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Abstract:

Since Hurricane Katrina, the government, along with private for profit and not for profit organizations, has worked to rebuild the city of New Orleans. This effort is most evident in the response to the housing crisis that followed the storm. The government has spent billions of dollars and brought thousands of people in to rebuild homes and other infrastructure in the long run and to provide stopgap measures in the short run. The approximately 120,000 Federal Emergency Management Agency (FEMA) trailers in the region are one of the most visible examples of government efforts. While the trailers did provide benefits to those who received them, we argue that the government's policies aimed toward solving the housing crisis suffer from Frédéric Bastiat's broken window fallacy. FEMA trailers and the multitude of workers brought in are examples of what is seen, and, as Bastiat showed, we must also look at what is unseen. This article analyzes some of the unseen negative effects of the post-Katrina government policies dealing with housing in New Orleans. The government may appear to be doing something useful by providing the trailers, but the unseen costs and consequences reveal otherwise. Furthermore, the multitude of workers who came into the city following the storm are often given jobs they are highly overqualified to do. These problems, among many others, have weakened the relief effort.

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1 Introduction

> *In the economic sphere an act, a habit, an institution, a law produces not only one effect, but a series of effects. Of these effects, the first alone is immediate; it appears simultaneously with its cause;* ***it is seen****. The other effects emerge only subsequently;* ***they are not seen****; we are fortunate if we* ***foresee*** *them.* – Frédéric Bastiat (1964, p. 1)

> *We've got a lot of rebuilding to do ... The good news is — and it's hard for some to see it now — that out of this chaos is going to come a fantastic Gulf Coast, like it was before. Out of the rubbles of Trent Lott's house — he's lost his entire house — there's going to be a fantastic house. And I'm looking forward to sitting on the porch.* – President George W. Bush, September 2, 2005 (Sarasota Herald-Tribune 2005)

Hurricane Katrina was certainly a disaster. Government estimates suggest that the storm destroyed more than 200,000 homes in New Orleans and throughout the Gulf Coast (Eaton 2007). The solution for those left homeless, at least in the short term, came in the form of mobile homes now known as FEMA trailers.

In the wake of the storm, the Federal Emergency Management Agency (FEMA) provided about 120,000 trailers to displaced victims of Hurricanes Katrina and Rita (Foster 2007). President Bush asked for $16.7 billion in tax money for long term housing solutions (DHS 2006). The government has also spent $5.6 billion on short-term housing solutions (The Globe and Mail 2006). In this way, the government visibly took action. It provided not only money to (or at least to try to move towards) alleviate the housing crisis in the Gulf Coast, but also produced clear evidence of their effort in the form of FEMA trailers. But is this really the optimal solution? Or are there better ones?[1]

[1] Economists have started to take deeper looks at the questions that have arisen since Katrina. For instance, see Ewing et al 2007; Landry et al 2007; Chappell et al 2007; Boettke et al 2007; Whitt and Wilson 2007; and Eckel et al 2007.

In this paper we argue the government's plan to alleviate the housing crisis is far from optimal because it fails to take into account unseen effects. The FEMA trailer solution is another example of Bastiat's (1964) broken window fallacy. Any action taken that does not look into all consequences, including those not immediately seen, or not seen at all, does not make economic sense. Viewing any step taken as a good step is incorrect because unintended consequences matter.[2] As Bastiat (1964, p. 1) notes,

> Yet this difference is tremendous; for it almost always happens that when the immediate consequence is favorable, the later consequences are disastrous, and vice versa. Whence it follows that the bad economist pursues a small present good that will be followed by a great evil to come, while the good economist pursues a great good to come, at the risk of a small present evil.

The government's policies have failed to see the unseen in the aftermath of Hurricane Katrina, and the trailers have created poor incentives to solve the housing crisis, as discussed below. Furthermore, the government is incapable of seeing all that it needs to solve the problem. While the government has tried to determine which people truly need a trailer, government solutions of this kind are essentially doomed to fail because they suffer from what Hayek (1948) called the knowledge problem. Hayek explained how markets and the price system enable individuals to utilize dispersed knowledge to coordinate their actions. Government planning, on the other hand, is unable to utilize market mechanisms and the price system so they will be unable to solve the problems that markets can. In the case of Katrina, the government has no way to determine the best

[2] Bastiat presents the broken window fallacy through the example of a young boy who throws a rock through a butcher's window. The boy is going to be punished when a man steps in and says not to punish him because he has done the economy a favor. He has stimulated the economy because now the butcher must pay to have the window fixed, thus giving money to the glazier. This, however, is a fallacy. The unseen consequence is that the butcher would have used the money for some other purpose but due to this destruction cannot.

solutions for alleviating the housing crisis because the necessary knowledge is dispersed by time and place. At a more fundamental level, if the program is socialized enough then it becomes impossible to achieve any sort of economic calculation because without a market there will be no prices, and without prices there is no way to know how to properly allocate resources.[3] Individuals may have knowledge about how to improve matters, but government is unable to centralize this knowledge to effectively centrally plan the recovery. As we shall see, the government has given trailers to those who do not need them and has used resources such as labor in a wasteful manner. Due to its lack of knowledge, the government cannot possibly foresee all that needs to be foreseen.

If we continue to only accept what is seen, we will one day be able to see the glories of Trent Lott's new house (Sarasota Herald-Tribune 2005), but we will be far behind what could have occurred if markets had handled the situation. The entire solution to the housing crisis is a victim of what we here call the broken trailer fallacy.

The paper is organized as follows. Section 2 will show that the government is distributing the trailers in an inefficient manner, providing them to those who do not need them, while those who do are not receiving them. Section 3 will give an example of how the government is improperly allocating labor. Many wanted to help in the aftermath of the storm, yet the labor was not organized well, so many people ended up doing jobs for which they were overqualified. Section 4 will conclude by discussing how the market would better overcome the knowledge problem and be able to foresee the unseen through entrepreneurship.

[3] For more on this, see Mises 1990. For the differences between Hayek and Mises's arguments, see Salerno 1990.

2 FEMA: Creating the Broken Trailer Fallacy

Many people lost their homes in the aftermath of Hurricane Katrina. FEMA responded with a short-term solution, namely offering trailers for people to live in while they rebuilt their homes or searched for other permanent dwellings. The success of the program is debatable. Many faced delays in receiving their trailers (Hall et al 2005; Steinhauer and Lipton 2006; Maggi 2005). The program has also been called wasteful (Harper 2006; Hsu 2005, 2007) and has been filled with cases of fraud (Hall 2006; Harper 2006). FEMA has even been sued (Clemetson 2005). Now FEMA is recalling many trailers because they have become a health concern for residents (Moran 2007). The federal government's second ranking disaster official in Louisiana criticized the program from the start, "calling the effort wasteful and counter to the long-term interest of more than 100,000 displaced families" (Hsu 2005). Many of those who were supposedly eligible for aid found it difficult to obtain. One lawsuit against FEMA charges them with "retroactively inconsistent rules" (Clemetson 2005).

The costs of the program have also been significant, amounting to roughly $5.6 billion in the first year alone (The Globe and Mail 2006). Each trailer costs $60,000 to $100,000 to purchase (Architectural Record 2006), and needs to be hooked up to the gas and sewer systems. Including installation and site costs over an 18 month period government ends up spending as much as $140,000 (Hsu 2005). At the program's peak about 120,000 households were living in FEMA trailers, and as of October 2007, about 65,000 were still living in them (Blumenthal 2007); the purportedly short-term solution does not seem to have an end in sight. Thus, the government now requires people to buy or rent the trailers (Eaton 2007) and has even paid people to leave (Blumenthal 2007).

The program's problems have been all over the news, but most commentators have missed what we consider the root cause: a fundamental economic problem that the government completely ignores. We believe that the government has not learned the lesson of Bastiat's broken window fallacy, in which the breaking of a window was not actually helpful. In effect, FEMA's unhelpful trailer solution is a broken trailer fallacy.

To shed light on this situation, we will present first hand accounts that illustrate how FEMA focused on the seen, but not the unseen, effects of their policy. These accounts help to show, on a personal level, exactly what FEMA fails to see. First, let us consider the experience of an ordinary resident of New Orleans. One of the authors of this paper, Snow, was studying in New Orleans when Katrina hit on August 29, 2005. He was able to leave the city the day before the storm, but the apartment he was renting was damaged in the hurricane. A tree tore a hole in the roof of the apartment, causing water to seep in. Because Snow, his roommate, and their landlord were not allowed back into the city for more than a month after the storm, the apartment became covered in mold, rendering it unlivable. Most of the property in the apartment was damaged, and the apartment was looted twice. Snow's car was also flooded and could not be started.

While the storm caused a great blow, his experience was not overwhelmingly bad. While most of Snow's possessions were uninsured (including his car, which was not insured for flood damage), he was able to recover from the storm relatively easily and without need of government assistance. Upon his return to New Orleans in late December 2005, Snow did apply for FEMA aid, but he was denied. He was able to sell the car for $400 (about 10 percent of its pre-Katrina value), and his landlord offered him and his roommate another apartment, so no housing assistance was needed from the federal government. Interestingly, most of Snow's friends, who were in very similar circumstances, were able to get money from FEMA, usually around $1,500. Some of Snow's friends who received FEMA aid had lost much less than him.[4] The reasons why some people received aid and others did not are murky.

Snow was a lot better off than most people in New Orleans after the storm, so the real shocker came in February 2006, when Snow received a telephone call from FEMA. They were offering him a trailer! And for free! Most of the FEMA trailers were 240 square feet and could fit 8 people (Barry 2006). Snow did not need a place to live, much less space for eight, so he promptly turned it down. The incident does raise a number of questions, however. Why was the trailer at a cost of $140,000 offered for free, but a measly sum of money (the equivalent of a small insurance payment) denied? How does FEMA go about deciding who gets what? Why did it take nearly six months for FEMA to offer the trailer? Whatever the answers to these questions are, the fact that they have arisen should surely shake any confidence in the government's relief effort.

This personal experience is telling for several reasons. FEMA's complete ignorance of how to allocate the funds allotted for the relief effort should be obvious. Snow was relatively well off after the storm, and some of his friends were even better off. He was not given money, but he was offered a $60,000 trailer. If one believes that government should provide insurance, one could argue that Snow was in need of a small payment, but was it a good use of resources to give someone who already had a place to

[4] Many of Snow's friends used their FEMA money on goods that most would not consider necessities, such as new music and stereo equipment. They were not alone. The rap music community has created many songs about Katrina (Bonisteel 2006), some of which state how the rappers spent their FEMA checks. The *Washington Post* reported on one New Orleans rapper using the name Juvenile. In his song 'Get Ya Hustle On' he proclaims, "Everybody need a check from FEMA, so he can go and score him some coca-i-na." (Freedom du Lac 2006) This helps assert how FEMA aid was being squandered.

live a free trailer? He had not even asked for housing. The only rational explanation for the government's actions is that providing people with money is a lot less visible than providing them with trailers. The trailers are much more costly, and, in Snow's case, unnecessary, but they were highly visible, so government could go around and point that they were doing something to solve the problem.

We can contrast the government's efforts, which had little concern for costs and more concern for visibility, with that of the private sector. Despite their profit driven incentives, private sector entrepreneurs helped Snow much more. At the time of the storm, Snow had rented from his landlord for about a year. Money may have been the landlord's primary motivation, but in the market one makes money by pleasing consumers. The landlord offered Snow and his roommate a house that he would have normally rented to a family for more money. Whether the landlord provided the replacement home for altruistic or self-interested reasons is unclear, but the landlord established a good reputation. In return for the landlord's goodwill, Snow and his roommate recommended other friends to him in following years. This market relationship benefited all parties involved (Rothbard, 1956).

Government, on the other hand, has little concern for customer satisfaction. Government is usually only punished in extreme cases, if voters make a stink and vote politicians out of office or get bureaucrats fired, but even this is often quite difficult. In the short term at least, no matter how bad a job FEMA does, they will continue to receive funds. The main difference between private enterprises and government can be illustrated through Bastiat's discussion of what is seen and unseen. FEMA only has to worry about what is seen. As long as the organization shows that it is doing something, employees are relatively safe in their jobs. Quality and other considerations are practically unimportant. In the market, on the other hand, participants must consider both the seen and the unseen. If they do not then, they bear the costs of their mistakes. FEMA does not have to pay the cost. The cost is distributed through the taxpayers.

3 FEMA creates many unseen costs, but at least the knobs on the stoves are red

In addition to looking at the account of a typical resident, let us consider things from the viewpoint of FEMA. We interviewed a man who was a FEMA Disaster Assistance Employee (DAE) for two months in fall 2006 (a friend of a friend of Stringham, another of the authors of this article). For privacy reasons, we will not refer to the interviewee by name, however, he is in his mid-fifties, is a registered Democrat, and has a graduate degree.

Our interviewee was one of 6,800 Disaster Assistance Employees hired after Katrina (Barr 2006). According to FEMA (2007),

> DAEs are a critical staff resource to FEMA. They perform key program, technical, and administrative functions during disasters. Without this work, FEMA's ability to assist State and local governments in recovering from the effects of disasters would be significantly less effective. DAEs must be free to travel at a minimum of two to six weeks at a time, and sometimes longer, usually with as little as a day or two of notice. They need to be able to produce high quality work with minimal supervision, under pressure and in a hectic work environment. Their travel to and from a disaster scene is paid for, along with day-to-day expenses for lodgings and an allotment for meals and expenses. DAEs receive a salary which is based on the kinds of work they perform.

To be hired as a Disaster Assistance Employee one must undergo an employment process that includes fingerprint checks and background investigations (Barr 2006). Disaster Assistance Employees perform many of the same tasks as full time FEMA workers, “such as helping to run disaster response centers, inspecting damage, manning telephone hotlines, assisting victims with claims, and coordinating relief activities with state and local officials.” (Witte 2005)

Disaster Assistance Employees are also known as reservists because they could be subject to 24-hour-on-call in the event of an emergency (FEMA 2007). One 45-year-old woman received a call from FEMA a year after she signed up asking her to be at the airport in one hour (Witte 2005). When our interviewee received his call, it was similarly clear that the government did not have its act together. He said, “Last fall [in 2006], more than a year after the disaster. I got a call at 5:30 pm on a Friday night saying they needed me on Monday morning.” He was not sure why they waited until Friday night to call him, as it seems they had to know that they would need new people well in advance, but he packed up his belongings and got there on Monday. “Why did they wait so long? It makes no sense,” he said. “I told them that I could arrive on Monday and be at work on Tuesday morning.”

The problems continued upon our interviewee’s arrival. He said, “When I arrived something related to my security clearance folder had been lost somewhere, so I had to sit around not doing anything for the first week until they could redo my paperwork.”[5] When he finally got to work, he worked on a team of 70 people. “Eight to ten people were strictly in the office, so about sixty of us were going out to document the number of trailers,” he said. FEMA did not have accurate records on the number of trailers they had disbursed or where they were. This was because “the priority after Katrina had been to

[5] A similar thing happened to the same 45-year-old woman who was called on at an hour’s notice. Due to a foul-up, FEMA never issued her the special credit card that is necessary for her work. “I couldn’t help,” she said, “because they couldn’t get their act together.” (Witte 2005)

get these trailers out there and to figure out the paperwork later. A year later we were setting up the paperwork." FEMA employees thus had to go find the trailers, mark down their Vehicle Identification Numbers, and talk to the occupants.

FEMA's records typically showed twelve trailers on a street of twenty homes. "The records were very inaccurate. Of the list of twelve, eight might actually there. Then there would be spaces where we could see that two were there at one time but were no longer there. Then there would be two that had never been there. But what was interesting was there might be six trailers that were not even on the list." In total they were supposed to find 28,000 trailers; instead they found 40,000. "There must have records somewhere in the government, but they were so disorganized," he said. FEMA allocated resources as if the number of trailers was 28,000, not 40,000. Clearly, the seen of getting the trailers out was more important than preventing many of the unintended consequences that would result in the future.

Some trailers were being used, but others were not. Our interviewee found that those living in the trailers and those not varied. "Some people would have moved back into their home and respond, 'When are you going to get this trailer out of here?' While others would still be in their trailer and had not fixed their home in the slightest; it looked as if the storm had just taken place the day before. They had not fixed a thing."

The clearest unseen cost was that of FEMA's ability to allocate labor. This is illustrated by the "red knob job." FEMA had many specifications and requirements. These often differed slightly from the consumer models, so right after the storm the requirements were waived so that FEMA could meet the demand for trailers. In particular, each trailer had a stove with two or three gas knobs and one sparker knob for each burner. FEMA specifications required the sparker knob to be red, to clearly label it to prevent deadly explosions (Deseret News 2006), but knobs on many consumer models were black. Thus, the DAEs on our interviewee's team also painted stove knobs red when they visited trailers. This "red knob job," as it was called in the field, was unnecessary; FEMA had red knobs on order. Furthermore, as our interviewee said, "If the residents had lived in the trailer for at least a half year and by this time they if they had not blown themselves up, how much safer would the red knobs make them?"

The "red knob job" illustrates FEMA's lack of concern for costs in the interest of visibly doing things. It also reveals government's inability to allocate labor to its highest valued use. FEMA spokesman Nicol Andrews has said, "We are looking for trained professionals who can bring their expertise to the table – with talent and skill sets – and we can add the knowledge about FEMA's programs" (Barr 2006). But do you really need people a master's degree to paint knobs? Is that really bringing a person's expertise to the table?

Our interviewee was not an economist, and to our knowledge he had never heard of Frederic Bastiat. But in the course of our conversation with no prodding, our interviewee helped explain Bastiat's lesson about the seen and the unseen to a tee. He stated,

> Here is the mentality of the typical person. A federal bureaucrat knows about a problem. The first thing he needs to do is show that he is doing something about it. They have no concern with efficiency, no concern with costs, and no concern for common sense. They need to be able to point to something they are doing. It doesn't have to make sense. It doesn't have to work. They want to be able to declare 'I know about it, and I can point to something I am doing.'

Distributing thousands of trailers and sending Disaster Assistance Employees to each one to paint knobs red are two highly visible actions. The seen consequences of the policy are that tasks "get done," but less easily seen are the tremendous costs and waste involved. The government simply lacks the knowledge and the incentives to do things that make sense.

As our interview was wrapping up, our interviewee volunteered his ideas on how to fix the problems with FEMA. He said, "My solution is to dismantle it. The whole organization has a fundamentally wrong approach to what they are trying to do." He concluded with, "They should dismantle FEMA, and whatever they replace it with, anyone who had worked for FEMA should not be allowed to join." This coming from a FEMA Disaster Assistance Employee!

4 Conclusion

The government's involvement with Hurricane Katrina recovery efforts has been problematic in many ways. Our first hand accounts help illustrate the fundamental problem with the governmental approach to dealing with problems on this scale. The government focuses on highly visible actions while ignoring the less easily seen but real costs of those actions. For many reasons inherent in their approach, the government simply does not look at the whole picture. By trying to centrally plan the recovery, they rely less on the price system and more on bureaucracy, which focuses on showing that they are doing something rather than actually doing it well.

As with other examples of government embarking on endeavors without markets, the government has no rational way to determine whether the benefits of any of their actions are worth more than the costs. By focusing on "doing something" while not considering costs, the government has created what we call the broken trailer fallacy. Had Bastiat been alive today and heard George W. Bush declare that he is going to rebuild New Orleans, Bastiat no doubt would have given the same response he gave to the politicians during his day: "But I beg him to begin again, entering *what is not seen* in the ledger beside *what is seen.*" (Bastiat 1964, p. 4) Government cannot simply point to what is good about their program without considering its costs.

The government likely chose the trailers because they are highly visible; it looks like the government is doing something. The government has not, however, taken into account the unseen effects, and the taxpayers are now footing the bill for the costs. The trailers also create poor incentives making people dependent on the government rather than encouraging people to help themselves. We are left with a wasteful program doing far less good than a market solution would have produced. More than 150 years after Bastiat described the broken window fallacy, the government still makes the same mistakes. The broken trailer fallacy is a perfect example of the government's inability to consider the less easily seen costs of their policies.

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