

War and the Broken Window Fallacy*

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April 2023

He who wishes to fight, must first count the cost
- Sun Tzu (544-496 BC). The Art of War.

The quote above is from Sun Tzu's treatise on military strategy and tactics, [The Art of War](#). Sun Tzu meant that before engaging in any war, it is essential to carefully consider the resources, risks, and potential outcomes of the conflict. In other words, before entering into any battle, one must assess the potential benefits and drawbacks of the fight and weigh them against each other. By counting the cost, Sun Tzu advises that one must be fully prepared and aware of the potential economic consequences of engaging in a war.

Sadly, today's news is dominated by war – more specifically the war in Ukraine. Daily, we are confronted with images of death, destruction, and human suffering. It is not unreasonable to ask, what are the costs of all this? And what else could have been bought with this money?

War is caused by a variety of factors, including territorial disputes and political, economic, and ideological differences. As von Clausewitz¹ put it: "War is the continuation of politics by other means".

The purpose of investing – and the responsibility of an investor – is to buy assets that are expected to increase in value over time and provide returns in the form of passive income, or capital gains. It is putting money to work to generate positive returns.

During and after a major war, there are (mostly defense) companies that profit handsomely from these conflicts. An investor, in search of "alpha" (the

* The views and opinions expressed in this paper are solely those of the author.

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¹ Carl von Clausewitz (1780-1831) was a Prussian general and military theorist. His most notable work, Vom Kriege ("On War") is considered a seminal treatise on military strategy.

excess return of an investment relative to the return of a benchmark index), might be tempted to acquire shares in these defense companies.

Perhaps he/she would be a fool not to. In February 2023, an article appeared in *Responsible Statecraft*¹ with the eye-catching title: “Ukraine War is great for the portfolio, as defense stocks enjoy a banner year”². This is true. Had you owned certain defense stocks over the last 12 months, you would have outperformed the overall market by a significant margin.

For example, the share prices of leading U.S. weapons manufacturers have exhibited remarkable growth following Russia's invasion, significantly outperforming the major indexes. As of this writing, Lockheed Martin (+33%), Raytheon (+32%), Boeing (+96%), Northrop Grumman (+29%), and General Dynamics (+24%) have all experienced substantial appreciation of their market capitalization since the start of the war in Ukraine. The share price of German arms manufacturer Rheinmetall has gone up by more than 85%.

Furthermore, when comparing the performance of these top defense stocks against that of the major indexes, their growth is even more impressive. On average, these defense stocks have outperformed the S&P 500, the NASDAQ Composite Index, and the Dow Jones Industrial Average by a wide margin. Leaving ethical considerations aside, any rational investor would be remiss to forego such an opportunity to generate returns of that magnitude.

The irony here, that a significant portion of the U.S. weapons industry's revenue stems from government contracts, which are ultimately funded by taxpayers, is worth noting.³ Remarkably, the profits of this predominantly government-funded industry are not solely reinvested in production, R&D, and other profitable growth initiatives. Rather, as their annual reports show, a considerable portion of the earnings is channeled back to shareholders through share repurchases and dividend payments. This results in an incongruous situation where a partially taxpayer-funded payout is being transferred to shareholders (i.e., the owners) of the company. Yet, despite this anomaly, the above would indicate that generally war is very good for business, at least for some.

In fact, it is a popular misconception that wars are beneficial to the economy. The example most often cited, is that World War II effectively

¹ *Responsible Statecraft* is the online magazine of the Quincy Institute, a U.S. think tank.

² <https://responsiblestatecraft.org/2023/02/24/war-is-great-for-the-portfolio-as-defense-stocks-enjoy-a-banner-year/>

³ <https://insight.factset.com/how-much-do-government-contracts-contribute-to-defense-suppliers-revenue-share>

ended the last remnants of the Great Depression. However, the idea that war stimulates the economy contradicts the principles of rational economic reasoning, as unambiguously demonstrated by the “Broken Window Fallacy”.

The Broken Window Fallacy is a parable that was first articulated by Frederic Bastiat¹ in his essay "Ce qu'on voit et ce qu'on ne voit pas" ("What Is Seen and What Is Not Seen"), which was published in 1850. The story underscores the fallacy that engaging in warfare is advantageous for a nation's economy. However, its broader implication is that an economic activity that appears beneficial for those directly involved, can have far-reaching adverse economic effects on numerous others.

Bastiat's parable involves a shopkeeper whose window is broken by a wayward rock. A crowd gathers around the broken window, and some bystanders suggest that the broken window will, in fact, be good for the economy because the shopkeeper will have to pay to have it repaired, which will create work for the glazier. The glazier, in turn, will spend his earnings on other goods and services, thereby stimulating economic activity. This, according to the proponents of this view, shows how destruction can actually be beneficial for the economy.

However, Bastiat points out that this belief overlooks the fact that the shopkeeper could have spent the money to pay the glazier on something else - if he did not have to repair the window. For example, he might have used the money to invest in his business, buy clothing, or a new pair of shoes, which would have stimulated economic activity in those industries instead.

Through the parable of the broken window, Bastiat introduced the concept of “opportunity cost” in all but name.² The money spent on the window repair is therefore a "seen" benefit, but the opportunity cost of the money spent, is a "not seen" cost, which represents the goods and services that could have been produced if the money had been used differently.

Bastiat uses this parable to illustrate a more general point about economic fallacies. He argues that people often focus only on the immediate, visible effects of economic activity, while ignoring the broader, longer-term

¹ Claude Frederic Bastiat (1801-1850) was a French classical liberal theorist and political economist.

² It was Friedrich von Wieser (1851-1926), who first coined this term in 1914 – 64 years after Bastiat’s death. Von Wieser was one of the principal members of the Austrian school of economics.

consequences. In doing so, they often make flawed assumptions and thus arrive at false conclusions.

In the context of war, the broken window fallacy is often used to justify the economic benefits of wartime spending. Advocates of this view argue that wartime spending creates jobs and stimulates economic growth. However, this perspective overlooks the fact that war resources are often taken away from other productive uses and that the costs of war can be staggering (see below). War can result in significant loss of life, displacement of people, destruction of infrastructure, and a drain on resources that could be used for other purposes.

There are many potential opportunity costs associated with a war. For example, funds that are allocated to military spending could instead be used for education, healthcare, or infrastructure projects. Similarly, the resources and talent that are committed to the military could be used for other purposes, such as scientific research, technological innovation, or entrepreneurship.

Additionally, war can have significant social and psychological costs that are often underestimated, or ignored. These might include the loss of human life, displacement of people, destruction of cultural heritage (e.g., in Syria and Iraq), and the psychological trauma that affects both soldiers and civilians. Indeed, 20 years after the invasion, the Iraqi people are still struggling to pick up the pieces.¹

The opportunity cost of a war can also have longer-term consequences. For example, resources that are allocated to military spending might not be available for investment in sustainable development, or climate change mitigation efforts. Furthermore, the instability and insecurity that often accompany war can create ongoing economic and political challenges for affected regions, making it more difficult to achieve long-term growth and stability.

Table 1 below, shows a break-down of the estimated costs for the United States of the wars in Iraq and Syria.

¹ <https://www.wrmea.org/iraq-iran/iraq-still-struggling-20-years-after-u.s.-invasion.html>

Department of Defense (DOD) "Emergency" or "OCO" Appropriations	\$ 862
Estimated Increase in DOD Base Spending Due to Iraq War (FY2002-FY2022)	\$ 406
Department of State, incl. OCO and Foreign Operations Budget	\$ 62
Estimated Interest on OCO Spending through FY2021	\$ 230
Estimated Veterans' Medical and Disability Care through FY2021	\$ 233
Costs of Iraq War not including Future Veterans' Care	\$ 1,793
Estimated Obligation Future Veterans' Medical & Disability, FY2022-2050	\$ 1,100
TOTAL Including Future Obligations for Veterans' Care	\$2,893

Table 1. Estimated U.S. Costs of War in Iraq and Syria, FY2003-FY2023, in Billions of Current Dollars (Rounded to the Nearest Billion).

Source: Crawford, N.C. (2023).¹

It is anticipated that the expenses of the conflict in Iraq and Syria will surpass \$2.89 trillion. The above financial estimate comprises current costs, which are approximately \$1.79 trillion, as well as the expenses of caring for veterans up to the year 2050. Since the US invasion of Iraq in 2003, the number of casualties in Iraq and Syria is estimated to be between 550,000 and 580,000 people, with over 7 million refugees and almost 8 million internally displaced persons in both nations.

\$3 trillion is a staggering number, especially when you think how such a vast amount of money could have been spent on projects and programs that will benefit society as a whole. It will not just fix a broken window; it will work towards fixing a broken world...

There are also other "unseen costs". The Watson Institute "Costs of War" report also estimates that 98-122 million metric tons of carbon dioxide were emitted from military operations between 2003 and 2021. And as wars are frequently financed through debt, U.S. taxpayers are paying \$9.25 million per hour (!) to cover the interest on war debt.²

Concerning the current war in Ukraine, the invasion by Russia has resulted in severe financial and humanitarian consequences worldwide, as energy prices rose, inflation increased, and disruptions occurred in numerous supply chains. At the local level, according to the Kyiv School of Economics, the invasion has caused damages valued at \$137.8 billion (at replacement cost) as of December 2022. This estimate covers the complete destruction of 344

¹ Crawford, Neta C. (2023). "Blood and Treasure: United States Budgetary Costs and Human Costs of 20 Years of War in Iraq and Syria, 2003-2023". *Costs of War*. Watson Institute. Brown University.

² <https://www.nationalpriorities.org/cost-of/interest-war-debt-2001/>

bridges, 440 educational facilities, 173 hospitals, and hundreds of thousands of homes, while many other structures have also sustained significant damage.¹ As of this writing the total war costs to Ukraine will be much higher.

It is neither unreasonable, nor unrealistic, to ask whether there such a thing as a "just war"? A war which is declared for right and honorable reasons and fought in a certain way. This concept of a "just" war does indeed exist, namely as a theory that suggests that a war can be implicitly legitimate under certain circumstances.² These include that the war must be fought for a morally justifiable reason, such as self-defense, or to protect innocent people from harm, and must be fought according to recognized rules of conduct. Also, the intention behind the war must be to achieve a just outcome, such as peace, or the protection of human rights. Moreover, the war must be a last resort, after all other reasonable options for resolving the conflict have been exhausted. And perhaps most importantly in terms of opportunity costs, the military action taken must be proportional to the threat posed by the enemy, and the harm caused to civilians and the economy must be minimized.

However, the application of these criteria is often subjective, and in the case of Ukraine simply ignored. Moreover, there is significant debate over what constitutes a "just" cause, or a "proportional" response. Besides, it could be argued that the very concept of a "just war" is flawed, as war inherently involves death and destruction, which is difficult to justify from a moral standpoint (and the broken window fallacy!).

The Broken Window Fallacy helps us understand that while the visible benefits of economic activity may seem attractive, the opportunity cost of not using scarce resources in more productive ways is often "unseen" and thus overlooked. In the context of war, the Broken Window Fallacy (or opportunity cost in today's terminology) can be used to challenge the economic benefits of wartime spending. It ignores the long-term consequences of war, such as loss of life, displacement of people, destruction of infrastructure, and the diversion of resources away from other productive uses.

To end on a personal note: I don't consider myself a pacifist, or someone who supports the idea of "peace at any cost". However, as an economist, I disparage war for its detrimental impact on people and wastefulness of

¹ <https://kse.ua/about-the-school/news/the-total-amount-of-damage-caused-to-ukraine-s-infrastructure-due-to-the-war-has-increased-to-almost-138-billion/>

² <https://iep.utm.edu/justwar/>

resources. I tend to agree with Bertrand Russell¹, who believed that war was a senseless and destructive activity that caused great harm to individuals and societies. In his essay "The Ethics of War"², Russell argued that war had no real benefits except for those who stood to gain financially, or politically.

And so it is. Investing in assets that increase in value over time and provide returns is a rational and intelligent approach. However, the extraordinary profitability of the defense industry during times of war may raise ethical concerns about investing in that space. So, at the end of the day, it's up to the individual.

General Dwight Eisenhower³, one of the key figures in the Second World War (planning and supervising two of the most consequential military campaigns of that war) once observed:

War is mankind's most tragic and stupid folly; to seek, or advise, its deliberate provocation is a crime against all humanity.

¹ Bertrand Russell (1872-1970) was a British polymath who greatly influenced mathematics, logic, set theory, linguistics, artificial intelligence, cognitive science, computer science, and various branches of analytic philosophy.

² Published in the International Journal of Ethics in 1915, "The Ethics of War" explores the question of whether war can be morally justified and, if so, under which conditions. It was written during World War I.

³ Dwight David Eisenhower (1890-1969) was an American military officer and the 34th president of the United States (1953-1961). During World War II, he served as Supreme Commander of the Allied Expeditionary Force in Europe.