

DISASTER ECONOMICS


Floods and the free market

by **Tim Mak**

In a flash, torrents of floodwater can sweep away homes, infrastructure, and even loved ones. What happens next matters quite a great deal: governments can either aid the recovery, or aggravate it. Looking at historical floods—the floods of the American Midwest in 1993, the 2005 levee breaches in New Orleans, and the floods in Pakistan in 2010—

we can learn lessons that will allow public policy makers and citizens to make better decisions, to advocate for better laws, and to minimize human suffering.

The chaos that is left in the wake of a flood can illustrate the importance of fundamental free-market concepts.

An aerial photograph showing a farm and several homes completely isolated by floodwaters. The water is a muddy brown color. In the foreground, there are several large, white, cylindrical objects, possibly silos or storage tanks, partially submerged. A red truck is visible in the water. The farm buildings have grey roofs and are surrounded by trees and other structures. The overall scene depicts a significant disaster.

Disasters on this scale can bring about emotional responses when sober thought is needed most

Farm and homes isolated by floodwaters in the American Midwest, 1993.

Politicians and survivors stricken by tragedy react emotionally when clear-headedness is needed most; rule of law collapses as property rights are abandoned for wanton thievery; and scrambling governments often show dizzying incompetence (Brinkley, 2006).

In the aftermath of floods, survivors have to deal with property damage, lawlessness, the threat of disease, possible looting, and the likelihood of financial distress because of capital destruction. Shouldn't they at least be spared from poor government policy that compounds their misfortunes?

Price gouging

In 1993, the Mississippi and Missouri rivers flooded, inundating an astonishing 30,000 square miles of the American Midwest—an area about the size of New Brunswick. Unfortunately, disasters on this scale can bring about emotional responses when sober thought is needed most, and authorities in Iowa—one of the most affected states—reacted emotionally and without consideration to basic economic realities.

In the aftermath of the floods, some Iowans alleged that certain individuals had engaged in price gouging in the rental of porta-potties and water pumping equipment—both vital to post-flood management (Office of the Iowa Attorney General, 2008a). In response, the state

Entrepreneurs will find innovative ways to meet the needs of survivors

government of Iowa passed a law against price gouging, defined as “charg[ing]...excessive prices for merchandise needed by victims of disasters...[above] a reasonable profit” (Office of the Iowa Attorney General, 2008b).

But laws against price gouging serve mainly to prolong the catastrophe. Natural disasters like floods lead to a sudden collapse in the supply of necessary tools, equipment, food, and medical supplies. The laws of supply and demand suggest that prices for these necessities will go up. One of the key advantages of a free market system is that prices can be used as signals. When prices go up, the opportunity for profit provides an incentive and a signal for those outside the region to bring supplies in, and for entrepreneurs to find innovative new ways to meet the needs of survivors.

George Horwich, Nobel Prize winner and professor emeritus in economics from Purdue University writes:

Unusual price increases are not likely to prevail beyond the first few days of the disaster aftermath. If they do, they perform the valuable function of signaling to the outside world the enormous gain to be made in breaking through the wreckage with additional—and inevitably more normally priced—supplies...suppressing



Flooding in New Orleans, 2005.

the prices is a form of denial that prolongs the problem and increases the likelihood of centrally determined allocations, with all the delays, mismatches, and de facto higher social costs that denial entails (Horwich, 1990: 550).

After a disaster, a free market beckons for help. Laws against price gauging end up muting these signals, increasing hardship for survivors.

Property rights and looting

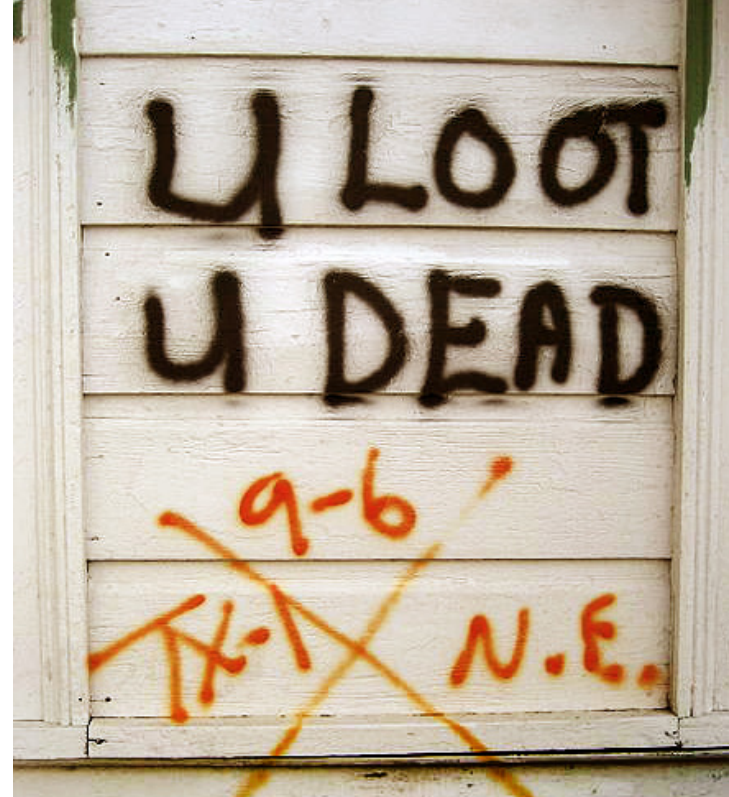
In 2005, Hurricane Katrina savaged New Orleans, a city built largely under sea level and protected only by levees. On August 29th, these levees suffered catastrophic failures, and the water was as deep as twenty feet in some parts of the city (Treaster and Kleinfield, 2005). By August 30th, looting had become widespread as some individuals took advantage of the desperate situation.

The looting is out of control. The French Quarter has been attacked," New Orleans Councilwoman Jackie Clarkson pleaded at the time. "We're using exhausted, scarce police to control looting when they should be used for search and rescue while we still have people on rooftops (Lagorio, 2005).

Looters besieged a Walmart, carting off stolen basketball hoops, jewelry and wide-screen TVs (Thevenot, Spera, & MacCash, 2006) and it was even alleged that some police officers joined in on the looting (Stix, 2006). Break-ins and robberies continued across the city unabated until the police and the National Guard could restore order days later. The breakdown of order in New Orleans illustrates that a key tenet of a functioning, prosperous economy is the right to keep what you have earned.

With the case of post-Katrina New Orleans, it would have been foolish for a supermarket chain to continue shipping goods to its New Orleans locations if looting was pervasive. Yes, suppliers would have faced logistical challenges in delivering goods, but in the absence of a deterrence to stealing, the delivery of these goods would have been an invitation for financial losses regardless. It says much about the importance of property rights that the absence of its enforcement will lead to an abrupt halt in the supply of critical goods.

In the aftermath of a natural disaster, lawless-



During the hurricane Katrina disaster warnings were posted to would-be looters in an attempt to protect private property.

ness can lead to the collapse of property rights. For any sort of recovery effort to begin, law enforcement officials need to quickly re-establish the rule of law and defend property from damage and theft. In chaos, there are lessons learned: for markets to function, property needs to be protected.

Capital destruction, inflation, and the road to recovery

In 2010, heavy rains during the monsoon season led to extensive flooding along the Indus River basin in Pakistan. The flood put approximately one-fifth of Pakistan underwater

(Goodwin, 2010), killing nearly 1,800 people, and affecting an additional 20 million (Singapore Red Cross, 2010).

One of the immediate effects of a disaster of this magnitude is inflation, a rise in the price of goods and services. In Pakistan, 17 million acres of agricultural land was submerged, and approximately 200,000 animals perished, sending the price of food and other basic needs soaring (Waraich, 2010). This sudden spike in food prices exacerbated an already tragic situation. It is in cases like this that even fiscal conservatives should give government action a second look.

According to the *Global Study on Participation by Affected Populations in Humanitarian Action*, in times of acute calamity, governments both foreign and local could be the only institutions able to mobilize food and medical aid in time to save lives (2002). Although private charities can and should play the leading role in providing medium- and long-term aid, they often lack the means to respond quickly enough to the immediate priorities after a disaster, especially search-and-rescue and emergency trauma care (Disease Control Priorities Project, 2006).

But after the initial shock of a natural disaster, a free-market environment, is crucial to the long task of rebuilding basic infrastructure, attracting investment, and restoring and creating jobs. Indeed, it has been shown that economic



Economic freedom and growth can decrease the negative impacts of natural disasters

freedom and the economic growth it brings (Gwartney et al., 2010) can decrease the negative impacts of natural disasters (Skidmore and Toya, 2007).

Horwich uses the example of post-war recovery in Japan and West Germany as an example of the power of how less government action can lead to an astonishing economic rebound. He writes:

Their extensive loss of capital, infrastructure, and life is...analogous to that of natural disasters—although much more vast in all dimensions...In both countries, reconstruction and sustainable independent recovery began only with the removal of price ceilings imposed during the war-time inflations. Centralized government played no significant role in directing [microeconomic] postwar economic activity (540).

For policy makers and survivors wishing to maximize growth and minimize recovery time,



Pakistan's flood victims being relocated to safer ground.

the long-term approach for rehabilitation must be the one that all countries should use to increase their general standard of living: attracting investment and innovation through a free market.

Unfortunately, Pakistan has not been doing well on these metrics. The government “operates with limited transparency and accountability” (Freedom House, 2010), and its economy ranks poorly in terms of economic freedom (Economic Freedom Network, 2010). A government that would be more accountable and less hostile to a free market, marked by lower taxes and less onerous regulations, could hasten Pakistan’s economic recovery.

A political wake-up call?

Thankfully, tragedy can galvanize citizens into action. Disasters expose government failures that citizens might have been more apathetic about before the incident. In democratic countries, a natural disaster can be a wake-up call; in fact, this can have an effect far beyond the scope of the original disaster.

“In the case of Katrina, the shared response was *shame*. The word was blasted across the headlines of magazines and newspapers. It was...a confession of culpability and a rejec-



US President Obama visiting the Martin Luther King Jr. Charter School in New Orleans in 2009. Support for school choice increased dramatically in Louisiana after the Katrina disaster.

tion of the seeming indifference and incompetence” writes Douglas Brinkley of the government response in his powerful 2006 overview of the Hurricane. He continues “the shame felt by voters over the government response to Katrina extended to shame over the state of government-run schools, which were in terrible shape even before the disaster (Brinkley, 2006). In 2002, “only 12 of 103 schools in New Orleans showed reasonably good levels of performance” (Bankston & Caldas, 2002).

After Katrina, the shocked citizens of New Orleans turned local school boards upside down, replacing incumbent board members with fresh faces. And after the local school boards declared that public schools would remain closed indefinitely after the hurricane, the state legislature intervened and allowed the estab-

lishment of an unprecedented number of charter schools.

School choice was a priority: students could go to any school in the district that had space for them. Before Katrina, 66% of schools in New Orleans were failing as defined by state law. This number has now since dropped to 26% (Educate Now, 2010). When New Orleans residents were asked an open-ended question as to what was better after Katrina than before it, the most frequent response was “education”; and 74% of locals now support school choice

(Council for a Better Louisiana, 2009). As this example shows, an appropriate response to a disaster can push societies towards greater freedom, and better results.

Conclusion

The 1993 floods in the American Midwest demonstrated how bad policy can occur when emotion is substituted for dispassionate analysis, and also communicated the importance of prices as a signal for help. The chaos of the looting in New Orleans showed the importance of property rights and the rule of law to a functioning economy.

Disasters wreak havoc, but with smart thinking and belief in the free market, recovery in places like Pakistan can be less painful. And maybe, as

the voters in New Orleans showed, some good can come out of profound tragedy.

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Tim Mak is a reporter for David Frum's FrumForum and a contributor to the National Post's Full Comment. In the summer of 2007, he was the Donner Canadian Awards intern at the Fraser Institute. He has previously worked at the American Enterprise Institute and in the Office of the Minister of Foreign Affairs.



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