



# Costs of Homeland Security

The national effort to enhance homeland security will yield tremendous benefits and entail substantial financial and other costs. The benefit will be a reduction in both the risk of future terrorist events and their consequences should an attack occur. The financial costs are the amount of money, manpower, equipment, and innovative potential that must be devoted to homeland security—resources which then cannot be used for goods, services, and other productive investments. Americans also incur substantial costs in longer delays at airport security checkpoints and restrictions on some individual freedoms. While these costs are often difficult to measure quantitatively, they are no less real and burdensome to Americans. We must measure and balance both benefits and costs to determine the correct level of homeland security efforts. This chapter describes the broad principles that should guide the allocation of financial resources for homeland security,

help determine who should bear the financial burdens, and help measure the costs.

The United States spends roughly \$100 billion per year on homeland security. This includes the services of federal, state, and local law enforcement and emergency services but excludes most spending for the armed forces. The cost is great, and we will strive to minimize the sacrifices asked of Americans, but as a Nation we will spend whatever is necessary to secure the homeland.

## Principles to Guide Allocation of Homeland Security Costs

*Balancing benefits and costs.* Decisions on homeland security activities and spending must achieve two overarching goals: to devote the right amount of scarce resources to homeland security and to spend these resources on the right activities. To achieve the first

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goal, we must carefully weigh the benefit of each homeland security endeavor and only allocate resources where the benefit of reducing risk is worth the amount of additional cost. One implication of this standard is that it is not practical or possible to eliminate all risks. There will always be some level of risk that cannot be mitigated without the use of unacceptably large expenditures.

The second goal for homeland security spending is to prioritize those activities that most require additional resources. Given the resources available, we should strive to maximize security by distributing additional funding in such a way that the value added is approximately equal in each sector. Because some activities might achieve substantial benefits at low cost, while others result in minimal gain at a high price, resources should be shifted to their most “productive” use. These shifts should continue until the additional value of risk mitigation per dollar is equalized.

*The role for government.* The government should only address those activities that the market does not adequately provide—for example, national defense or border security. Our government provides these services on behalf of American citizens for our collective benefit. Many homeland security activities—such as a national incident management system—require government action.

For other aspects of homeland security, sufficient incentives exist in the private market to supply protection. In these cases, we should rely on the private sector. For example, owners of large buildings and hosts of large events may have a sufficient incentive to provide security for those venues.

*Federalism and cost sharing of expenditures.* The homeland security mission requires a national effort—federal, state, and local governments partnering together and with the private sector. It is critical that we identify tasks that are most efficiently accomplished at the federal versus local or regional level. A central criterion is the degree to which the activity is national or sub-national in scope. Many homeland security activities, such as intelligence gathering, border security, and policy coordination, are best accomplished at the federal level. In other circumstances, such as with first responder capabilities, state and local governments are better positioned to handle these responsibilities.

At a time when budgets are tight across the country, the federal government will play a key role in securing the homeland. It is critical, however, that all levels of government work cooperatively to shoulder the costs of homeland security. The federal government will lead the effort, but state and local governments can and should play important roles. As a result, Americans will

gain from these homeland security efforts every day with improvements in public services such as law enforcement and public health systems.

*Regulations.* Traditionally, governments have used regulations in addition to direct expenditures to meet their objectives. Rigid regulation, however, has proven to be an inefficient means of meeting objectives. To the extent that homeland security objectives are to be met by regulations for state and local governments or private-sector firms, the federal government will provide an incentive to minimize costs and reward innovation by permitting maximum flexibility in meeting those objectives. The federal government will focus on specifying outcomes rather than the means by which they will be achieved.

## The Costs of Homeland Security

Homeland security requirements take real resources (such as labor, capital, technology, and managerial expertise) away from valued economic activities (such as household consumption or business investment). In some cases, homeland security spending also reduces resources that could be used to purchase other types of public safety, such as cleaner water or safer highways. In other cases, the investment in homeland security will result in public safety benefits; water testing to detect chemical or biological agents, for example, will improve overall water quality. The sum of these economic resources shifted toward homeland security is the fundamental economic cost of the endeavor.

*Direct federal expenditure.* In recent years, the federal government has allocated considerable resources to homeland security. Including supplemental funding, the federal budget allocated \$17 billion to homeland security in Fiscal Year 2001. This amount increased to \$29 billion in Fiscal Year 2002. In Fiscal Year 2003, the President budgeted \$38 billion for homeland security activities. These budget allocations must be viewed as down payments to cover the most immediate security vulnerabilities.

The President has noted that terrorism is the greatest national security threat since World War II. Minimizing the overall economic impact of fighting the war on terrorism will require that increased budgetary spending on homeland security occur within the context of overall fiscal spending restraint. It is important to reprioritize spending to meet our homeland security needs, and not simply to permit unchecked overall growth in federal outlays. Over the long term, government spending is balanced by either higher taxes or inflation, both of which hinder the rapid economic growth that serves as the ultimate source of resources for families’ standards of living and national needs.

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If we do not reprioritize spending, then the costs of homeland security will be even greater because these expenditures do not represent the full cost of homeland security to the economy. As noted earlier, the \$38 billion in taxes needed to finance the Fiscal Year 2003 homeland security budget request will not be available for other uses such as personal consumption and private sector investments. The Council of Economic Advisers estimates that of the \$38 billion, \$24 billion would come from reduced consumption, while \$14 billion would take the form of reduced private sector investment. The cost is even higher, however, because of the economic distortions introduced by the tax system. Under any tax system, every dollar collected in taxes results in distortions that reduce the efficiency of the economy and lower national income. This economic distortion (referred to as deadweight loss) is roughly \$0.27 per dollar of tax revenue.

*State and local governments.* It is difficult to measure the financial contributions to homeland security made by state and local governments. It is evident, however, that state and local governments are spending money or planning to spend money which was never expected to be spent on defending and protecting their respective communities. These costs include protecting critical infrastructure, improving technologies for information sharing and communications, and building emergency response capacity. At this time, the National Governors' Association estimates that additional homeland security-related costs, incurred since September 11 and through the end of 2002, will reach approximately \$6 billion. Similarly, the U.S. Conference of Mayors has estimated the costs incurred by cities during this time period to be \$2.6 billion.

*Private expenditures.* Private businesses and individuals have incentives to take on expenditures to protect property and reduce liability that contribute to homeland security. Owners of buildings have a significant stake in ensuring that their buildings are structurally sound, properly maintained, and safe for occupants. To accomplish this, they often take protective measures that include employee education and training, securing services, infrastructure assessment, technology, and communication enhancements. Properly functioning insurance markets should provide the private sector with economic incentives to mitigate risks.

Costs of homeland security in the private sector are borne by both the owners of businesses in the form of lower income and their customers in the form of higher prices. The Council of Economic Advisers estimates that private business spent approximately \$55 billion per year on private security before the September 11 attacks. As a result of the attacks, their

annual costs of fighting terrorism may increase by 50 to 100 percent. Increases in the cost of insurance premiums have been more dramatic.

## Economic Recovery

Additional homeland security costs would be incurred in the event of a terrorist attack. The economic response and recovery efforts would involve four central activities.

*Local economic recovery.* The federal government is developing a comprehensive and coordinated economic recovery plan. The plan will improve federal support to state and local governments for incidents that overwhelm state, local, and private-sector resources. This approach will help develop a better planned and more flexible federal response, support stronger local planning for economic recovery, lessen federal demands on state and local officials at the time of an incident, and provide federal assistance to state and local bodies, when appropriate, in a more user-friendly and effective way.

*Restoration of financial markets.* In the aftermath of an attack, the Department of Homeland Security, the Department of the Treasury, and the White House would oversee efforts to: effectively monitor financial market status; identify and assess impacts on the markets from direct or indirect attacks; develop appropriate responses to such impacts; inform senior federal officials of the nature of the incident and the appropriate response options; and implement response decisions through appropriate federal, state, local, and private sector entities.

*National economic recovery.* A major terrorist incident can have economic impacts beyond the immediate area. Therefore, the Departments of Homeland Security, Treasury, and State and the White House would identify the policies, procedures and participants necessary to assess economic consequences in a coordinated and effective manner. This group will develop recommendations to senior federal officials on the appropriate federal response. The group will ensure that government actions after an attack restore critical infrastructure, services, and our way of life as quickly as possible and minimize economic disruptions. This group will also develop effective policies and procedures for the implementation of those responses through appropriate federal, state, local, and private sector bodies.

*Economic impact data.* Sound information about the nature and extent of the economic impact of an incident is important in developing an effective response. The Department of Commerce's Economics

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and Statistics Administration and other federal agencies are developing an economic monitoring, assessment, and reporting protocol to provide credible information concerning the economic status of the area before an incident, assess the direct economic impacts of the incident, and estimate the total economic consequences in a more timely and accurate manner. This protocol will help develop more accurate national, regional, and local economic impact data. This information will be provided to appropriate government officials to help assess the appropriate response to the economic consequences of an incident.