

1 Introduction

Terrorism – use of unlawful violence to impart fear – is as old as history itself (Laqueur, 1987; Law, 2015, 2016; Chaliand and Blin, 2016). “Modern” terrorism finds its roots in the wake of the French Revolution and the Jacobins – the most influential and extreme political group of the period. With Maximilien Robespierre as the main public figure, they instituted what is now known as the “Reign of Terror,” a period marked by extreme violence and the persistent threat thereof. “[While] fixated on eliminating as many people as possible who could challenge the new revolutionary order,” writes Randall Law (2020: 87, emphasis added), “Robespierre and his colleagues understood they could not kill them all. Hence, this *policy of terror* was intended to destroy those enemies who fell into the government’s clutches and intimidate the rest, even if they had not yet committed an overt act of counter-revolution.” Writing elsewhere about the Reign of Terror, Law (2009: 62–63) states: “[W]e could say that the Terror was perversely educational since a primary goal was to shape the mind and behavior of the populace. This was the advent of modern terrorism, if not in form, then in function.”

Though the world has experienced terrorism for ages, the seemingly unending, intensive focus on the topic is more contemporary. The attacks on the World Trade Center and the Pentagon on September 11, 2001, and the ensuing twenty-year “War on Terror,” have prompted policymakers, scholars, and the general public to think about terrorism as never before. Since 9/11, thousands of articles in economics, sociology, psychology, military studies, and other disciplines explore issues related to the topic. Even a cursory search reveals the absolute explosion of research on the subject. Between 2018 and 2021 alone, at least 9,700 academic articles on the topic were published. If we look over the same period, more than 21.2 million popular press articles discuss terrorism.¹ This does not include the myriad television and news broadcasts, podcasts, and other media dedicated to the topic. For those alive in the period after 9/11, terrorism – and the policies intended to thwart it – is everywhere. From added security at movie theaters, sports arenas, and the airport, to increasingly alarmist television news broadcasts and speeches, press conferences, and debates by elected officials, discussions of terrorism, the impacts of terrorist activities, and the war against it are now an ever-present feature of daily life for many around the world. Whether we are traveling, banking, or just watching television, the war on terror permeates everyday life (see Coyne and Hall, 2021).

¹ Review of articles on Google Scholar related to “terrorism” narrowed by date.

Within economics, research on terrorism falls into two main categories.² One of these strands of literature engages with the study of terrorism from a *microeconomic* perspective, analyzing the choices faced by individual actors (see, for example, Pape, 2003). The second strand of literature takes a *macroeconomic* approach to exploring terrorism, examining how aggregate factors such as high unemployment and low economic growth correspond to outcomes related to terrorism (see, for example, Shughart, 2011).

Within the microeconomic vein, several themes and important insights emerge. Despite popular narratives that those engaged in terrorist activity are prone to mental illness, scholars agree that mental illness does not properly define terrorist behavior (Caplan, 2006; Shughart, 2011; Capellan, 2015). Similarly, despite frequent discussions of a “common” terrorist profile, research has not found any systematic way to describe terrorist actors – including both terrorism more broadly and suicide terrorism more specifically (see Pape, 2003 and Bhui, James, and Wessely, 2016).

Although the theory is not without dispute (Abrahms, 2008), rational choice economists within the microeconomic literature provide important evidence that terrorists operate as *rational actors* (Kydd and Walter, 2006). That is, terrorist actors undertake terrorism activities to obtain some end – an ideological or a political goal (Crenshaw, 1981; Enders and Sandler, 2000; Berman, 2003; Pape, 2003; Wintrobe, 2006; Hoffman and McCormick, 2004; Sandler and Enders, 2004; Anderton and Carter, 2005; Berman and Laitin, 2005; Caplan, 2006; Iannaccone, 2006; Shughart, 2006, 2011; Sprinzak, 2009; Sandler, 2015), financial reward, elevated status, or greater access to social services or education that is otherwise inaccessible (Zakaria, 2003). Like other actors facing scarcity, terrorists respond to their given environments, weigh the perceived costs and benefits when considering terrorist activity, and select action plans from their given choice set (Berman and Laitin, 2005; Caplan, 2006; Abrahms, 2008). Considering the relative costs associated with terrorist activities, terrorist perpetrators decide not only whether or not to participate but also their degree of involvement. While avoiding active participation may lessen the physical costs of a failed attack, it also weakens the individual’s claim to first pick of the bounty in the event of success (Shughart, 2011).

While certain factors may alter terrorists’ cost–benefit calculations, efforts to define macro-level, universal economic determinants of terrorism – such as poverty, demographics, and so on – have largely failed when controlling for institutional and political factors (Krieger and Meierrieks, 2011). While failed

² For literature reviews of the scholarship on the economics of terrorism and counterterrorism, see Bueno de Mesquita (2008), Schneider, Brück, and Meierrieks (2014), and Gaibullov and Sandler (2019).

or failing states, or states experiencing war, are more likely arenas for terrorists' activity, these factors alone are insufficient for explaining terrorism (Coggins, 2015). Scholars find the most significant contributor to terrorist affiliation to be a lack of civil liberties, rather than specific qualities of any given region, demographic area, race, or ethnicity (Hassan, 2001; Krueger and Malečková, 2003; Lee, 2011).

A country's political freedom and history of political transitions can help explain its experience with terrorism (Abadie, 2006). Poor institutional environments effectively lower the opportunity cost of engaging in terrorism, as individuals have few ways to peaceably voice discontent or participate in markets to improve their conditions in a scalable way. Embedded in these institutional inadequacies is the fundamental failing to protect property rights, such protection being necessary for robust markets. A healthy domestic economy not only lowers the risk of ethnic violence but significantly lessens the chance of ethnic tension culminating in transnational terrorism (Basuchoudhary and Shughart, 2010). Ethnic fractionalization and distinctions are ubiquitous, but violent conflict is not (Fearon and Laitin, 1996). Understanding these institutional constraints is integral to making sense of seemingly "irrational outcomes" – willing involvement in violent activity, suicide bombing, and so on – under the rational actor model.

This Element draws on insights from Austrian economics and public choice economics to understand both the contextual and the emergent nature of terrorism with a view to informing policy and statecraft in fighting terrorism. Applying these insights is important for understanding the complex global network of terrorism, the economic foundations for such behavior, and the persistence of terrorist organizations despite worldwide efforts to detain and punish perpetrators of terrorism.

Consensus on a universal definition of terrorism is lacking (see Schmid, 1983; Weinberg, Pedahzur, and Hirsch-Hoefler, 2004; Lutz and Lutz, 2005: 6). The post-9/11 increase in terrorism-related scholarship has done nothing to alleviate this lack of agreement. Particular hurdles to a universal definition include legal considerations, the tendency to conflate terrorism with other forms of political behavior (see Rathbone and Rowley, 2002), and subjective value judgments about behavior (e.g., one person's "terrorist" is another person's "freedom fighter") (see Kennedy, 1999; Ganor, 2002; Sageman, 2008; Shughart, 2011).

We employ the definition of terrorism generally adopted by US government agencies. The Department of Defense (DOD) defines terrorism as "the unlawful use of violence or threat of violence, often motivated by religious, political, or other ideological beliefs, to instill fear and coerce governments or societies in

pursuit of goals that are usually political” (Joint Chiefs of Staff, 2014: vii). We use this characterization of terrorism for three reasons.

First, this definition captures the essential elements of what is generally accepted as terrorism: (1) the unlawful use of force, (2) activities conducted for the purpose of instilling fear beyond the terrorist event, and (3) activities undertaken with the goal of instituting political change. Importantly, this definition separates “terrorism” from violent and suppressive activities committed by states; that kind of “state-sponsored terrorism” is outside the scope of this Element. Second, this definition aligns well with what the literature has identified as the purpose of terrorist activities. Terrorists look to create psychological repercussions that extend beyond the attack and target (Crenshaw, 1995; Hoffman, 2017: 43; Ackerman et al., 2006). This definition illustrates that terrorism is purposive action on the part of terrorist actors. It is a means to an end – intended to induce some form of change – political or otherwise. This is important as terrorism is yet another form of purposive human action; this places terror activity in the analytical domain of political economy. Third, this definition allows us to better analyze counterterrorism policy, using the government’s own definition. We will be better able to ascertain whether counterterrorism policy is obtaining its desired results and if not, what can be done differently.

We proceed as follows. Section 2 provides a discussion of the foundations of the economics of terrorism, emphasizing that terrorist behavior is purposeful and goal-oriented, that all of the decision-making processes of terrorists and terrorist organizations entail subjective evaluation of costs and benefits, and that the terrorist market, like all others, consists of suppliers and demanders. From this perspective, terrorism is a phenomenon that can be traced to the individual choices of people embedded in a complex set of institutions.

In Section 3 we turn to counterterrorism policy. We consider three categories of policies – income-based policies, price-based policies, and opportunity cost-based policies – and discuss the economics of each. We then discuss the importance of institutions for counterterrorism policy. Institutions matter because without changes to the deeper environment that incentivizes terrorism, the root cause will persist. Income- and price-based policies might reduce terrorism in a particular time and place, but, absent other changes, these policies will not reduce the underlying demand for terrorism itself. Given this, we then discuss the implications for institutional change and the feasibility of such efforts.

Section 4 considers three dilemmas facing liberal societies related to counterterrorism efforts: the vulnerability of liberal societies to terrorism, the potential erosion of liberal values in general, and the possible permanent expansion of

government and loss of domestic liberties. To engage in this discussion, we present two alternative models of government growth. The first, the trade-off model, views liberty and security as a trade-off balanced by a well-functioning democratic government that seeks to maximize the welfare of its citizens. The second, the ratchet effect model, offers insight into how government can permanently grow (in scale and scope) in the face of a crisis. We discuss the pathologies of democratic decision-making and how these frictions can influence counterterrorism policy.

Section 5 provides an assessment of the US government's war on terror, which turned twenty years old in 2021. We discuss the origins of the war, whether it can be judged a success or a failure (relative to the baseline set by those who initiated it), and some of the main effects abroad and within the United States. Section 6 concludes by putting forward several areas for future research.

2 The Economic Foundations of Terrorism

Purposive Plans and Actions

Terrorism is an emergent phenomenon; it arises from the culmination of calculated choices, and those choices can change. Terrorists and aspiring terrorists act after they assess the likely outcomes of their plans; as such, terrorism falls within the category of rational choice. Societies plagued by high or increasing levels of terrorism represent an emergent order of violent competition and plunder rather than the peaceful cooperation facilitated by the market order. Terrorists are goal-oriented (Shughart, 2011) and their plans are “calculated and systematic” (Hoffman, 1998: 15). This is consistent with Mises (1998) who noted that people act purposefully to achieve their goals. Just as we would state that a businessman acts to generate profit or a politician acts purposefully to win reelection, we can say the same for a terrorist. A terrorist acts to obtain some end.

Terrorists face resource constraints in terms of the budgets, time, and knowledge available to them. They must choose how, when, and where to allocate their scarce resources (Shughart, 2011). Each choice carries with it an opportunity cost – or the next best alternative that must be forgone. For example, the decision to dedicate time and human capital to carrying out a specific attack means fewer resources available for alternative plans. Terrorists choose to allocate their time and capital across an array of activities, both legal and illegal, violent and nonviolent. The ultimate mix of activities selected will be based on their own subjective perceptions of the relative costs and benefits of each activity. As we would expect any other economic actor to change their behavior

when circumstances change, so the terrorist will adjust to changing costs and constraints. Policies can make things temporarily more costly for terrorists, but if the underlying issues that cause people to demand terrorism – that is, the contextual environment and the terrorists’ perceptions of the rules and constraints – do not change, we will forever be fighting and creating the unintended consequence of more, rather than less, terrorists and terrorism.

Some post-9/11 scholarship on terrorism has attempted to ascertain whether terrorists have a “type” – that is, universal or common attributes that explain who becomes a terrorist and why. These attempts to typify a terrorist have been largely unsuccessful; not poverty, race, religion, employment, or social status alone can create a terrorist profile (Laqueur, 1999; Pape, 2005; Shughart, 2011). The motivation behind uncovering some single “profile” is rooted in policy. If authorities could identify would-be terrorists prior to their actions, they could implement policies to stop them. But such an understanding of terrorism fails to appreciate the underlying economic problem facing terrorists and potential terrorists. Terrorists are not some monolithic group; rather, they are individuals who assess their environments and act based on their own subjective valuations. Changing the costs and benefits faced by terrorists will alter their behavior, but effectively changing incentives surrounding possible terrorists is no simple matter.

The modern terrorism of al-Qaeda, Islamic State in Iraq and Syria (ISIS), Hamas, and others is illustrative. Each group, through its various activities, uses violence and other means in an effort to achieve particular ends. To understand al-Qaeda, for example, we must apply the logic of human action to the individual actors within the organization and see al-Qaeda as an emergent phenomenon, part of the “third wave” of post-World War II terrorism (Shughart, 2011). This includes attempting to understand the conditions influencing the perceived costs and benefits facing specific terrorists, and the organizations to which they belong. As conditions and perceptions change, so too do the costs and benefits as perceived by terrorists.

To provide an example of evolving conditions, consider that the third wave of modern terrorism is tied to the Iranian Revolution of 1979 (Enders and Sandler, 2000). This wave of terrorism was exacerbated by the collapse of the Soviet Union in the early 1990s and a decade of fighting against the Mujahideen in Central Asia (Shughart, 2011: 6). Those specific political conditions contributed to the formation of the terrorism we see today, which continues to morph and adapt.

Osama bin Laden, the founder and cult personality within al-Qaeda, clearly stated his grievances about American intervention in the Middle East, and how Saudi Arabia was the impetus for al-Qaeda’s emergence. In a 1996 interview, bin Laden stated:

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The ordinary man knows that [Saudi Arabia] is the largest oil producer in the world, yet at the same time he is suffering from taxes and bad services. Now the people understand the speeches of the ulemas in the mosques – that our country has become an American colony. They act decisively with every action to kick the Americans out of Saudi Arabia. What happened in Riyadh and [Dhahran] when 24 Americans were killed in two bombings is clear evidence of the huge anger of Saudi people against America. The Saudis now know their real enemy is America. (quoted in Foreign Broadcast Information Service, 2004: 12)

The Taliban emerged in 1994 in Afghanistan in response to the Soviet invasion and imposed an authoritarian Islamic state over three-quarters of Afghanistan until 2001 (Katzman and Thomas, 2017). After the US withdrawal from Afghanistan in 2021, the Taliban regained control of the country. In addition to the Taliban, the most prolific terror groups today – ISIS/Islamic State of Iraq and the Levant (ISIL),³ Boko Haram, and al-Shabaab (Institute for Economics and Peace, 2020: 15) – all fall under this third wave of post-World War II terrorism. As conditions change, we should expect terrorism to change, in both the organizing principles of the groups and the tactics they use.

Even the most ruthless terrorist groups, such as IS, respond to incentives. In its early days, IS was quite successful as a terrorist group; it was able to drive Iraqi security forces out of key cities and to capture the city of Mosul in Iraq (Al-Salhy and Arango, 2014). It pursued ostentatious and brutal tactics, including releasing videos of beheadings and executions.

At one time IS had 30,000 fighters, an annual budget of a billion dollars (Fawaz, 2016), and the support of military affiliates in 12 countries (Zavadski, 2014). As a point of comparison, consider that at the time of the 9/11 attacks (estimated to cost a mere \$500,000) al-Qaeda had a budget of 30 million dollars per year financed through Islamic charities and donors (Roth, Greenburg, and Wille, n.d.). Yet no matter its financial prowess or its military manpower, IS was damaged by forces that fought against it in 2014 under Operation Inherent Resolve, killing thousands of its troops and reducing its financial strength (*Straits Times*, 2017). The costs rose, the targets hardened, and ISIL lost key territories, which forced members to retreat and redirect their efforts.

Policymakers considered the fight against ISIL to be a success. However, what did not change were the underlying conditions that made joining ISIL attractive in the first place. Terrorism is an effort to obtain social change. As such, we must assess why terrorism is an attractive option relative to

³ The names ISIS and ISIL are used somewhat interchangeably but the group has called itself Islamic State (IS) since 2014 when it declared itself a global caliphate. It is an Islamist jihadist militant group that subscribes to a Salafi jihadist doctrine within Sunni Islam. It was founded in 1999 and pledged its allegiance to al-Qaeda.

alternatives. This matters for the way we think about the efficacy of counterterrorism policies in both the short term and the long term.

Supply of and Demand for Terrorism

Terrorism is about the use of violence and fear to engender political change. For most people living in societies with economic, human, and political freedom, the cost of engaging in terrorism is high relative to the expected payoffs. In cases where economic, political, and other forms of freedom are weak or absent, terrorism is more likely to emerge because the opportunity cost of engaging in terrorist activities is comparatively lower.

Terrorists can act independently – that is, be “lone-wolf” terrorists (see Kenyon, Baker-Beall, and Binder, 2021) – or as part of a group. Terrorists and terrorist organizations can be understood through the lens of economics. Like all human actors, the terrorist must weigh the expected benefit against the expected costs of group membership. The leadership must make similar calculations when forming the group. The challenge for the terrorist organization is like the challenges facing other organizations, which entail aligning the incentives of the participants and the leadership in the pursuit of the organization’s overarching mission. The rewards and internal incentives for terrorist members must be aligned with the overall goals of the organization for the group to be successful.

We can conceptualize terrorism as we could any other economic good – being both demanded by hypothetical consumers and produced by hypothetical suppliers. From the consumer side, we consider a consumer’s willingness and ability to pay for terrorism relative to other alternative goods. The higher the price of terrorism, the less terrorism is consumed by potential “buyers.” Just as conditions in the market for butter or automobiles change the overarching demand for butter and automobiles, changing conditions alter the demand for terrorism. Changes in preferences or ideology, expectations about the future, income, the price of complementary or substitute goods will all change the demand for terrorism. To the extent that terrorists provide collective or public goods to their members and beyond, terrorism solves collective action problems within societies (Oberschall, 2006), which will contribute to the demand for the activities of the terrorist organization.

Terrorists on the supply side organize into nonprofit, paramilitary organizations, or act as proto-states. They operate like a nonprofit bureau in which they raise their own revenues through legal and illegal means and through donor contributions. To provide an example, in a post-9/11 raid in Bosnia, authorities discovered documents related to what members of al-Qaeda referred to as the