

The Economic Effects of Proposals for Federal Natural Catastrophe Reinsurance and New Loan Programs: Who Pays and Who Benefits?

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Executive Summary

- Congress is considering proposals to create new federal reinsurance and loan programs for states with natural catastrophe funds. Our analysis of the terms and costs of these proposals finds that they would impose very large costs on taxpayers in most states and unnecessarily displace private insurance and reinsurance arrangements which have worked well.
- These new proposals include:
 - Legislation passed by the House that would direct the treasury to provide loans to state “qualified reinsurance programs” for natural disasters, especially hurricanes.
 - Legislation passed by the House to create a Federal Natural Disaster Reinsurance Fund to provide direct federal reinsurance to states for most of a state’s insured losses.
 - Legislation passed by the House, and rejected by the Senate, to expand the National Flood Insurance Program to cover damage from winds in hurricanes.
- We estimate that the losses which would be covered by the federal government under these proposals, if a hurricane season comparable to 2005 occurred again, would reach \$140 billion to \$161 billion in 2009, \$197 billion to \$230 billion in 2013, and \$278 billion to \$332 billion in 2017, depending on the approach used to set premiums for state programs.
- These losses would be borne by federal taxpayers, and we have estimated the distribution of these costs based on the share of federal revenues provided by each state. If hurricanes comparable to 2005 struck again in 2009, taxpayers in at least 20 states would face new, multi-billion burdens, including burdens of *at least* \$19 billion for Californians, \$11 billion for New Yorkers, \$7 billion for Illinoisans, \$6 billion for taxpayers in Pennsylvania and New Jersey, \$5 billion for those in Ohio, \$4 billion each from the taxpayers of Massachusetts, Michigan, and Virginia, and at least \$3 billion for those in Connecticut, Indiana, Maryland, Minnesota, North Carolina, and Washington State.
- These proposals would displace private capital deployed in insurance and reinsurance companies, and in its place create enormous transfers from taxpayers in most states to some businesses and residents in Gulf states, especially Florida and Louisiana.
- These measures are unnecessary, because the private insurance and reinsurance sectors have the capacity to handle even very large claims arising from unusually severe natural catastrophes. Despite huge claims arising from the 2005 hurricane season (Katrina, Rita, Wilma and Dennis),

insurers covered the claims easily, with foreign and U.S. based reinsurers absorbing 60 percent of the costs. Throughout 2005 and 2006, the amount of capacity supplied by reinsurers and the capital markets for natural disasters continued to expand despite the record losses of 2004 and 2005, and the capital base of the U.S. property and casualty insurance industry continued to expand.

- These proposals are targeted especially at assisting Florida, which while especially prone to frequent and severe hurricane damage, nevertheless imposed regulations that have deterred many private insurers from expanding there. Florida legislators also created a subsidized state reinsurance system for natural disasters that has largely displaced private reinsurance. This program is currently the nation's only "qualified reinsurance program" under the terms of the proposed federal program.
- Other states in the Gulf and Atlantic seaboard would likely follow Florida's lead in this regard if the proposed federal legislation is approved, since it would allow a state that offers highly-subsidized coverage to its residents and private businesses to then shift to the Federal Treasury the cost of large claims from a bad hurricane season. In order to give other states time to follow Florida's lead, in the first five years states could qualify for the new federal loans and reinsurance by simply providing "last-resort" natural disaster coverage for high-risk people and businesses. Such programs of state-subsidized coverage have become the "first choice" for many homeowners in many states, and the programs have grown significantly in recent years.
- The availability of state-funded, natural disaster insurance at below market rates also will increase the liabilities of these programs by reducing the incentives for firms and people to locate in safer areas or to harden their homes and other buildings against damage. When private insurance premiums rise to reflect new risks and preclude coverage for lower-income people and some small firms, states could provide financial assistance to that subset without disabling the private insurance and reinsurance industry.

About the Authors

Robert J. Shapiro is the chairman of Sonecon, LLC, a private firm that advises senior executives of U.S. and foreign businesses, governments and non-profit organizations. Dr. Shapiro has advised, among others, U.S. President Bill Clinton, British Prime Minister Tony Blair, and senators Evan Bayh, Hillary Clinton and Barack Obama; private firms including Amgen, AT&T, Gilead Sciences, Google, MCI, Inc., SLM Corporation, Nordstjernan of Sweden, and Fujitsu of Japan; and non-profit organizations including the American Public Transportation Association, the Education Finance Council, BIO, and the U.S. Chamber of Commerce. He is a Senior Fellow of the Georgetown University School of Business and the Progressive Policy Institute (PPI), a director of the Ax:son-Johnson Foundation in Sweden, chairman of the Globalization Initiative of NDN, chair of the Climate Task Force, and co-chair of the American Task Force Argentina . From 1997 to 2001, he was Under Secretary of Commerce for Economic Affairs. Prior to that, he was co-founder and Vice President of PPI. Dr. Shapiro also served as principal economic advisor in William Clinton's 1991-1992 presidential campaign, senior economic advisor to Albert Gore, Jr. in 2000 and John Kerry in 2004, Legislative Director for Senator Daniel P. Moynihan, and Associate Editor of *U.S. News & World Report*. He has been a Fellow of Harvard University, the Brookings Institution, and the National Bureau of Economic Research. He holds a Ph.D. from Harvard, as well as degrees from the University of Chicago and the London School of Economics. He is the author of numerous articles in scholarly and popular journals, and most recently of *Futurecast: How Superpowers, Populations and Globalization Will Change the Way You Live and Work* (St. Martin's Press, April 2008).

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