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The myths of hurricane economics

Adam B. Summers

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There is just something about a hurricane that seems to bring out the worst in economic thinking. And when Hurricanes Harvey and Irma came calling, many lawmakers and other sympathizers did not disappoint. Let's tackle some of the economic myths most loudly and proudly proclaimed during such natural — and sometimes man-made — disasters.

Broken windows, broken logic

AccuWeather predicts that the devastation wrought by Hurricanes Harvey and Irma will impose a total cost of $290 billion on the U.S. economy, amounting to 1.5 percent of the nation's GDP. Yet, some, including many purportedly smart people, claim that the storms may actually benefit economic growth in the long run.

"Devastating storm may ultimately boost U.S. GDP," a recent CNBC headline crowed. "[E]conomists say it may ultimately provide a tiny boost to the national economy because of the rebuilding in the Houston area," the article chirped.

"The long-run effect of these disasters unfortunately is it actually lifts economic activity because you have to rebuild all the things that have been damaged by the storms," New York Fed President William Dudley offered during a separate interview on the financial network.

Others have made similar arguments in the past. The New York Times' Paul Krugman penned a column days after the Sept. 11 terrorist attacks in which he noted that the attacks "could even do some economic good." After all, "we need some new office buildings" and "rebuilding will generate at least some increase in business spending."

And, after a massive earthquake, and resulting tsunami waves, hit Japan in 2011, former Treasury Secretary and Harvard University president Larry Summers (no relation of mine) asserted, "It may lead to some temporary increments, ironically, to GDP, as a process of rebuilding takes place."

All have fallen victim to the "broken window fallacy," elucidated by 19th-century French economist and statesman Frédéric Bastiat in his brilliant "That Which Is Seen, and That Which Is Not Seen," in which he cautions that we should look beyond the short-term, most easily visible effects of laws and changes to the economy to discern the less visible and unintended consequences that will result.

Bastiat illustrates this through his story of a shopkeeper whose careless son accidentally breaks a window in the shop. Some witnesses, who might easily be named Dudley or Krugman, claim that there is an upside to the destruction: "Everybody must live, and what would become of the glaziers if panes of glass were never broken?" they ask.

But, Bastiat notes, the money the shopkeeper must spend to repair the window would otherwise have been used to buy shoes, or books or whatever. Now, that money will not go to the shoemaker or the bookseller, and instead of having both a functional window and shoes or books, he only has the window in the same repair as it was before the accident.

In sum, "Society loses the value of things which are uselessly destroyed," Bastiat concludes. "To break, to spoil, to waste, is not to encourage national labor," for "destruction is not profit."

Yet, whether it is a natural disaster or a war, some of us still try to delude ourselves that we may achieve prosperity through destruction.

When 'gouging' isn't a dirty word

The other false narrative we always hear from politicians and the media are the tales of the victims of natural disaster who are exploited by the heartless businessmen who jack up the prices of necessities like bottled water, gas and shelter in their greedy quest to maximize their profits. In the current crises caused by the hurricanes, newspapers and local TV stations have decried those who sold $99 cases of bottled water, $20-per-gallon gas, and hotel rooms at triple the normal rates.

"These are things you can't do in Texas," Texas Attorney General Ken Paxton admonished during a recent CNBC interview. "There are significant penalties if you price gouge in a crisis like this."

Added Deputy Attorney General Jim Davis, "Texans know right from wrong. This is an easy one: Don't take advantage of people who are vulnerable because they're running away from a flood or affected by a hurricane," Davis told Austin NBC affiliate KXAN.

Yet, Paxton and Davis' policies actually create more suffering, not less. While no one wants to pay high prices, especially during a calamity, this "price gouging" actually has many beneficial effects.

Prices are not merely what we pay for goods and services; they are the market's way of conveying information about, and coordinating, the changing wants and needs of millions of people conducting millions more economic transactions. When situations — and demand — change, so do prices.

If prices are allowed to rise during a crisis, they not only encourage conservation and prevent unnecessary hoarding by those who happen to get to the store first, leaving bare shelves for others, they also signal to others that demand has risen and, more importantly, provide them with an incentive to bring in more of the things that people are demanding. If prices rise enough, for example, it might make sense for someone 100 miles away to undertake the expense to truck in additional supplies.

Besides, "a merchant has no moral obligation to sell his goods in the first place," Richmond Times-Dispatch columnist and Reason.com senior editorial writer A. Barton Hinkle maintains. "And if a merchant has no moral duty to sell something at all, then it makes little sense to say he has a duty to sell it at a certain price."

We see the results where laws prevent prices from rising to their market value: lengthy gas lines and people literally fighting over the last cases of bottled water in grocery store aisles and stores

— if, indeed, there are any supplies left at all, like the hundreds of gas stations that ran dry prior to the hurricanes' landfalls. In a word: shortages.

These price caps deny people the things that they need when they need them most — even if they are at exorbitant prices in the short term. That hardly seems to be a compassionate policy.

But, as Cato Institute economist and senior fellow Daniel J. Mitchell noted in a recent column, "[S]ince buyers generally outnumber sellers, politicians will always have an incentive to demagogue on the issue."

Moreover, it is worth noting that setting price caps during catastrophes does not prevent prices from rising when demand spikes, it merely shifts such activities to the black market, where consumers are forced to deal with sometimes unscrupulous and dangerous people, and have little legal recourse if they end up getting ripped off.

Putting the 'hazard' in moral hazard

Lastly, the damage that is done by severe storms and hurricanes like Harvey and Irma is exacerbated by federal subsidization of flood insurance. It should seem obvious that it is unwise to build — or rebuild — in areas subject to frequent flooding and storm damage. But such behavior is actually encouraged by the federal government.

The National Flood Insurance Program creates a "moral hazard," whereby people engage in overly risky behavior (like building in dangerous flood plains), because much of the cost of their actions is borne by others — whether flood insurance policyholders in less risky areas or taxpayers — who have to pay for it when the destruction occurs. Between 1978 and 2015, for example, less than 4 percent of flood insurance policyholders, filing repeated claims, comprised 35.5 percent of all flood loss claims, and 30.5 percent of all claim payments, according to the Federal Emergency Management Agency. Not surprisingly, the NFIP is now $24 billion in the red.

This policy also creates a very real physical hazard for those who live in the flood zones, endangering the lives of those who have been encouraged to reside in these risky areas when disaster strikes.

The simple answer is to get rid of the subsidies and the federal flood insurance. If the private insurance market is unwilling to underwrite development in such areas, or is only willing to do so at extremely high prices, then it is a sign that we should probably not be building there in the first place.

Incidentally, the NFIP is up for reauthorization, as it is currently scheduled to expire at the end of the month, but I am not holding out much hope that our political leaders will learn the lessons they should from Harvey and Irma. Expect them, instead, to simply throw more money at the problem with little to no reform.

It is more than a bit ironic that free-market remedies are castigated as callous when the preferred alternatives have been used to justify unnecessary and brutal wars and costly Keynesian expansions of government spending (and debt); cause shortages and deny crucial supplies to those who need them most during a crisis; and jeopardize lives by encouraging people to engage in risky behavior, while forcing others to pick up the tab for the resulting destruction.

Hurricanes Harvey and Irma are just the latest reminders of how destructive Mother Nature can be. But, with a little economic logic and devotion to free markets, our man-made policies don’t have to be.