

Local Public Finance in the Aftermath of September 11

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The terrorist attacks of September 11, 2001, present significant challenges for policy-makers at all levels of government. Since terrorism seems to present particularly acute risks for core urban areas, it may influence economic and policy decisions in ways that affect the spatial distribution of population and economic activity. These impacts, however, will depend importantly on the assignment of responsibilities among federal, state, and local governments for dealing with terrorism and on the distribution of the costs of these responsibilities. The policy interactions among different levels of government, and between the private and the public sectors, should provide students of political economy with much insight into the nature of the policy process in the American federation.

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1. INTRODUCTION

It is too early, by far, to arrive at a well-informed and balanced assessment of the economic and policy consequences of the terrorist attacks of September 11, 2001. These events do, however, have potentially far-reaching implications for urban areas in the United States and throughout the world and deserve the attention of economists interested in urban issues, local public finance, and related topics. The following remarks seek to outline some of the potential economic and policy effects and issues that arise in connection with these attacks.

To begin with, the possible effects of the attacks include both market and policy responses. What happens to the market for real estate in lower Manhattan, for example, is likely to depend importantly on the policies chosen by the city government of New York, the state government, and the Federal government. The city must divide its limited fiscal resources among many competing demands, including the restoration of transportation capacity, urban social services, and public safety. The state government of New York may or may not inject large amounts of fiscal resources into the city government or into the provision of public services for city residents. The Federal government may absorb little, much, or all of the cost of the demolition and rebuilding of damaged sites. The policy responses of the city and state governments are likely to depend on the behavior of the Federal government. In short, the terrorist attacks have triggered a complex process of simultaneous adjustment in markets and in the policies of several levels of government.



The policy adjustments made by different levels of government can be examined from a positive or predictive viewpoint as well as from a normative perspective. As is often (perhaps always) the case, useful normative analysis must build at least partly on positive analysis. Whether and how the Federal government should subsidize and regulate households, firms, and lower-level governments depends on the ways in which these agents respond to policy choices. Much of the discussion below is therefore devoted to a consideration of the incentives facing market and public-sector decisionmakers in this environment.

One can hope that the terrorist attacks were a one-time aberration and that there will never again be individuals or groups that would wish to wreak such destruction on civilian targets in the U.S. or elsewhere. If this could be known to be true, the effects of the September 11 attacks, on markets and on policies, would derive from the destruction occasioned by these attacks themselves. These effects would then be localized in nature and probably somewhat transitory.

Unfortunately, terrorism cannot be expected to disappear spontaneously of its own accord. At best, one might hope that active efforts by national security authorities, both in the domestic and foreign arenas, might disable terrorist groups and make it impossible for them to perpetrate major attacks in the future. Of course, this points directly to some of the key policy issues to be decided: What actions *can* governments take to forestall future attacks, how effective will these actions be, how much will they cost, and what costs will or should be incurred in an effort to eradicate or protect against terrorism? Experts in domestic or international security affairs might somehow devise relatively costless means by which terrorism can be stopped, but it seems most probable that the cost of fail-safe security would be prohibitive and that the U.S. and other societies must therefore make difficult trade-offs between cost and security.¹ The future, therefore, holds the realistic prospect of significant costs to be incurred in an effort to counter terrorism as well as the prospect that counter-terrorism efforts will not succeed completely in stopping terrorist attacks. This at least is the premise under which the following discussion proceeds, and it carries important implications. First, it means that minimization of the costs of anti-terrorism policies is an important policy issue. Second, however, the costs of anti-terrorism efforts, even if held to a minimum, will be nontrivial and will fall, directly or indirectly, on economic agents. The distribution of these costs will have important incentive effects. Third, decisionmakers in both the private and the public sector can be expected to adjust their behavior in view of the risks of future terrorist attacks, some of which may result in significant damage and loss of life.

¹There have been many studies, reports, and recommendations in the past decade that have drawn attention to the threat of terrorism, as discussed in [6]. The costs of anti-terrorism and other security policies are indirectly revealed by the limited degree to which these policies have actually been implemented.

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