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Alberta needs private flood insurance

Derek Fildebrandt

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Following the disastrous floods in southern Alberta this summer the province is holding a flood mitigation symposium. The goal is to gather ideas on how to move forward to avoid in the future both the physical and financial disaster that flooding brings.

On the agenda is new and improved infrastructure to mitigate the actual damage caused by floods, but also insurance to minimize the financial impact in the future.

The decisions taken around flood insurance have the potential to be incredibly positive for both taxpayers and property owners, or ruinous for both. There is a (potentially) right way to do flood insurance, and there is a wrong way. Case in point: the United States' National Flood Insurance Program (NFIP). While well intended, the U.S. program has devolved into a massive wealth transfer scheme, encouraging and subsidizing living in high-risk areas.

The U.S. created the NFIP in 1938 after private insurers withdrew from the market following the 1927 Mississippi floods. This made the U.S. taxpayer the primary flood insurance provider for homeowners and small businesses, although still delivered by private firms. If a firm couldn't handle the costs, Uncle Sam would always be there with a bag of bailout money in hand.

"Mandatory" insurance in the U.S. has largely been a failure in its current form. The "mandatory" part of the program was often not enforced by the government, and more often ignored by homeowners. People systemically underestimate risk and opt not to purchase flood insurance in the U.S., even though taxpayers heavily subsidize it.

However, the subsidized premiums are seen as the good deal that they are by many in the US. Erwann Michel-Kerjan wrote in the U.S. National Tax Journal, "Highly subsidized premiums... without clear communication on the actual risk facing individuals... encourage development of hazard-prone areas in ways that are costly to both the individuals who locate there as well as others who are likely to incur the costs of bailing out victims following the next disaster."

Senior players in Canada's insurance industry told the Canadian Taxpayers Federation (CTF) that the designation of Special Flood Hazard Areas (requiring mandatory insurance) is highly politicized, as U.S. Congressmen in flood-prone areas lobby to redraw maps to include areas with little to no risk of flooding in order to ease the premiums of those actually at risk.

According to the US-based CATO institute, "Government policies are the cause of, not the cure for, the limited supply and narrow scope of privatesector disaster insurance."

This may be entirely true, but the status quo in Canada and Alberta is also unacceptable. That is, that homeowners and taxpayers alike have no protection whatsoever. As it stands, government de facto insures property (through flood assistance payments) without collecting premiums.

Insurance is the only option available to externalize the costs of floods, but it is difficult to make it available in a way that will not devolve into the disaster that is the American program of government-backed private insurers, or the even more risky prospect of a directly government-run program.

There is no watertight solution, but the best prospect of successfully externalizing flood costs lies with encouraging the creation of a self-sufficient, private insurance market.

The first step in the creation of any market is to have demand for a product. To start, at-risk property owners should be required to purchase flood insurance. The best way to safeguard against U.S.-style gerrymandering in who must have insurance is to only require insurance for properties that have made claims under the Disaster Recovery Program (DRP). If you've made a claim for assistance, you need insurance.

Like automobile insurance, making a product mandatory creates a market where one would otherwise not exist.

Derek Fildebrandt is the Alberta director of the Canadian Taxpayers Federation and the author of Responsibly Rebuilding Alberta.