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978-0-521-88758-8 - Terrorism, Economic Development, and Political Openness

Edited by Philip Keefer and Norman Loayza

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## Overview

### Terrorism, Economic Development, and Political Openness

Philip Keefer and Norman Loayza

Terrorism is as old as war, but only with the attacks of September 2001 in New York and Washington, March 2004 in Madrid, and July 2005 in London did it become a central concern of governments in the rich countries of the West. This concern prompted policy makers to focus on the potential links to development of both terrorism and the response to terrorism, quickly revealing important lacunae in the literature. To what extent is terrorism related to development? If development is a determinant of terrorism, what are the relative weights of the economic, political, and social aspects of development? And what is the development effect of different responses to terrorism? This volume addresses these crucial questions, synthesizing what we know about the development links with terrorism – and pointing out what we do not.

Policy makers and scholars are concerned with development-terrorism links in both directions: the economic effect of terrorism, but also the development roots of terrorist activity. This volume bridges both, first with contributors who examine the economic and fiscal costs of terrorism and the response to terrorism, and second with others who assess how development affects terrorism, drawing on existing linkages and also reporting on new evidence. The first is a much-investigated issue. Nevertheless, as chapters by Enders and Sandler and Treverton et al. demonstrate, evidence is much more abundant about the costs of terrorism in developed countries than in poor countries. Enders and Sandler also find that the economic costs of terrorism appear to be low in rich countries and, in all likelihood, high in poor countries.

A contentious debate surrounds the second question. Does terrorism relate to development? If it does, is it the economic or another dimension of development that matters? On the one hand, the contributors to this volume present consistent empirical support for the hypothesis that

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political openness and the quality of government are inversely associated with the emergence of terrorist organizations. On the other hand, the research presented here points to continued dispute about the role of economic development. The question is difficult to answer, however, because factors identified as having a significant effect on terrorist activity – such as governance, political openness, and trade openness – also significantly affect incomes.

A key question that we do *not* take up in this volume is the development effect of the largely military and security-based response to terrorism. This is undoubtedly an important and difficult question, but little research on the development effect of either type of response has been carried out. The direct and short-run development costs of military intervention are likely to be large but are unknown with any precision; research into the much more contentious issue of the long-run effects of military intervention on the development of countries that are sources of terrorism is practically nonexistent. Many of the security-based responses to terrorism restrict the free movement of labor and goods from countries thought to harbor terrorists into North America and Europe and also stymie the flow of capital into and out of those countries. These measures certainly have a development effect; whether this effect is large in absolute terms, or relative to the net benefits to richer countries (recognizing that richer countries also incur an economic cost from such restrictions), is unclear.

The unprecedented terrorist attacks of 9/11, which froze financial markets and brought air transportation to a halt in the United States, are a focal point of some contributors: if the costs of terrorism were not dramatic in the case of 9/11, the economic costs of terrorism are unlikely to be the main threat confronting large, rich countries. Both Enders and Sandler and Treverton et al. examine this case. Enders and Sandler conclude that the economic consequences of the 9/11 attacks were large, but fleeting, leading to a small drop (in percentage terms) in national income (\$90 billion over a period in which the U.S. economy generated \$10 trillion worth of goods and services). Growth dropped briefly but quickly returned to its pre-attack path.<sup>1</sup>

Enders and Sandler note, though, that in areas that are still rich on a per capita basis but that have economies much smaller than that of the United States, the economic effects may be large, particularly when the terrorist

<sup>1</sup> It can be argued that the costs of 9/11 are low precisely because of the large security response by the U.S. and other nations' governments. However, even counting the costs of this security response, the economic consequences of 9/11 remain small in proportion to the size of the U.S. economy.

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threat is endemic. They cite evidence from the Basque Country in Spain showing that chronic terrorism can drive income per capita 10 percent below where it would otherwise be, for at least as long as the terrorist threat persists. In addition, even within large rich countries, some industries, such as those connected with travel, suffer disproportionately (even these fully recovered in the United States, however).

Poor countries are also frequent targets of terrorist activity, but scant evidence exists about its economic effects. Enders and Sandler conclude that the available evidence indicates that the costs of terrorism are much greater in small, poor countries. Why the difference between large rich and small poor countries? The reasons are intuitive: large, diversified economies are better able to shift resources to less affected sectors. Moreover, rich countries tend to have well-functioning policy institutions that can respond to shocks adroitly and with ample information.

Treverton et al. focus more narrowly on the budget costs of the response to terrorism in the United States and Britain. Using a number of approaches, they estimate that the incremental increases in U.S. government expenditures that can be traced to 9/11 amount to \$19–\$26 billion per year, most of which has gone to domestic security, or \$69–\$96 billion if the military operations in Afghanistan and Iraq are included.<sup>2</sup> Of these expenditures, \$2–\$4 billion represent incremental annual spending on development assistance. Their evidence does not suggest that wealthy countries have increased assistance to offset the costs of terrorism for the poor countries victimized by terror.

From the discussions in Enders and Sandler and Treverton et al., as well as the review in Llussá and Tavares, we can draw conclusions about the nature of the economic threat to large, wealthy countries posed by terrorism and about the types of policies adopted, at least by the United States, in response to it. Most of the remaining contributors to this volume, by looking explicitly at the development roots of terrorism, offer analyses that help to frame the evolution of policy in the future. They examine the extent to which low incomes directly lead to terrorist activity. However, they also examine other factors, such as weak governance, political openness, and openness to the rest of the world; these other factors may affect both poverty and terrorism

<sup>2</sup> Their estimates of war costs are conservative, based only on cash outlays for the war. Bilmes and Stiglitz (2006) estimate that war costs to date would be approximately 50% higher if one takes into account the increment of total indirect defense spending that should be attributed to the wars, payments made to cover injured and disabled veterans, and the interest on government debt incurred to finance the war.

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and, therefore, exercise both an indirect influence (through poverty) and a direct influence on terrorism.

As the thorough literature review in the chapter by Llussá and Tavares makes clear, comprehensive studies that address the long-run determinants of terrorism are scarce. Policy makers have nevertheless expressed support for three possibilities – poverty, weak governance, and lack of openness. In a 2005 speech, the Secretary of State for International Development of the UK, Hilary Benn, argued that “terrorism can plant its roots in poverty. Corruption, poor governance, economic mismanagement and a lack of representative politics all can play a part in alienating and radicalising poor people.”<sup>3</sup> Andrew Tobias, Administrator of the United States Agency for International Development (USAID), echoed these ideas in April 2006, pointing out that “the locus of national security threats has shifted to the developing world, where poverty, oppression, injustice and state indifference are exploited by our enemies to provide haven for criminals and the planning of criminal acts.”<sup>4</sup> The Danish Ministry of Foreign Affairs notes that the connection between good government, economic development, and terrorism has been assumed, not demonstrated, but accepts as an operating principle “the fundamental assumption that people will be less inclined to embrace extremist fundamentalism and terrorism when they live in an open, democratic society based on the rule of law, where they may exert an impact through free exchange of opinions and democratic participation, and where conflicts are resolved through negotiation.”<sup>5</sup>

Cross-national evidence identifies a nuanced role for *economic* development in reducing terrorist activity. Chapters by Blomberg and Hess support policy maker conclusions that poverty drives terrorism, finding that higher incomes impede terrorist activity. Krueger and Laitin, on the other hand, find little economic foundation for terrorist origins. Why the different conclusions? Krueger and Laitin investigate the overall effects of income across all countries. In “From (No) Guns to Butter,” Blomberg and Hess argue that the effects may differ between richer and poorer countries. Looking at these two groups of countries separately, they find that higher incomes significantly reduce the threat of terrorism in poorer countries, while the

<sup>3</sup> Hilary Benn, Secretary of State for International Development “Connecting People and Places,” Development Studies Association, September 8, 2005. <http://www.dfid.gov.uk/news/files/Speeches/dsa-connect-pandp.asp>.

<sup>4</sup> Speech to InterAction April 10, 2006. <http://www.usaid.gov/press/speeches/2006/sp060410.html>.

<sup>5</sup> “Principles Governing Danish Development Assistance for the Fight against the New Terrorism.” Ministry of Foreign Affairs of Denmark 4.

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opposite holds in richer countries. Pooling all countries, the two effects would cancel out. The aggregate result may then mask the important role of economic development to offset terrorist threats to poorer countries. Because of methodological and data challenges, however, we must recognize that the issue is not yet resolved.

In contrast to the lack of conclusive evidence on whether the poverty of nations is a determinant of terrorism, the evidence is more uniform that individual poverty does *not* make people more likely to support or participate in terrorist activity. In a survey of 6,000 Muslims from 14 countries, the poorest respondents were the *least* sympathetic to terrorism (Fair and Haqqani 2006). Krueger and Laitin, Laitin and Shapiro, and Llussá and Tavares, in this volume, review evidence showing that individual terrorists are neither poor nor uneducated.

The second question of concern to this volume's contributors is whether weak governance and closed political systems foment terrorism. Results in Krueger and Laitin and Blomberg and Hess, though using substantially different approaches, coincide in finding that terrorism is more likely to originate in countries that exhibit closed political systems. Their findings lend strong support to policy maker assertions that good governance and political responsiveness to citizens are fundamental deterrents of terrorism.

Krueger and Laitin and Blomberg and Hess also agree that the economic characteristics of countries affect whether they will be the *target* of terrorist activity. This leads to a provocative dichotomy. The origins of terrorism seem to be in countries that suffer from political oppression; the targets are countries that enjoy economic success.

Economic openness is another factor that affects both economic development and, potentially, terrorism. In "The Lexus and the Olive Branch," Blomberg and Hess turn precisely to the question of terrorism and globalization. Using an innovative approach to explore this question directly, they examine every country-pair in the world (for which data are available). Not only is it the case that poor, nondemocracies are more likely to be the sources of terrorism in rich, democratic countries but also that more trade reduces terrorism between country pairs. Although these results are intuitive in view of recent terrorist attacks in rich countries, they emerge from estimates based on thousands of terrorist episodes recorded in the data.

Blomberg and Hess and Krueger and Laitin focus on cross-national terrorism, the greatest concern of developed countries. Not least because domestic terrorism can lay the groundwork for cross-national terrorism (the infrastructure of domestic terrorism can be used to project terror internationally), the sources of domestic terror are also important. In his chapter, Sambanis

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analyzes domestic terrorism and finds that many of the same causal factors as for transnational terrorism emerge. Globalization, for example, has a dampening effect not only on cross-national but also on domestic terrorism. Moreover, Sambanis identifies striking similarities between the causes of civil war and those of terrorism. The exception is precisely economic development: civil war is significantly more likely in poorer and less open countries, while (lack of) openness alone matters most for domestic terrorism.

The conclusion that terrorists are driven not by personal poverty, but by the political and economic climate of the countries from which they come raises new questions. Why should the social environment be more important than individual income? Why are terrorist organizations more common in countries with difficult political climates? In their chapter, Laitin and Shapiro provide reason to believe that the answer lies in the challenges of constructing a terrorist organization. Even though terrorism is not a purely ideological phenomenon, terrorist organizations depend on ideologically motivated, educated recruits. Unlike, for example, trench warfare, terrorism requires individual initiative and the exercise of judgment. Close monitoring by terrorist leaders of their “employees” is not possible. Ideological commitment helps solve part of this contracting problem. So also does an emphasis on recruiting well-educated individuals, who are most likely to come from more prosperous families.

Laitin and Shapiro emphasize that terrorism is not simply the direct outcome of irrational behavior. Terrorism is a complex strategy to achieve economic and political goals, having roots in distinct cultural and religious differences and using ideological commitment to sharpen its organization. Their conclusion is not surprising and could extend to the role of cultural and religious factors in social conflict throughout history. The One Hundred Years War is just one example of prolonged conflict in the West in which religious motivations were intertwined with other serious economic and political differences.

Their argument explains why terrorists themselves are rarely poor and why terrorist organizations are most likely to emerge in politically closed countries. On the one hand, terrorist organization is difficult and requires individuals with substantial human capital, which is more prevalent in families rich enough to educate their children well. On the other hand, to persuade such well-educated, relatively prosperous individuals to join a terrorist organization in democratic countries is difficult: the ideological payoffs are fewer and peaceful alternatives to terrorist methods are more abundant and effective. This also explains the paradox that individual poverty is less

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associated with terrorist activities than national poverty. National incomes and the political responsiveness of national governments are closely related: political environments that are repressive enough to facilitate terrorist recruitment are less likely to attract substantial investment and entrepreneurial activity.

The conclusions of contributors to this book demonstrate substantial overlaps with policy maker beliefs about the underlying sources of terrorism. Ideology is important, especially in facilitating terrorist organization; political openness and responsiveness to citizens matters, though perhaps mostly in their effects on ideological commitment; economic development plays a nuanced role, which policy makers have also noted – to the extent that low income per capita drives terrorism, it is likely because of underlying factors that affect both national income per capita and the emergence of terrorist organizations. Research does not identify easy policy alternatives but does underline the potential for development interventions as a way to counter terrorist threats.

Broadly speaking, policy makers have four options to draw upon in their response to terrorism: defensive (homeland security); broadly offensive (detecting and eliminating terrorist organizations even if this implies fighting an international war); narrowly tactical (focusing on the individuals and groups who are on the fence between becoming terrorists or not); and developmental (correcting the deep social and economic conditions that breed terrorists). These options are not necessarily mutually exclusive – the military defeat of governments in Germany and Japan in World War II preceded successful economic and institutional development efforts in those countries. However, military objectives usually do not include economic and political development, and development strategies usually have little effect on short-run terrorist threats.

The budget information from Treverton et al. indicates that security and military expenditures have consumed the lion's share of antiterrorism resources in the United States. Development expenditures unrelated to military training or to the military engagements in Iraq and Afghanistan increased, at most, by \$4 billion annually in response to the 9/11 attacks, as little as 5 percent of the annual increased expenditures that they trace to the U.S. response to terrorism. However, development assistance, as outlined in USAID's antiterrorism program, does target the full range of development outcomes that research suggests support the emergence of terrorism, emphasizing elections, education, and economic assistance.<sup>6</sup> More generally,

<sup>6</sup> [http://www.usaid.gov/policy/par05/USAID\\_PAR05\\_Highlights.pdf](http://www.usaid.gov/policy/par05/USAID_PAR05_Highlights.pdf).



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and independent of concerns about terrorism, bilateral and multilateral aid agencies are in the midst of a concerted effort to improve governance in poor countries.

The incremental spending on development assistance that can be directly linked to 9/11 is nevertheless small. It is, therefore, worth reflecting on whether the evidence about the links between terrorism and development might justify a greater focus of counterterrorism resources on development objectives, particularly on governance-related development interventions. Policy makers, while recognizing the importance of development in reducing the long-run threat of terrorism, might nevertheless focus on military and security responses to terrorism for two plausible reasons: the instruments of development agencies for improving governance and political accountability may not be sufficiently effective; and even if development instruments do effectively address the root causes of terrorism, they do so too slowly to mitigate clear and present dangers the growing terrorist threat poses.

Regarding the first point, there is no doubt that debates continue to rage about the efficacy of international assistance. These debates often turn precisely on the difficulties that donors have in persuading government elites to sacrifice their private rents to provide economic and political opportunities to citizens. However, in response to threats to their security, wealthy countries have made it abundantly clear that they are willing to exert pressure on governments that goes far beyond the typical financial conditionality that donors, particularly multinational donors, can apply. The contributions to this volume underline the priority that donors should give to accountability in their development programs in these circumstances.

Hesitation to fully incorporate development concerns into a counterterrorism strategy may also be due to doubts about the efficacy of political development assistance in particular. Research has made substantial progress in identifying specific political features of countries that improve government accountability and performance. Ample evidence suggests, for example, that elections alone are entirely insufficient to ensure the good governance essential to prevent terrorism. If one compares poor countries that hold competitive elections with those that do not, for example, there is little difference in governance performance, as Table 0.1 indicates. Poor democracies and nondemocracies exhibit similar measures of corruption, of bureaucratic quality and the rule of law, and of broader measures of policy accountability, such as secondary school enrollment. Nevertheless, analyses have pointed with some precision to additional factors that are needed to ensure more effective citizen oversight of governments, including citizen information about political performance (see Keefer and Khemani 2005).



Table 0.1. Elections and good government

	Poor nondemocracies (#)	Poor democracies (#)	Rich democracies (#)
Corruption, 1997 (0–6, least corrupt = 6)	2.7 (25)	2.9 (34)	4.1 (49)
Bureaucratic quality, 2000 (0–6, 6 = highest quality)	2.3 (28)	2.4 (30)	4.6 (51)
Rule of law, 2000 (0–6, 6 = highest quality)	3.7 (28)	2.9 (30)	4.6 (51)
Gross secondary school enrollment, 1998 (% of school age children enrolled)	39.8 (34)	45.7 (25)	95.8 (48)

Note: Table reprinted from Keefer (forthcoming), Corruption, Bureaucratic Quality and Rule of Law from Political Risk Services, *International Country Risk Guide*. All other indicators from *World Development Indicators*, The World Bank.

The delays with which development efforts take hold are a more likely reason to focus budget allocations on security responses, if one believes that the threat of terrorism is large and imminent. Countries routinely confront a spectrum of security threats, ranging from armed conflict with other sovereign nations to crime. It is useful to compare the response to terrorism with country responses to threats at either end of this spectrum to better assess how development assistance might usefully fit into future counter-terrorism strategies.

As Enders and Sandler emphasize, a defining characteristic of terrorism is the intent of terrorists to create a perception of risk among the general population that is large relative to the size and capabilities of the terrorist group. To the extent that the menace of terrorism rises to the level of national security threats characterized by massed hostile armies and blocked sea lanes, no rational government would consider leavening its military response with development assistance; such assistance would await the resolution of the military conflict.

It is possible, for example, that countries might foment terrorism in lieu of conducting international warfare by traditional means, particularly if they are poor and their enemies are rich and have well-endowed conventional armies. To the extent that this is true, a military response to terrorism is a natural and potentially least-cost method of reducing terrorist activities. It seems difficult to characterize terrorism purely in this way, however, as a manifestation of government-government conflict. Even if in some cases

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transnational terrorism has been an instrument of governments, it is also evident that when supportive governments fall, terrorist organizations continue to operate, suggesting either that they are not particularly dependent on the support of governments or that the supply of those supportive governments is large.

Crime lies at the other end of the security spectrum from war. It imposes greater risks on citizens in developed countries than does terrorism, at least measured in number of lives lost. To take one example, in the United States, the Federal Bureau of Investigation reports approximately 16,000 murders per year over the past decade (16,528 in 2004). This is approximately six times the number of people who died on 9/11 and more than a thousand times greater than the number of Americans who died in terrorist incidents in a typical year prior to 2001.<sup>7</sup> Compared with the Enders and Sandler estimate of the economic costs of terrorism (that the *total* cost of the 9/11 attacks to the U.S. economy was \$90 billion of lost output), Anderson (1999) estimated the cost of crime in the United States to be more than \$1 trillion annually.

The response to crime also routinely includes a mix of policy options (military/police, defensive/security, developmental, tactical). With respect to the allocation of effort among different crime-fighting strategies in the United States, the latest figures on total criminal justice expenditures, from 2003 (covering city, state, and federal governments and including police, courts, and corrections) amounted to \$185.5 billion, of which \$83 billion went to police. It is difficult to quantify the costs of U.S. efforts to pursue a “developmental” strategy to reduce crime. However, economic assistance to the poor is roughly similar to the economic development strategies that donors have adopted to mitigate terrorist threats in poor countries. Such assistance includes public education, including special education programs; health care (through Medicaid); social interventions of various kinds; and direct transfers.

If one looks only at money transfers to the poor, excluding all other government programs, the proportion spent relative to criminal justice expenditures is far larger than the ratio of developmental assistance to homeland security and military operations in the U.S. government’s counterterrorism strategy. The Department of Health and Human Services spent \$48.7 billion in 2005 (the latest period available) on the Administration for Children and Families program.<sup>8</sup> The Social Security Administration spent \$40.9 billion

<sup>7</sup> [http://www.fbi.gov/ucr/cius\\_04/offenses\\_reported/violent\\_crime/murder.html](http://www.fbi.gov/ucr/cius_04/offenses_reported/violent_crime/murder.html).

<sup>8</sup> Department of Health and Human Services. *Budget in Brief*. 2007. <http://www.hhs.gov/budget/07budget/2007BudgetInBrief.pdf>.