

Overview of *Protecting the American Homeland*

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In a forthcoming Brookings volume (*Protecting the American Homeland*, by Michael O’Hanlon, Peter Orszag, Ivo Daalder, Mac Destler, David Gunter, Robert Litan, and James Steinberg), we propose a homeland security strategy to deter extremely destructive terrorist attacks. The standard we set for focusing homeland security efforts is the prevention of those attacks that would involve the loss of thousands of lives, the interruption of crucial social and economic services for millions of people for an extended period, or significant damage to the reputation of the United States in the global community.

To be sure, protecting against extremely costly terrorism may displace attacks toward less damaging scenarios, involving fewer people or less important infrastructure. Since it is impossible to eliminate all potential terrorist activity, however, such displacement of terrorism toward significantly less damaging attacks is a necessary consequence of providing better prevention and protection against the most damaging attacks. In other words, some displacement is unavoidable, and it is notably better to displace terrorist activity toward significantly less damaging attacks than to displace it from one catastrophic area to another.

Our approach involves addressing vulnerabilities at four key stages. The first stage is perimeter defense. That means keeping dangerous people and dangerous objects -- notably weapons of mass destruction, threatening aircraft and cruise missiles, high explosives, anti-aircraft missiles such as the Stinger, and certain other weapons -- out of the country. The second stage encompasses preventive measures within the nation, including tracking potential terrorists and keeping dangerous materials -- such as biological weapons or toxic chemicals -- out of the hands of those who would use them to commit acts of terrorism. The third stage involves the direct protection of key targets -- such as population centers and critical infrastructure -- against any dangerous threats that elude perimeter defense and internal interdiction. The final stage is consequence management, or mitigating the costs of any attacks that do occur.

In total, our proposals would expand annual Federal budgetary expenditures on homeland security to about \$45 billion, or \$25 billion above levels originally planned for 2002. (These costs include homeland security costs within the Department of Defense, but do not include efforts to defeat terrorism overseas, such as the role of intelligence or military operations in Afghanistan.) The budgetary costs of our proposals raise important related issues: who should implement and pay for various new homeland security measures, and why and when government intervention is required.

The first and final categories of our approach -- minimizing terrorist access to the country and reducing the costs of any attacks that do occur -- are areas in which a governmental role is uncontroversial. The principal questions with respect to these categories, therefore, are what level of government should undertake the measures and whether that same level of government should finance them. Although the appropriate response varies from issue to issue, the general principle we

adopt is that the Federal government should finance those measures that are primarily and specifically linked to reducing the threat or severity of terrorist attacks. Measures that primarily provide collateral benefits to the local area should generally be financed by local or state governments, even if they provide some anti-terrorism benefits. The Federal government thus should finance specialized anti-terrorism training and equipment for police and fire departments, but should not finance the hiring of additional police or firefighters.

Some of the thorniest issues involve components of our second and third categories of homeland security -- preventive activities and the protection of key sites within the United States. Impeding access to dangerous materials and protecting domestic sites, in particular, raise difficult questions: Why should the government be involved in protecting private property and activities within the United States against terrorist attacks, how should it be involved, and who should pay for the required security measures?

Industry groups will invariably claim that voluntary efforts would provide adequate levels of security in private-sector settings. There are, however, at least six potential justifications for government intervention:

- First, a significant terrorist attack undermines the nation's sovereignty and its international image, just as an invasion of the nation's territory by enemy armed forces would. Firms will not generally take this cost into account in evaluating security measures.

- Second, a more specific negative externality exists with regard to *inputs* into terrorism. For example, loose security at a chemical facility can provide terrorists with the materials they need for an attack on other targets.
- A third potential motivation for government intervention involves information costs. For example, each individual could individually conduct biological safety tests on the food that he or she was about to consume. The information costs associated with that type of system, however, make it much less attractive than a system of food safety regulation.
- The fourth justification for government intervention is that corporate and individual financial exposures to the losses from a major terrorist attack are inherently limited by the bankruptcy laws. The incentive to invest in protective measures is therefore muted.
- The fifth justification for government intervention is that the private sector may expect the government to bail it out should a terrorist attack occur. Such expectations create a moral hazard problem.
- The final justification for government intervention involves incomplete markets. The most relevant examples involve imperfections in capital and insurance markets. In addition, certain types of activities may require large-scale coordination, which may be possible but difficult to achieve without governmental intervention.

The importance of these six factors varies from situation to situation, and the degree (as well as existence) of government intervention should therefore also vary by circumstance. For example, consider the difference between security at a shopping mall and security at a chemical facility. Poor security at a mall typically does not pose a risk to as many lives as poor security at a chemical facility. Thus security regulations for chemical plants may make sense, even if they don't for shopping malls.

Furthermore, the benefits of government intervention must be weighed against the costs of government failure, and the various forms of government intervention must be weighed against each other. Despite the sector-specific nature of such evaluations, one longer-term approach appears to be the least undesirable and most cost-effective in many settings: a combination of regulatory standards and insurance requirements. A mixed system of minimum standards coupled with an insurance mandate not only can encourage actors to bolster security, but can provide incentives for innovation to reduce the costs of achieving any given level of security. The presence of minimum regulatory standards also helps to attenuate the moral hazard effect from insurance, and can provide guidance to courts in determining negligence under the liability laws.

A mixed regulatory-insurance model also highlights one of the themes we emphasize in our forthcoming volume: To reduce the costs involved and provide incentives for additional security measures, the government should promote an “EZ-pass” approach whenever possible. That is, individuals or firms willing to undergo additional security background checks or willing to undertake additional security measures should receive some benefit – for example, in the form of expedited clearance through Immigration or Customs or lower insurance premiums – in exchange.