, that two big buildings collapsed, and that many other buildings and infrastructure were badly affected, the reality also is that relative to the nation as a whole, the death and damage has been minor. The nation consists, after all, of over 280 million people and of their daily production. Important as they are, Manhattan and the Pentagon building are small in relation to the United States as a whole. The country's overall capacity to be productive is unaffected. Taking a long-run perspective, the estimate of \$10, \$20, or even \$50 billion worth of direct damage is not much when compared to our \$10 trillion economy. To many, this will sound heartless, cynical even. Perhaps. But this sort of calculation is just as real as are the death and destruction we have witnessed.

Continuing with this “hard-nosed” attitude, I said, note that the country's financial functions are essentially unaffected by the attack. The financial markets work as before, and your money's still in the bank. The computerized financial records that are kept in the World Trade Center are backed up nightly and are nearly fully available as well. The Federal Reserve Bank made clear that there is no monetary crisis, it injected extra liquidity into the economy and, in conjunction with Central Banks elsewhere in the world, lowered interest rates yet again. As an independent observer and economist, I fully concur that there is no economic or financial crisis.

Half a year on, this set of comments turned out to be correct. The economic recession, if indeed there was any at all (that is still debated) was dated to have begun in March 2001. My own story is that it was caused by the uncertainty surrounding the US presidential election in November 2000. The terror attack certainly added to the further slowing of economic activity, especially in business travel and tourism, but was primarily a function of Americans shooting themselves in the economic foot – fear

induces one to consume less, and thereby to rob your neighbor of his job. The forceful federal response improved the people's confidence, so that economic activity resumed at normal levels (i.e., economic growth resumed).

The "impact" part of the attack is trivial from an economist's point of view (sad, to be sure, and it involves such dicey moral and technical issues as how to value the loss of lives, but nonetheless trivial). The much more interesting part concerns the economics of terrorism, i.e., the understanding of the terrorist mind. What makes it tick, and what can be done? Let's start with a definition, supplied by my esteemed colleagues Todd Sandler of the University of Southern California, Los Angeles, and Keith Hartley of the University of York, UK:

"Terrorism is the premeditated use, or threat of use, of extra-normal violence or brutality to gain a political objective through intimidation or fear" (Sandler and Hartley, 1995, p. 308).

There are four elements in this definition: (a) the inducement of intimidation or fear; (b) the use, or threat of use, of extra-normal violence; (c) the premeditated character of such violence; and (d) the political objective. This goes for nuclear-weapons posturing as it applies to the narco-rebels in the Colombian jungle as it fits 11 September 2001. The last element – the political objective – is of particular interest because it requires that terrorists must reveal their identity and that they must communicate their demands.

Before proceeding, let us understand a couple of general items. First, we need to distinguish between domestic and transnational terrorism. The attack on New York and Washington, DC and the December 2001 attack on the Indian parliament are examples of transnational terror. The attacks by Basque terrorists in Spain or the aforementioned jungle in the Colombian hinterland involve acts of domestic terror, as did the Sarin nerve-gas attack in Tokyo and the Oklahoma bombing a few years back. Second, recognize that terror comes in a variety of flavors. The four major categories are: first, bombings (embassies, letter bombs, car bombs, etc.), second, hostage taking (hi-jackings or kidnappings at sea, in the air, or on the ground, say at embassies or at Philippine scuba diving resorts), third, assassinations, and fourth, threats and hoaxes. These tend to move in cycles for reasons to be discussed. Bombings are the most frequently undertaken terror action, again for reasons to be discussed shortly. Terror activities come in cycles, with around 150 transnational incidents per three-month period since 1968.

A large theoretical and empirical literature on terrorism exists to help us probe the

terrorist mind. My aforementioned colleague, Prof. Todd Sandler, is teaching a class on terrorism at the University of Southern California, and you can download the course reading list from the web (see Sandler, 2002, in the *For Further Reading* section). Drawing on this literature, let me make a few salient points on how we believe the terrorist mind works and what effect government action has on terrorist perceptions and opportunities. First, economists are interested in behavior. We treat all subjects, even terrorists, as behaving rationally. This does not mean that we condone their actions. Rather, it means that we assume (and then test empirically) that once terrorists have decided on their objective, they go about their beastly business in a rational manner, given the resources at their disposal. These include their own financial resources, shelter, and logistic and other support (such as expertise, training, intelligence information) offered by other groups a/o governments. Resources can be augmented by training, by profits derived from legitimate businesses, by conversion of new recruits to the cause, and by other means. The reports of al-Qaida training camps in Afghanistan, and training camps of other groups elsewhere, make perfect sense to an economist. We would see this as an investment that pays off in terms of future terrorist productivity, i.e., increased effectiveness per incident. It is a matter of maximum bang for your bark, to put it provocatively.

Second, even terrorists have the option of choosing among legal action, illegal action, or an arbitrary combination between the two (the IRA in Northern Ireland would be an example). Repressive governments, by foreclosing legal avenues of voicing dissent, are therefore directly responsible for limiting dissenters' feasible set options that push them into illegal, i.e., terrorist, activity. If the cost of legal dissent is raised by government (by limiting or forbidding it), then the relative cost of illegal dissent has in effect been lowered, and we would expect to observe a larger quantity of terror behavior (as theory predicts, a price change induces behavioral changes). Repressive Arab regimes – of which there are many – bear direct responsibility for 11 September, protestations notwithstanding.

Third, if one raises the cost of one type of illegal behavior, theory predicts that terrorists will substitute and pursue other types of terror. That indeed is what happened. The installation of airport metal detectors as from 1973 increased the cost of hi-jackings and induced terrorists to switch to other targets, namely increased attacks on embassies. As embassies were secured as from 1976 onward, terrorists shifted to attacking diplomatic personnel away from secured embassy grounds. As US interests abroad were secured, terrorists now shifted to the US mainland itself.

Fourth, as mentioned, bombings are by far the preferred method of terror. The

reason, once more, has to do with the cost of the action. Hostage taking is logistically more complex and operationally more risky than is bombing. Bombing is not only cheap for the terrorist but more costly to detect for government (far fewer communications available for interception for instance, making it harder to track down potential bombers). Once more, as theory predicts, a lower cost will attract more activity.

Fifth, the availability of large numbers of terrorist recruits makes them more expendable and will permit more suicide missions, especially if the recruits can be offered immaterial rewards (“heaven”). Whereas European terrorists in the 1960s and 1970s rarely committed suicide missions to preserve their personnel base, Islamic fundamentalists, in contrast, have been able to draw on a much larger terrorist labor pool. Also note that the next generation of terrorists has already been “farmed” on the nutrient of past discontent and repression of freedom of speech. Current ideological intervention is unlikely to affect the current crop of late teens and early 20+ old martyrs. Terror will be with us for at least another generation, and probably more than that.

Sixth, terrorism moves in cycles. The length of the cycle corresponds to the logistical complexity of the incident. Threats and hoaxes display the shortest cycles, after all they cost nothing; bombings run on somewhat longer cycles but much shorter than do hostage taking events. The cycles occur because after each severe event, governments take “decisive” action, making terrorism costlier for terrorists. After government attention wanes, the cycle swings upward again. Terrorists substitute not only one mode of attack for another, they also substitute over time by shifting presently planned into future attacks (intertemporal substitution).

Seventh, there is more recent evidence that terrorism is limited by media attention and outlets. Recall that the objective is political in nature. Some demand must be made and communicated via the use, or threat of use, of force against those not directly involved in the decision-making process. That is, popular pressure must be incited against the target government. But popular pressure works only via media channels, and there is some evidence of media clogging or “crowding.” Absent a free press, terrorist dissent in China or Myanmar (Burma) does not work well. Terror is a “western” phenomenon.

Eighth, in dealing with terrorists, governments possess but three options: (a) capitulate; (b) never capitulate; and (c) negotiate. Option (a) is unavailable to most governments who, to safeguard democratic principles, cannot give in to the demands of the unelected. Also, theory predicts that capitulation encourages ever bolder follow-

on acts of terror. India capitulated to a group of hi-jackers that then, it turns out, attacked the Indian Parliament last December. In 1999, Colombian president Andrés Pastrana granted FARC rebels control of territory equivalent to the size of Switzerland, in exchange for peace negotiations, only to have the FARC become even more audacious. It follows that government must oppose terrorists but the response must be carefully calibrated between negotiate but don't capitulate. Regrettably, we have data only on terrorist events, not on the details of negotiation, and we therefore cannot test any theories we might devise.

Ninth, countries can protect themselves from terrorism by offering terrorists safe-haven in exchange for not themselves being attacked. As it turns out, France, Germany, Spain, and the UK do not appear to have been particularly vigilant with regard to "Islamic" fundamentalist terrorism directed, for the most part, at the US. Theory says that, so long as transnational terrorism is directed against any one nation, the other nations have little incentive to help bear the cost of that nation's anti-terrorist operations and requests for anti-terror cooperation. This helps explain why a number of European nations have only in the past few months "discovered" so very many terrorist cells directed against the United States. The hypothesis here is that this happened because the US quickly issued substantial and rather more credible threats against its European allies that made it "cheaper" for the Europeans to cooperate with the US than not to cooperate – at least for the time being. After all, the US is a substantial power and can make things uncomfortable for Europe.

In sum, terrorism is not a "crime of passion." Contrary to public opinion, terrorists do not take lives indiscriminately. Instead, terrorists are rational: they take lives deliberately, or else they use the threat of taking lives as a tool of negotiation to achieve their objectives at least-cost.

Finally, what are the policy-options and prospects? Again with apologies to my aforementioned colleagues, let me highlight a few points: first, government must beware of terrorist rationality, fortify likely *substitute targets*, and direct future terrorist attacks toward substitute targets that are increasingly less costly to the target society; second, government must also beware of *intertemporal substitution* and maintain fortification for considerable lengths of time and not relax its vigilance too early (this implies extended costs); third, government must further beware of *spatial substitution* (from attacks on the US to attacks on US citizens abroad or vice versa, which was why the 11 September 2001 attack came as a surprise); fourth, governments must beware of *target-country substitution*, meaning that if the US protects itself, more attacks might take place on or from other countries (e.g., the attempted Paris-Miami

flight bombing). This raises a collective action problem where the set of target countries will want to free-ride on each others' anti-terror efforts and expenditures. Fifth, government must minimize terrorist resources, both directly in terms of their finances, personnel, and bases of operation and indirectly by genuinely addressing whatever true and honest kernel of grievances may underlie the acts of terror, i.e., government must ultimately starve terrorists of their recruitment base. Sixth, piecemeal anti-terror policy is ineffective because it allows too many loopholes through which terrorist activity will slip. Anti-terror action must be collective and comprehensive. The achievement of either, or both, of these is questionable. Already President Bush is straining to repeatedly remind Europeans in particular to keep doing their part, and that the US government will ever do anything comprehensively strains credulity also.

For further reading

Sandler, Todd. 2002. Course syllabus.

<http://www.ecaar.org/ECAAR/Library/Syllabi/sandler.pdf> .

Sandler, Todd and Keith Hartley. *The Economics of Defense*. Cambridge: Cambridge University Press, 1995.

Sandler, Todd and Keith Hartley. *The Political Economy of NATO*. Cambridge: Cambridge University Press, 1999.

By-line

Jurgen Brauer's most recent book (with J. Paul Dunne) is due out in April 2002, *Arming the South: The Economics of Military Expenditure, Arms Production, and Arms Trade in Developing Countries* (Palgrave). He is vice-chair of Economists Allied for Arms Reduction (www.ecaar.org) and is Professor of Economics at Augusta State University in Augusta, GA, where he can be reached at www.aug.edu/~sbajmb.