

Insuring against Terrorism: The Policy Challenge

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Terrorist attacks worldwide during the past several years have spurred an interest in understanding not only how governments can mitigate terrorism risk but also how governments might help finance future losses. This interest was buttressed by the seemingly failure of the private insurance market to provide coverage for terrorism losses after the attack on September 11, 2001. This paper surveys the evidence of the supposed private market failures after 9/11 and the arguments for government provision of terrorism insurance. The paper argues that mostly unfettered insurance and capital markets are capable of insuring large terrorism losses. If there is any "failure," it rests with government tax, accounting, and regulatory policies that have made it costly for insurers to hold surplus capital. Government policy has also hindered the implementation of instruments that could securitize the underlying risks. Correcting these policies would likely enable private insurers to cover both terrorism and war risks.