COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

BUDGET UPDATE
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The Tragedy of Katrina Underscores the Need for Congress To Budget for Natural Disasters

It will be some time before officials will be able to fully assess the amount of disaster relief funding that will be necessary in the wake of Hurricane Katrina, but it is already becoming clear that the costs of responding to Katrina will vastly exceed any previous natural disaster in the U.S. Though the specifics of any one disaster cannot be anticipated, they are an unfortunate, costly, and regular reality. Budgeting for disasters is part of being prepared for these recurring tragedies.

Insured losses for Katrina have been estimated to be as high as $25 billion, but that number could increase. The general rule has been that total losses are double insured losses, but much of the damaged caused by Katrina is flood damage, which is not covered by private insurance. Thus the ratio of public to private costs is likely to be much larger for this disaster.

FEMA has been spending approximately half a billion dollars a day on relief and recovery efforts, quickly depleting the $2.5 billion available when the hurricane hit. Congress has already approved the Administration's initial supplemental appropriations request of $10.5 billion. This request is intended to cover the immediate relief and recovery efforts by FEMA and the Department of Defense for the next couple of weeks until a more complete damage assessment can be made. This initial supplemental already places Hurricane Katrina among the more costly disasters in terms of federal government spending, with the bulk of the spending yet to come.

Given the current rate of spending by FEMA and the tremendous challenges that remain, it is likely that FEMA will require further supplemental funds for relief and recovery efforts. Additional funding will be needed for Small Business Administration, which helps individuals pay for temporary housing and offers low-interest loans to businesses, and the Federal Crop Insurance Program. The federal government will also face substantial costs of rebuilding infrastructure and federal facilities as well as grants to state and local governments for efforts, but these costs will not be known for some time. In addition, the federal government is likely to face substantial costs for flood insurance claims under the National Flood Insurance Program.

The table below shows the costs of major natural disasters in the last two decades for the federal government and private insurers. The federal disaster relief includes both immediate relief and recovery efforts as well as costs of repairing damage to infrastructure, federal facilities, etc. The final numbers for Katrina will certainly be much higher than any of the disasters contained in the table.

Costs of Major Natural Disasters
(Costs in constant 2005 dollars in parenthesis)

Event	Federal disaster relief[1]	Insured claims[2]	Total damage[3]
Hurricane Hugo (1989)	$1.3 billion ($2.1 billion)	$4.2 billion ($6.6 billion)	$9.0 billion ($14.2 billion)
Hurricane Andrew (1992)	$12.5 billion ($17.4 billion)	$15.5 billion ($21.6 billion)	$27.0 billion ($37.6 billion)
Mississippi Flooding (1993)	$4.4 billion ($6.0 billion)	$0.3 billion ($0.4 billion)	$21.0 billion ($28.4 billion)
Los Angeles Earthquake (1994)	$8.4 billion ($11.1 billion)	$12.5 billion ($16.5 billion)	$20+ billion ($26+ billion)
Hurricanes Charley, Francis, Ivan & Jeanne (2004)	$13.5 billion ($14.0 billion)	$24.5 billion ($25.3 billion)	$41.5 billion ($42.9 billion)

[1] Source: Congressional Budget Office, Congressional Research Service
[2] Source: Insurance Information Institute, Federal Emergency Management Agency
[3] Source: National Climatic Data Center

While the immediate focus will be on providing whatever resources are necessary to respond to the tremendous damage and hardship caused by Hurricane Katrina, the impact that this disaster will have on the federal budget is a reminder that the federal government needs to do a better job budgeting for emergencies.

The exemption for emergency spending has been used as an excuse to avoid planning for emergencies and has served as a loophole in some years for unnecessary or excessive spending. Congress and the President routinely underfund FEMA and other agencies involved in disaster relief in the regular appropriations process, knowing that additional funding can be provided above budgetary limits as disasters strike.

The growing use of this practice can be seen by looking at the declining amount of unobligated balances carried over by the Federal Emergency Management Agency Disaster Relief Fund. Money in the disaster relief fund is obligated as necessary in response to disasters, with any unused funds carried over to the subsequent fiscal year. The fund is replenished in supplemental appropriations and the following year's appropriations process. Because the costs of disasters fluctuates year to year, the amount of unobligated balances carried over provides a more useful measure of how well Congress and the Administration budget for disasters. The annual appropriation for the disaster relief fund should reflect prior year obligations in order to replenish the fund.

The amount of the balances fluctuate based on disasters and obligation of funds in any given year, but there has been a clear trend of carrying over lower balances in recent years. This is a result, at least in part, of Congress and the Administration not appropriating sufficient funds to cover prior year obligations and allowing the balances to slowly decline to comply with discretionary spending limits.

The impact of Hurricane Katrina is also likely to expose the financial vulnerability of the National Flood Insurance Program (NFIP). Because private insurers do not offer flood insurance, the National Flood Insurance Act was enacted in 1968. The General Accounting Office and others have warned for years that the NFIP is not actuarially sound because it does not collect sufficient premiums to build reserves to meet future flood losses.

The program is not actuarially sound in part by design, because Congress authorized subsidized insurance rates for certain structures to be made available to encourage communities to participate in the program. Approximately 30% of the policies are subsidized, with premiums representing only about 38% of the full premium they otherwise would pay. The federal subsidy is worth approximately $500 million a year.

More fundamentally, the NFIP is not financially sound because premiums are based on the average annual losses and expenses experienced since 1978. There have been no catastrophic loss years (generally defined as $5.5-$6 billion in claims losses) since 1978, so collecting premiums based on average losses since 1978 does not allow the program to build sufficient reserves to cover catastrophic losses. While the flood related losses from Katrina will not be known for some time, it seems likely that they will qualify as a catastrophic loss. For comparison purposes, the National Flood Insurance Program paid out $1.74 billion in claims last year as a result of floods caused by hurricanes Charley, Francis, Ivan and Jeanne, none of which involved flooding anywhere close to the magnitude of Katrina.

At the end of 2004, the NFIP had a balance of $1.475 billion. FEMA is authorized to borrow up to $1 billion from the US Treasury to cover losses that exceed the reserves and repay the funds with interest from premiums in future years. Congress will almost certainly need to appropriate additional funds to the NFIP in order to pay claims beyond the funds reserves and borrowing authority.

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The Committee for a Responsible Federal Budget has long supported the use of “rainy day funds” to help prepare for emergency spending. Such reserve funds would require that Congress set aside funding levels reflecting average costs of past years’ disasters, to prepare for unforeseen disaster-related costs in the budget while using strong rules to govern expenditures of such funds. In all likelihood, the costs of Katrina would have exceeded the amount in a rainy day fund, but at least we would have been starting from a better fiscal position.

While it does not rival the human tragedy of the occurrence, the fiscal impact of Katrina will be significant. Given the already unhealthy starting fiscal position of the federal government, the Committee agrees that while Congress and the Administration should provide whatever resources are necessary (while restraining from piling on unrelated spending items), this substantial, unanticipated expense should cause Congress to exercise greater restraint in the rest of the budget.