

Statement of Dr. Daniel Sutter

**Before the Subcommittee on Emergency Management, Intergovernmental Relations, and
the District of Columbia**

Of the Senate Homeland Security and Governmental Affairs Committee

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**The Path to Efficiency: Making FEMA More Effective for Streamlined Disaster
Operations**

Chairman Begich, Ranking Member Paul, and Members of the Subcommittee. Thank you for the invitation to discuss the need to make FEMA more efficient for effective disaster response. I appreciate the opportunity to testify today.

The enormous generosity of Americans is never more evident than in the aftermath of natural disasters, and naturally some of this assistance will be channeled through the federal government. Stafford Act assistance to state and local governments and individuals must be allocated efficiently to ensure that intended beneficiaries receive maximum assistance possible. In addition, FEMA assistance should not disrupt the rebuilding and recovery process, undermine the incentive for individuals or local governments to prepare for and respond to disasters prudently, be used for political gain, or contribute to corruption.¹

Today I'd like to outline three recommendations that can help increase efficiency in the use of disaster funding:

First, Congress should consider revising the definition or criteria for "major disaster" declarations; FEMA assistance with smaller events raises disaster costs and threatens the availability of assistance for those who need it most.

Second, Congress should consider significantly raising the damage threshold and tying it to per capita personal income in the future, to eliminate the problem of costly FEMA response to “small” disasters.

Third, a more thorough assessment of the potential for state and local governments to respond to disasters should inform the establishment of a new threshold for federal assistance.

An increase in the number of major disaster declarations, due to the designation of many “small” events being as major disasters, impedes FEMA’s response to major disasters. Presidents have declared an average of 60 major disasters per year since 1996, or more than one a week.ⁱⁱ Few Americans would likely use the term major disaster for a weekly event. Indeed, 36% of declarations between 2004 and 2011 involved less than \$10 million in Federal assistance, indicating that the “weekly” disasters include many relatively minor events.ⁱⁱⁱ The damage threshold upon which FEMA makes recommendations on disaster requests should be raised significantly to ensure the availability of Federal assistance when truly needed, help stem rising disaster losses, and encourage state and local self-reliance for “ordinary” disasters.

MINOR DISASTERS DISSIPATE FEMA RESOURCES

In addition to offending the commonsense meaning of major disaster, minor disasters dissipate federal resources and divert FEMA’s energy. Disasters with total assistance under \$50 million have distressingly high administrative costs, at an average of 20%, compared with 12-13% for larger disaster declarations. Administrative costs exceeded total federal assistance for 12 small disasters.^{iv} We pay a high price for FEMA assisting with relatively small events.

FEMA public assistance to state and local governments introduces to third party payment of disaster response and rebuilding costs. Third party payment is well-known to increase costs due to the problem of moral hazard. Third party payment cost inflation will affect disaster losses as assuredly as it does for the more familiar case of medical costs. Rising administrative costs, improper payments identified by the Office of the Inspector General, and disaster declarations which remain open for years are the most visible forms of third party payment cost inflation.^v The GAO's observation that "enhanced capabilities and professionalization of state and local emergency management personnel ... has helped state and local officials better justify a request for federal disaster assistance"^{vi} also reveals evidence of third party cost inflation. The best efforts of FEMA and the Office of the Inspector General can only limit moral hazard. Third party payment costs should be avoided whenever possible, and limiting FEMA assistance to truly major or unanticipated disasters allows this.

THE PUBLIC ASSISTANCE DAMAGE THRESHOLD SHOULD BE REVISED

The proximate cause of excessive disaster declarations is the low damage threshold FEMA uses to evaluate requests from governors. FEMA established a threshold of \$1.00 per capita in 1986, which was not adjusted at all until 1999, and adjusted since for inflation. It stands at \$1.39 for FY 2014. The threshold for public assistance should be tied to growth in per capita income, in line with the normalization of natural disaster losses by researchers for changes in population, inflation, and real income or wealth.^{vii} FEMA's damage threshold is expressed per capita, rendering a population adjustment unnecessary. An adjustment based on (nominal) per capita income would control for inflation and real income. Adjusting based on (nominal) per capita person income since 1986 would have produced a threshold of \$3.57 in FY instead of \$1.35, and

44 percent of declared disasters between 2004 and 2011 would not have met the higher threshold.^{viii} Resetting the threshold would largely eliminate the problem of small disasters.

The public assistance damage threshold could also be adjusted to a state's specific ability to pay for disaster losses. In essence, this would set a damage threshold for each state instead of one threshold for all states. State specific damage thresholds could be set based on state per capital personal income, Gross State Product, or Total Taxable Resources, consistent with matching rates for federal grant programs based on state income.^{ix} The efficiency gains, however, will come from significantly raising the damage threshold and tying it to per capita personal income in the future; tailoring a significantly higher threshold for each state is secondary.

FEDERAL ASSISTANCE SHOULD BE BASED ON POTENTIAL STATE AND LOCAL RESPONSE ABILITY

FEMA should use a much higher damage threshold on disaster declaration recommendations. But the \$1.00 per capita threshold was arbitrarily set in 1986, and a significant revision need not be tied to an arbitrary baseline. A new threshold for federal assistance should be established based on a more thorough assessment of the potential for state and local governments to respond to disasters. Financial instruments, some of which did not exist in 1986, allow state and local governments to tap into private sector capital to cover disaster losses. The threshold for federal assistance should take this into account.

Public assistance covers losses to property and equipment, the costs of debris removal, and emergency protective measures. Adequate insurance can cover much of state and local governments' property and equipment losses, increasing their ability to meet any given disaster.

Insurance must be maintained on a structure rebuilt using FEMA public assistance,^x and federal taxpayers should not bail out jurisdictions which fail to properly insure before a disaster.

New financial instruments like weather derivatives and catastrophe bonds have emerged since passage of the Stafford Act. Although primarily to date used by businesses or insurers to manage weather and catastrophe risk, these financial instruments could help state and local governments pay for personnel expenses, debris removal, and other response costs.

Establishing a damage threshold in consideration of the financial instruments now available to state and local governments would help ensure the availability of federal assistance when it is needed, namely for truly major or unexpected disasters. By avoiding the cost inflation due to third party payment and providing better incentives for state and local governments to prepare, a reduction in the federal role will also help stem rising disaster costs for the nation.

ABOUT THE AUTHOR

Daniel Sutter is the Charles G. Koch Professor of Economics with the Manuel H. Johnson Center for Political Economy at Troy University, and a Senior Affiliated Scholar with the Mercatus Center at George Mason University. He has authored or co-authored two books and more than two dozen academic papers on the economic and societal impacts of extreme weather and natural disasters. He holds a Ph.D. in economics from George Mason University and has previously taught at the University of Oklahoma and the University of Texas – Pan American.

ⁱ Communities often exhibit considerable resilience to natural disasters, as economists since Thomas Malthus and John Stuart Mill have observed. Two of the elements of disaster policy which can interfere with the natural forces of recovery are delay and uncertainty; see Emily Chamlee-Wright and Virgil Henry Storr, “Expectations of Government’s Response to Disaster,” *Public Choice*, 2010, Volume 144, pp. 429-458, Emily Chamlee-Wright, *The Cultural and Political Economy of Recovery: Social Learning in a Post-Disaster Environment*, 2010, Routledge Publishers, and Daniel J. Smith and Daniel Sutter, “Response and Recovery from the Joplin Tornado: Lessons Applied and Lessons Learned,” *Independent Review*, 2013, Volume 18, pp. 165-188. On the influence of political factors in major disaster declarations, Thomas A. Garrett and Russell S. Sobel, “The Political Economy of FEMA Disaster Payments,” *Economic Inquiry*, 2003, Volume 41, pp. 496-509, found that swing electoral states had a higher probability of receiving a disaster declaration and that the composition of Congressional oversight committees affected the amount of assistance, in a statistical analysis controlling for the severity of the disaster and other factors. Peter T. Leeson and Russell S. Sobel, “Weathering Corruption,” *Journal of Law and Economics*, 2008, volume 51, pp. 667-681, found that the amount of FEMA disaster assistance a state receives was statistically associated with federal corruption convictions.

ⁱⁱ Author’s calculations based on Federal Emergency Management Agency, “Disaster Declarations by Year,” <http://www.fema.gov/disasters/grid/year>.

ⁱⁱⁱ U.S. Government Accountability Office, *Federal Disaster Assistance: Improved Criteria Needed to Assess a Jurisdiction’s Capability to Respond and Recover on Its Own*, GAO-12-838, September 2012, Table 4, p. 22.

^{iv} GAO-12-838, p. 40.

^v GAO-12-838, Table 7, p. 41 notes that average administrative costs for disaster declarations have risen from 9% in 1989-1995 to 18% for 2004-2011. The Department of Homeland Security Office of Inspector General identified \$308 million in potential savings from audits of FEMA public assistance and hazard mitigation programs in 2013, and almost \$1.4 billion for 2009-2013; see *Capping Report: FY 2013 FEMA Public Assistance and Hazard Mitigation Grant and Subgrant Audits*, OIG-14-102-D, http://www.oig.dhs.gov/assets/GrantReports/2014/OIG_14-102-D_Jun14.pdf.

^{vi} GAO-12-838, p. 11.

^{vii} Damage normalizations are conducted to allow losses from historical disasters to be projected into the present day, to provide perspective on contemporary disaster losses. Clearly past damage amounts must be adjusted for inflation, but the normalizations also adjust for changes in population and either wealth or per capita income. The damage normalization method has been applied to hurricanes (R. A. Pielke, Jr., J. Gratz, C. Landsea, D. Collins, M. Saunders, and R. Musulin, “Normalized Hurricane Damage in the United States: 1900-2005,” *Natural Hazards Review*, 2008, Volume 9, pp. 29-42), earthquakes (K. Vranes and R. A. Pielke, Jr., “Normalized Earthquake Damage and Fatalities in the United States, 1900-2005,” *Natural Hazards Review*, 2009, Volume 10, pp. 84-101), floods (M. W. Downton, J. Z. B. Miller, and R. A. Pielke, Jr., “Reanalysis of the U.S. National Flood Loss Database,” *Natural Hazards Review*, 2005, Volume 6, pp. 6-13), and tornadoes (H. E. Brooks and C. A. Doswell, “Normalized Damage from Major Tornadoes in the United States: 1890-1999,” *Weather and Forecasting*, 2001, volume 16, pp. 168-176, and K. M. Simmons, D. Sutter, and R. A. Pielke, Jr., “Normalized Tornado Damage in the United States: 1950-2011,” *Environmental Hazards*, 2013, Volume 12, pp. 132-147).

^{viii} GAO-12-838, p.27.

^{ix} GAO-12-838, pp. 31-32.

^x Department of Homeland Security, Office of Inspector General, “FEMA Should Recover \$48.9 Million for Inadequate Insurance Coverage for Holy Cross School, New Orleans, Louisiana,” OIG-14-10-D, November 2013, http://www.oig.dhs.gov/assets/GrantReports/2014/OIG_SLP_14-10-D_Nov13.pdf.