

# The Broken Window Fallacy

BY AARON STEELMAN

Florida was ravaged by four major hurricanes in 2004. According to the Insurance Information Institute, victims of the storms filed more than \$22 billion in insurance claims. That exceeds the amount of payouts following 1992's massive Hurricane Andrew and is roughly two-thirds the \$32 billion in claims resulting from the terrorist attacks of Sept. 11, 2001.

The hurricanes that hit the Sunshine State were clearly a tremendous personal disaster, killing dozens and displacing thousands more from their homes. But they were also a major financial setback, right? Not according to some reporters and analysts.

In September, *USA Today* ran a story headlined "Economic Growth from Hurricanes Could Outweigh Costs." Among the people interviewed for the story was Steve Cochrane, managing director at Economy.com. "It's a perverse thing ... there's real pain," he said. "But from an economic point of view it's a plus."

The places destroyed by the storms will need to be rebuilt, Cochrane noted. And according to some estimates, this will mean 20,000 new construction jobs, not to mention large expenditures on building materials and telecommunications equipment.

What this ignores, though, is how those resources would have been spent otherwise. Sure, a lot of money will go toward the rebuilding effort. But the key word here is "rebuilding." The construction workers in Florida are not putting up new buildings. They are simply replacing those that have been destroyed. No new net wealth is being created. In fact, as the insurance claims make clear, more than \$22 billion was *lost* because of the storms.

In the absence of the storms, that money could have gone toward any number of productive uses. But instead it will be spent to return Florida to its pre-hurricane condition.

To illustrate this point, consider the following two scenarios. First, \$22 billion is spent on college scholarships for gifted but poor students in Florida and other parts of the Southeast. That money will fund their educations, enabling them to acquire better-paying jobs than they would have otherwise. And some may even go on to start their businesses. Second, \$22 billion is spent rebuilding houses, hospitals, and retail centers that were destroyed by the storms, while in the meantime people live at shelters or with family members, forgo medical care or seek it at more distant facilities, and shop at less favored stores.

Which scenario seems more desirable? Most would say that scenario No. 1 is clearly preferable. But those who argue that the hurricanes are good for Florida's economy would lead you to believe that scenario No. 2 is just as good if not better.

How could they believe something so seemingly unreasonable? Perhaps these people are concerned about income distribution, and believe that the hurricanes will have egalitarian effects. After all, much of the property destroyed belonged to relatively wealthy people, while many of the rebuilding jobs will go to lower- and middle-income people.

Another explanation is that they have fallen prey to what the 19th century French economist Frederic Bastiat called the "broken window fallacy." In one of his most widely cited essays, Bastiat asks the reader to consider the example of a fictional character named James Goodfellow.

Goodfellow has a rambunctious son, who one day breaks a window in the family's house. The repairman who replaces the window will be made better off, but how about Goodfellow and society as a whole?

If Goodfellow "had not had a windowpane to replace, he would have replaced, for example, his worn-out shoes or added another book to his library," writes Bastiat. In short, the money that was spent repairing the window could have been spent in another, more productive way.

Not only that: Society, in general, does not benefit from the broken window and its subsequent repair. "To break, to destroy, to dissipate is

not to encourage national employment," writes Bastiat. More to the point, "Destruction is not profitable."

When analyzing the economic effects of a certain action or event, Bastiat reminds us that it is important to pay attention to both "what is seen" and "what is not seen." In the case of Goodfellow, what is seen is the money being spent to repair the window. What is not seen is how that money would have been spent otherwise. Similarly, in the case of Florida, it's easy to see the billions of dollars going toward reconstruction efforts, but more difficult to see how those resources could have been put toward more useful ends.

This second step — considering what is not seen — often eludes many observers and leads them to spurious conclusions that upon closer inspection are obviously wrong. When you hear someone argue that destruction is good for the economy — and you almost certainly will the next time a natural disaster strikes — remember the case of the broken window. It's a simple example, but one that yields important insights. **RF**

"Those who argue that hurricanes are good for Florida's economy have fallen prey to the broken window fallacy."