ARTICLE

Terrorism Insurance: Rethinking the Government's Role

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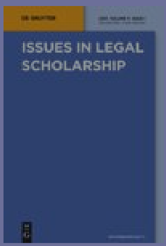

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Following a major terrorist attack, private providers of terrorism insurance often cease providing this coverage. As a result, the governments in developed countries around the world now provide some form of support to their terrorism insurance markets. This paper considers several questions regarding the private market failure and the resulting government intervention: Why do private markets for terrorism insurance fail? Given the failure, what is the optimal form of government intervention? And, what would be the likely economic ramifications if a government chose not to intervene? The paper's discussion of these questions focuses on the 9/11 attacks on the United States, and on the 2002 Terrorism Risk Insurance Act (TRIA) and its 2005 extension (TRIAE). The paper argues that government support for the terrorism insurance market should be priced based on the expected cost of the support provided. The paper also argues that such support should generally be temporary, with a sunset as the private market recovers. A specific proposal is that the government intervention take the form of loans to the affected insurance companies, similar to the manner that central banks provide loans to banks facing temporary liquidity crises.

Keywords: terrorism insurance; terrorism risk insurance act; TRIA; insurance market failure

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