# Federal Flood Insurance Drowning in Red Ink

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The National Flood Insurance Program (NFIP) is drowning in red ink — $19 billion in red ink, to be exact, according to Fox News. The reason is simple: The federal government charges below-market premiums to people who choose to live in flood-prone areas. This encourages people to build in such areas; and the more people who live there, the greater the liability for taxpayers. When a major disaster occurs, as in 2005 with Hurricanes Katrina and Rita, the outlays far outstrip the premiums, and the program goes into debt.

As Mark Calabria of the libertarian Cato Institute told Fox News, “For most properties, premiums would probably have to be about twice as high as they are today to even help the program get anywhere near to breaking even.” Moreover, added Calabria, “Even getting the rates to be ‘fair’ doesn’t get anywhere near to paying the deficit.”

Indeed, as an April 2010 study (PDF) from the Institute for Policy Integrity at the New York University School of Law found, “It would take more than ten consecutive years without a single flood claim for the median premium payments to cover the deficit,” assuming the U.S. Treasury doesn’t charge the program interest on the debt. “Assuming median losses and a 5% interest on the program’s debt,” authors J. Scott Holladay and Jason A. Schwartz continue, “the repayment window rises to over 100 years. The program, as currently structured, will never repay its debt.”

The NFIP was created by Congress in 1968 in response to the devastation wrought by Hurricane Betsy three years earlier. Private insurers did not offer flood insurance at the time, precisely because it is so risky; but politicians, in typical fashion, thought they could buck the laws of economics and create a solvent flood-insurance program.

Communities that wish to be eligible for the NFIP must develop floodplain management plans in an effort to reduce the risk of flooding. Clearly most flood-prone communities have done so: About 5.5 million properties are insured under the NFIP.

Like many other government programs, its aims are at cross-purposes with each other. On the one hand, the program is supposed to encourage communities to mitigate flood risks, while on the other hand, as Holladay and Schwartz note,

> By making development in the floodplain more affordable, communities increase the land available for development in areas with high property values. This generates economic benefits at the local level, but can also increase exposure to flood risk compared to the level of risk that would be produced by the private markets. The NFIP, by serving as a backstop for those risks, favors development in communities with floodplains, by shifting some of those risks onto taxpayers.

“The existence of the program,” they add, “can also be expected to increase property values in general, and therefore the wealth of the individuals and communities that participate.” For those who live in the communities on the receiving end of NFIP largesse, what’s not to like? For the rest of us, it’s another matter.

Undoubtedly most of those congressmen and senators who voted for the program back in ’68 thought they were doing a good deed. By offering inexpensive flood insurance, they wanted to help poor people avoid being ruined by future natural disasters. In fact, the result has been quite different, with Holladay and Schwartz finding that "the benefits of subsidized flood insurance accrue primarily to wealthy households," regardless of the relative wealth or poverty of the counties in which their property resides.

Furthermore, the benefits are "highly concentrated in the Gulf states," according to Holladay and Schwartz, with more than half the NFIP-covered houses in either Florida or Texas. "Similarly," they write, "while only 4% of households in the nation participate in the program, over a quarter of the residents in both Florida and Louisiana have policies through the NFIP."

In other words, taxpayers in the rest of the country are being soaked — and will have to be soaked more to pay off the $19 billion debt — to assume the risk for rich people in Gulf states to build in flood zones that private insurers, who actually have to turn a profit or go under, won't touch.

Holladay and Schwartz also found that the financial costs of the NFIP "are likely dwarfed by the ecological damages that the programs encourage." They explain:

> River basins and coastal zones provide natural purification of water and wastewater; erosion control and weather mitigation; and habitat for fish and wildlife. They also offer opportunities for valuable recreational use, improve irrigation return flows for agriculture, and support fisheries and other raw natural resources with considerable economic value.…
>
> [By] shifting the insurance risks to the taxpayers and reducing the long-term private costs of building in floodplains, the NFIP encourages development in these ecological hot zones. Such development will inevitably trigger environmental damage.

You don't have to be a member of Earth First to find some cause for concern here. The federal government — the same one that strangles private enterprise in an effort to protect the environment — is itself causing significant environmental damage by encouraging overdevelopment of flood plains. That damage, in turn, could have deleterious effects on agriculture and other industries, ultimately affecting our way of life.

The NFIP has expired, though Congress is considering legislation to renew it. No one expects our legislators to refuse to renew it on constitutional grounds — though they should — but they ought at least to reconsider renewing it on the basis that it's not just a failure, but one with serious financial and ecological consequences. Alas, as it was in the days of Noah, most Washington politicians are going about their business as usual, as if unaware that a flood of red ink is about to overtake them. Keeping the debt hole that was the NFIP plugged would be a small but worthwhile step toward keeping all of our heads above water.

*Photo: AP Images*