

On Hobbes, Social Contracts and Constraints:  
A Brief Look at the Economic Implications of Terrorism

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### Abstract

Politics and economics are inextricably linked; the fathers of modern economics referred to the genre as political economy. As such, acts of violence designed to exert pressure on political institutions and achieve certain objectives have a pronounced, if often subtle, effect upon the economy. Much study has been given over to the study of terrorism in terms the social sciences: political science, military science, psychology, international relations, etc. In keeping with this academic convention, this paper seeks to look at terrorism through the lense of economics, presenting the actors as members of the market with their own unique combinations of utility and constraints. Utilizing the relevant literature, it also seeks to assess the impact, both direct and indirect, terrorism has on a nation's economy, and provide a point of emphasis for public policy.

## **A Brief Look at the Economic Implications of Terrorism**

### **Defining the Issue**

In order to assess the various implications of acts of terrorism, it is first necessary to provide some sort of working definition for what terrorism is. Intriligator (2010) defines terrorism as “the use or threat of use of violence to achieve political objectives through intimidation” (para. 2). The purpose of the terrorist is to exert pressure upon political institutions by shattering the belief the public has in those institutions to provide a reasonable measure of security. Its aim, then, is to void the social contract.

Ascribing to Hobbes, Sznajder (2006) observes “Life under the threat of terrorism has the constant potential of being ‘solitary, poor, nasty, brutish, and short’” (p. 8). This, according to social scientists, is what men entered into civil societies to act as proof against. In essence, the modern state was created as “as a means to avoid civil war and as a means to create peace by monopolising the means of violence” (p. 6). It was posited that men would live in peace with one another only so long as the great Leviathan possessed the only means of shattering that peace. Williams (2009) concurs, noting “Equality in the sense of the ability to kill one another fuels competition for the resources entailed by people’s (material) interests... Without the artificial constraints of a state, then, we will necessarily be reduced to this state of war” (p. 93, 94). Terrorism, then, calls into question the efficacy of this social contract. With all of the resources at its disposal, if the Leviathan is not able to provide protection from a relatively small group of social dissidents, what is the benefit of living under its rule?

Having established the overarching theme of the terrorist, the link between the arbiters of the social contract and the economy must necessarily be established. For the purposes of this

paper, it is assumed that the Hobbesian view of the origins and purposes of civil society is accepted. Necessarily, then, it must be noted that in order to maintain order, stability and provide for the common peace, certain costs must be assessed to those living within the auspices of the contract. There must, then, be some form of marketplace from which these costs can, indeed, be assessed. As McNair (2009) observes, “when governments are dependent on the economic activity of their own citizens...they will truly act in their interests” (p. 33). This is somewhat of a redundancy; all governments, regardless of form, are to some degree dependent upon the economic activity of their own citizens.

As such, it is in the interests of all, especially the state, that they provide for and affect policy that maintains a large degree of vibrancy in the marketplace. By collecting a portion of every man’s labor as their contribution to the maintenance of the social contract, the state allows itself to remain viable. Any disruption to the fabric of the public order necessarily causes disruption to the economy of that order. While, the state is not necessarily the economy, nor the economy necessarily the state, they are inescapably connected. One cannot long exist without the other.

As such, intentional or not, acts of terrorism are acts within the marketplace and terrorists are economic agents. Intriligator et al. (2010) agrees with this assessment, noting that acts of terrorism involve “interaction between terrorists and antiterrorists as economic agents with equilibrium prices and quantities” (para. 9). Both agents must operate under whatever constraints there situation imposes upon them, maximizing utility and keeping an eye upon opportunity costs. The remainder of this paper takes a brief look at these constraints, how each party seeks to operate within said constraints, and the impact this competition has upon society.

### **Disruptive Flows of Violence**

That terrorism has a decided impact upon the economy of the victim state is hardly in question. Jamal (2010) points to studies that show empirically that “productivity and growth decline in areas where the threat of terrorism escalates” (para. 1). Schneider, Bruck and Meierrieks (2010) (2010) agree, noting “terrorism may damage economic growth and globalization, e.g., by reducing trade flows and investment flows”(p.4). The market is a voluntary construct in which confidence is the key psychological variant necessary for continued and efficient operations. Men will trade in the face on many adverse conditions, even coercion, so long as they remain confident that the trade somehow benefits their overall level of security.

The direct economic implications of terrorist actions are relatively simple to assess. As Scneider at al. (2010) note, “Estimating these impacts requires accounting for the physical destruction of buildings and infrastructure and losses of human life or capabilities” (p. 32). This is the stuff of a simple risk analysis; add the costs of damage real property, estimate the loss in revenue, and adjust for the effects of accumulated appreciation/depreciation. To this, add the estimated cost of loss wages, adjust for relevant tax receipts, and one has a reasonable idea of the direct costs of any attack. Not only are governments and firms fully capable of such assessments, a reasonably intelligent individual; with access to public information and a spreadsheet program could come to a fairly accurate assessment of the matter.

Were it truly this simple, insurance agencies would serve as the first line of offense against terrorists. Moreover, it is unlikely that their actions would disrupt the market in any meaningful way; in the grand scheme of things, the direct costs of these actions are comparatively minimal. The rub, as Enders and Sandler (2006) note, is that “calculating the associated cost of any attack is difficult, since, unlike traditional crimes, terrorism is designed to

create a general and ongoing atmosphere of intimidation and fear” (p. 204). These hidden costs, economically speaking, are the terrorists’ most effective weapon.

Blomberg, Hess and Tan (2011) refer to this as the economics of trust. To fully understand its impacts, they posit, one must understand that “terrorism can reduce economic growth through destroying production inputs, diverting resources away from economic production to enhancing national security, and interrupting economic activity by disrupting household and business spending plans” (p. 384). Thus, while every additional terrorist incident per million people leads to a 1.5% decline” in verifiable local revenue, the hidden costs are exponentially higher.

### **Comparative Disadvantage: Defeating the Constraints of the Non-State Actor**

It is a universally accepted economic principle that everyone works under constraints. Resources are limited, and are often allocated through mechanisms widely beyond the control of the common citizenry. As previously noted, sovereign states maintain their existence by assessing a portion of the incomes of the citizens of that state. In a manner of speaking, the resources of the entire populace are, to varying degrees, at the state's disposal. While this does not defeat the problem of limited resources, it gives the state a comparative advantage over any one individual, or even a relatively small body of individuals.

It is against this backdrop that the terrorist operates. Most terrorist organizations operate as non-state actors. Schneckener (2006) provides a working definition of non-state actors as a individual or group of individuals that is "1) willing and able to use violence for pursuing their objectives; and 2) not integrated into formalised state institutions such as regular armies, presidential guards, police or special forces" (p. 25). As a note, some organizations work as sub-state-actors who operate by under the tacit approval of a sovereign state, and may even receive clandestine state funding. They shall not be the focus of this discussion; however, it must be noted that they operate under a similar system of constraints as the non-state actor, albeit with greater resources and a safe haven.

Due to relatively limited resources, Intriligator et al (2010), notes that it is the constant duty of the terrorist to engage in "maximizing utility in terms of inflicting damage subject to constraints on funding, personnel, technology, etc. leading to the supply of terrorist acts as a perverse type of 'good' from the vantage point of the terrorists" (para. 6). In any economically vital state, a single act of terrorism, no matter how spectacular, will have a negligible effect in

terms of direct dollars, so the terrorist must figure how to get the most “bang for his buck,” so to speak. The answer lies somewhere in a rational expectations theory of the marketplace.

To simplify this concept, the actors in a marketplace have a generally good idea of what to expect when completing any transaction. Past experience reinforces these notions; if Buyer A has had a previous positive experience in purchasing Item B from Seller C, then it is rational to expect that a similar transaction with Seller C will result in a comparably positive experience. Conversely, the same is true of negative experiences. One who has had a root canal knows what to expect if another root canal becomes necessary; unpleasant necessity may drive this transaction, but both parties have a reasonable expectation of satisfying their individual needs.

Macroeconomically, rational expectations guide markets even through periods of shock, so long as this shock has been experienced before and can be accounted for. A sudden decline in the stock market usually leads to resurgence in the bonds market. Experience has taught that bond yields become more attractive when stocks lose value, and vice versa. Even natural disaster has only a temporary effect upon the economy, even when that effect is comparably large. As Richardson, Gordon and Moore (2007) note, “If a shock (flood, earthquake) destroys a nontrivial part of the capital stock of an urban area, then recovery, manifested by rebuilding and replacement, depends upon the expected rate of return of the new capital in the old location” (p. 159). If the benefits of rebuilding are deemed to outweigh the costs of future disasters, or if the disaster is deemed to be an occasional event, the citizens will rebuild. If not, they will move on elsewhere.

A well-performed act of terrorism maximizes limited resources by defying rational expectations. Equity markets cycle, earthquakes happen, but premeditated acts of violence cannot be accounted for. Ironically, the limited resources of the terrorist acts in his favor.



Because his major concern is maximizing the utility of his actions, there can be no prediction of what, when or where his next action will be. If this knowledge is not immediately available to him, it cannot then be available to the public whose sense of security he has shaken, nor to the state's counterterrorism agents who must act as proof against his next act of aggression.

This explains the terrorists' predilection towards choosing targets that will generate large amounts of publicity or are endemic to the victimized nation's national psyche. As Shapiro and Siegel (2007) astutely note, most terrorists realize that with the disparity between their resources and those of the state with which they are aggrieved, "their chances of getting particularistic benefits out of doing so are quite slight given the low likelihood of overthrowing the government" (p. 407). As such, they must challenge the notion that the only purpose of the modern state is "the assumption that people have to give up their liberty in order to be safe" (Sznajder, 2006, p. 8). In other words, they must engage in actions that have a mushrooming effect, leaving it to an unwitting populace to further the impact of their actions. By creating uncertainty of rational expectations, they do just that,

This has led Enders, et al. (2006) to note "Terrorism is a powerful weapon that exploits crucial asymmetries between governments and terrorists to governments' disadvantage and terrorists' advantage" (p. 288). It damages the trust between the state and its citizens, necessitating a shift of resources not only to combatting the threat, but in regaining that trust, even if that trust involves a tradeoff between liberty and added security. The history of terrorism, then, is the story of enterprising non-state actors astutely turning a disadvantage into a decided advantage.

### **The Constraints of Counter-Terrorism: A Comparatively Disadvantaged Advantage**

In protecting against the incursion of further terrorist activities into their fiefdoms, the governing mechanism of sovereign states operates under an entirely different set of constraints. While their resources are certainly not inexhaustible, they have a decided advantage over non-state actors in terms of resources. Simply put, while a terrorist organization can raise funds from sympathetic parties, governments have no need of sympathizers to further their cause. They possess the power of the tax receipt.

As such, Intriligator (2010) notes, governments, and more specifically government counter-terrorist personnel, are in the business of “maximizing utility subject to constraints, in terms of seeking both protection from terrorism, risk reduction, ... (and) risk perception effects on economic decisions to prevent terrorism” (para. 7). Their constraints tend to be ones of opportunity cost, shifting resources from other priorities to address a threat that is difficult to identify, or predict with any level of certainty.

Enders et al. (2006) observe “enhanced expenditure on homeland security does not include the tens of billions of dollars spent on terrorism-related military operations” (p. 288). Moreover, “Antiterrorism actions redirect government funds away from social welfare, education, highways, and scientific research” (p. 288). While it is theoretically relatively simple, given the necessary clearances and a great deal of persuasive power, to estimate the number of dollars being diverted towards military operations, it is impossible to assess the compounded opportunity costs of diverting scarce resources away from such areas as social programs, research and education.

In diverting resources away from other areas that have value for society, counter-terrorism efforts have the unfortunate side effect of heightening expectations. To the credit of the

terrorist, these expectations are rarely, if ever, truly rational. Trust has been breached, liberties have been sacrificed and government services once taken for granted have been necessarily reduced. Even were a government to counter a possible reduction in services by increasing tax levies, the end result would be the same, psychologically, as a reduction in services. Terrorism represents the rare case in the market where the party with the comparative advantage begins the transaction at a disadvantage.

### **Drawing Conclusions**

All that has been proven here is that it is difficult, if not impossible, to give an accurate picture of the true economic impact of acts of terrorism. This is acceptable, as this result was always the premise. This does not mean, however, that certain valuable conclusions cannot be drawn, and that policymakers and counter-terrorism actors would not derive benefit from drawing these conclusions. The first conclusion is that terrorism is an inverse form of market activity, in which the disadvantaged party begins the transaction in the position of power. This alone gives experts a valuable starting point, giving them (with creative thinking), the ability to trace an action backwards, with the conclusion as the premise.

It can also be said that terrorism involves three distinct set of actors; the aggrieved party (the terrorist), the victimized state, and the general population. All three parties are impacted economically in different ways, but these impacts are linked and follow some semblance of a reasonable pattern. As per the public, “When terrorists strike consumer and business confidence weakens” (Jamal, 2010, para. 4). This is to be expected, as the fear engendered by the terrorist act erodes trust in the social contract, establishing an aberration of rational expectations.

Perhaps Schneider et al (2010) describe this phenomenon best, noting that acts of terrorism cause public injury via

“(i) direct impacts through losses in physical and human capital, and... indirect impacts that emerge as consequence of the distortion of the economy...they themselves may influence the economy through their immediate responses to the violent shock that occurred” (p.32)

In essence, losses are incurred and spending patterns distorted. With little in the way of being able to assess what happens next, the efficacy of the market comes into question. This is the

(admittedly simplified) indirect impact. Just like with any downturn in the market, the key to mitigating the economic losses incurred by the public is to restore the public's psyche, but without rational expectations, this is a task easier said than done.

The economic impact on government is a bit more difficult to quantify. Governments are little more than representations of the tacit agreement of the public to be governed. They are actors within the economy, but it is the economy that provides the resources whereby they exist. In a very meaningful way, whether they simply create the environment in which the cycles of supply and demand operate, or they control the supply and thus manipulate the demand, they are beholden to the market for their daily bread. Although the power of the levy is a powerful resource, there can be no levy if there exists nothing from which to assess levies. As such, the state is bound to protect its citizens, but it needs its citizens in order to survive. The inverse is not necessarily true, as the continued astronomical birth rates in any number of failed states would attest to,

No matter how healthy and vital the state, ultimately its receipts are limited, but its mandate to protect its citizens is not; it is, presumably, the only true reason for its existence. Its direct costs derive from its portion in rebuilding damaged or destroyed physical capital, loss of tax receipts from a temporarily depressed market, and the direct costs inherent in reducing risk. What cannot be measured with any accuracy are the opportunity costs involved "engaging in an impossible task of trying to protect vulnerable sites given the possibility of substitution and the enormous number of potential terrorist targets" (Intriligator, 2010, para. 5), tying up national currency in defense schemes and security operations (thus preventing it from being productively allocated in the marketplace), or the diminishing of public trust.

For the terrorist, assessing their gain and loss is the easiest of the three. As Enders et al. notes, “terrorists can force governments to spend ever-greater amounts on defense, thereby being a costly nuisance” (p. 290). Simply put, their actions act as an economic multiplier. For every dollar lost in the marketplace, every loss of household income to injury or death, every diminished tax receipt and every diverted dollar that goes to defense rather than other, critical programs, the terrorist has received an exponential compound on his relatively low investment. So long as he remains the weaker party, every effort made to counter his existence is a victory, economically or otherwise.

Understanding this strange dance may lead policymakers to understand this; in order to effectively combat terrorism, they must create equilibrium between the advantaged and disadvantaged. Many policy prescriptions have been posited concerning the eradication of terrorism, most dealing either with transforming military conventions or cutting off the terrorists’ inflow of funds. It is the belief of this author that either method will ultimately prove futile: For one, terrorists do not engage in pitched battle; there is no possible utility for them in such actions. Neither can national defense personnel constantly engage themselves in mimicking the patterns of terrorists; it will ultimately atrophy their identity as a unified fighting force. Moreover, terrorists can always find new sources of funds, even without the states’ ability to levy. There will always be aggrieved parties, and those with deep enough purses who sympathize with them. Failing this, there is no shortage of common criminal activity available for terrorists to engage in to provide resources for their more nefarious schemes.

As Intriligator (2010) observes, there “is an interaction between terrorists and antiterrorists as economic agents with equilibrium prices and quantities, as in a general equilibrium model of the overall economy (para. 8). In other words, the terrorist demand for

resources drives counterterrorist's drive for resources indefinitely, so long as either party has any advantage. As such, policymakers must make terrorism a zero-sum game, in which neither side can derive any benefit. Minimizing utility is not enough, as terrorists care little or less about such things as deprivation, loss, or, in many cases, their own lives. Both parties seek benefit, and it is only the victim state that fears loss. Consequently, there must be an equilibrium in which neither side can gain, effectively counting as a crushing loss for the terrorists. Whether such a thing is even possible is subject to rigorous debate. The cost of avoiding the debate may ultimately be too much to bear.

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