

...And the Economics of Disaster Management

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John Stuart Mill, the great 19th century English economist and philosopher, optimistically, but I believe accurately, remarked on the "great rapidity with which countries recover from a state of devastation, the disappearance in a short time, of all traces of mischief done by earthquakes, floods, hurricanes, and the ravages of war." The history of both natural and man-made disasters during the subsequent century-and-a-half generally supports Mill.

The 9/11 terrorist attacks were quickly recognized as the beginning of a series of possibly more destructive attacks on U.S. citizens and property, and many commentators then believed it would cause a major economic depression. Yet it had a slight overall impact on the course of GDP and employment in the United States, although some industries and New York City were affected for several years. The Kobe earthquake of 1995 killed over 6,000 persons, and destroyed more than 100,000 homes, still the economic recovery not only of Japan but also of the Kobe economy was rapid. The flu pandemic of 1918-19 killed about 30 million persons world-wide without having a major impact on the world's economy. The lasting economic effects are similarly small for most other natural disasters that have occurred during the past couple of centuries.

Many natural catastrophes have very low probabilities of occurring, but cause considerable destruction of both life and property when they do happen. The recent tsunami in the Indian Ocean is one horrible example: it killed many more people than either 9/11 or the Kobe earthquake. But bad as it is, the loss of life is much smaller relative to the populations of the nations affected than some previous disasters.

History and analysis both indicate that the economic recovery of the nations most adversely affected by this tsunami will be rapid, although it will take longer in the resorts and coastal regions hit the hardest. The expectation of rapid recovery explains why Asian stock markets did not change much after the tsunami struck: Indonesia's and Malaysia's actually rose a little during the last week of December, while Thailand's declined a little, and Sri Lanka's declined by a few percent.

I fully agree with Richard Posner that it is worth spending considerably more to provide better early warning systems about the future occurrence of earthquakes and tsunamis, asteroids that might strike the earth, and other catastrophes. But no matter how much is spent and how much planning takes place, natural catastrophes will continue and will sometimes be unexpected.

Survivors of disasters that strike rich nations usually have medical coverage to pay for their treatment and rehabilitation, and insurance to cover much of their property destroyed, while those who perish usually leave life insurance for their families, and the opportunity to obtain decent education for their children. By contrast, most individuals in

poor nations of Asia and elsewhere mainly rely on help from their families and neighbors when disasters strike. Unfortunately, such help is not available when disasters attack many members of the same family and whole neighborhoods, as in major tsunamis and earthquakes.

An effective way for poorer nations to respond in the longer run would be to encourage greater investment in education. Since education raises the earnings of individuals and the per-capita incomes of countries, education clearly makes it easier to cope with disasters -- as Mill had already recognized. Beyond that, however, my colleague Casey Mulligan and I have shown that educated persons take a much longer time perspective in their personal decisions. This means that they are much more likely to anticipate the incidence and location of natural catastrophes when they decide where to live and how their houses are built, and they better protect themselves in other ways as well.

Greater access to private market insurance, even if subsidized by governments, is obviously also desirable, but such insurance is not likely to be available to, or chosen by, the type of very poor families disproportionately affected by this tsunami. The large outpouring of aid from rich nations will help only in the very near term. The next best alternative to private insurance would be government disaster programs in poor countries that designate areas hit by major earthquakes, hurricanes, and other catastrophes, manmade or natural, as eligible for disaster assistance. Such programs could make sufficient payments to poor families of husbands and fathers who died, and to families that lost most of their property, to help put them on their economic feet, without causing much of a drain on the government budgets of even poorer developing nations like Indonesia and Sri Lanka.

The moral hazard effects of such programs are always worrisome -- families might continue to build homes on earthquake fault lines if they expect government compensation when their homes are destroyed, or continue to build close to the shore in potential water-borne disaster areas. There is no perfect offset against such rational responses to government coverage of losses, but incomplete protection ("co-payments"), and regulatory exclusion of certain types of construction and other vulnerable activities in potential disaster regions would encourage individuals to consider the risks involved in their actions.