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Insuring Against Terrorism -- And Crime

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INSURING AGAINST TERRORISM
— AND CRIME

Saul Levmore* and Kyle D. Logue**

I. INTRODUCTION

The attacks of September 11th produced staggering losses of life and property. They also brought forth substantial private-insurance payouts, as well as federal relief for the City of New York and for the families of individuals who perished on that day. The losses suffered during and after the attacks, and the structure of the relief effort, have raised questions about the availability of insurance against terrorism, the role of government in providing for, subsidizing, or ensuring the presence of such insurance, as well as the interaction between relief and the incentives for taking precautions against similar losses in the future. In response to such losses, and in anticipation of others, one might imagine an array of government responses — ranging from nonintervention, to subsidized private insurance, to after-the-fact government payments of a fixed or uncertain kind.

It is our claim that the particular mix of responses the government has chosen with respect to 9/11, including the September 11th Victims' Compensation Fund1 and the Terrorism Risk Insurance Act of 2002,2 will significantly affect private expectations about the government’s likely response to future terrorist attacks. These expectations will in turn affect future private actions, ranging from the types of insurance policies that will be written, to the character of real estate development that will take place (especially in the country’s largest cities), and to the level of charitable contributions that will be made following any future terrorist attack. The causal arrow can also point

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in the opposite direction. Future political actors may evaluate private responses to the risk of terrorism in deciding on the character or degree of a governmental response.

One aim of this Article is the exploration of the relationships between promised or expected government actions (or inactions) and private decisions regarding terrorism risk. These issues lead to some novel ideas about the role of government in insuring against terrorism — and then against crime more generally. In Part II we begin with some background on the response of the private-insurance market and the federal government to the losses resulting from September 11th. Part III looks at the positive question of how government and private actors should be expected to respond to the losses of 9/11 and to the prospect of such losses in the future. It explores the interactions between government relief and charitable responses to 9/11, as well as the existence or absence of private insurance, and it draws contrasts between terrorism disasters and natural disasters, as well as between 9/11 and prior terrorist attacks. Part III also analyzes the circumstances in which episodic relief of the 9/11 variety will lead to (or be replaced by) more permanent, routinized relief, as is available in some other countries.

Part IV takes up the normative question of the optimal mix of government and private relief (including insurance) for terrorism-related losses. It provides a skeptical view of government intervention in property-insurance markets generally and of the particular federal terrorism-reinsurance regime that Congress recently adopted. Part V then broadens the inquiry by arguing that, whatever one thinks of the case for government-sponsored terrorism compensation or insurance, the case for government-sponsored insurance against crime — which is to say a much broader set of crimes than terrorism alone — is at least as sound. Part VI concludes. Throughout the Article, we refer to “insurance” and government “relief” because specific programs and reactions have been in the form of insurance-market interventions and relief programs. But we also use these expressions to refer to government payments, subsidies, and liability rules more generally. It is the larger questions we are after, and those concern the government’s role in preventing losses and in compensating victims following certain events.

II. INSURANCE, RELIEF, AND THE EVENTS OF 9/11

The terrorist attacks of September 11th produced an enormous set of losses, some insured through private markets and some not. Insured loss estimates range from 30 to 100 billion dollars, and include
property-, liability-, workers-compensation-, and life-insurance claims. Much of the damage done on 9/11 to private property and private economic interests was insured through policies sold by insurance companies, although substantial damage was inflicted on publicly owned facilities in lower Manhattan, including the New York City subway system, that were likely underinsured. To this we add the staggering loss of nearly 3000 lives, some completely uninsured and many underinsured by any plausible standards of measurement. The total loss dwarfs that of any other single-day disaster or insurable event in U.S. history, at least since the major battles of the great wars and the Galveston hurricane of 1900 in which 6000 people perished, and rivals the losses experienced in the Kobe, Japan earthquake of 1995, which may be the most costly natural disaster in modern history.

When thinking about these issues, it makes sense to separate the loss of property, private and public, from the loss of life and limb, in large part because the present mix of private and public insurance, and of relief generally, is different for property than it is for persons. In addition, government relief or compensation for lost property presents somewhat different moral-hazard issues than does relief for lost life; the politics of relief may also differ. We consider these important differences below.

A. Losses to Property

The bulk of private property losses suffered in the 9/11 attacks was covered by private insurers. Some claims remain in dispute, of course, but by and large the assets that were lost, including buildings, aircraft,
and office contents, were insured under conventional insurance policies that did not (following conventional practice) exclude losses from terrorism.\textsuperscript{8} The federal government did and will provide some relief for losses of uninsured private property, but this relief often takes the form of subsidized loans and is small in comparison with the role of private insurance.\textsuperscript{9}

The picture is quite different with respect to losses to public property. The largest such losses associated with 9/11 in New York City concern damage to the subway system in lower Manhattan.\textsuperscript{10} The Metropolitan Transportation Authority claims that those losses will be covered mostly by private-insurance policies, with only relatively small amounts coming from the Federal Emergency Management Agency ("FEMA") and its state equivalent to fill in the gaps.\textsuperscript{11} We suspect, however, that when all of the insurance claims have been finally settled and when all of the damages to public facilities (not just the subways) are taken into account, the amount to be covered by government relief dollars will represent a sizeable fraction of the total

\textsuperscript{8} This conclusion assumes that the "war risk" exclusion will either not be invoked by insurers or, if invoked, will be found by courts not to apply to the 9/11 attacks. See infra note 36.

\textsuperscript{9} In general, after a "major disaster" has been declared by the President (which comes only after state and local governments have responded and the governor of the affected state has requested a disaster declaration from the President), individuals and businesses that have suffered uninsured property losses or temporary job losses as a result of the disaster become eligible for loans from the Small Business Administration ("SBA"), and, in some cases, modest grants administered by the Federal Emergency Management Agency ("FEMA"). When homes have been damaged, loans can be issued for up to $200,000 and loans to replace damaged personal property can reach $40,000. Businesses can receive loans up to $1.5 million to repair or replace damaged property. The loans may carry subsidized rates of interest, but they must be repaid in full. Individuals or families who do not qualify for these loans, typically those with very low incomes or no collateral, can receive up to $14,800 from FEMA in the form of one-time grants. Christopher M. Lewis & Kevin C. Murdock, \textit{Alternative Means of Redistributing Catastrophic Risk in a National Risk-Management System, in The Financing of Catastrophe Risk} 51, 68-69 (Kenneth A. Froot ed., 1999). See generally \textit{Fed. Emergency Mgmt. Agency, The Disaster Process and Disaster Aid Programs}, at http://www.fema.gov/library/dproc.shtm (last updated Feb. 12, 2003)

\textsuperscript{10} According to a report of the New York City Metropolitan Transportation Authority ("MTA"), the most substantial damage was to the subway tunnel running underneath the World Trade Center Towers — the Interborough Rapid Transit lines numbers 1 and 9 — which will need to be completely rebuilt, and the related stations and infrastructure, as well as damage to the N/R Line Cortlandt Street Station. The total property damage to the transit system is estimated to be $855 million. \textit{See Metro. Transp. Auth., 2002 Combined Continuing Disclosure Filings} app. A at 7-9, at http://www.mta.nyc.ny.us/mta/investor/pdf/2002app-a-v2.pdf/ (last visited Apr. 19, 2004).

losses.12 Indeed, the sheer magnitude of the federal funding that has already been earmarked for the reconstruction and overhauling of lower Manhattan strongly suggests that the federal government will end up bearing a substantial portion of the losses.13

Apart from the physical damage to property, many New York businesses also experienced substantial monetary losses in the aftermath of 9/11. Focusing solely on the businesses in and around the World Trade Center site, the lost profits during the period of recovery and reconstruction have been undoubtedly enormous. Indeed, the total private-insurance payouts for “business interruption” coverage

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12. This suspicion is justified by the available evidence. While the total property losses to the subway system are estimated to be $855 million, the MTA apparently has submitted only $685 million in insurance claims for 9/11-related property losses. Apparently, the difference may be attributable to the actual subway cars that were destroyed and that were not insured. Another suggestive (though certainly not dispositive) piece of evidence is that the MTA, in its 2000-2001 financial statements, did not include any amount for expected insurance recovery because the “Authority is pursuing the resolution of various contingencies with the insurance providers.” COMPREHENSIVE ANNUAL FINANCIAL REPORT, supra note 11, at 39. What this means, of course, is that the insurers may interpret the relevant insurance policies somewhat differently than the MTA does. In addition, however, one would expect a general tendency for municipalities to underinsure given the prospect of FEMA (or Department of Transportation (“DOT”)) relief.

13. A total of twenty-one billion dollars of federal funds has been allocated for the New York recovery effort. See Press Release, Office of Management and Budget, OMB Releases Updated Summary of Government Expenditures Directly Related to September 11th Attacks (Sept. 10, 2002), http://www.whitehouse.gov/omb/pubpress/2002-61.pdf (last visited Apr. 12, 2004). Of that amount, $5.5 billion is designated for reconstructing, replacing, overhauling, and upgrading the infrastructure damaged by the attacks. Press Release, Office of Management and Budget, President Submits $27.1 Billion Emergency FY 2002 Supplemental Appropriations Request, Provides Resources for the War on Terrorism, Homeland Security and Economic Recovery (Mar. 21, 2002), http://www.whitehouse.gov/omb/pubpress/2002-16.pdf (last visited Apr. 12, 2004). Of that amount, $4.55 billion will apparently go to transportation-related infrastructure expenditures — $2.75 billion coming from FEMA and another $1.8 billion coming from DOT. The money will be jointly administered by FEMA and the U.S. Department of Transportation’s Federal Transit Administration. Edward Wyatt, Money for Just Some of a Transit Wish List, N.Y. TIMES, Aug.13, 2002, at B4; see also Charles V. Bagli & Randy Kennedy, Old or New? Debate Rages Over Transit Downtown, N.Y. TIMES, Oct. 13, 2002, at B1; Press Release, Federal Emergency Management Agency, FEMA and FTA Announce Aid To Revamp Transportation Network For Lower Manhattan (Aug. 12, 2002), http://www.fema.gov/news/newsrelease.fema?id=5529 (last visited Apr. 12, 2004). Although much of this money may be used to “upgrade” the subway system in lower Manhattan, such an improvement over New York’s prior transportation situation can be viewed as only partial and incomplete compensation for the economic losses suffered by the city that were never covered by private insurance — such as the huge loss of tax revenues due to the drop in tourism and business flight out of the city. Moreover, the rest of that $5.5 billion is designated for “restoration and reconstruction” of certain highways and local roads “damaged by the September 11th terrorist attacks,” to “rebuild utility infrastructure destroyed as a result of the September 11th terrorist attacks,” and to assist Lower Manhattan Development Corporation’s efforts to “rebuild Lower Manhattan.” Office of Management and Budget, supra. The rest of the $21 billion includes the costs for the rescue and recovery efforts that immediately followed the attacks and the massive cleanup costs in the ensuing months, as well as the anticipated amounts of FEMA and SBA grants and loans. This $21 billion is separate from the $5 billion allocated to the Victim Compensation Fund, the $8 billion allocated to airline subsidies, the $35 billion for Homeland Security, and the $30 billion for the “war on terrorism.” Id.
are expected to be larger for 9/11-related lost profits than for any previous single-day event, amounting to more than twenty-five percent of all private-insurance payouts related to the 9/11 losses.\textsuperscript{14} Despite this insurance coverage, however, and despite the presence of federal grants and loans for some business losses,\textsuperscript{15} it must be the case that huge financial losses that can be directly attributed to the attacks will go uncompensated.\textsuperscript{16} To be sure, some of these losses are private rather than social losses because some of these losses are offset by gains to other businesses located far from Ground Zero. This distinction may matter when it comes to encouraging governments to take precautions or when structuring optimal insurance policies, but it seems safe to proceed from the assumption that there were substantial uninsured social losses associated with the interruption and destruction of business caused by the attacks.

In sum, we might think of the 9/11 physical property losses as having been effectively insured whether through private insurance or government relief, but regard other property-related financial losses as having been only partially insured. This summary, and much of the discussion below, intentionally bends the idea of insurance to include government relief. Insurance and relief are obviously not the same — one may be expected by contract while the other depends on politics and circumstances. But inasmuch as governments can subsidize insurance or offer insurance without requiring premiums, and because private parties can come to expect relief in some circumstances, it can be useful to fold insurance and relief into one package.

B. Losses to Life

As for loss of life, it is almost certain that a large number of those killed on 9/11 were uninsured or underinsured.\textsuperscript{17} Although there are no publicly available data on this issue, the likelihood that many of the victims had only small life-insurance policies, or none at all, is

\begin{itemize}
\item \textsuperscript{14} Press Release, Insurance Information Institute, 9/11 and Insurance, One Year Later — Terror Attacks Most Complex Disaster in History (Sept. 5, 2002), http://www.iii.org/media/updates/press.635680/ (last visited Apr. 12, 2004).
\item \textsuperscript{16} See Diane Levick & Matthew Lubanko, What Price, Terror?; for Insurers, Stalled-Business Claims Complicate Picture, HARTFORD COURANT, Nov. 25, 2001, at D1 (estimating business interruption claims in the range of $15-25 billion, compared to the total estimate of all 9/11 claims of $40-72 billion); Christian Murray, Adjusting to Disaster Strains Claims Team; Despite Heartbreak, Some Payouts Must End, NEWSDAY, Nov. 6, 2001, at A42 (noting the industry had received $16.6 billion of business interruption claims to date).
\item \textsuperscript{17} Jason Bram et al., Measuring the effects of the September 11 attack on New York City, ECON. POL'Y REV. — FED. RES. BANK OF N.Y., Nov. 1, 2002, at 6 ("Although private insurance is expected to cover a portion of these losses, it is not likely that all of the workers had taken out private life-insurance policies.")).
\end{itemize}
overwhelming. For one thing, underinvestment in life insurance is a pervasive problem.\textsuperscript{18} Although many households purchase life insurance, few purchase enough to maintain their standard of living should a primary earner die prematurely.\textsuperscript{19} Moreover, the main motivation for the large amount of charitable giving, as well as the Victims' Compensation Fund, discussed below, was the realization that many of the victims were uninsured or underinsured.\textsuperscript{20} Still, many of the deceased did have some life insurance or were covered by pension benefits payable upon death (or both).\textsuperscript{21}

In addition, immediately following 9/11 there was an unprecedented amount of charitable giving aimed at compensating, or at least assisting, the families of deceased victims.\textsuperscript{22} The other primary source of compensation for victims' families is the September 11th Victims' Compensation Fund, established by Congress shortly after the disaster.\textsuperscript{23} Under this unprecedented program, the families of individuals who suffered physical injury or death in the 9/11 attacks can apply for fairly generous benefits.\textsuperscript{24} If they elect to do so, however,


\textsuperscript{19} Id.

\textsuperscript{20} Of course, the definition of full or adequate coverage is highly subjective. The "optimal" amount of life insurance for any given family on the life of an earner depends not only on the income level of the earner, but also on the expectations with respect to what the surviving dependents' standard of living should be if the insured earner dies. For example, to what extent, if at all, will the surviving spouse be expected to work additional hours to make up for the loss of income? And to what extent will the family's savings be considered a self-insurance reserve of sorts? These are questions that each family must answer for itself.

\textsuperscript{21} The Special Master of the Fund, Kenneth Feinberg, has published a very small sample of payout profiles, including the amount of the award, the individual's annual income and number of dependents, and the collateral offset (which includes life-insurance proceeds). Although no strong conclusions can be drawn from such a small sample, which was probably not randomly selected, it provides support for the idea that at least some of the victims had significant amounts of life insurance. U.S. DEPT OF JUSTICE, CLAIMANT AWARD SUMMARIES (Dec. 2002), http://www.usdoj.gov/victimcompensation/award_summaries.pdf (last visited Apr. 12, 2004).

\textsuperscript{22} AM. RED CROSS, SEPTEMBER 11, 2001: UNPRECEDENTED EVENTS, UNPRECEDENTED RESPONSE 6 (Sept. 2002) (reporting that the American Red Cross's Liberty Fund had by September 11, 2002 received roughly $1 billion in donations, approximately $800 million of which was to be distributed by the end of 2002), http://www.redcross.org/press/disaster/ds_pr/pdfs/arcwhitepaper.pdf (last visited Apr. 12, 2004). Interestingly, according to one news report, the bulk of those funds were designated for the families of firefighters, police officers, and other rescue workers who perished. Thus, according to this story, the average charitable award to the families of slain or severely injured firefighters and rescue workers was just over (and the amount to families of police officers just under) $1 million. By contrast, the average charitable payout to the families of other victims was around $146,000. Martin Kasindorf, \textit{Big Gaps Found in 9/11 Benefits}, USA TODAY, Aug. 19, 2002, at 1A. These amounts do not include any amounts received from insurance policies, pension payments, or the Victims' Compensation Fund.

\textsuperscript{23} ATSSS Act, supra note 1.

\textsuperscript{24} See U.S. Department of Justice, Compensation for Deceased Victims; Award Payment Statistics tbl.1, at http://www.usdoj.gov/victimcompensation/payments_deceased.
the payouts they receive from the Fund must, under the collateral-offset provision of the statute, be reduced dollar for dollar by the amount of life insurance or other death benefits to which they are otherwise entitled — though not by the amount of charitable gifts received. As is customary, however, none of these life-insurance policies or pension-policy death benefits that were in effect contained clauses requiring the reduction of death benefits in the event of third-party or other insurance payments. The presence of private insurance therefore reduced or eliminated the payments from the Fund that might have been made to the families of some victims, and in turn may have increased the pool of funds (and thus the payments) available to the families of other victims.

Another unusual aspect of the Fund is the requirement that claimants forego tort litigation with respect to their losses, at least insofar as the most obvious potential domestic defendants are concerned. Thus, a family cannot accept a payment from the Fund and then seek to recover from an airline, an employer, an owner or builder of a collapsed building, engineers who designed the buildings, and so forth. Suits against construction firms or designers of buildings are of course still possible if brought by claimants who do not collect from the Fund, or if brought by the City of New York or by businesses or property owners affected by the attack. Suits against foreign organizations and tortfeasors are of course possible, and are enthusiastically reported in the news.

To summarize, the families of individuals who lost their lives in the 9/11 attacks may receive payments from one or more (but not all) of the following sources: the Victims' Compensation Fund (assuming they waive their tort rights and, once again, subject to reductions corresponding to amounts recovered under existing life-insurance benefits), third-party tort defendants (either because they choose not to collect from the Fund or because they pursue foreign tortfeasors


26. ATSSS Act, supra note 1, § 405(c)(3)(B).

27. 28 C.F.R. § 104.61 (2003).

relentlessly), charities, and life insurers (under contracts that conventionally contain no collateral-offset provisions).

C. The Effects on the Insurance Industry and the Federal Response

Despite the vast magnitude of the insured life and property losses, there seems to be little doubt that most life insurers and property insurers will be able to meet their financial obligations arising out of the events of 9/11. As for the life-insurance market, the number of insured deaths was not so great as to threaten instability among insurers. Nor will the demand for life-insurance policies disappear; individuals will hardly cease to purchase policies merely because policy ownership will likely cause a reduction in government relief following (the very unlikely event of) death as a result of terrorism. To the contrary, although there are no hard data on this, we suspect that the events of 9/11 encouraged a short-term run on trusts and estate lawyers' services and perhaps a temporary surge in the market for life insurance as well.

The property-insurance market is apparently more easily ruffled. A few of the less well-capitalized reinsurers may yet become insolvent as a result of 9/11-related property losses (much as some firms collapsed following Hurricane Andrew and the Northridge Earthquake), but the overall solvency of the property-casualty insurance industry is not in doubt. The uncertainty is with respect to the availability of terrorism coverage in the future and, in turn, the possibility that there will be less building, or less building in some locations and of certain types of properties, not simply because insurance premiums rise accurately in response to newly understood threats, but rather because insurance markets will not adjust smoothly to the post-9/11 world.

Immediately following 9/11, a number of commentators and industry officials expressed concerns about an impending “crisis” in terrorism insurance. It was widely reported that international reinsurers were planning to insert broad terrorism exclusions in their new policies and that these exclusions would be applied as old policies came up for renewal. Primary insurers would in turn seek permission from state regulators to insert similar exclusions in their policies. The ultimate effect, or so the argument went, would be to cause disruptions in the mortgage lending and commercial real estate markets. Commercial lenders would be reluctant to issue loans — or would

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29. Catastrophes: Insurance Issues, INS. ISSUES UPDATE, Aug. 2002, 1995 WL 628905 ("Eleven property-casualty insurers became insolvent due to Hurricane Andrew (10 in Florida and one in Louisiana) and others were financially impaired.").

30. See TILLINGHAST-TOWERS PERRIN, supra note 3.
demand compensation in the form of exorbitant interest rates — in the absence of insurance coverage for terrorism-related losses.

Based on these concerns, Congress enacted the Terrorism Risk Insurance Act of 2002, which, as we will see, is similar to the British system for dealing with terrorism risks to property. Under this new regime, the federal government will provide reinsurance for ninety percent of all property-casualty losses attributable to “acts of terrorism” (as determined by the Secretary of Treasury), but only to the extent that the aggregate losses fall between $10 billion (rising to $15 billion over three years) and $100 billion. By introducing government reinsurance, this program radically alters the public/private mix of insurance and compensation for terrorism-related property risks. In effect, it makes the federal government the terrorism reinsurer of last resort. We discuss the related issues of whether this type and degree of federal intervention was called for and what the relevant justifications might be in Part IV below.

III. TERRORISM INSURANCE, CHARITABLE GIVING, AND EPISODIC GOVERNMENT RELIEF

We turn now to the question of what sort of compensation, insurance, and charitable developments should be expected in the event of another major loss from terrorism, given recent events. The question may seem little more than a thought experiment, though there are safe and interesting predictions to be made. Our analysis includes a comparison of terrorism-related disasters with natural disasters and incorporates the interactions among private insurance, public relief, and charitable giving in the two contexts. One of our predictions is that, as with natural disasters, public and charitable relief will more likely be forthcoming if there is (or is perceived to be) less than full private insurance. In this Part we also explore the question of why 9/11 prompted such unprecedented amounts of relief — especially in the form of the Victim's Compensation Fund — and whether future attacks should be expected to do the same. Along the same lines, we consider the unpleasant possibility that what began as a series of terrorist attacks might expand into a long-term war, resulting in political pressure to shift from a system of episodic relief to a more systematized and permanent compensation regime.

31. See Terrorism Risk Insurance Act, supra note 2.
32. See infra Part III.C.2.
33. Terrorism Risk Insurance Act, supra note 2, § 103(e).
A. Private- and Public-Insurance Responses to Another Attack

There is every reason to think that, in the event of another attack on U.S. soil, and especially one aimed at a civilian target, significant government-provided compensation would again be forthcoming, even though the attacks experienced before 9/11 did not produce such aid. One reason for this prediction is the Victims' Compensation Fund itself and the precedent it now represents. It is conceivable, however, that the political and emotional underpinnings of the Fund would fail to reappear if terror-related losses became common. Indeed, it is something of conventional wisdom to say that the 9/11 attacks were a historic event of the worst kind, and that the reactions to it should also be understood as singular. But the case seems to be stronger for the prediction that the Fund would serve as a kind of precedent for relief following future attacks, much as the substantial federal appropriation that followed the Alaskan earthquake of 1964 is thought to have been the first of what then became a series of relief plans.34 What is interesting about this example for the present situation is not the legislative history but the emerging pattern, in which victims of new disasters point to recent precedents to strengthen their own claims for government relief.

And this pattern of relief should come as no surprise. Natural catastrophes attract media attention and political interest, in part because of the dramatic and vivid stories of woe that they produce. In addition, there is the effect of geographic concentration; that is, natural disasters typically hit only a well-defined fraction of the country and of the economy, creating the quintessential concentrated and politically effective interest group. In any event, this attention attracts charitable interest as well as governmental funds, although, as discussed more fully below, the extent to which the victims will be seen as sympathetic to mainstream voters, and hence politicians in other parts of the country, depends importantly on the extent of uninsured rather than insured losses.35

We would expect a similar dynamic to play out to an even greater degree if there were to be another terrorist attack or a series of such

34. In the twenty or so years following that earthquake, legislators who sought disaster relief for their home states readily pointed to the Alaskan example, where there was relief after a significant but not unprecedented quake. See DOUGLAS C. DACY & HOWARD KUNREUTHER, THE ECONOMICS OF NATURAL DISASTERS: IMPLICATIONS FOR FEDERAL POLICY 54-57 (1969); Saul Levmore, Coalitions and Quakes: Disaster Relief and Its Prevention, 3 U. CHI. L. SCH. ROUNDTABLE 1, 18-19 (1996).

35. We do not, of course, assume that voters generally are aware of how much property or life-insurance coverage the average household has. Rather, the idea is that the calls for relief will be more likely to come from those who do not have other sources of compensation, and that it will be the pleas (and stories) of the uninsured victims that will get the most (and most effective) play in the media and with politicians, and then perhaps with voters.
attacks. Terrorism, after all, draws in the entire nation in a way that natural disasters do not. This is because an attack from abroad, including a pronouncement or history of animus toward the country as a whole, is seen as one aimed at the integrity or confidence of all citizens. Thus, just as Pearl Harbor was considered an attack on the entire nation and not just an attack on the state of Hawaii, so too a terrorist attack on U.S. soil (perhaps especially one carried out by an attacker who is or is perceived to be a “foreign combatant”) would be considered an attack on the U.S. people and government. A natural disaster will trigger a weaker reaction than an enemy assault; hurricanes do not hit Florida because it is a part of the United States, whereas terrorists struck New York and Washington precisely for what they signified about our nation.

Indeed, part of what may have motivated the Victims’ Compensation Fund was the feeling that the losses suffered on 9/11 were no different from losses caused by the attack of a foreign sovereign, thus putting them in the category of losses appropriately addressed by the federal government.36 Political parties, economists, and citizens may disagree as to the proper scope of the federal government, but national defense is on everyone’s list of governmental functions, and it is only one additional step to the idea that the federal government ought to be responsible or generous where losses are incurred because of a failure of this federal function.37 This leap from failed protection to generous compensation may be primarily an emotional reaction rather than a logical progression, but it helps to explain the comfort with federal relief following 9/11.

36. The Israeli example is instructive here. When the Israeli Parliament first adopted its terrorism compensation regime, discussed more fully below, the primary rationale was the notion that any losses experienced by individuals or particular families as a result of the terrorist war on the Israeli government and people as a whole should be spread across all of its citizens. See Hillel Sommer, Providing Compensation for Harm Caused by Terrorism: Lessons Learned in the Israeli Experience, 36 IND. L. REV. 335, 336-39 (2003). Of course, whereas viewing the attack on 9/11 as an “act of war” against the U.S. government and its people may have increased the willingness of Congress to enact a generous compensation regime, such an interpretation of events would tend to undermine the argument for private-insurance coverage for those losses, since most insurance policies contain “war-risk” exclusions. Interestingly, almost immediately following the 9/11 attack, several of the largest property-casualty insurers publicly stated their intention not to invoke the war-risk exclusion. This may have been a patriotic gesture, or it may have represented a savvy legal judgment that, under prevailing case law, the war-risk exclusion would not likely apply in the 9/11 case anyway. See Pan Am. World Airways v. Aetna Cas. & Sur. Co., 505 F.2d 989 (2d Cir. 1974).

37. We do not mean to imply that a government function need always be encouraged by compensation in the event of failure or even disappointment, because governments are often disciplined by political checks and other means. But compensation is surely more easily explained or defended where losses are incurred because of government failure, or at least where it is the government rather than a private party that might have best prevented the loss.
Indeed, it is just this sort of visceral reaction to the 9/11 attacks, together with the inspiring example of the rescue workers running into the burning towers (and perhaps the suppression of stories about the misdeeds of a very few rescue workers), that may explain the extraordinary level of charitable giving both in terms of money and volunteer efforts, including the extraordinary increase in blood donations.\textsuperscript{38} In fact, the only periods in U.S. history of comparable charitable involvement have been during times of war when American citizens rallied together to battle a foreign enemy.\textsuperscript{39}

The other major factor that may lead to substantial government relief for victims of terrorism-related disasters is the predictable pattern connecting uninsured losses, public sympathy, and government relief. This link builds on the following fact: public sympathy following a disaster will almost certainly be more intense, and hence the political determination to provide relief funds will be greater, to the extent there are uninsured victims. It is, of course, those victims who will most likely come to the attention of voters through media coverage, personal or political relationships, and other channels.\textsuperscript{40} If a disaster largely creates victims who already have private insurance for their losses, there is apt to be less sympathy and therefore a lower probability of public or charitable relief. The idea is that politicians will respond less readily to pleas for help from those who are known to have other sources of compensation.\textsuperscript{41}

It is noteworthy that the existing disaster-relief programs always condition relief on the absence of insurance coverage. For example, Farm Service Agency and Small Business Administration low-interest loans to eligible individuals, farmers, and businesses who suffer damaged property is conditional on the absence of insurance. Similarly, FEMA grants to cover certain expenses are conditioned on an absence of insurance coverage.\textsuperscript{42}

The overall picture comes with something of a cynical gloss; relief requires a sizeable group of sympathetic beneficiaries who, ideally, are also politically coordinated or appealing to the media, which increases the likelihood of a major disaster declaration. If a disaster creates victims who are insured, however, there is apt to be less sympathy and therefore a lower probability of monetary relief, because politicians

\textsuperscript{38} See AM. RED CROSS, supra note 22.

\textsuperscript{39} Notably, the attack on Pearl Harbor did not give rise to the enactment of a 9/11-type compensation fund for the victims of that attack. One reason for this might be that there were relatively few civilian deaths and relatively little damage to non-government property.

\textsuperscript{40} Levmore, supra note 34, at 18-19.

\textsuperscript{41} Id. See generally David A. Moss, Courting Disaster? The Transformation of Federal Disaster Policy Since 1803, in THE FINANCING OF CATASTROPHIC RISK 307 (Kenneth A. Frost ed., 1999) (detailing the growth of the federal budget allocations for disaster relief).

\textsuperscript{42} 44 C.F.R. § 206.110, 206.113 (2003).
who are considering special appropriations will respond more readily to pleas for help from those who have no other source of compensation. Given this relationship between uninsured losses and the likelihood of government relief, an incentive is created among individuals and businesses not to purchase insurance (or to purchase less-than-full insurance) against disaster losses.\footnote{Louis Kaplow, *Incentives and Government Relief of Risk*, 4 J. RISK & UNCERTAINTY 167 (1991) (modeling how government insurance for various risks, including disaster risks, distorts individual incentives). Note that, because government disaster relief is dispersed only in the event of a declared “major disaster,” private insurance is, from the insured’s point of view, a better buy for small-scale than for large-scale disasters. More precisely, an insurance purchaser should be willing to pay more for insurance against a given expected loss that is not likely to be covered by government relief (for example, a loss associated with a small-scale disaster) than she would pay for the same expected loss that is expected to be reimbursed, at least partially, by the government. This conclusion assumes that insurance companies would not lower their price-per-unit of insurance to take account of likely large-scale disaster coverage. If they could — and they would in a perfectly competitive market — then both the coverage for the small-scale and the coverage for the large-scale disasters would be priced at actuarially fair rates.} A final implication is that this dynamic at the margins may affect “real” — and not merely insurance — decisions. For example, the expectation of federal relief has almost certainly increased the willingness of some individuals and businesses to locate or remain in disaster prone areas. This sort of moral hazard actually increases the risk of the hazards being insured against.

It is possible that there will be a similar perverse interaction between government relief and charitable giving for future terror victims. For example, having observed the magnitude of charitable giving following 9/11, government officials may be inclined to be less generous in the event of a future attack. It may be that the memory of the remarkable outpouring of charity for the victims of 9/11 will dampen the federal government’s willingness to appropriate large amounts of relief aid for victims if and when the next terrorism-related disaster occurs. Alternatively, rather than reducing relief payments, Congress might, in a future version of the Victim Compensation Fund, explicitly include charitable contributions on the list of collateral sources to be offset against any relief award.

Of course, the effect may run in the opposite direction as well. Having seen how generous the federal government can be when there is an extraordinary foreign-based attack on American soil, potential donors may reduce their contributions in future cases, relying on the government to do the job once again. And if contributions were to diminish (or were expected to diminish) in this way, there would be even more political pressure for the government to provide relief. Similarly, one might imagine that charities would then focus their attention on victims whose losses went uncompensated by government relief or private insurance; charities could in this way fill in the
coverage gaps and also signal where future government relief might be
directed. How all of these interacting influences will ultimately play
out remains to be seen.

Another factor that might lead to a reduction in both government
benefits and charitable relief following future terrorism disasters is the
perception that, for all the recollections and evidence of tragedy and
heroism, a significant number of affected families emerged with more
wealth than before the attacks — and stories of outright fraud will also
continue to appear. If such stories remain salient, one can easily
imagine that congressional policymakers and potential donors would
be reluctant to replicate the unprecedented generosity following 9/11.

We have already emphasized the importance of the extent of
uninsurance or underinsurance as related to the amount of likely
government relief. Given this relationship, one might reasonably ask
how significant the underinsurance problem will be in the future for
terrorism-related risks. As to life insurance, it seems highly unlikely
that even the unprecedented generosity of the 9/11 Fund’s payouts will
affect future life-insurance-purchasing decisions. With respect to
property insurance, questions of insurability and underinsurance are
more complex. We take up these questions in Part IV below and find
both that the uninsurability problem has been exaggerated, and that
the new federal property-casualty reinsurance program may not be
terribly effective. In particular, when individuals and businesses can
decline the new terrorism coverage, as they can under the new law, the
program may actually end up contributing to the underinsurance-
followed-by-relief cycle. In any case, in the event of a future attack,
there will likely be room for a federal-program response similar to the
response engendered by the attacks on 9/11. A somewhat different
question is raised by the prospect of a protracted war against civilian
targets, rather than another isolated terrorist attack, and we take up
this question in Part III.C below.

B. What Made 9/11 Different from Previous Terror Attacks?

A related but distinct comparative question is why the 9/11 attacks
triggered so much more government relief than did previous terrorist
attacks. Put differently, once compensation for terror-related losses
was placed on the table, why was the program not expanded to include
benefits to victims of the earlier World Trade Center bombing, the
Oklahoma City bombing, or the attack on the U.S.S. Cole, which
killed a number of U.S. sailors?

Part of the answer lies in a simple reference to scale. Many more
people died on 9/11 than in any of the previous terrorist attacks. The
erlier attacks also affected fewer uninsured parties. In the case of 9/11
there was a huge loss of uninsured life, not because of terrorism
exclusions, but because of simple underinsurance problems resulting
from myopia, overoptimism, bad planning, or passivity on the part of persons who are unlikely to purchase insurance coverage above what is provided through their employment contracts. Given what we know about patterns of life-insurance purchasing generally, approximately three thousand sudden deaths would almost certainly generate a significant number of uninsured or underinsured lives. Moreover, given that some lower-income households may view life insurance as a luxury, it is likely that the underinsurance problem may even be worse among the relatively low-income workers who worked at the World Trade Center.\footnote{The countervailing effect, however, would be that the normal, government-provided life insurance — paid out through the Social Security Survivorship program to dependents of qualifying workers — would provide a higher percentage income replacement for low-income than for high-income recipients.}

At the same time, the amount of uninsured and underinsured damage to New York's infrastructure and businesses created immediate and overwhelming (and probably desirable) political pressure on the President and Congress to commit federal funds to rebuild and reinvigorate the city, which in turn may have had an effect on victim relief initiatives. Put directly, it might have been politically difficult to transfer large amounts of money for property damage or other economic losses without also doing much for the families of those who were killed in the attack. In contrast, the families of the sailors killed on the U.S.S. Cole received some payments from the government as a matter of course, because all members of the armed forces are covered by modest death benefits.\footnote{Currently the government will pay a "death gratuity" to the surviving heirs of military personnel killed on active or inactive duty. See 10 U.S.C. § 1475, 1478 (2000). Military Family Tax Relief Act of 2003, Pub. L. No. 108-121, 117 Stat. 1335. Most military personnel also participate in the Servicemembers' Group Life Insurance program ("SGLI"), which provides $250,000 of coverage. The premiums are automatically deducted from the servicemember's pay, unless they elect for a lower amount of coverage. See Armed Forces Services Corporation, Servicemember's Group Life Insurance Benefits, at http://www.afscusa.com/sgli.html (last visited Jan. 24, 2003).}

Moreover, in the case of the U.S.S. Cole, there was no need to assemble a political coalition to legislate a strategy for replacing the lost property. Inasmuch as such a repair is obviously a better investment than is the abandonment of the ship, the vessel was probably repaired either with funds found in the ordinary budget for naval operations or through a special appropriation. Somewhat similarly, in the Oklahoma City case, there was no large-scale damage to state and local infrastructure, but rather the destruction of a building owned by the federal government itself. It is likely that the lives lost in that tragedy included few who were both uninsured, or dramatically underinsured, and in position to support a family.\footnote{Many of those killed in the Oklahoma City bombing were federal employees who participated in the Federal Employee Group Life Insurance Program. Basic coverage is at least $10,000 and most employees are automatically enrolled. Optional coverage is available...}
The 9/11 attacks did great harm to a workplace that naturally had many breadwinners who in turn left families that claimed our sympathy. Oklahoma City took the lives of fewer heads of households; the death of children upsets us as much as anything, but it does not produce circumstances that seem much improved by the appropriation of money. In short, it is unsurprising that Oklahoma City families eventually received but modest tax relief, while the 9/11 Fund provided quite substantial direct payments.

Although these distinctions can help us to predict when and where after-the-fact government relief will be forthcoming, they do not solve the puzzle entirely. Had the political picture been slightly different, the 9/11 Fund might have been expanded to include families affected by the earlier terrorist attacks, with the same collateral-offset provisions to limit the coverage to uninsured losses only. In this way, the relief would have flowed mostly to sympathetic, uninsured, or underinsured families. Indeed, it is possible that this sort of retroactive expansion may yet occur in the event of another attack, but it is doubtful, if only because of the obvious line-drawing problems. If the benefits were expanded to include the families of the victims of the World Trade Center and Oklahoma City bombings, it seems difficult to justify excluding the U.S.S. Cole victims and then the victims of the contemporaneous anthrax attacks and so on. Of course, difficulty in drawing lines is not the same as impossibility; nevertheless, it might be thought easiest and safest for the federal budget simply to draw a bright line between pre- and post-9/11 events, so that future terrorist attacks might be treated along the lines of the 9/11 model with no new relief for losses caused before that infamous day.

Again, we do not mean to insist that one can examine tragedies as they occur and always predict the character and magnitude of subsequent relief. If the 9/11 relief package had required a few more votes in Congress, for example, or a political appeal to the hinterland, one can easily imagine the last-minute inclusion of the families of victims of the Oklahoma City blast. A politician might then have emphasized the expense of constructing a new federal building in Oklahoma City, and while legislating funds for that reconstruction or for a memorial to be built on the site of that blast, it might have seemed unfeeling to provide nothing for lost lives.47 In the event of up to five times the employee's annual salary. See Office of Personnel Management, Federal Employees' Group Life Insurance Program, at http://www.opm.gov/insure/life/FAQs/FAQs-l.htm (last updated March 13, 2003). Victims also received modest compensation from the Murrah Crime Victims Compensation Fund. The original ambitions of this fund never materialized, however, and its benefits were limited to $10,000. See Gary Fields, Oklahoma City Aid Not Reaching Victims, USA TODAY, Nov. 15, 1995, at 3A.

47. One argument for including victims of the first World Trade Center bombing might have emphasized the similarity of the attackers' origins and motivations with those behind the 9/11 attacks.
another tragedy, and assuming as we are now that such a tragedy would give rise to ex post relief in accordance with the 9/11 model, there would likely be attempts of just this sort to include the families of victims of past terrorist attacks and perhaps the victims of wars and wrongs experienced long ago. Indeed, it is noteworthy that although Oklahoma City victims were not included in the 9/11 package, they were eventually provided with modest assistance in the Victims of Terrorism Tax Relief Act of 2001.48 These attempts to equate tragedies, in the sense of using one disaster or relief effort as precedent for another, may succeed — but they may also unwittingly bring about the collapse of political coalitions and hence of relief along the lines of the 9/11 Fund. For example, if the next terror attack in the United States were to provoke calls for 9/11-like levels of compensation, the coalition of political forces that supported the 9/11 Fund as a one-time occurrence may, owing to the prospect of excessive cost, fail to reconstitute.

In any event, we maintain our basic claim that a future large-scale terrorist event will almost certainly generate ex post relief of the sort that followed 9/11. A further prediction is that the precise shape of the episodic relief will, as always, hinge on the pattern of insured and uninsured losses.

There is an alternative explanation for the generous compensation regime that followed 9/11 that deserves as much consideration as one that emphasizes uninsured losses. Recall that beneficiaries who file for benefits under the Fund must waive most of their rights to sue in tort.49 The primary and intended beneficiary of that provision is almost certainly the airline industry.50 The airline industry was, for obvious reasons, among the hardest hit by the events of 9/11. Demand for tickets dropped, there was an immediate spike in airline insurance premiums, and, by some reports, the available insurance policies removed coverage for losses caused by terrorism. Congressional reactions to this state of affairs, and to the fear of airline bankruptcies

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48. Pub. L. No. 107-134, 115 Stat. 2427 (2002); see also INTERNAL REVENUE SERV., PUBLICATION 3920: TAX RELIEF FOR VICTIMS OF TERRORIST ATTACKS (2002), available at http://www.irs.gov/pub/irs-pdf/p3920.pdf (summarizing tax benefits made available to victims of 9/11, the Oklahoma City bombing, and the 2001 anthrax attacks). Under this provision, the qualifying survivors of those attacks are exempt from income tax for the year of attack and the previous year, with the minimum refund being set at $10,000. Thus, even those who owed no income taxes in a given tax year will be considered to have paid $10,000 in income tax in that year, and will receive a $10,000 federal tax refund check. See id. at 5. Interestingly, these tax relief checks will not be treated as a "collateral offset" under the 9/11 Victim Compensation Fund. See ATSSS Act, supra note 1; 28 C.F.R. § 104.47 (2003).

49. ATSSS Act, supra note 1, § 405(c)(3)(B)(i).

and economic disaster, included the Air Transportation Safety and System Stabilization Act's provision of cash transfers, loans, insurance subsidies, and safeguards from litigation to the airline industry. Given the generosity of the benefits available to the families of victims through the 9/11 Fund, and the requirement that recipients waive the right to litigate, this waiver requirement provides great value to the airlines. This is not the place to explore the question of whether under the principles of our tort system the airlines ought to have feared the legal aftermath of 9/11. A respectable argument can be made that in the absence of obvious negligence and in the presence of other potential defendants who could have been linked to the 9/11 losses under some theory of negligence or strict liability (focusing on the failure to reinforce cockpit doors or to design buildings in a different manner, for example), the only thing to fear was the inclination of some juries to move money to sympathetic victims. But it is possible that the waiver idea was critical to post-9/11 relief and that this disaster is different from most others. And to the extent that the 9/11 Fund is therefore seen as nothing more than such an industry-specific and episodic subsidization scheme — accompanied by compensation for victims' families in order to maintain appearances perhaps — there is not much to say about future relief. Industry bailouts are episodic in their own way and in any event do not suggest a move toward routinized relief.

C. From Episodic Relief to Permanent (Routinized) Compensation

The discussion of public and private responses to future terrorist attacks has assumed to this point that future attacks would be rare, even if devastating. If, however, the 9/11 attacks prove to be the beginning of a protracted conflict involving numerous events that produce losses of life and property on American soil, then expectations would likely change. Calls for generous episodic relief on

51. ATSSS Act, supra note 1, § 101(a)(2) (calling for payments of up to $5 billion for losses due to ground top order following attacks of 9/11).

52. Id. § 101(a)(1) (authorizing up to $10 billion in loans).

53. Id. § 201(b) (authorizing temporary subsidies for increased cost of airlines-insurance coverage).

54. Id. § 405(c)(3)(B)(i).

55. The other protection for the air transportation industry in the Act was a provision limiting the airlines' tort damages arising out of 9/11 to the amount of liability insurance in force at the time of the attacks. See ATSSS Act, supra note 1, § 408.

56. Although one can, with respect to Oklahoma City and the earlier World Trade Center bombing, begin to imagine potential tort defendants, none of those defendants can make as plausible a case as could the airline industry post-9/11 that an entire and critical industry was in jeopardy — at least in the sense of being threatened with enormous transaction costs as firms reorganized or closed and new owners of old aircraft emerged.
the order of the 9/11 Fund payouts might help to fuel a preemptive political move to adopt a more permanent regime of compensation, though with more modest benefit levels. Another potential political justification for such a regime would be the idea of boosting public morale by establishing a framework in which all citizens and taxpayers must share somewhat in the burdens of war. In addition, such a regime might be considered a valid response to the failure of (or gaps in) the private-insurance market. Although private insurers may be able to function amidst a full-scale war — that is, they may be able to cover war-related risks in return for high premiums — a society that is involved in a full-scale war is likely to find itself with numerous insolvent insurers, and then with customers who are unwilling to rely on private insurance because of the risk of insurer insolvency.  

Thus, if it becomes clear that a long-term war is at hand, involving a substantial risk of recurring strikes on the U.S. mainland, substantial government involvement in providing terrorism compensation directly to victims seems likely. In this Part, we discuss this possibility, and we draw lessons from the examples of Britain and Israel.

1. To What Extent Is the Current U.S. Relief Regime “Permanent”?  

As a preliminary matter, we should note that there already exists a permanent federal program that provides some relief from the economic losses caused by any disaster the President declares a “major disaster,” including terrorism-related disasters. That relief comes in the form of loans and grants following property damage, both private and public; but these funds are available only after the governor of the state in which the disaster has occurred makes the required disaster declaration and the President follows with a similar declaration. In an important sense, then, the existing regime of government compensation for disaster-caused losses to property is largely ad hoc or episodic, except to the extent that these disaster declarations are largely predictable. With respect to terrorism-related losses specifically, there are some existing federal programs (enacted

57. At that point, of course, an unassisted market might respond through a consortium of insurers. This solution, however, would likely prompt some government involvement, as regulatory constraints on monopolization would need to be relaxed (to allow for the increased risk sharing among insurers) and greater oversight of premiums exercised.

58. See supra note 9.

59. The exception to this pattern is flood insurance. Under the National Flood Insurance Program (“NFIP”), there are predetermined floodplain areas in which property owners are eligible to purchase federally subsidized flood insurance. Thus, once such coverage is purchased, there need be no disaster declaration for property owners to be able to recover on their policies. If, however, the property owner in a floodplain area fails to purchase flood coverage, or underinsures, and wishes to receive a FEMA grant or SBA loan, the disaster declaration is necessary and relief is episodic. See infra text accompanying notes 79-82 for further discussion of the NFIP.
well before 9/11), that provide modest compensation for victims of terrorist attacks. For example, following the Iranian hostage episode and a number of other terrorist attacks in the 1980s, Congress created a regime that pays a small amount of compensation to certain victims of terrorism.60 Under this program, citizens who are held hostage by terrorists receive a stipend of fifty dollars for each day that they are held in captivity,61 and there is a small death benefit paid to the families of victims who are killed by terrorists.62

2. When Terrorism Turns to War: Lessons from England and Israel

It is fairly easy to imagine that repeated attacks or a prolonged war on U.S. soil would create enormous political pressure to expand the rather paltry terror-compensation benefits described in the previous Part. A transition of this sort occurred in both Great Britain and Israel, although the resulting programs in those countries differ significantly from each other.

In Britain during the Second World War, Churchill famously set forth the notion that the British people should share-in the economic hardships imposed by the war. Incessant bombings, targeted at civilians and urban centers, threatened to demoralize the country, and part of the idea behind Churchill's message was to reflect the conviction that the entire nation was joined in the struggle as one.63 Of course, no system could fully equalize the burdens of war, and no attempt was made to impose equal sacrifice following deaths in a family, whether on the battlefield or in London. But the law that was passed, The War Damage Act of 1943, did provide compensation for war damages to property that occurred between September 3, 1939 and October 1, 1964.64 Though the "risk period" during which the Act


63. Winston Churchill determined "that it was 'unfair for British society to place the entire burden of the destruction on those unlucky enough to be hit.' " See Sommer, supra note 36, at 338 (quoting Green v. Smith & Nephew AHP, Inc., 617 N.W.2d 881, 888 n.3 (Wis. Ct. App. 2000), aff'd, 629 N.W.2d 727 (Wis. 2001)).

64. War Damage Act, 1943, 6 & 7 Geo. 6, c. 21 (Eng.). Half of the funds for this Act came from a new tax on landowners and the other half came from general welfare funds. Id. An earlier piece of similar legislation is the War Risk Insurance Act of 1939, which authorized the Board of Trade to "undertake the insurance of ships and other goods" and to "requir[e] persons to insure goods against certain risks in time of war." S.M. KRUSIN & P.H.
was to apply ended in 1964, the Act was eventually repealed in its entirety in 1981.65 Following this repeal, the only remaining provision of government property insurance was the “Pool Re” scheme, which we discuss below in connection with the new U.S. terrorism-risk-insurance program.66

Personal injuries were also included under the British war-insurance regime. The Personal Injuries (Emergency Provisions) Act of 1939 made “provisions as respects certain personal injuries sustained during the period of the present emergency.”67 This scheme was not limited exclusively to military personnel, but rather applied to all “gainfully occupied persons... and [to] persons of such other classes as may be specified in the scheme.”68 The program still remains in force and is maintained by the Secretary of State under the Personal Injuries (Civilians) Scheme 1983.69

A full-scale war on the U.S. mainland, comparable to the situation in Britain during World War II, is almost impossible to imagine given the current state of world affairs. More imaginable would be a series of coordinated terrorist attacks on U.S. soil and against U.S. interests and citizens around the world. The obvious analogue to such a hypothetical is the state of war in present-day Israel, and indeed that country has adopted a permanent terrorism compensation regime that seems relevant for our purposes.

Israeli law provides a system of direct compensation by the government for civilian losses of life and limb, and for losses of

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65. Statute Law (Repeals) Act of 1981 (Eng.).

66. See infra Part IV.B.

67. The “period of the present emergency” extended to March 9, 1946. Personal Injuries (Emergency Provisions) Act, 1939, 2 & 3 Geo. 6, c. 82 (Eng.).

68. Id.

69. Personal Injuries (Civilians) Scheme, (1983) SI 1983/686 (Eng.), amended by Personal Injuries (Civilians) Scheme, (2002) SI 2002/672 (Eng.). The payment amounts are modest compared to the Victims' Compensation Fund, amounting at most to a few hundred pounds a week, depending on one’s degree of disability. The base compensation to a widow or widower is ninety-two pounds a week. Despite the fact that the rate schedule is updated annually, the amounts have changed little, if at all, since 1983. Id. at 2108 sched.2.
The level of compensation is middling, much lower than that provided by the 9/11 fund but much more than that expected from charitable collections or from the U.S. legislation that followed the Iranian hostage crisis. Medical care is provided, and lost earnings are partially replaced up to a middle-class standard. We might think of the Israeli system for compensating terrorism losses as comparable to the worker's compensation program found in the United States, but of course this program does not presently extend its benefits from the place of work to the place of war.

The Israeli regime grew out of a wartime scheme that sought to spread the burdens of war across the population. The idea behind the expansion of the war-loss compensation regime was that terrorist attacks were essentially an extension of the wars that Israel had been fighting, and, just as acts of war were directed at Israel as a country (so that the rhetoric or politics of burden-sharing was found attractive), acts of terrorism were also directed at the Israeli people as a whole.

American history and politics do not much resemble Israel's, but terrorist attacks, and recent anthrax and sniper attacks, have affected the nation as a whole, whereas most other crimes have not. It is not at all difficult to imagine that more attacks on U.S. soil, perhaps producing salient uninsured losses, would create the will or political opportunity to think of the nation as involved in a protracted war, or to expand our scheme for compensating members (and families of members) of the armed services to include all victims of terrorism. The details of this sort of scheme, and the relative generosity of these imagined routinized benefits would depend, no doubt, on the mood

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71. The only English source we have been able to find describing the benefits available under the Israeli compensation regime is the article by Hillel Sommer. Our very brief summary of these benefits derives entirely from that article. See Sommer, supra note 36, at 343-51 nn.41-100 and accompanying text. Sommer states that his description of the program was compiled "from a variety of formal and mostly informal sources." Id. at 343 n.41.

72. Id. at 343-51 nn.41-100 and accompanying text. The Israeli payouts for personal injury or death are generous compared to other types of social welfare benefits in Israel (and, certainly, in the United States), but substantially smaller than the benefits offered under the 9/11 Victims' Compensation Fund. Injured victims receive state-provided medical care, disability benefits during the period of treatment and recovery, and additional amounts designed to assist their reentry into the workplace. The families of victims killed by terrorist attacks receive monthly survivorship benefits (based on the salary of a mid-level government employee) as well as payments for some incidental expenses. With respect to property losses, the Israeli government essentially acts as an insurance company, paying to replace or repair property damaged or destroyed in a terrorist attack. Id.

73. Id. at 353-54.

74. See supra note 45 (reviewing the military compensation scheme).
created by the final precipitating events, on the level of social insurance that is otherwise available, and on the question of whether these routinized benefits are cast as a substitute for, or a supplement to, episodic ex post relief.

3. **Expanding Routinized Terrorism Compensation in the U.S.**

If a regime of permanent, routinized terrorism relief were adopted in the U.S. (and here we focus on compensation for loss of life), we would expect such relief to provide only for uncompensated or uninsured losses. This structural spine of any relief system — the limitation of benefits to uninsured losses — is what sustains public sympathy for the relief effort, even as it serves the function of reducing moral hazard. The pervasiveness of this principle can be seen not only in the collateral-offset provisions of the 9/11 Fund and in the uncompensated-loss requirements of federal disaster relief programs more generally, as discussed above, but also in such legal doctrines as the insurable interest requirement and the principle of indemnity in insurance law.

There is, therefore, reason to expect that the adoption of a permanent regime of terrorism compensation would reduce, though not eliminate, episodic relief payouts of the sort seen in the 9/11 Fund. Once such a regime is known to be in place, there would be relatively little political pressure for after-the-fact relief. The same argument extends to private contributions as well. If citizens knew that some level of compensation would be paid to families of terror attacks, charitable giving would likely decrease. There are other examples of this phenomenon in the private sector. For example, when an individual within a workplace experiences a sudden family crisis or unusual emergency, coworkers may contribute money to a fund to help the person through the difficult period. But such informal ex post mutual-insurance arrangements are rare with respect to illnesses or deaths that are known to be covered by insurance that is provided

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75. In the United States, of course, we have a variety of domestic social insurance and employment schemes to use for comparison, and other countries have compensation systems that are more directly comparable.

76. See infra Part IV.B., where we discuss the government’s routinized response to terrorism-related property losses.

77. This point is emphasized in Abraham & Logue, supra note 25. The principle of indemnity says that an insurance policyholder should never receive more than full compensation for a given insured loss. One example of this principle is the doctrine of insurable interest, which holds that an insurance policy is valid only to the extent the insured will suffer a loss if the property (or person) insured is destroyed or harmed. ROBERT H. JERRY II, UNDERSTANDING INSURANCE LAW 295 (3d ed. 2002). The principle of indemnity in general, and the doctrine of insurable interest in particular, are intended to combat moral hazard.
through the workplace.78 Similarly, politicians do not sponsor or obtain
government payouts for the families of military personnel killed in
battle, as these families are known to receive death benefits, albeit
modest ones.

It is unlikely, however, that the adoption of a routinized terror
compensation system would bring ex post episodic relief to an end, in
part because it is impossible to predict the scale of a disaster. Thus,
even if a routinized regime were in place, another major terrorism-
related disaster could produce enough uninsured losses, public
sympathy, and interest group influences to bring about yet another ad
hoc response. An example of this dynamic can be seen in the
application of the National Flood Insurance Program ["NFIP"]').79 The
NFIP is a routinized regime of sorts, funded in part by American tax
dollars and in part through premiums paid by the insureds, and
administered by private-insurance companies.80 Under this program,
the U.S. government in effect subsidizes the ex ante purchase of flood
insurance by those who live in floodplains.81 Thus, when a flood
occurs, there is a permanent and routinized regime in place that
provides scheduled compensation without regard to the level of
sympathy generated by a particular flood. Nevertheless, serious floods
inevitably create losses that are uncovered by this insurance as many
floodplain property owners still do not buy flood coverage, and the
ensuing public sympathy creates pressure to provide additional ex post
relief. Indeed, once there is enough of a public outcry to produce a
declaration of a disaster, the relief to uninsured losses automatically
begins to flow via FEMA and related programs.82

78. Somewhat similarly but tangentially, in a workplace with an employee pension fund,
it is less likely that a retirement is accompanied by a voluntary and sizeable monetary
payment from the employer or from fellow employees. Substantial voluntary payments to
retiring employees became a thing of the past once formal and planned retirement plans
came into being.


Insurance Fund for compensating qualified flood losses and funded via premiums, bond
issuances, and congressional appropriations).

81. See also Edward T. Pasterick, The National Flood Insurance Program, in PAYING
THE PRICE: THE STATUS AND ROLE OF INSURANCE AGAINST NATURAL DISASTERS IN THE
the National Flood Insurance Program, at http://www.fema.gov/nfip/ntfip.shtm (last
updated Jan. 13, 2004). Although flood insurance is marketed through private-insurance
companies, it is underwritten by the federal government and funded out of general tax
revenues.

82. Flood victims in designated floodplains are supposed to get only one free bite at the
ex post disaster relief apple. That is, if an individual applies for flood-disaster relief and then
does not purchase and maintain flood insurance thereafter, that person is by law supposed to
be barred from receiving any future flood-disaster relief. Thus, with a homeowner who fails
to purchase flood insurance initially, then receives flood-disaster relief when a major flood
Still, the presence of the in-place compensation regime would likely reduce the size and extent of any such relief; after all, many do buy flood insurance. Therefore, the combined outcome may be an overall reduction of total payouts to victims.83 That possibility increases the political attractiveness of such a regime, if we can assume that voters are sufficiently well informed and sophisticated to appreciate the way in which it might deflect the sympathy factor and thereby avoid add-on compensation.84

If the class of taxpayers/voters and the class of potential terror victims are overlapping but not identical groups, perhaps because some regions but not others are thought to be primary terrorist targets, the rational actor and political pictures just described become fuzzier. Those who live in high-risk areas might prefer to rely on episodic relief, as they count on ex post sympathy to maximize their recoveries. The majority of citizens might oppose this plan, but they are too poorly organized to precommit the country to a system with no ex post episodic relief, though they may be able to organize sufficiently to push for routinized relief — with the expectation that episodic relief will be rare once the basic relief package is in place. At the same time, even citizens in high-risk areas will recognize that moderate attacks may not yield ex post relief. The victims of the first World Trade Center bombing may yet get some compensation for their losses, but they have gone many years with no relief. These victims or families may turn out to be worse off than they would have been with a regime of permanent compensation. But if they come to be included in a relief package, or had they been included in the 9/11 Fund as they almost were, they will be better off. In sum, citizens as a whole may favor routinized relief; some because the overall payouts will be lower once sympathy can be reduced, and others because they

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83. The other potential benefit of moving from a system of purely episodic relief to a system of permanent routinized compensation (or, more likely, to a blended system) is that if legislation is drafted with no specific victims in view, it is possible that precautions against fraud and other problems are easier to set in place.

84. Of course, the sympathy factor might also be deflected in other ways. If more victims, for instance, were fully insured through private markets, this would eliminate or reduce the need for a compensation regime in the first place. Thus, an alternative to routinized direct compensation might be government subsidies for insurance purchases, see infra Part IV, although even that approach seems unlikely to eliminate the possibility of some level of ex post relief, as some uninsurables will always remain.
prefer routinization in order to ensure coverage in the event of unspectacular losses.

Long delays can also contribute to the uncertainty of relief. Consider the episodic relief that eventually came to Japanese-Americans who were interned during World War II. These reparative payments came only after many years and only when the class of surviving and sympathetic internees was on the verge of disappearance because of natural deaths. The precipitating cause seemed to be the age of these survivors or the geographical loyalty or political inclinations of the sitting President rather than the spread of news about the suffering of this class. Moreover, other tragedies and wrongs have yielded no relief. In short, generous ex-post sympathy-enhanced benefits may come at the price of substantial uncertainty and even delay. At some point the delay makes the payments symbolic and political, rather than compensatory or influential, because expected charges are too far off to influence the behavior of any political or other actor.

Much of this will seem familiar to readers who have thought about relief and reparative programs, and so it may be useful to stress that a remarkable thing about the 9/11 Fund is that it offers generous payouts even though most of the persons who were killed could have been expected to carry life insurance, payable even for deaths caused by terrorism. We have already suggested that the destruction of so much uninsured or underinsured property, along with the desire to insulate the airline industry from lawsuit, are the real keys to understanding the development and scope of the 9/11 Fund. The modest life insurance that most firefighters carry may also have contributed to the sympathy, the charity, and thereby to the Fund, though of course we do not find similar relief following the death of one or several firefighters in the line of duty. The point is that it might have been politically impossible to establish a Fund that covered property — including such property as New York City's infrastructure — and not persons.

In any event, if a routinized regime of terror compensation were adopted, it is almost certain that the benefits would have to be significantly reduced. The level of payouts expected from the Fund — averaging approximately $1.9 million per claimant after collateral offsets — could not be sustained in a long-term conflict involving many such attacks. In a sense, then, the creation of such a Fund, and the unprecedented generosity of the payouts, reflect an optimistic


assumption that business will go on as usual. If attacks became more regular, however, and the move to a routinized regime were to occur, fiscal responsibility would require that benefit levels be set lower — perhaps something closer to the minimally compensatory levels of either the Israeli model or something approaching what the families of American soldiers receive. Sadly, this change might in turn send a pessimistic and alarming signal to an already rattled citizenry, as the reduction in benefits would represent a modest sort of defeat.

All of this is not to say, however, that it would have been politically wiser to structure the 9/11 Fund as a permanent regime from the beginning. That approach would have made it more difficult to secure the funds for New York’s rebuilding effort and would have immediately raised the vexing question of whether to include only attacks on American soil and/or attacks on American citizens. In addition, it would have raised the issue of retroactivity in a more serious way. That is, with the admission that a comprehensive, permanent terror compensation regime was necessary, it would have been much more difficult to draw a clear line between pre-9/11 and post-9/11 terror attacks. Relief for a given flood or earthquake does not necessarily bring with it serious pressure to return to earlier, perhaps smaller disasters in order to treat victims with equal generosity and sympathy. Once a set of events are linked to a common enemy in what is seen as a single conflict, however, it is unlikely that relief can be kept episodic.

What is more, these and related questions would have distracted from the more important tasks at hand following the attacks. If these matters — the questions concerning the proper amount of benefits and who should be entitled to receive them — must be confronted in the future, it will be during a period of dramatic national mobilization, at a time when interest groups, politicians, and civil libertarians, who all sometimes make too much of these somewhat arbitrary lines, will either be more willing to compromise or more easily marginalized by the majority.

IV. The Optimal Mix of Government Relief and Private Insurance

We turn now to the more normative side of the terrorism-insurance question — the issue of the optimal mix of government and private relief (including insurance) for terrorism-related losses. Some discussion of the various justifications for government intervention in the private-terrorism-insurance market is a necessary part of this analysis. Included will be our critique of the “insurance crisis” rationale for the Terrorism Risk Insurance Act of 2002 and our assessment of arguments for subsidizing, in one way or another, the private-terrorism-insurance market.
A. Of Exaggerated Crises, "Uninsurable" Risks, and the Case for (and Stronger Case Against) Government Intervention

We have already described the apparent, or perhaps opportunistic, panic in the insurance industry following the attacks of 9/11 and the claim that those attacks had rendered terrorism risks, especially risks to certain types of high-profile properties, essentially "uninsurable." These concerns culminated in the enactment of the Terrorism Risk Insurance Act of 2002, which radically altered the public-private mix with respect to terrorism-risk compensation. Some time has now passed since the early prophecies of doom in the insurance markets, and a good case can be made that terrorism-related property risks never in fact became permanently uninsurable.

Even before the enactment of the new legislation designed to stabilize the property-casualty insurance market, there were private insurers willing to cover terrorism risks, albeit at rates substantially (and understandably) higher than those that prevailed pre-9/11. Moreover, past experience and sound insurance theory tell us that any insurance problem produced by 9/11 is, in the long run, either modest or nonexistent. Whatever insurance-availability problems appeared in the period immediately following the attacks were probably manifestations of temporary capacity constraints caused by the unexpected claims on industry-wide reinsurance capital. Such effects are similar to those that followed the unusually large natural catastrophes in the early 1990s, which were also temporary. Thus, even without government intervention, as new capital entered the market in response to the new demand for terrorism insurance, coverage would likely have become more readily available and prices would have fallen, though obviously not down to the level of pre-9/11 premiums.

Of course, it may well be that the property-insurance market for terrorism risks did undergo a permanent change (even with the adoption of the federal regime), in the sense that standard commercial property policies may henceforth contain broad terrorism exclusions.

87. See supra Part II.C.
88. Terrorism Risk Insurance Act, supra note 2.
91. Id.
Those who wish to secure terrorism coverage for their properties will then need to buy separate and expensive terrorism policies or secure terrorism coverage through existing "political risk" policies. But such a change is not necessarily a sign of market failure; to the contrary, it might be a sign that the private-insurance market is working reasonably well. Market segmentation of this sort is common for earthquake and hurricane insurance, and there may be good reasons for it. For example, some insurers may have a comparative advantage in insuring such risks, while others may be particularly ill-suited to do so. Customers may also prefer choice rather than the bundling of insurance products.

Another lasting effect of 9/11 on property insurance and real estate markets may be a significant increase in insurance premiums and perhaps a reduction in the availability of coverage for certain kinds of properties, such as skyscrapers and other high-profile landmarks, and certainly for anything built at Ground Zero. This difficulty may reflect the sensible judgment of the market regarding relative risks; some properties carry a much larger terrorism risk than others. The market may judge such structures to be too attractive a target for terrorists or for copycat criminals, and hence insurance for those properties without some government intervention may truly be unavailable at a price any investor would pay. Moreover, there may be no sound reason for the government to overrule this judgment with a subsidy or mandate. That is, it is not obvious that the country's morale or the overall health of the economy requires the construction of new one-hundred-story skyscrapers to replace those that were lost. It is even possible that the current public debate over the future of the World Trade Center site itself is influenced by a common understanding that it would be foolhardy to reproduce what was there, because it would offer too tempting a target for terrorist attacks. If, however, politicians are determined to intervene in this market (as seems to be the case), the government could simply promise insurance at low cost to buildings built at Ground Zero if it deems reconstruction at that location worthwhile for the national psyche or because of beneficial externalities related to reconstruction of the area and those related to the deflection of attention from other landmarks.

92. See Pasterick, supra note 81; FEMA Flood Insurance Guidelines, supra note 82.

93. Gron and Sykes note a comparative advantage rationale for this sort of market segmentation. They first observe that, with respect to catastrophic risks such as earthquakes, hurricanes, and now terrorism, the only insurers that can effectively provide coverage are either those with enormous capital reserves of their own or those with efficient access to reinsurance capital. Thus, they note that AIG, the best-capitalized insurer in the world, was the first to come back and offer ground damage coverage for the airlines, a type of coverage that the government had stepped in to supply in the immediate aftermath of 9/11. Gron & Sykes, supra note 90, at 48-49.
Existing skyscrapers in New York and in other cities may have become more difficult to insure, but this problem is one of redistribution rather than efficiency. That is, inasmuch as these buildings have already been constructed, a sudden reduction in insurance availability has the effect of reducing the wealth of the buildings' owners and, depending on supply and demand elasticities, perhaps the wealth of the tenants as well. But the inability to insure existing properties would have little effect on investor or tenant incentives. This redistributive effect may be exacerbated by the disinclination of tenants to locate or remain in certain skyscrapers. It is difficult to think of this as a market failure except to the extent that the market fails to sort workers quickly into firms according to their willingness to be employed in skyscrapers. In any event, insurance is unlikely to solve this problem.

Thus, the uninsurability claim in our view is overstated, and the move to specialized terrorism insurers is likely an efficient one. It is furthermore our intuition, and it is the view of some other market-oriented commentators, that, even without the new federal terrorism-insurance regime, the terrorism-reinsurance market would have bounced back as quickly and as fully as the natural-disaster reinsurance market did following the earthquakes and hurricanes of the 1990s. These conclusions, however, do not prove the absence of a market failure to which the government might usefully respond. Terrorism risks may be different from natural-disaster risks in ways that suggest a potential role for the government as reinsurer or excess insurer. Thus, a familiar argument heard in support of the Terrorism Risk Insurance Act was that terrorism disasters are uniquely unpredictable, so that intervention was necessary because the pricing of insurance is especially problematic for the private market. There is something to this argument, in that terrorists, unlike hurricanes, intentionally seek to thwart prediction. Terrorists exploit the element of surprise not only to avoid capture but also to maximize the destabilizing effect of their attacks.

94. Note that these buildings might even serve as decoys or diversions of some value to other structures. This phenomenon is closely analogous to the well-known diversion effect that arises when individual property owners engage in differing levels of private but observable precaution-taking. Steven Shavell, Individual Precautions to Prevent Theft: Private Versus Socially Optimal Behavior, 11 INT’L REV. L. & ECON. 123 (1991) (showing, among other things, that the individual incentive to divert crime away from oneself and to others may lead to socially excessive private precaution-taking in some circumstances).


96. This view of the unpredictability of terrorism risks was incorporated into the congressional findings in the preliminary parts of the Act itself. Pub. L. No. 107-297, § 101(a)(4), 116 Stat. 2322 (2002) (“Widespread financial market uncertainties have arisen following the terrorist attacks of September 11, 2001, including the absence of information from which financial institutions can make statistically valid estimates of the probability and cost of future terrorist events . . . .”)
Although this is a difference between terrorist attacks and natural disasters, it may not be an important one. There is no reason to expect that the presence of intentional human agents makes the risk inherently impossible to calculate. Many insurance policies cover risks associated with intentionally caused harms, and this does not typically present a problem so long as the intentional harm is not caused by the insureds themselves. Large, sophisticated insurers can reduce the initial uncertainty associated with terrorism risks by employing terrorism experts, mathematicians, and game theorists to construct models that reduce terrorism risks to something that is calculable.\(^{97}\) Competition among insurers would then drive premiums to the actuarially correct level. To some extent, again, this is already happening. Thus, we might be encouraged (and somewhat alarmed) when we see terrorism-insurance premiums skyrocketing for the Golden Gate Bridge and other national landmarks — encouraged, because the focus on these targets may mean that security will improve through competition and government activity, and yet alarmed that these risks are presently thought to be substantial.\(^{98}\)

The case for government intervention is fueled by another difference between terrorism and natural disasters, namely the location of expertise and information about these risks. In the case of potential terrorist attacks, the government has powerful intelligence-gathering capabilities that no private insurer can muster — and this is the sort of information that the government will not readily share with insurance companies. Although it is easy to imagine an information-sharing partnership between the public and private sectors with respect to natural disasters (so that meteorological and seismological data might, for example, be exchanged), such an arrangement is difficult to imagine with respect to terrorism.\(^{99}\) This difference between

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97. There is some evidence that the country's mathematicians are beginning to get involved in the business of terrorism prediction, albeit not expressly on behalf of insurance companies. According to an interview on National Public Radio with Stanford mathematician Kevin Devlin, there was a recent meeting of mathematicians in Washington, D.C., to discuss just such types of research. According to Devlin, mathematicians may be able to employ Bayesain inference techniques to narrow down the universe of possible terrorist targets and disaster scenarios. Interview by Scott Simon with Kevin Devlin (NPR Weekend Edition radio broadcast, May 18, 2002).

98. According to one report, almost immediately after 9/11, the insurance premiums for the Golden Gate Bridge doubled, even though policy limits were drastically cut. Jane Weaver, *Paying Terror's Premiums* (MSNBC television broadcast, Apr. 29, 2002), http://msnbc.msn.com/id/3073488/ (Apr. 29, 2002).

99. Although it is difficult to imagine the government sharing its intelligence regarding terrorist targets with private insurers, the reverse — using private-insurance markets to produce useful information for the government — is certainly conceivable. Indeed, the short-lived plan to create a market in “terrorism futures” would have produced a version of this. The idea there was to generate new sources of reliable information regarding when and where the next attack would occur by letting people — including (it was hoped) some people with exceptionally good private information on the issue — essentially bet on the question, and thereby profit from their information. When the program was made public, however,
natural and human-made disasters might at first appear to suggest a reason for government intervention in the manner of the British system, in which the government is a reinsurer rather than a primary insurer. But the reasoning is weakened by the realization that if the government conceals information in the interest of national security, then it is unclear how the government will be able to use that very same information in designing and pricing its own brand of terrorism insurance. Observers who value the behavioral effects that market pricing can produce will thus be slow to approve of government involvement in this arena.

On the other hand, there may be sound reasons for the government to offer reconstruction encouragements in the guise of insurance subsidies in the post-9/11 world. It is easy to see that once a business district is destroyed (especially if destroyed by terrorism, domestic riots, atrophy, or other causes that may be expected to continue or recur), there will be a disinclination among private investors to be among the first to rebuild in the area. Many businesses thrive on a critical mass of activity. In these circumstances, governments can do some good by leading the way with investments in infrastructure and even incentives for early rebuilding. No doubt this point could be exploited by politicians and private groups seeking special treatment, and in a world with flawed governments and overachieving interest groups, the best policy may be to avoid favoring some building plans over others. We will proceed, however, with the presumption that when the destroyed area is near major ports, transportation hubs, accumulations of human capital, and dense residential areas, it is likely that rebuilding is socially desirable and that the private market might rationally and strategically await government interventions to pave the way. In this context, what appears as uninsurability may, in fact, be nothing more than a reflection of strategic behavior emanating either from the supply side

there was an outcry among commentators and politicians, leading to a decision by the Defense Department to end it. One of the main concerns was that terrorists themselves might, either directly or indirectly, be able to profit from the program. See Reuven Brenner, A Safe Bet, WALL ST. J., Aug. 1, 2003, at A8.

100. On the British system, see infra Part IV.B. The Israeli example is not a reinsurance scheme, rather, the coverage is provided directly, and citizens are included involuntarily. See Sommer, supra note 36, at 343-50 (describing benefits under Israeli program).

101. Gron and Sykes make a similar point about the likelihood that the government will charge premiums that are not based on actuarial calculations. See Gron & Sykes, supra note 90, at 49.

or the demand side, or both, as property insurers and real estate interests attempt to induce government aid. Nevertheless, it is at least plausible that government money can be efficiently expended to encourage the formation of a critical mass of business activity in Manhattan and the surrounding area.

One obvious problem with the new federal terrorism-reinsurance program as a response to the first-mover problem, however, is that the program seems much broader than necessary to provide a subsidy for the reconstruction of privately owned buildings in New York. The program could have been limited to reinsuring the risk of terror attacks in New York, if the primary goal were to provide a reconstruction subsidy rather than a construction subsidy. Of course, there is an obvious political explanation for why Congress would not enact a federal-reinsurance program that would apply only to one state, when there is at least a plausible case to be made that terrorists will next strike someplace other than New York. Such an ex ante program, by its nature, will almost have to be made generally applicable to be politically feasible, since all voting jurisdictions can imagine themselves (rightly or wrongly) needing such a subsidy. This observation is entirely consistent with the provision of ex post relief directed at New York only. There, the understanding is that if other states suffer a terrorist attack, they will receive similar relief.103

B. The Federal-Reinsurance Program

We turn next to a more careful analysis of the Terrorism Risk Insurance Act, which again seems to be based, albeit rather loosely, on the British model. Again, we should emphasize that the new terrorism-reinsurance program is mainly (and perhaps exclusively) a subsidy for property-insurance markets, as was the British system on which it appears to have been modeled.104 The British system, unsurprisingly, was also adopted in response to increased terrorist activity. When stepped-up IRA bombings caused most reinsurers to withdraw from insuring property risks within the British Isles in 1993, the British

103. Another potential justification for the subsidy for terrorism insurance relates to the diversion effect mentioned supra note 94. If it is thought that individual property owners will engage in inefficient private precaution-taking of the sort that mainly diverts the attention of terrorists to the building next door rather than truly deters, then there is an argument for government subsidized insurance to reduce this externality. DARIUS LAKDAWALLA & GEORGE ZANJANI, INSURANCE, SELF-PROTECTION, AND THE ECONOMICS OF TERRORISM (Nat'l Bureau of Econ. Research, Working Paper No. 9215, 2002), available at http://www.nber.org/papers/w9215. This argument acknowledges, of course, that the optimal level of private precautions is non-zero, and may be substantial.

104. Note also that the Israeli scheme covers property losses as well, but the benefits are provided directly by the government. See Sommer, supra note 36, at 353-58 (discussing Israel's Property Tax and Compensation Fund Law of 1961). Thus, the Israeli model is not a reinsurance model.
Government intervened. Their solution was to form Pool Reinsurance Ltd. ("Pool Re"), a mutual-reinsurance company set up by the Association of British Insurers and the British government that consists of approximately 115 insurance companies and 120 Lloyd’s syndicates.105 Under this regime, which is still in effect today, Pool Re provides insurance coverage above the first £100,000 of damage, which is expected to be covered by companies applying to Pool Re for reinsurance. Companies that wish to purchase Pool Re coverage must do so for all of their properties, thus avoiding any potential adverse selection. Funds for Pool Re are collected not only from policy premiums, but also from a 3% levy on all household and motor vehicle policies written in Great Britain. If Pool Re has to pay out claims that exceed its collected premiums, there is a "call" on all members to pay an additional premium equaling 10% of the funds in the pool. Any amount above this is paid by the British government.106

The new U.S. terror-reinsurance system is somewhat different from its British forbearer. Under the new program, adopted in 2002, the federal government will cover losses arising out of “an act of terrorism” as certified by the Secretaries of Treasury and State and the Attorney General,107 subject to the following limitations. The program, set to last for a three-year trial period, will cover only 90% of property-casualty insurers’ terrorism-related losses exceeding $10 billion (with the floor rising to $15 billion over the three-year period).108 During this period, there will be a cap on the government’s terrorism-reinsurance liability of $100 billion.109 Under this program, insurance companies would be expected to pay off “smaller” claims up to specified fractions of their collected premiums. Specifically, private insurers will pay an initial deductible equal to a percentage of their earned premiums.110 For losses above this deductible, the government would again cover 90% of the losses, with the insurance companies — and their policyholders — bearing the 10% co-payment.111 The funding

105. Reinsurance (Acts of Terrorism) Act, 1993, c. 18, § 2(a) (Eng.).


108. Id. § 103(e).

109. Id. § 103(e)(2).

110. 1% for 2002, 7% for 2003, 10% for 2004, and 15% for 2005. Id. § 102(7).

111. Id. § 103(e). If, for a particular terrorist attack, the sum of the deductibles and copayments made by private insurers is less than $10 billion, then the federal government will essentially tax the insurers the difference. As a result, the insurance industry must bear the first $10 billion of terror-related risk. That is what is meant by the term “Insurance Marketplace Aggregate Retention Amount” in § 103(e) of the Act. This retention amount rises to $15 billion over three years. Between this (rising) floor and the $100 billion ceiling,
for the program is expected to come from premiums or surcharges imposed (and determined) by the Secretary of Treasury on property-casualty insurers.

The program also requires all property-casualty insurers doing business in the United States to "make available" in their policies terrorism coverage on roughly the same terms, amounts, and coverage limitations as are applied to their non-terrorism coverage, although the price of that coverage remains an open question.\footnote{112} At the same time, however, individual insurance purchasers can decline to purchase the terrorism coverage if they so choose. The Act contains no provision making the purchase of terrorism insurance mandatory, and there is no set premium that must be charged for such coverage. Thus, once an insurer has "made available" terrorism coverage at some price, then the purchaser may decline. Insurance is thus available in the sense that its offer is mandated, but the purchase of the coverage is not required.\footnote{113}

As was suggested in the previous Part, a good case can be made for the proposition that this legislation was unnecessary (and certainly so in the long run, as new capital enters the terrorism-insurance market), except, perhaps, as a further construction subsidy for lower Manhattan.\footnote{114} Advocates of free markets, for example, will complain that government insurance generally tends to be inefficient.\footnote{115} And although last-resort reinsurance coverage leaves more space for the private marketplace, it nevertheless intervenes where free market proponents think intervention imprudent. Thus, although the British approach of last-resort reinsurance may be superior to the Israeli approach of occupying the entire market, either approach would be

\footnote{112. Specifically, the Act provides that each insurer "shall make available, in all of its property and casualty insurance policies, coverage for insured losses; and . . . shall make available property and casualty insurance coverage for insured losses that does not differ materially from the terms, amounts, and other coverage limitations applicable to losses arising from events other than acts of terrorism." Terrorism Risk Insurance Act, \textit{supra} note 2, § 103(c)(1)(A)-(B). The price will be a function of (a) the actuarial market price for that portion of the coverage that will not be federally reinsured (though it might be privately reinsured) and (b) the prices that the Secretary of the Treasury ultimately decides to charge for the federal reinsurance.}

\footnote{113. All terrorism exclusions in property-casualty policies in effect on the date of the Act were expressly nullified, but, according to the Act, could be reinstated if the insurer receives a written statement from the insured authorizing reinstatement, or if the insured fails to pay the increased premiums. \textit{Id.} § 105.}

\footnote{114. Again, a narrowly tailored construction subsidy might have limited the application of the Act to insurance in New York State, but such an outcome seems politically unlikely.}

\footnote{115. Gron & Sykes, \textit{supra} note 90, at 51.}
unwelcome from the perspective of those opposed to government intervention. In contrast, advocates of a government-centered scheme begin with the idea that it is the government's role to protect citizens against external attacks and to ease the burdens such attacks create, and they then move quickly to the view that the British approach does not go far enough because war and terrorism ought to be entirely the responsibility of the government.

There are other reasons to criticize a reinsurer-of-last-resort type of subsidy, even if one takes some market-based intervention as a given. First, for the regime to have its desired effect (of encouraging the purchase of commercially provided terrorism coverage), it must involve a substantial subsidy. Thus, it is not enough simply to require insurers to make coverage "available." If the end price insurers charge is not meaningfully reduced via subsidy from what those prices were pre-9/11, terrorism risks will remain "uninsurable," or at least as uninsurable as they were before the new law. Hence, the subsidy must be real. But the Act, as we have seen, leaves open the amount and nature of the subsidy; the Treasury Secretary's discretion is a critical feature of the scheme.116

A second internal criticism of the legislation focuses on the fact that it does not actually require the purchase of terrorism insurance. The law's noncompulsory character leaves open the possibility that insureds may opt not to buy coverage — or to buy relatively little coverage — in the hope of receiving ex post government relief upon the occurrence of another terrorism disaster. The pattern might follow that of flood insurance, where we have an optional scheme, sporting semi-mandatory and subsidized insurance, with large numbers of nonsubscribers who appeal for relief in the event of a disaster. At least the flood-insurance program allows only one bite at the ex post relief apple.117 We might have expected a similar rule to be applied here; however, it is difficult to imagine that anyone harmed by a future terrorist attack will be denied ex post relief for failing to purchase what may still be very expensive (albeit "available") terrorism insurance. If the goal is to minimize ex post relief, then perhaps the better approach would have been routinized (though modest) benefits provided directly by the government, comparable to the Israeli property-loss compensation regime.

That the new Act requires insurers to make terrorism coverage available but not compulsory may also contribute to a particular sort

116. Even after the enactment of the federal terrorism-insurance regime, there is some evidence that, in the areas considered to be the most likely targets for terrorist attacks, rates for terrorism risk have yet to come down. See, e.g., Spencer S. Hsu, D.C. Disputes Insurance Study Raising Rates for Terrorism, WASH. POST, Jan. 7, 2003, at A1 (reporting the District of Columbia Insurance Commissioner as saying that D.C. will reject the large rate increases for terrorism insurance in D.C. recommended by insurance industry ratemaking bureau).

117. See supra note 82.
of political economy, or externality, problem. The general power to regulate insurance rates lies with state insurance commissioners; there is no general federal regulation of insurance rates. The Terrorism Risk Insurance Act leaves this unchanged, even for terrorism risks, except that the Treasury Secretary is empowered to set the reinsurance premiums that property-casualty insurers must pay if they wish to receive federal terrorism reinsurance. Thus, if insurers seek large increases for terrorism rates in such high-terror-risk jurisdictions as the District of Columbia and New York, the insurance regulators can refuse to authorize the increases and, because of the new law, the insurers will still have to offer terrorism coverage in that jurisdiction or withdraw from the market entirely.\(^{118}\) To the extent insurers decide to remain in these markets (perhaps because of a desire to maintain a presence in the area and to profit from other lines of insurance that are not as affected by terror risks), they would in effect be forced to offer below-cost property insurance. Thus, in a small jurisdiction such as D.C., insurance purchasers — that is, property owners — would receive a significant cross-subsidy from policyholders and property owners in the rest of the country. In larger markets (defined by single regulatory schemes), such as New York or California, there would be intrastate cross-subsidization as well.

In this manner, a sufficiently generous subsidy may induce some insureds who otherwise would not have purchased terrorism insurance to do so, while others may still (despite the subsidy) decide to do without such coverage (and to allow insurers to insert exclusions) because of their expectation that federal relief would be forthcoming in the event of a disaster.\(^{119}\) This, in turn, might lead to more uninsured property owners, which would inevitably create public pressure to provide ex post relief as the victims in those gaps become apparent following a disaster. It is thus easy to see an argument as to why Congress should have taken the further step of actually requiring insurance policies to include terrorism coverage, or forbidding them to include terrorism exclusions. Such an outcome, however, was not to be expected. Compulsory insurance, though not uncommon at the state level (for example, consider auto liability coverage) is quite rare at the federal level. Even the National Flood Insurance Program, with respect to which there is a fairly strong argument to be made in favor

\(^{118}\) According to news reports, the D.C. Insurance Commissioner seems to be taking precisely this approach. See Hsu, supra note 116.

\(^{119}\) Given that federal relief for disaster-related property losses is generally quite meager (involving mostly loans, with small outright grants in some cases), opting out of private insurance in anticipation of government relief may seem irrational. Nonetheless, the combination of the high price of private disaster insurance and persistent this-will-never-happen-to-me optimism among property-insurance purchasers, decisions to opt out of disaster-insurance coverage are quite common.
of a compulsory insurance regime, is only semi-compulsory,\footnote{The purchase of flood insurance since 1994 has been made mandatory in only a limited sense. Federally subsidized mortgages are available only to those with flood insurance. Moreover, all private mortgage lenders are now "required" to insist on a showing of flood insurance not only at the time a mortgage loan is issued, but also during the continuing life of the loan. Finally, for those property owners seeking relief aid (SBA loans or FEMA grants) following a flood who have not purchased flood insurance, the relief aid is made contingent on the purchase and future maintenance of flood insurance; those who fail to buy flood insurance at that point are to be denied flood relief aid. See generally Pasterick, \textit{supra} note 81, at 153; FEMA FLOOD INSURANCE GUIDELINES, \textit{supra} note 82. On the other hand, there are no federal fines imposed on homeowners who fail to purchase flood insurance as might exist under a serious (though unlikely) compulsory insurance regime.} and many people who should purchase the coverage still do not.\footnote{Before the changes to the NFIP in 1994, there were studies indicating that less than twenty percent of individuals living in floodplain areas and who were supposed to have flood insurance, actually purchased such insurance. FEMA FLOOD INSURANCE GUIDELINES, \textit{supra} note 82, at 2. One would expect compliance to have increased since the 1994 amendments to the program that introduced, for example, the requirement that lenders insist on flood coverage throughout the life of mortgage loans. And it may have. It is generally believed, however, that there is still significant underinsurance for flood risks.} Moreover, to make the purchase of terrorism coverage compulsory for all property owners under federal law would have required the enactment of explicit subsidies to fund the purchase of terrorism coverage in the highest risk areas. In contrast, as we have seen, the approach chosen by the Act produces more hidden, but perhaps no less substantial, cross-subsidies. Finally, note that federally mandated coverage may also thrust federal regulators into the role of setting primary-level insurance premiums (given that the premiums set by the market might be deemed excessive and therefore federal regulation necessary); this role of regulating insurance premiums has traditionally been left to insurers and to state regulators.

C. \textbf{How Will the Federal-Reinsurance Program for Property-Casualty Losses Affect Future Relief?}

It bears restating that the new federal legislation deals primarily with property losses and not (or at least not directly) with personal injury and death. More precisely, the program pays benefits only for qualifying terrorism-related losses that are covered by property-casualty insurers.\footnote{Terrorism Risk Insurance Act, \textit{supra} note 2, § 102(5) (qualifying "insured losses" defined as losses resulting from terrorist act that is covered by property-casualty insurance).} Property-casualty insurance includes property insurance and various forms of casualty (or liability) insurance, including workers’ compensation coverage. It does not, however, include life insurance or health insurance.\footnote{\textit{Id.} § 102(12).} Thus, while the federal terror-insurance program can be seen as a subsidy for property and casualty insurance, it provides no direct subsidy with respect to losses...
of life or limb caused by terrorist attacks. Therefore, even if we think of the program as a sort of permanent (routinized) regime for dealing with property losses, it is unlikely to have a large direct effect on the probability of future 9/11-Fund-type relief for loss of life. The real question is whether the existence of the subsidy will affect the likelihood of future disaster declarations and FEMA-type relief for property losses.

As discussed above, there is a complex, and somewhat counterintuitive, relationship among permanent compensation regimes, private-insurance purchases, private charity, and, ultimately, ex post government relief. Indeed, that is one of the major themes of this Article. Thus, as an initial matter, if we assume that the subsidies paid out ex post under the new program to property-casualty insurers are substantial, there are reasons to expect that some property owners who otherwise would not purchase coverage will at the margin be induced to do so. This is so because some of the subsidy to property-casualty insurers may be passed along to consumers through reduced premiums. And if the program works this way, inducing an increase (or expected increase) in the purchase of private terrorism insurance, we should expect less in the way of ex post relief. Given the additional insurance, and thus the drop in uninsured losses, there will be less of a sympathy factor, and perhaps less political pressure, to make a disaster declaration. And even if a disaster is declared, less relief would be forthcoming because of the uninsured loss limitations discussed above. Finally, because the federal program will induce more ex ante insurance purchases, it may inhibit charitable giving — on the theory that donors' giving decisions in disaster cases are also affected by the presence of uninsured losses.

Although the driving force behind the Terrorism Risk Insurance Act was the (perceived) crisis in property-insurance markets, the program is not limited to property losses. Technically, the program covers any type of terrorism-related losses that are of the sort covered by property-casualty insurers. Again, this does not include life or health insurers, but it may include liability insurers. Although the Act does not mention liability insurance specifically, the term “casualty” insurance generally means liability insurance. Moreover, the Act

124. See supra Part III.

125. The argument in the text suggests one way in which the federal terrorism-insurance program might affect the likelihood of future 9/11-Fund-type relief. The argument involves the link, which we identified in Part III.B above, concerning relief for lost property and relief for lost life. If we are right that large-scale government relief for property losses is politically unlikely unless there is simultaneously a large-scale effort to compensate families of the deceased, then a program that will ultimately produce less ex post episodic property relief — such as this one — may also reduce the political pressure to enact a generous compensation regime for lost life.

126. JERRY, supra note 77, at 47.
does specifically incorporate workers' compensation insurance, which is a type of liability insurance. Thus Congress at least had in mind that in the event of another large-scale attack federal dollars could be spent to pay workers' compensation claims. Such a possibility, if it becomes widely known, could have some of the same effects on charitable giving and ex post relief discussed above. The interesting question, though, is whether, in the event of another attack sufficiently large to trigger the new federal program, payments from the program would also be used to pay tort awards and settlements arising out of the attacks. On a straightforward reading of the Act, the answer would seem to be yes, although Congress and the courts may construe it otherwise, or the Treasury Secretary may issue regulations altering that result. Still, if tort liability is expected to be covered, then there would be reduced political pressure to provide ex post relief (of the FEMA sort) or, more likely, increased political and financial pressure for Congress to eliminate or at least impose limits on tort liability for losses linked to the event.

D. Other Subsidy Alternatives

Even if one were to accept the propriety of government intervention in the terrorism-insurance market, the superiority of the particular type of subsidy embodied in the federal-reinsurance regime is by no means self-evident. Instead of routinized relief, it might have been better to use some sort of permanent regime of ex post subsidization for charitable contributions in the event of disasters of a certain magnitude. For example, the government could legislate that when emergencies are designated as “national disasters,” charitable contributions to designated relief agencies would qualify for something much more attractive than mere tax deductions; donors might, for example, be encouraged with 90% tax credits. Private insurance would be discouraged only as much as it is presently, which is to say that insurance might go unsold to the extent that people expected relief—or (tax) supercharged charitable relief.

There are at least two reasons to prefer a supercharged subsidy for charitable gifts over direct government relief. First, there is the benefit of decentralized private monitoring of the efficiency with which the money is distributed. The idea here is that charitable organizations may be more responsive to efficiency concerns and donor preferences than is the federal government, because charities must continue to earn the support of their donors. Uncoordinated private donations,

127. Terrorism Risk Insurance Act, supra note 2, § 103(5). Indeed, the program's application to workers' compensation losses is broader than with respect to other types of losses. That is, the program does not apply to losses arising out of "war," unless they are workers' compensation losses. Id. § 102(1)(B)(i).
however, as opposed to centrally coordinated government relief, may lead to the over- or under-compensation of some losses, so that government relief may remain superior to better-monitored private relief.

The second potential benefit of the supercharged charitable-giving approach requires some implicit assumptions about relief and redistribution, including the idea that such an approach may actually lead to more dollars of relief per tax-dollars spent than does direct relief funded through tax increases. There is some evidence that, at least with respect to high-bracket taxpayers, the price elasticity for charitable contributions is greater than one: that is, for every dollar of tax revenue foregone because of the deduction, more than a dollar of charitable transfer is made to the relevant charity. That this effect seems to be concentrated in high-bracket taxpayers is unsurprising (given the relationship between the value of a deduction and the taxpayer's marginal rate bracket) and suggests why a credit — and perhaps a supercharged credit — might be desirable in some settings.

As another alternative, the government might simply subsidize, through a demand-side deduction, credit, or direct cash transfer, all property insurance that covers terrorism risk. Under such a regime, the more significant the risk, the more insurance will be sold — and there will be less pressure for relief in the event of large losses. Recent legislation and current patterns in the insurance market seem to assume that future terrorist strikes will resemble those of 9/11, aiming at large buildings in urban centers — especially those in D.C., New York, and San Francisco. Yet other horrors are imaginable, and while there is no need to spell them out here in gruesome detail, it does not take much imagination to see that billions of dollars in economic losses could be suffered through terrorist attacks on transportation networks and various industries, such that there would again be a clamor for federal relief, and property insurance would play a smaller role than business interruption or disability insurance, for example. If the war on and with terrorists continues, we should not be surprised to see the question of the structure of federal relief revisited. And, again, an attempt to move expectations away from episodic federal relief seems likely and under the circumstances healthy.

128. CHARLES T. CLOTFELTER, FEDERAL TAX POLICY AND CHARITABLE GIVING 274 (1985) (summarizing studies which consistently found price elasticities greater than one in absolute value for all but the lowest income groups; for low-income groups, the studies were inconclusive); Charles T. Clotfelter & C. Eugene Steuerle, Charitable Contributions, in HOW TAXES AFFECT ECONOMIC BEHAVIOR 436 (Henry J. Aaron & Joseph A. Pechman eds., 1981) (finding highest price elasticities in higher income groups).

129. See Hsu, supra note 116.
E. Does the Expectation of (Episodic or Routine) Relief Internalize Costs?

A different sort of normative question about disaster relief (whether such relief comes predictably, episodically, or even routinely) concerns the behavioral or cost-internalization function of expected relief. Our focus is on government actors, and interest groups that influence these actors and their budgets. One might argue that a government that expects to pay relief in the event of famines and earthquakes might be more inclined to take precautions that would limit the losses suffered from such catastrophes. These natural disasters bring on losses, to be sure, but these losses can be curtailed with good distribution systems, warning mechanisms, building codes, and other items within the government’s control. The prospect of large-scale payouts in the aftermath of major losses might, the argument goes, encourage government to take cost-benefit justified precautions long before disasters strike. This might happen because the government is responsive to such an internalization tool, which is how we might think of the budgetary pressure associated with expected relief payments. More subtly and convincingly, such precautions might be encouraged by various interest groups eager to see the government avoid large disasters, because these interest groups project that expected relief efforts might one day crowd out the government projects they desire.¹³⁰

This argument about disaster relief as an indirect means of encouraging precautions that are in the government’s domain is surely a weak one when it comes to post-terrorism relief or subsidized insurance. First, the probability of large-scale attacks is low, and as we have seen, governments and disparate interest groups could reason that most terrorist incidents will not in fact be followed by relief packages because the scale of loss will most likely be small. In anticipation of the argument in the next Part we might say that most terrorism is like most crime in the sense that most incidents impose direct losses on very few victims and businesses, so that there is no political pressure for aid. A graphic murder (or terror attack) might jar a jurisdiction, or at least its eager politicians, into taking new steps to reduce crime or fright, but it is less likely to create a movement for

¹³⁰ See Levmore, supra note 34, at 18-19. The term “interest group” normally implies a relatively small and well-organized politically active unit, and that is how we use the term here. Note, however, that the internalization effect of creating an expectation of relief (or a permanent regime of compensation) can also be driven not by interest groups per se, but also by majoritarian politics. This could occur if the issue of large compensation payouts were to become sufficiently salient (or were to be made salient by an issue entrepreneur) such that the “average” voter might even demand a response. Thus, the budgetary pressure mentioned in the text might be majoritarian pressure that would create the incentive to prevent compensated losses from leading to large government deficits.
economic relief, which seems to require a massive scale of loss. A second reason that the prospect of post-terror relief is unlikely to play an important role in encouraging pre-terror precautions is that such precautions are already encouraged by political self-interest and, no doubt, by a deeply held commitment to the safety of the country. It is hard to imagine that politicians need much extra incentive to combat and deter terrorism. Few things attract as much media and public attention; the political repercussions from a successful but preventable or foreseeable terrorist attack are enormous, and even politicians appear able to rise to the occasions offered by war and terrorism such that they do what they genuinely believe to be in the best interest of the country, or perhaps in the interest of an attractive historical record, rather than in their narrow self-interest, though it may simply be the case that the two converge.

Thinking about post-terror relief (or pre-terror insurance and subsidized insurance) in such functional terms may inform the division of labor between governments and private property owners. Thus, it is plausible that routinized relief, perhaps along the lines of the British model or the new U.S. terror-insurance program, can send signals to property owners as to what their losses might be, and that property owners will in turn secure buildings more carefully or take other steps that are more in their control than in the government's. Although somewhat plausible, this possibility does seem unlikely. The government can mandate private security precautions, and even the strongest proponents of privatization typically see the government as having a comparative advantage in this regard. It is worth remembering, for example, that Israel's El Al Airline, which is the only carrier known for taking extra (and, since the 1970s, highly effective) precautions against terrorist attacks, has been government owned.

F. Summary

We are skeptical of the recent efforts by the federal government to intervene in the terrorism-insurance market for property coverage. We agree with other market-oriented commentators that if left alone the market would likely have been able to provide the necessary coverage, along with some useful signals as to the largest outstanding risks and some valuable, if individually painful, cost-internalization incentives to individual decision-makers. It may be that in the absence of such intervention developers would have shied away from constructing very tall skyscrapers, but that result is not patently unreasonable. In fact, it is hard to imagine that the government has a positive-externality reason to encourage the very buildings that might impose the most attractive targets. One could imagine a political movement to rebuild the World Trade Center exactly as it was, structural improvements
aside. This sort of symbolic or political reaction, amounting to a statement aimed at domestic and foreign audiences or as a reaffirmation of the spirit of community, might indeed have required some government subsidy or at least a promise of insurance coverage. But by and large the private market is likely to perform well over the long run.

To the extent that some sort of government intervention was called for — whether as a construction subsidy or as a potentially desirable redistributive transfer from the rest of the country to the business centers of our major cities — it remains unclear whether the particular type of subsidy chosen by Congress reflects the most effective approach. Certainly, it should not be expected that the enactment of this program will eliminate the possibility of future ex post relief payments in the event of another catastrophe on the order of 9/11. So long as insurance is not compulsory, there will be some underinsurance and — as we have argued throughout this Article — pressure to provide relief in the event of large disaster losses, especially in the case of terrorism losses. A serious change in the war on terrorism must take place before a routinized permanent regime of terrorism-loss compensation is established. Nonetheless, even this sort of regime will not do much in the way of creating improved incentives for government decisionmakers, for existing political checks already provide effective incentives in this regard.

In sum, the case for public and subsidized insurance covering terrorism risks is surprisingly weak. In contrast — and as we are about to explore — the case for public insurance with respect to the harms of everyday crime is relatively and remarkably strong. The comparison can be put in terms of a positive puzzle: given the mix of private and public compensation that we have described for disaster losses (terrorism losses in particular), why do we not see a similar mix of private and public compensation for losses of property and life caused by crimes more generally? First-party insurance is generally available for property and lives, but many crime-caused losses are uninsured; yet there is generally no government relief or government liability following crimes — even for crimes that the government might easily have prevented.

The absence of government payments or "relief" — an expression that we now expand to include government liability for the failure to prevent losses — in the crime setting, taken together with the presence of government relief in the terrorism setting, is especially interesting, because a policy or expectation that the government will provide relief for crime losses seems somewhat likely to provide a useful cost-internalization or incentive effect for government actors. Governments do not seem to need much of a push to battle terrorists, but government's inclination to prevent crime, and especially crime that affects poorer citizens, appears to be less impressively encouraged.
by politics as usual. The idea is that governments at every level have a strong political reason to take precautions against terrorism, if only because there is no issue that is as salient to the electorate and as central to the self-conception of our political leaders. In contrast, some politicians seem to thrive (or at least to win reelection) despite rather poor crime-fighting records. We might say that governments appear naturally to internalize the costs of terrorism more than they do the costs associated with crime. This is the argument that we explore in the next Part.

V. INSURING AGAINST CRIME

One conclusion that emerges from careful thinking about insuring against terrorism is that there may be more to be gained from a program of government-sponsored crime insurance, or a promise of government relief for crime losses, than first meets the eye. The idea of government crime insurance gives rise to both normative and positive observations. As a normative matter, the argument for subsidized crime insurance, or simply the promise of ex post relief from crime, is stronger than the argument for government involvement with terrorism risks. As a positive matter, the current absence of a strong federal crime-insurance or crime-relief program is likely attributable to failures of the political process — in the sense that the parties most likely to benefit from such a regime are least likely to overcome collective-action problems to lobby for its enactment.131 It is worth emphasizing that neither form of relief —

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131. Two efforts at the federal level to provide government-subsidized insurance for crime, and government subsidies for general property coverage in high-crime areas, respectively, were the Federal Crime Insurance Program ("FCIP"), which was created in 1971, and the Urban Property Protection and Reinsurance Act of 1968 ("UPPRA"). 12 U.S.C. §§ 1749bbb to 1749bbb-21 (2003). Both were adopted in response to the urban riots of the 1960s and a concern that widespread withdrawal of insurance coverage within urban areas might ultimately contribute to decay in urban neighborhoods. See, e.g., ALICE R. ZIMMERMAN, LYNDON B. JOHNSON SCH. OF PUB. AFF. SPECIAL REP., WHAT IS FAIR? AN EXAMINATION OF THE EFFECTS OF THE 'FAIR ACCESS TO INSURANCE REQUIREMENTS' PLAN ON THE AVAILABILITY AND AFFORDABILITY OF URBAN PROPERTY INSURANCE 29 (2000) (noting that the main stated purpose of the federal UPPRA was to "bring stability back to the urban insurance market and reverse the cycle of decline in urban areas"); David I. Badain, Insurance Redlining and the Future of the Urban Core, 16 COLUM. J.L. & SOC. PROBS. 1, 6 (1980) (asserting that the riots created widespread refusals to insure in urban areas). Under the FCIP, which was administered by FEMA through its Federal Insurance Administration, the federal government provided small amounts of robbery and/or burglary insurance ($10,000 for individuals and $15,000 for businesses) to tenants in high-crime areas. Adrienne C. Locke, Several Criteria Restrict Crime Cover Eligibility, BUS. INS., Sept. 25, 1989, at 35. Premiums were collected to fund the claims, although there was some element of government subsidy as well. Premiums were based on a rough degree of risk assessment and on a showing of lack of affordable private insurance for the risk. Id. Thus, the FCIP was a form of direct government insurance for inner-city crime losses. The UPPRA, in contrast, was different; it was a program, not wholly unlike the Terrorism Risk Reinsurance Act, under which the federal government agreed to provide subsidized riot reinsurance to private insurers who participated in what are called Fair Access to Insurance ("FAIR") programs
whether for crime or for terror — may be wise, unless the goal is to express sympathy or engage in opportunistic wealth redistribution. And it is also possible that both amount to sensible policies. The argument here is simply that the case for crime relief is probably sounder than that for terror relief. Terror can be seen as a subset of crime, so that the argument can also be seen as one which takes the continuing experience with the 9/11 Fund’s post-terror relief as an opportunity to think about crime relief more generally. The arguments are simple and build in a straightforward fashion on the discussion up to this point.

The best case for government-subsidized or government-provided crime insurance (that is, for crime-caused losses of both life and property) is one that combines a dose of awareness about potential underinsurance problems with internalization and critical mass considerations. The argument gains force if we think that redistribution in favor of less affluent citizens is a good thing. We try to set aside this consideration, however, if only because even those who favor wealth redistribution through law might see that it is generally more efficient to accomplish this goal through unconstrained lump sum transfers rather than through ongoing regulatory or welfare systems.\(^\text{132}\) Notwithstanding these considerations, there are, as we will see, surprisingly sound arguments for government-sponsored crime insurance or some comparable compensation or liability regime.\(^\text{133}\)

run by the states, under which all insurers operating in the states must participate in providing insurance to the residual, or riskiest, market. Ultimately, both the FCIP and UPPRA were eliminated. The former was abolished in 1996, see Office of Inspector General, Fed. Emergency Mgmt. Agency, FIA’s Federal Crime Insurance Program, at http://www.fema.gov/ig/h-09-95.shtm (last updated on Feb. 11, 2003), and the latter was terminated in 1983, 12 U.S.C.A. § 1749bbb(b), although a number of states continue to operate FAIR plans. We are aware of no definitive study on what caused the failures of these federal efforts. There is some evidence, however, that one of the problems was lack of adequate marketing. Carla Rivera, Few In Riot Area Used Federal Crime Insurance, L.A. TIMES, July 14, 1992, at A1 (asserting that evidence in California suggests “that residents of riot-scarred communities who might have benefited from the insurance did not know of its availability”). Another perceived problem was the feeling that the program was essentially a subsidy for New York City, where roughly half of the nationwide FCIP policies were written by 1992. Kevin McKenzie, Insurance; Government-Backed Protection from Crime Cancelled in Tennessee, COMMERCIAL APPEAL (Memphis), Aug. 23, 1992, at C1. In part due to this perceived unfairness, many states began to opt out of the program throughout the 1980s. Consumer Credit and Insurance Property, Insurance in Low Income Areas: Hearing Before the Subcomm. on Consumer Credit and Ins. of the House Comm. on Banking, Fin. and Urban Affairs, 103rd Cong. (1994) WL14187690 (statement of Elaine A. McReynolds, Member, Federal Emergency Management Agency). With respect to this last problem, one obvious solution would be to make the program compulsory, so that opt-outs of this sort would not occur.

132. For a reconsideration of this question, see Kyle D. Logue & Ronen Avraham, Redistributing Optimally: Of Tax Rules, Legal Rules, and Insurance, 56 TAX L. REV. 157 (2003).

133. The idea of government-sponsored crime insurance has received scant attention in the academic literature on crime, and no jurisdiction of which we are aware — in the United States or elsewhere — has adopted the sort of crime-compensation regime that we describe
But then there are counterarguments as well. The most significant of these builds on the concern that a subsidized crime insurance or crime relief program would create enormous incentives to commit or tolerate crime. This is nothing more than an instance of the obvious moral hazard problem according to which payments for death or injury will result in more deaths and more injuries. Another, perhaps less dramatic, concern is that a legal system that provided government-sponsored crime insurance but not government-sponsored terrorism insurance would generate what we might call sorting costs, because of the need to decide whether given crimes were or were not committed by terrorists. These concerns are real but not insurmountable. Before turning to these problems, however, it is useful to consider the character of the existing market for crime insurance.

A. The Crime-Insurance Market

Losses from crime include life and property, and we consider both here, if only to parallel our discussion of terrorism coverage. We are not claiming, as some have done in the terrorism context, that there should be general government involvement in compensating crime losses due to an uninsurability problem. To the contrary, crime-related losses to both life and property can be, and often are, covered under standard insurance policies. In the typical life-insurance case, where family members are the beneficiaries of a policy that is written on the life of the primary earner in the family, the death benefit will be paid out whether the insured dies of natural causes or is murdered. Life-insurance policies generally do not contain murder or foul-play exclusions. Special murder policies — policies that pay out only for murder — are not generally used (and likely would be considered void as against public policy), both because it is thought that standard life-insurance policies do the job well enough and because explicit murder policies might be considered too much of an invitation to moral hazard.

Many property-insurance policies are equally broad. Standard property policies tend to cover crime-related property losses, which means that such policies do not generally contain crime exclusions.


134. This assumes, of course, that the beneficiary is not the murderer, which would amount to a very egregious form of insurance fraud — as well as murder.
although there are exceptions. In addition there are special crime-loss policies; for example, insurance companies offer business policies covering robbery and employee theft. These policies may fill in gaps (perhaps left by the occasional crime-related exclusion) in standard property policies, or they may provide additional or overlapping coverage.

B. The (Modest) Case for Government-Sponsored Crime Insurance

1. The Underinsurance Argument

Given that there exists a market for insurance against many of the risks associated with crime, why would we need government involvement? The arguments contain elements of paternalism and market failure, and to some extent repeat those referred to in our earlier discussion of terrorism. One argument in favor of government-sponsored crime insurance is that additional coverage is desirable because individuals tend to purchase inadequate coverage for a variety of contingencies. This problem of myopia or a disinclination to dwell on unpleasant eventualities would seem to apply most clearly to life-insurance purchases, but it is plausible for property insurance as well, and it is an argument that extends rather easily to planning and insuring against crime.

Taken alone, however, the concern with underinvestment in insurance would probably not be enough to justify government intervention in crime-insurance markets, given the moral hazard concerns discussed below and given that there may be better ways of dealing with a general problem of underinvestment in property and life insurance — if such a problem does indeed exist. There are, however, reasons to suspect that the underinsurance problem is especially significant with respect to crime losses and, thus, that a crime-compensation regime or crime-insurance subsidy might be more justified than a similar regime for, say, disaster losses.

135. Some property policies contain exclusions for thefts under certain conditions. For example, in an obvious effort to minimize moral hazard, some property policies limit theft coverage to situations in which there is visible evidence of forced entry. See, e.g., Atwater Creamery Co. v. W. Nat'l Mut. Ins. Co., 366 N.W.2d 271 (Minn. 1985) (interpreting "forcible entry" clause in burglary policy).

136. See Logue, supra note 18, at 28 (analogizing problem of underinvestment in life insurance to well-known problem of underinvestment in retirement savings).

137. A mitigating factor in property-insurance markets, however, is the involvement of commercial lenders, who tend to insist on a certain amount of property coverage before approving mortgage loans, and, who one would expect, because of repeat play and competitive pressures, to suffer less from myopia and other cognitive biases.

138. If underinsurance is a general problem, then a broader solution would seem to be called for than one which focuses on crime-related risks alone.
Many victims of crime are underinsured. Inner-city property owners, including businesses and homeowners, self-insure far more than their counterparts in affluent areas, in part because of availability problems. In addition, inner-city property owners and the businesses they deal with may expect crime to lead to insolvency, so that insurance of a sort is accomplished through higher interest rates and less credit with respect to goods and services. As far as life insurance is concerned, it simply is not possible for low-income earners to purchase significant insurance coverage, even though the value of their lives to their families can be substantial in economic terms. Thus, with respect to life insurance and in some cases homeowners’ insurance, the underinsurance problem, especially in inner cities, has a distributional component.

In contrast, although there is no doubt that many of the victims of the 9/11 tragedy were underinsured, there is no reason to think that the bulk of them were as underinsured as most crime victims are, given their relative wealth. More interesting, when we turn to our third front (namely, natural disasters), those who receive flood and earthquake relief can be thought of as underinsured due to anticipation of government relief. Underinsurance may even be considered a strategy for seeking relief, and perhaps therefore not an especially powerful normative justification for such relief. Victims of crime, by contrast, have no reason to expect relief because their losses are episodic and not normally of the sort that trigger large-scale relief or charitable efforts. The idea of payments to these underinsured persons thus seems more palatable than comparable payments to victims of floods and earthquakes. One can think of such payments as redistributive, to be sure, but one can also think of them as aiming to encourage economic activity and a residential presence in inner cities and other places where crime is prevalent and where a population revival would probably lead to less crime and to greater economic growth. We turn to this justification more fully in the next Part.


140. We need not resort to an argument that there is underinsurance for noneconomic losses; the family of a victim may not be made whole by receiving money in return for life, but an important part of the plan, as discussed more fully below, is to give the government a budgetary incentive to fight crime, so that payments for noneconomic losses make excellent sense.
2. The Internalization Argument

Internalization arguments build on the idea that a party will take the implications of what it does more seriously if it is made to pay for the consequences of its actions. When firms or governments are made to pay, however, there is reason to doubt the internalization logic, because there are agency problems and other barriers between the expected payments and the employees on the front line who act in the name of the firm or government. Yet there is no doubt that monetary burdens will eventually have an impact on governmental (and other enterprises') actions. If courts raise the compensation level required of governments that take private property for public use, we can, for example, expect these governments to take less property. When we say that liability may not be necessary to make the government combat terrorism effectively it is not because governments do not care about making payments, but rather because it seems likely that the political repercussions following an incompetently managed war against terrorism are likely to motivate government officials at least as much as any monetary incentives.

In the case of crime fighting, the argument is that the same governments that might be dismissed by the electorate in the event of failed wars, unchecked epidemics, and other such failures, might survive perfectly well even though a minority of the population continues to live in fear of crime and suffers greatly from it. In these circumstances, economic incentives aimed at the government, or, in a subtler version of the argument, at interest groups in positions to influence the government, may play an important role. Specifically, a government that pays for crime, or for losses suffered where there are high crime rates, might do a superior job at fighting crime, or budgeting the resources necessary to do so.

This argument is premised on the assumptions that crime can be discouraged and that, while the government is the obvious party, or even the only party, to take both the costs and the benefits of crime prevention into account, it might not have the incentive to do so if left to its own devices. In a simple sense, the argument is that the government could be encouraged with economic incentives to do that which is largely already in its control. The argument becomes more compelling the more we think of the government as politically unresponsive to many of crime's victims. This is especially true of the vast number of ordinary crime victims — individuals and businesses whose cases, because they are so numerous, are not reported in the media and do not thereby garner public sympathy. These victims may not be brought together as a political unit by a single, galvanizing event, as happens with terrorist attacks or disasters more generally, and thus may lack the power necessary to attract political attention and government action.
In sum, to the extent that crime victims, or those who live in fear of becoming crime victims, are diffuse and poorly organized, and to the extent that a large part of the population need not share the fear that these victims bear, crime losses may be undervalued by local and state authorities, and are certainly undervalued by federal government officials. Crime rates in some areas may then be higher than is optimal.\textsuperscript{141} Given the presence of imperfect political checks and market failures, economic incentives become more valuable instruments of reform. At the very least, interest groups that make claims on the government’s resources may take the task of crime fighting more seriously if their own projects are threatened by the payouts that the government would need to make in a world where crime insurance was the government’s concern.

Interest groups would also play an important role if the proposal were structured not as government-provided ex post compensation for crime losses, but as an ex ante subsidy for privately provided crime insurance. This approach, which is more market-based than the direct crime-insurance alternative, would enhance crime-cost internalization by creating a cohesive and potentially powerful interest group — the insurance industry — with an interest in crime prevention. Once a number of large property insurers have been induced, via the subsidy, to sell policies on buildings located in high-crime areas, those insurers will have an enormous financial stake in seeing that property crime is reduced in that area. Thus, just as auto insurers compose a powerful political force in this country for increased auto-safety standards, so too the property and life-insurance industry under this sort of regime would have an interest in encouraging lawmakers to adopt effective crime-reducing measures.\textsuperscript{142}

What would an ex ante crime-insurance subsidy look like? It could appear on the demand side or the supply side. The subsidy could take the form of a tax deduction or credit available to individuals who purchase property insurance on buildings located in high-crime areas. Alternatively, the subsidy could be on the supply side, perhaps administered through some sort of government-provided reinsurance for crime-related losses. Such a proposal would be analogous to the Terrorism Risk Insurance Act program, except that the government would provide reinsurance for acts of crime rather than for acts of terrorism. As with that program, adverse selection problems could give rise to the need for a rule compelling insurers to provide crime

\textsuperscript{141} This is a theoretical claim about the structure of incentives for crime prevention. The claim, if right, applies even though crime rates may have gone down in recent years. The point is that, under a crime-compensation regime, crime rates might have decreased even further.

\textsuperscript{142} We predict that this phenomenon is already taking place with respect to legislation designed to reduce auto theft, given that many auto-insurance policies currently cover such losses.
coverage (or not to exclude such coverage) in their general property policies. This would be similar to the prohibition on terrorism exclusions in the Act.\textsuperscript{143} In addition, the crime-insurance program might go so far as to compel property owners, or owners in some areas, to purchase crime coverage. As mentioned in the previous Part, however, there are practical and political limits to enforcing compulsory insurance laws.\textsuperscript{144}

3. \textit{The Critical Mass Argument (or the First-Mover Problem)}

The critical mass argument applies primarily to property insurance and may provide the strongest basis for advocating government involvement in crime-insurance markets. The concern is that efficient and desirable economic development might be stifled or foregone where private actors wait for one another to move forward. In particular, a high-crime area might require a first mover, or a promise of development, to induce investors to come forward. The collective-action problem among business owners, real-estate developers, and property insurers is that, whereas business investment in high-crime areas may ultimately be profitable if enough businesses decide to locate there (or decide not to move away), there is relatively little incentive for any single business or insurer to take the first step. Indeed, the underinsurance problem within urban areas mentioned above, especially with respect to property coverage, may be in part attributable to this critical mass or first-mover problem.\textsuperscript{145} Therefore, government-subsidized or government-provided insurance in high-crime areas might serve to signal or guarantee that an investment in such an area is better than it seems to private investors who cannot yet observe the influx of other, like-minded investors. Moreover, if one is persuaded by the internalization argument, the announcement of such a government program should credibly signal a renewed commitment to crime prevention on the part of the government, and thus lower crime-insurance premiums in the long run.

C. \textit{Objections to Government-Sponsored Crime Insurance}

1. \textit{Sorting Costs}

We argued in Part IV above that the case for government-sponsored terrorism insurance is rather weak, at least in the current state of the world. In this Part we have argued that the case for

\textsuperscript{143} Terrorism Risk Insurance Act, \textit{supra} note 2, § 105.

\textsuperscript{144} \textit{See supra} note 82 (discussing the difficulties that the National Flood Insurance Program has had in “compelling” purchase of flood coverage).

\textsuperscript{145} \textit{See supra} Part V.B.1.
government-sponsored crime insurance is relatively strong. Thus, we might imagine a regime in which crime but not terrorism losses were compensated by the government — or by an insurer who in turn receives subsidies from the government. Under such a regime, then, there would be a need to distinguish general crime losses from terrorism losses. An obvious objection to such an approach would be to raise the specter of sorting costs and to suggest that we can have either relief for terror and crime, or relief for neither, but not for just one of the two. This objection seeks to avoid the litigation and other transaction costs that will be associated with determining whether a death or property loss was caused by terrorist activity or by mere crime. This need to distinguish terrorism from other crimes arises, of course, in a system of relief or subsidized insurance that covers crime but excludes terrorism losses, just as it does in a scheme that covers terrorism but not other crimes.

It seems fair to assume that this sorting problem is a minor one, especially when evaluated on the scale of the potential costs and benefits arising from crime insurance. The sorting cost is likely to be modest because terrorists, in more cases than not, take credit for their deeds, while most criminals seek to draw less attention to their identities. The 9/11 attacks are an important and perhaps overwhelming counterexample, but it is hardly unreasonable to say that terrorists take credit for their deeds far more often than do ordinary criminals.

It could be otherwise; terrorists might for example seek to advance their causes by over-claiming, taking credit for crimes, such as arsons and deaths, that were not of their doing. In such cases, the information received following a loss event would be virtually useless. The over-claiming phenomenon, which doubtless happens on occasion, would obviously work at cross-purposes with those terrorist organizations that do in fact commit the terrorist acts and that wish to maintain the clarity and control of their messages. An obvious response to this over-claiming phenomenon on the part of such terrorists would be for the terrorists to identify themselves before an event rather than soon after, and this they sometimes do. This sort of signaling technique was common, for example, in the case of the Irish Republican Army, though it is either uncommon or unheard of in Israel’s intifada and in other theaters. The media have often regarded advance notice as a humanitarian gesture aimed at saving lives, but we now see that it is possible that this is a strategy for taking credit where it is due.146

146. It is also unclear how the prospect of victim compensation or relief affects the motives of terrorists, either in the choice of their targets or their decisions to claim credit or not. Under a regime of compensation for terrorism but not for other crime, terrorists might consider whether their objectives are better achieved by imposing compensated or uncompensated losses. But this issue seems quite small when compared with the other sorts of calculations that will come into play.
Another way of ensuring proper credit (which is to say blame) would be for the perpetrators to disclose details of the attack that have not been made public and that only the they would know.

There is no need to dwell on this issue. We are not arguing that there will be no sorting costs; our point is that those costs should be relatively low and should not be different in kind or magnitude from the sorting costs that are associated with any type of insurance regime. Private-insurance contracts, for example, generate huge sorting costs, as policyholders and insurers spend enormous sums litigating the question of whether a particular loss is covered or excluded under the policy in question. One strategy from the insurance context for dealing with these costs is to use the burden of proof as part of the sorting process. In most insurance coverage cases, the burden of proof lies, in the first instance, with the policyholder to demonstrate that a claim is covered under the policy — that the individual is the named insured, that an insured event has occurred, and the like. Once this showing has been made, the burden switches to the insurer to prove the existence of a particular exclusion that excuses coverage. Thus, under a terrorism compensation regime, insureds or claimants for relief might be given the burden of proving that a loss was caused by terrorists, or, under a crime compensation regime, that it was not caused by terrorists. It is noteworthy that Israel, which again offers modest relief for victims of terror but hardly anything for victims of other crimes, has had little difficulty with sorting between the two. In one exceptional Israeli case, the murder of an Israeli by a Palestinian who had been the victim’s lover raised the crime-versus-terror question because the claimants argued that animus against Israelis contributed to the perpetrator’s motivation. Cases such as this one seem to be remarkable rather than normal; they should not be seen as harbingers of incessant litigation.

A much more serious sorting problem would likely arise in distinguishing between crimes and accidents rather than between

147. Consolidated Edison v. Allstate Ins. Co., 774 N.E.2d 687, 690 (N.Y. 2002) (“Generally, it is for the insured to establish coverage and for the insurer to prove that an exclusion in the policy applies to defeat coverage.”); see generally 9 LEE R. RUSS, COUCH ON INSURANCE § 137:5 (3d ed. 2003) (summarizing the burden of proof in insurance cases).

148. In Coca v. Approving Auth., an Israeli District Court held that murder did qualify as a “hostile act,” thereby invoking the program’s relatively generous terror-compensation benefits. See Sommer, supra note 36, at 340-42 (citing V.A. (T.A.) 4076/98, Coca v. Approving Auth., 32(10) Dinim-Dis. Ct. 485). The Israeli legislature has created a rebuttable presumption that “[w]here a person has been injured under circumstances affording reasonable grounds for believing that he has sustained an enemy-inflicted injury, the injury shall be regarded as enemy-inflicted unless the contrary is proved.” Victim of Hostile Acts (Pensions) Law, 1970, 24 L.S.I. 131, (1969-70). Such a presumption is unsurprising in a country that experiences as many attacks as Israel does, and that wishes to avoid significant litigation over close cases. Interestingly, however, there is no such presumption in property-damage cases, although there too Israeli courts face the terror-crime distinction. Sommer, supra note 36, at 355.
(mere) crimes and terrorism. Any system of crime insurance or other payments must deal with cases where there is arguably criminal wrongdoing and also a massive tort. Generally speaking, we assume that the higher standard necessary for a criminal conviction will serve to police this line. In any event, we might think of the crime-insurance plan as beginning with very specific crimes rather than all crimes. Murder and armed robbery might be crimes with which to begin. There is probably little reason to fear that governments will quickly lower these crime rates and allow other uninsured crimes to mushroom. Moreover, all these insurance schemes work best when the government pays for losses after a certain threshold, so that it is high crime rates, rather than all crime, that trigger payments.

2. The Moral Hazard Problem

The strongest argument against government-sponsored crime insurance will already have occurred to most readers. There is a formidable potential for moral hazard associated with compensation for crime-related losses. On the life-insurance side, compensation at the high levels provided, say, by the 9/11 Fund could certainly cause an increase in the murder rate. No life-insurance company would agree to a million dollars of term or whole life insurance on every citizen of a city at prevailing rates, because the provision of such coverage, even at rates that were initially set by the prevailing market, might well lead to murders or to negligence on the part of likely beneficiaries. The life-insurance market would soon spiral out of control. Companies do agree to sell life insurance to groups, but the amounts are modest in comparison to the known earnings of the members of the group. These insureds are then worth more alive than dead to their beneficiaries. It would be startling, therefore, to see life insurers offering substantial amounts of group life insurance to unemployed persons. Without the ability to reduce coverage amounts or to screen applicants or even beneficiaries (as is possible with employer-provided group coverage), insurance costs would rise, squeezing out good-faith purchasers. Put differently, insurance companies cannot easily gather information about disaffected relatives or disgruntled business partners, and so they will decline to enter into a contract that gives the beneficiary an incentive to prefer that the insured be dead rather than alive. The moral hazard issue is, if anything, of yet greater concern to the government when it is the insurer, because it cares or ought to care about the lives of its citizenry more than any for-profit insurer does. For-profit life insurers will seek to prevent murders because murder prevention increases profits; in contrast, the government as life insurer is, or ought to be, concerned about murder rates for intrinsic as well as for revenue reasons. The moral hazard problem also extends to coverage for property crimes (or insurance); full compensation would
surely generate an increase in the number of reported thefts, arsons, vandalism episodes, and other purported crimes.

How might a government-sponsored regime of crime insurance or relief respond to these serious concerns? This question can be considered in connection with direct government relief for crime-related losses or with the crime-insurance subsidy alternative. In both cases, the private-insurance market can be instructive.

First, at a minimum, we must imagine that crime relief would provide modest benefits, or amounts that could be shown to represent no more than true economic losses. Much as a jewelry store owner who carries theft insurance might find his recovery limited to the actual cost of stolen goods in order to avoid the moral hazard and then the self-destructive market that we can associate with payments that generate a profit in the event of an alleged theft, so too we must limit the insurance or relief for loss of life to modest amounts in an attempt to reduce harmful temptations. Yet the very reduction in temptation effected through such cautious coverage might as a political matter doom crime relief from the start. If the families of wealthy or high-earning crime victims can receive larger amounts of relief, while the families of poor victims receive skeleton amounts adjusted to reflect anticipated lost earnings, there arises the problem of the government investing more resources in crime fighting in affluent areas than in poor ones. Governments may already allocate resources and political chips in this manner, but the idea of making it more obvious, and even encouraging more protection for wealthy persons than for destitute ones, is unimaginable at the political level. It will be politically unacceptable to find governments balancing their budgets in difficult periods by moving police cars from higher-crime poor neighborhoods to lower-crime affluent ones, in order to economize on relief costs. Any such relief system would reinforce the politically unattractive idea that the government should internalize earning power, valuing well-dressed citizens more than struggling ones.

Income disparities do appear to be politically acceptable in the operation of the 9/11 Fund, both because the recoveries were structured to take the place of tort recoveries, which could themselves be income based and which would no doubt have been sought at a greater rate if the Fund had offered very modest payments to high earners' families, and because the moral hazard problem was nonexistent inasmuch as 9/11 was an unexpected horror. Murders and traffic accidents may be within the control of victims and their families, especially so because many are known to go unsolved, but the

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149. There are other numerous analogies from private-insurance markets that would be relevant here. For example, many auto collision policies require repairs actually to be made, that is, they will issue checks only to the party doing the repair — and in some cases only to the repair person picked by the insurer.
bombing of lower Manhattan was hardly in the control of the victims. It is of course possible to imagine a future tragedy in which a calculating and very troubled rescue worker dashed into a building with knowledge that, if death strikes, his surviving family will be wealthy. But none of this can be the case with respect to 9/11 itself, for which there was no close precedent.150

One method of escaping this set of moral-hazard problems associated with crime relief is to make the required payments more substantial, but then have the payments go not to the victims’ families but rather to some third party that is not in a position to exacerbate the hazard. Thus, if the government paid half a million dollars following each murder (or each unsolved murder, or each murder above some modest base rate) and transferred this amount to a group of local charities (and perhaps even to a group whose members were not identified precisely at the start of each year), it is unlikely that the crime relief payments would give anyone an economic incentive to commit a crime. A major problem with this plan, however, is that it reduces the idea of crime relief to an academic exercise, since it is difficult to imagine politicians agreeing to a system in which tax revenues must be raised, and in which disbursements are undertaken in a manner that advertises the government’s own failures with respect to crime, but in which the funds then go not to voters or victims but rather to parties that are situated outside the political process. Indeed, in the preceding sketch, the funds would go to organizations that could be seen as competing with the government. But the basic point remains to encourage crime prevention and economic development in high-crime areas by using economic incentives, and at the same time to combat the moral hazard by directing these payouts to parties that are not in the position to increase the crime rate.

A palatable alternative may be to combine the two schemes just described. We might seek to encourage crime fighting and responsiveness to the citizenry by requiring the larger payments from the government, and we might make these payments uniform, regardless of the earnings of the victim, in order to make the scheme politically and morally acceptable. But then the victims and an outside set of charities might have claims on the payments only as required to avoid any moral hazard. The payments could go to a “Crime Fund,” and the Fund’s manager could be instructed to pay victims or their families only so much as necessary to replace provable lost earnings, with a cap of perhaps half a million dollars. The Fund would develop a

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150. It is also noteworthy that the reduction in 9/11 Fund payouts for life insurance and pension benefits (payable on death) flattens the payouts from the Fund. It is as if high-income families are favored by the formula calling for payments to be a function of lost earnings but, in return, high-income families do worse, both in relative and absolute terms, because insurance recoveries reduce what one receives from the Fund, and high earners are extremely likely to have more of this insurance, or collateral source, than are low earners.
balance, as many beneficiaries would receive less than that amount, and then the Fund's surplus could, on a periodic basis, be distributed to specified (or, to fight moral hazard yet more, to unspecified) charities.\footnote{Other plans are discussed in Saul Levmore, \textit{Citizen, Warranties and Majorities}, 31 FLA. ST. U. L. REV. 409 (2004).}

The only reason we have not been insisting on per-life payments of the magnitude used in risk management calculations, ranging from perhaps $1 million to $5 million, is that moral hazard dangers are present, and political pressures will likely prevent payments to wealthy families that are dramatically greater than those made to poor ones. Moreover, it is not entirely clear that the nonprofit sector (or other recipients of the surplus insurance payouts described above) could absorb large amounts of funding without producing new inefficiencies. Ideally, the surplus payments would go to other crime fighting causes, but that method of allocation is a topic left for another day.

3. Other Objections

There are, to be sure, other serious objections to a scheme in which the government pays when the crime rate is high. There is, for example, the danger that a government threatened with liability for high crime rates will simply redefine crimes, or so underenforce criminal prosecution as to make crime rates look lower simply because victims do not bother to report the crimes in question. At least insofar as crime fighting is concerned, the sort of scheme described here must be put into force by a government (though perhaps one that seeks to monitor a subordinate government unit) rather than brought about through liability that is imposed by courts. Thus, it is plain that if a state means to control a municipality in this way, it cannot allow the municipality to define the crimes in question. We imagine a state-sponsored scheme in which local governments must insure or otherwise pay when they exceed rates set and defined by the state. The state would need to take steps to make sure that citizens could report serious crimes even where the local government preferred to ignore or deny the crime. Alternatively, we can imagine innovative politicians putting such a scheme into effect in order to bind themselves and those who follow them in office.

There is also a danger that crime payments of the sort sketched here would perversely cause an increase in crime. This might occur if government payments drew away funds from the very tools that governments use to fight or prevent crime. Perverse effects of this kind are of course possible, though rare, but we have some faith that a well-drafted and flexible scheme could avoid such unusual effects. In any event, one aim here is merely to introduce the idea of crime insurance
VI. Conclusion

In the wake of the adoption of the 9/11 Victim Compensation Fund and the new federal terrorism-reinsurance regime, we have encouraged the idea of, or at least a comparison to, and a thought experiment about, government-sponsored crime insurance. But our aim has not been to insist that we must try such a scheme, be it local or national in design. Nor has it been to weigh in on the question of federal terrorism coverage. Instead, we have simply suggested that the case for crime coverage is superior to that for terrorism insurance. This is because financial responsibility might well make the government a better crime fighter, the underinsurance problem is surely greater for crime in impoverished communities than it is for terrorism anywhere, and the likelihood that crime insurance will generate desirable economic externalities is substantial.

At the same time, the political emergence of terrorism coverage — but not crime coverage — is unsurprising. Our analysis began with the observation that after-the-fact episodic relief often pours forth after catastrophic events, so that disaster insurance can be understood as a way of providing certainty and encouraging modest insurance requirements at low cost. The idea is that since relief payments will be made one way or another, they might as well be marshaled in a way that provides some salutary effects in advance of a disaster. In contrast, very few crimes elicit sympathetic, public relief of significant magnitude, if only because few persons or properties suffer in any one event, so that media coverage and political interest are limited. However formidable the normative argument in favor of crime insurance, it is terrorism coverage that we ought first to expect.

We would like to see some experimentation with crime insurance. The moral hazard problem associated with crime insurance could be solved, as suggested, by making partial payments to outside parties such as charities. This idea of crime insurance with payments to beneficiaries who are in no position to increase crime rates is a novel one, but real experience with such a scheme is needed in order to judge the success of this solution. We are satisfied that governments fight terrorism with full force even when there is no threat of liability, but real experience for an extended period of time is needed to assess the claim that financial responsibility will make governments take superior precautions against more mundane crimes. It is thus possible that a useful byproduct of the contemporary inclination to provide insurance against terrorism will, in a roundabout way, introduce the idea of insuring against crime.