

**Statement of Paul J. Gessing
Director of Government Affairs, National Taxpayers Union**

**before the
United States Senate Committee on Banking, Housing, and Urban Affairs
on
The National Flood Insurance Program
February 2, 2006**

Chairman Shelby, Ranking Member Sarbanes, and distinguished Members of the Committee, thank you for holding these important hearings today. My name is Paul Gessing. I am Director of Government Affairs with the National Taxpayers Union (NTU), America's oldest and largest grassroots taxpayer lobbying organization with 350,000 members nationwide (you can learn more about NTU – and our educational affiliate, the National Taxpayers Union Foundation – on our website: www.ntu.org). I would also note that my organization works closely with the group Taxpayers for Common Sense, and that I am here to testify not only on behalf of my own organization, but also on behalf of Taxpayers for Common Sense, and their Vice President of Programs Steve Ellis who could not attend today.

I come here to offer testimony regarding what we believe to be some rather significant problems with the National Flood Insurance Program (NFIP) as they relate to taxpayers, to illustrate to the Committee why many of these taxpayer concerns also have a direct impact on those who living in flood-prone areas, and lastly, to outline the need for bold steps on the part of Congress to ensure that the next major hurricane or flood inflicts less of a toll, both in the form of human suffering and lost economic productivity and taxpayer money. Although the original intent of the existing federal flood insurance program was to mitigate many of these problems, it has not done so and as such must be considered a failure.

The recent spate of hurricanes may have been unique in recent history for their intensity and frequency, but they are perfectly normal in costing federal taxpayers billions of dollars. Worse, there is wide agreement in the scientific community that the trend of increasing intensity and numbers of hurricanes will continue for several years. Even before these hurricanes, the NFIP had repeatedly relied on the U.S. Treasury to supplement its premium revenues.

Last week, several of those testifying on NFIP stated that from 1986 through 2004, NFIP was self-supporting. I would argue that those statements are in error. First of all, how can you bookend a program like that? Starting in 1986, the program shifted from direct appropriations to the current system in which the program borrows from the Treasury and repays its debt with interest. (By the way, it must be noted that NFIP was forgiven well over a billion in debt at that time). Then over the 18-year period in question, the NFIP borrowed when it needed to and repaid with interest, but the simple fact that it was able to borrow shows that it is not self-supporting or even actuarially sound. There is no catastrophic reserve because the program has the federal taxpayer to fall back on.

In the aftermath of the 2005 hurricane season, the program will be forced to borrow an astonishing \$24 billion from the Treasury. It's time to face facts: With premium payments yielding \$2 billion per year and flooding likely to continue, even if not at the level we have seen in recent years, there is little likelihood of taxpayers ever recouping much of the \$24 billion they are now owed. Thus, as Chairman Shelby said in his opening remarks at last week's hearing, the NFIP is bankrupt. As taxpayer advocates, what we must do now is work

to ensure that the NFIP no longer serves as a fiscal black hole into which taxpayer dollars continually go, never to be seen again.

Prior to the NFIP's existence, insurance coverage for flood losses was not provided by any private insurance carriers. Insurance losses stemming from flood damage were largely the responsibility of the property owner, although the consequences were sometimes mitigated through provisions for disaster aid. Today, owners of property in flood plains sometimes receive disaster aid *AND* payment for insured losses, which in many ways negates the original intent of the NFIP (that being to encourage property owners to pay some of the upfront costs of expected disasters, rather than forcing taxpayers to foot the bill after the fact).¹ These policy decisions have contributed to an escalation in losses stemming from floods in recent years, both in terms of property and life.

Also, although this is not of primary importance to taxpayers, I must point out that subsidizing insurance in high-risk areas takes a significant environmental toll. Coastal areas are often among the most ecologically sensitive and diverse. Thus, it is disconcerting to know that while they spend untold billions of dollars annually on an array of environmental mitigation efforts, and often see their land's usefulness decline under federal mandates (also created for the purpose of environmental mitigation), taxpayers would then be forced to pay once again – this time for a program that actually *encourages* the destruction of environmentally sensitive areas.

The final areas of concern taxpayers have about this program are those involving fairness and moral hazard. Specifically, I would like to bring to your attention and submit for

¹ First American Flood Data Services, "Frequently Asked Questions," <http://fafds.floodcert.com/faqs/>.

the record a story conducted by John Stossel of ABC News. In 2003, in the wake of Hurricane Isabel, Mr. Stossel did a story called *Taxpayers Get Soaked by Government's Flood Insurance*. In this piece, Stossel recounted his own personal experience of purchasing beachfront property on Long Island, New York and constructing a house there in 1980. Stossel noted, among other things, that the most he ever paid was a few hundred dollars for insurance that actuaries say should realistically have been priced at thousands of dollars.

John Stossel is not the only well-heeled individual taking advantage of taxpayer-subsidized flood insurance. According to a 2000 report done by *The Philadelphia Inquirer*, six of 10 NFIP insured properties are in beach towns and, since the program does not differentiate between primary residences and vacation homes, the program's mission could be said to include ensuring that wealthy Americans are protected from floods by the full faith and credit of the U.S. taxpayer.²

Asking U.S. taxpayers to spend billions annually on government programs and revenue transfers designed with the purpose of assisting poor and lower-income Americans is one thing; but asking them to spend additional billions on the NFIP, which is more of a taxpayer-financed "safety net" for millionaires, is yet another. It is after all predominantly wealthy people with enough disposable income to own beachfront property who choose to live or have a second home in risky areas. Then, because it is priced far below market value, flood insurance proves even more attractive to wealthy homeowners who know a good deal when they see it. Thus, the wealthy snap up coverage while the poor are often left unprotected when disaster strikes.

² Gilbert Gaul and Anthony Wood, "A Flawed Program Facilitates Building in Hazardous Areas," *The Philadelphia Inquirer*, March 7, 2000, <http://marine.rutgers.edu/mrs/education/coast08.htm>.

To continue with John Stossel's story, as it turns out – despite beach replenishment efforts by the Army Corps of Engineers (again taxpayer-financed) – his house was washed completely away in a storm that he described as “fairly ordinary.” Of course, the NFIP paid for the house (the first \$250,000 of which is insured under the federal program) and its contents (insured to \$100,000) and there were only minimal restrictions prohibiting him from rebuilding on the same piece of land. Worse, he pays the same price for insurance the day after the storm as the day before. Quite simply, this is ridiculous policy. We have clear results that a location is at great risk for loss and yet we don't restrict reconstruction and we charge the same rate. I certainly can't think of anyone who would run a business that way; no wonder we're in the hole.

It is said that the road to hell is paved with good intentions, and like all government programs, NFIP was created with good intentions in mind. To this day, many of the program's supporters believe that the NFIP actually saves taxpayer dollars because with insurance, taxpayers receive at least some compensation before the disaster strikes whereas they are never compensated for disaster relief. Even had it been well-planned and executed effectively, the federal flood insurance program has had other unintended consequences.

Rather than simply compensating homeowners for losses, the cheap insurance has actually encouraged more people to build in flood prone areas. Last week, David Maurstad testified that NFIP insured more than \$800 billion in assets on 4.8 million policies.³ Back in FY 2002, that number was “only” \$644 billion on 4.5 million policies.⁴ That's a 24 percent

³ David Maurstad, “Testimony before the Banking, Housing, and Urban Affairs Committee of the United States Senate,” January 25, 2006, <http://banking.senate.gov/files/ACF43B7.pdf>.

⁴ Federal Emergency Management Agency, “Total Policies in Force by Fiscal Year,” <http://www.fema.gov/nfip/fy04pif.shtm>.

increase in insured assets on just more than a 6.5 percent increase in policies. Sure, the housing sector has been strong nationwide, but clearly there is a taxpayer-subsidized building boom going on at our nation's shorelines, as increasing numbers of wealthy people build their "castles" on the sand.

So, what do we do now? As in a twelve-step program, the first part of solving a problem is recognizing that you do in fact have one. The recent spate of hurricanes has only exposed what experts and taxpayers have known for a long time: federal meddling in the marketplace inevitably results in subsidies for some and significant costs for all taxpayers. Congress must act now to restore some semblance of a marketplace for flood insurance that provides adequate taxpayer protections or it must be willing to abandon the program entirely, leaving the responsibility of finding adequate insurance in the hands of individuals and insurance companies.

If nothing else, at a bare minimum, Congress must consider taking action to address the subsidies inherent in the 25 percent of NFIP's covered properties that pre-flood insurance rate map (FIRM). NFIP has been in effect for nearly 40 years. That is far longer than even the longest mortgage. Surely, it is time to stop paying massive subsidies to the shrinking group of unaware pre-FIRM homeowners. Other reform measures lawmakers might consider would be: collecting actuarially sound rates that finance expected annual payments as well as a catastrophic reserve; increasing program participation through greater enforcement and by expanding the floodplain areas requiring coverage; and, increasing the use of disaster relief funds to mitigate future damage by making communities more flood/disaster resistant (through flood-proofing, elevating, and relocating repetitively damaged properties).

Unfortunately, the fact that for all these years Congress has been unwilling to reform the NFIP in ways that adequately protect taxpayers, eliminate subsidies, and make the program actuarially sound, may serve as a clear sign that the best way to address the program's shortcomings may be to eliminate it entirely. Federal involvement in the provision of flood insurance has been, on the whole, counterproductive. Rather than discouraging development in flood-prone areas, it encourages such development; rather than protecting Americans from nature's ravages, it puts them in harm's way; and rather than saving taxpayers money, it has resulted in additional expenditures and subsidies on a massive scale. That sounds like failure to most reasonable people!

If, after the marketplace is free of federal subsidies that have kept for-profit firms out of the business, private companies remain skeptical of the profitability of providing flood insurance, all is still not lost. That reaction may be yet another tool to reinforce the message that living in flood-prone areas is risky and that people should be forced to bear the costs of such an unwise move. Of course, it is also quite possible that some entrepreneurial company might figure out a way to reduce its risks enough to make a profit, thus creating a private flood insurance marketplace more viable than it has been in the past. I must note that although NTU and the Consumer Federation of America rarely agree on much and we certainly don't have the same philosophical approach to many issues, Bob Hunter's comments at the Committee's October hearing on flood insurance were spot on when he suggested the

insurance industry might be better able to engage in the flood insurance market than they have been in the past due to the development of improved mapping technologies.⁵

Had the NFIP not been created in 1968 and were we discussing the possible creation of such a program today, in the wake of the recent hurricane season and flooding, I don't think anyone would choose to replicate the existing system. Thus, if I were sitting before you today to testify on whether or not to create the NFIP and, if so, what it should look like, I would tell you that at times during which we as a nation are presented with difficult policy decisions, we advocate looking to the Constitution and the Founding Fathers for guidance. Thus, it is our belief that leaving flood insurance policymaking up to the states would allow for the most creative and responsible outcomes possible. State and local officials, aware of the unique needs and challenges of their own states, could design the best solutions for their particular situations.

Although this hearing is strictly about the federal flood insurance program, as a brief aside I would like to point out that NTU and our members believe that rather than centralizing the job of flood prevention in one federal body that receives its funding and marching orders from Washington, states and localities should be likewise empowered to take charge of flood prevention efforts whenever possible. I point you to the example of Galveston, Texas: In the wake of the worst natural disaster in U.S. history in which approximately 6,000 Galvestonians lost their lives (the Hurricane of 1900) citizens of the city – in their desire to make sure that such a profound tragedy never happened again – took it upon themselves to prepare for the next storm. Thus, to break the force of the waves, a concrete seawall three miles long was

⁵ J. Robert Hunter, Consumer Federation of America, "Testimony before the Banking, Housing, and Urban Affairs Committee of the United States Senate," October 18, 2005, <http://banking.senate.gov/files/ACFD8E.pdf>.

constructed. As an additional safeguard against flooding, the entire city was raised by picking up most of the structures and filling in beneath them with sand.⁶

The entire project cost an estimated \$3.5 million (or approximately \$70 million in 2005 dollars based on 1913 Bureau of Labor Statistics data calculations). The county paid for the seawall through a bond issue and the Texas Legislature financed the grade elevation. Although hurricanes still threaten the Gulf of Mexico, Galveston is a far safer place to be in a hurricane than before. They also proved at a time before Americans had grown accustomed to relying so heavily on Washington, DC, that local responses to natural disasters are viable.

The emphasis on local control does not mean that there is no federal role, especially in disaster relief. But as we saw in New Orleans, when the responsibilities of federal, state, and local governments overlap, too often there are also massive cracks in the system through which responsibilities tend to fall. If Congress were to take a close look at the interactions among the various flood prevention, insurance, and relief tools, we believe it would discover that restoring the primary responsibility for natural disaster planning and responses to the states (with federal agencies in a supporting role) would leave all of us – citizens, taxpayers, and policymakers alike – better off.

Thank you, Chairman Shelby for allowing NTU to testify today and for your work on this important topic. NTU and its 350,000 members stand ready to work with you in fixing or eliminating the problems associated with the National Flood Insurance Program.

⁶ Mary G. Ramos, “After the Great Storm: Galveston’s Response to the Hurricane of September 8, 1900,” *Texas Almanac*, 1998-1999, <http://www.texasalmanac.com/history/highlights/storm/>.