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BROKEN WINDOWS: A PERSPECTIVE ON THE JAPANESE ECONOMY

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Natural disasters abound all around the globe; from hurricanes along the coast; to tornadoes on the mainland, to fearsome earthquakes that can strike virtually anywhere. Incredible destructive forces like these cause great amounts of property damage. Most people, especially those in the affected areas, realize, nothing beneficial could come from natural disasters of this sort. This, of course, is a reasonable assumption.

But it is one to which economists are sometimes blind. For example, in the Wall Street Journal on September 17, 1999, "Hurricane Floyd may leave robust economy in its wake." Marilyn Schaja, chief economist at Donaldson, Lufkin and Jenrette Securities Corp in New York, tells a journalist that, "one of the most powerful storms to surge out of the Atlantic this century may actually give the economy a boost." The article, which focuses on the rebuilding effort, claims all this new activity is giving the economy a shot in the arm, and is actually expected to boost GDP by 0.2 per cent. However, it is not at all true that a natural disaster can help spur economic growth.

The same article contains a similar analysis of hurricane Andrew stating: "In 1992, after Hurricane Andrew tried to sink Miami, damage estimates – and they are always estimates – topped $ 26 billion. Ian Shepherdson at High Frequency Economics Inc., a New York research firm, notes the damage was equal to about 0.4 per cent of gross domestic product. But rather than slowing national growth, GDP for the quarter actually accelerated by 0.5 per cent to the equivalent of about $ 30 billion."[1]

A similar report from Reuters dated September 23, 1999, concerning the affect of the great Taiwanese earthquake averred. "A giant earthquake forced Taiwan to trim its 1999 economic growth target to 5.5 per cent, but officials said on Thursday a post quake reconstruction boom should drive growth beyond six per cent in 2000." The author report that, "....the earthquake, which measured 7.6 on the open-ended Richter Scale, would have a positive effect in 2000, with reconstruction stimulating domestic demand, said Chang Yao-tsung, the (economic) ministry's chief statistician."

It appears that after a natural disaster we can count upon a person calling himself an economist to reassure his audience that there is always an upside. He proclaims that all the rebuilding that takes place will provide a productivity boost for the economy. The architects, carpenters, plumbers, roofers, building suppliers, etc., all enjoy business they would otherwise not have had. The money they make will be spent on other goods. Theoretically, all this new activity spurs the economy and boosts GDP. Apparently, instead of weeping about Floyd we should be celebrating in the streets.

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[1] *One could conceivably interpret this as the claim that in spite of the hurricane there was economic growth. The context, however, seems to suggest that the good economic record was because of the storm.*

[2] *Citation is from the Arlington House Publishers, New York, 1979 edition.*

Henry Hazlitt[2] in Economics in One Lesson" (1946) P.23, eviscerates the fallacy that one can break a window and thereby benefit the economy. A boy throws a rock through the baker's window, and the on looking crowd debates the meaning of it. An "economist" of the Keynesian[3] stripe mistakenly concludes that it is a good thing the glass was broken. After all, now some glazier will benefit from the shopkeeper's business and have more money to spend on the product of other merchants. These in turn will have more to spend with still others. This is the Keynesian multiplier effect in economics, which is similar to the ripple effect of a pebble cast into a pool of water; it will go on providing money and employment in ever widening circles. The fallacy is uncovered when it is realized that property destruction will always make people worse off than they were before. The cash paid out for rebuilding is always a poor use of resources. Wealth is lost when something of value is destroyed; it takes capital and resources to replace it. As in the broken window fallacy, the economic activity seen at the time of reconstruction is the accumulation of capital and resources that otherwise would have been used for better economic alternatives.

True, when a building is destroyed, and a new one comes into being to replace it, that latter activity creates jobs. But had not the building been destroyed, and a new one erected, as before, then there would be not one but two edifies. Yes, when Hiroshima and Nagasaki were destroyed during World War-II, it took Herculean effort, many jobs and many raw materials to replace them. But had these efforts been made in the absence of the destruction of these two cities, there could have been four cities, not two. If bombing really brings about economic value, why did not the west destroy Chicago, London and Paris instead.

When it comes to calculating the cost of something, the alternative uses of the resources used in its creation simply must be considered. The gross domestic product is a poor instrument to use when trying to measure the losses and or gains from economic destruction. For example, you can't add and subtract, what you can't see, and most of the costs of hurricanes consist of goods not produced and services not provided. Also, the GDP only calculates money spent and resources produced. It does not take into account, the fact that, there were better economic alternatives. Yes, it is true there were X amount of homes built, and there were X amount of cars built, etc., but it should not be considered an addition to economic growth when identical amounts were previously destroyed. If this crazy principle were applied we could all destroy our homes and rebuild and the gains would be astronomical! So, of course, hurricanes cause the GDP to rise, but that should not be the same thing as causing productivity to rise.

Seemingly, an economic benefit can develop from a natural disaster when individual firms and households make new and often better decisions while rebuilding. A report, written by Douglas Ostrom, dated 16 June 1995, from the Japan Economic Institute, disasters, especially earthquakes and the Japanese economy, attempts to demonstrates this fallacy.

The great Hanshin earthquake that struck in January this year – arguably the second-worst temblor to hit Japan this century – serves to highlight the perceived vulnerability of the Japanese archipelago to a variety of natural disasters. The economic effects of the quake to date illustrate the ways in which a market economy like Japan's responds to a catastrophe. Individual firms

[3] *See Keynes, John Maynard, General Theory of Money, Interest and Money, New York: Harcourt, Brace, 1936; for a refutation, see Hazlitt, Henry, The Failure of the "New Economics," New York: Van Nostrand, 1959: Garrison, Roger.*