Senate Budget Committee Republican Staff
BUDGET BULLETIN
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INFORMED BUDGETEER

CONGRESSIONAL RESPONSE TO HURRICANE KATRINA
($ BILLIONS)

Enacted/cleared for President	Bill #	5-year cost
First supplemental 1/	H.R. 3645	10.5
Second supplemental 1/	H.R. 3673	51.8
Flood insurance borrowing authority	H.R. 3669	2.0
TANF benefits for evacuees	H.R. 3672	0.3
Pell grant relief	H.R. 3169	*
Total increase in deficit		64.6
Passed by Senate		
Katrina tax package 2/	H.R. 3768	6.5
Housing assistance	H.R. 2862	3.5
Small Business Administration	H.R. 2862	0.6
Economic Development Administration	H.R. 2862	0.2
Legal services	H.R. 2862	*
Total increase in deficit		10.8
Passed by House		
Liability protection for volunteers 3/	H.R. 3736	NA
Katrina tax package 2/	H.R. 3768	5.4

*Estimated to cost less than $50 million.
1/ Reflects BA, all outlays are not estimated to occur in 5-year window.
2/ Includes revenue and outlay effects.
3/ CBO score pending.

FLOOD INSURANCE

- Aside from the two appropriation bills that provided emergency funding mostly for the Federal Emergency Management Agency (FEMA), the largest bill that Congress has cleared for the President's signature thus far in response to Katrina is $2 billion for flood insurance (H.R. 3669).

- Typically, we think about insurance as a for-profit business where those buying insurance policies pay premiums that, over time and in aggregate, are more than enough to cover the losses that the insurance company pays out to a subset of policyholders who make claims. But the private sector, by and large, does not consider insuring structures for flood damage a profitable line of business because the losses can be so catastrophic.

- Beginning with the federal government's concern with disastrous flooding in the Mississippi River Valley back in the second half of the 19th century (see Congressional Research Service, *Federal Flood Insurance: The Repetitive Loss Problem*, http://www.congress.gov/erp/rl/pdf/RL32972.pdf), various federal responses to major floods culminated in 1968 with enactment of the National Flood Insurance Act, creating the federal National Flood Insurance Program (NFIP, housed in FEMA). The availability of flood insurance was expected to manage flood hazard risk and reduce the reliance or need for federal disaster relief for floods. Given that the federal government's flood insurance program is supposedly designed to just cover its costs and not make a profit, why would it need $2 billion now? (Note that while most policyholders theoretically pay actuarially sound premiums, a subset in older structures in high-risk areas pay premiums that are subsidized.)

Previous Legislative Action on Flood Insurance

- Congress first revised the NFIP in the Flood Disaster Protection Act of 1973, making federal flood insurance mandatory for certain properties to remain eligible for loans from federally regulated lending institutions. In spite of this new requirement, which was not strictly enforced by the federal government or mortgage lenders, many policyholders skirted the law and dropped required polices.

- As a result of this problem and the 1993 midwest flood, Congress enacted the National Flood Insurance Reform Act of 1994. This new law continued to require owners of structures in certain flood-prone areas to purchase coverage; however, if an owner failed to do so, the lender was required to purchase flood insurance on behalf of the property owner or else suffer civil monetary penalties. Subsequent studies of owner and lender behavior (Government Accountability Office, *Extent of Noncompliance with Purchase Requirements Is Unknown*, http://www.gao.gov/new.items/d02396.pdf) have demonstrated that compliance with these requirements has been weak.

- Nonetheless, as of a year ago, NFIP had 4.5 million policies outstanding nationwide to the tune of $723 billion in total insurance coverage. Of these, media reports have noted that 85,000 policies with $12.5 billion in coverage are in force in Orleans parish, suggesting that only one in three structures there had flood insurance. In Mississippi, about 43,000 policies amounting to $5.5 billion were in place before Katrina. Residential owners with policies can be covered up to $350,000 in total losses for structure and content; nonresidential owners have coverage up to $1 million.

Budgetary Effects of Flood Insurance

- Like the Pension Benefit Guaranty Corporation, which insures private pension programs, or Federal Deposit Insurance, which insures deposits in financial institutions, flood insurance is a cash program whose annual cash snapshot on September 30th of a surplus or deficit does not provide good information about the long-term health of the insurance program.

- Before 1985, to the extent that premium income had been insufficient for the NFIP to cover its claim payments in any year, the money that NFIP was allowed to borrow from Treasury to pay claims was repaid with appropriations from Congress.

- Since 1994, NFIP has used its borrowing authority (which was increased to $1.5 billion in June 2004) in almost every year, but has always repaid (with interest, as required by law) such borrowing with premiums collected from policyholders in subsequent years. Before Katrina, NFIP was collecting about $2 billion annually in premiums, and was expecting total annual costs (based on historical loss experience and including administrative costs) of about $1.6 billion. NFIP has run a cash surplus every year from 2000-2004, except in 2001; the average surplus for that five-year period was $0.3 billion per year.

SNAPSHOT OF NFIP's RESOURCES TO PAY CLAIMS
($ billions)

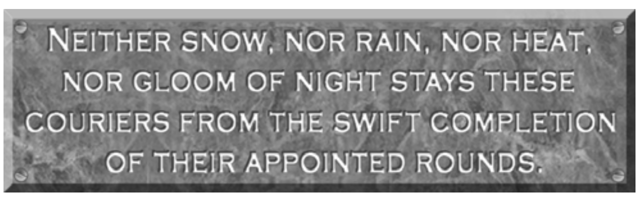
Status at Certain Benchmarks	Amount Owed to Treasury	Room Under Borrowing Limit
When Katrina Hit	$0.2	$1.3
After Katrina Left	$1.5	0
Upon Enactment of HR 3669	$1.5	$2
Upon Implementing HR 3669	$3.5	0

- The four hurricanes that came in quick succession a year ago generated (coincidentally) about $2 billion in flood insurance losses, which required NFIP to use up any accumulated balances from previous years and then borrow from Treasury – all but $0.2 billion of which had already been repaid when Katrina struck. That means that immediately after Katrina, NFIP was able to borrow $1.3 billion from the Treasury to pay flood insurance claims (see table above).

- Although there is no federal estimate available of the amount of likely claims post-Katrina, the CBO estimate of H.R. 3669 (http://www.cbo.gov/ftpdocs/66xx/doc6647/hr3669.pdf) observes that "the total amount of those claims. . .will exceed the total resources that will be available to FEMA under H.R. 3669." As a result, CBO expects NFIP will certainly exercise the additional $2 billion in borrowing authority provided by H.R. 3669 to pay out on expected Katrina claims during 2006. (If the borrowing authority had not been increased, NFIP would have only been able to cover losses as each dollar of premium income trickled in. This eventuality could still arise when NFIP reaches the $3.5 billion borrowing limit, perhaps by the end of calendar 2005, suggesting the likelihood of future legislation further increasing the limit.)

- CBO's estimate further expects that NFIP "would be unlikely to repay funds borrowed under H.R. 3669 within the next 10 years [as]. . . .repayments of borrowed funds to the Treasury would total about $400 million annually, once claims from Hurricane Katrina are fully paid." However much NFIP ultimately has to borrow from Treasury (once Congress enacts subsequent increases in NFIP's borrowing limit), CBO expects it "would take FEMA several years to finance [total, unknown] outstanding claims for Hurricane Katrina using annual income from premiums and...repayments of borrowed funds would not occur until after 2015." The *Bulletin* suspects that this is partly a result of NFIP's limited authority to increase premiums going forward; unlike private insurers, NFIP cannot "get healthy" after a major loss by significantly increasing premiums on policyholders.

- Of course, CBO's estimate assumes that, over the next 10 years, there will be no more flood losses like Katrina that push NFIP's total costs out of line with historical experience (the $1.6 billion per year). One could wonder whether it is reasonable to expect that the borrowing from Treasury really will be repaid by future premiums or whether Congress will return to an appropriation (as before 1985) to cover the borrowing that covers the losses. One might also wonder whether an insurance program that has maximum exposure of $723 billion is actuarially sound when it has no accumulated reserves to cover future losses.



- When one thinks of the U.S. Postal Service's unofficial motto (inscribed on the General Post Office building in New York City), one might forget they are the words of the ancient Greek historian Herodotus describing the dedication of Persian couriers during the Greek-Persian War in 500 B.C. However, the Persians did not have to contend with competition from electronic commerce and escalating health care costs. In a recent letter examining the long-term financial condition of the Postal Service, CBO found that the Postal Service will face continued challenges in meeting its legal requirement that it be self-financing (http://www.cbo.gov/ftpdocs/66xx/doc6624/09-01-PostalService.pdf).

- The Postal Service was re-established as an independent agency in 1971 and maintains a legal monopoly in the delivery of first-class mail, standard mail and periodicals. The delivery of first-class mail (post cards, letters, bills, and account statements) has traditionally represented the core of the Postal Service's business operations. The advent of electronic commerce permitted banks and utility providers to offer electronic statements and online bill paying. As a result, first-class mail volumes declined from their peak of 104 billion pieces of mail in 2001 to just 98 billion in 2004. Over this same period, the Postal Service increased its delivery of standard mail (bulk and presorted mail such as circulars, advertising or newsletters) from 90 billion to 96 billion pieces. Taken together with other forms of mail, total deliveries are roughly the same as they were in 2001 -- 206 billion pieces of mail annually.

- On the surface, the decline in first-class mail volume may not seem problematic. However, the changing composition of the Postal Service's business lines makes it harder for it to cover its overhead costs. According to CBO, "although standard mail costs 6 cents less to deliver, the average revenue per piece is 18 cents lower [than first class mail]." As standard mail becomes an increasingly larger share of the Postal Service's deliveries, the Postal Service will have a harder time covering its costs.

- In 2004, the Postal Service charged "cost-covering" rates that generated $70 billion in revenue, yielding a $4 billion cash surplus. However, its current definition of costs does not take into account the cost of its future retirees' health benefits. Under current law, the Postal Service pays 45% of its current retirees' annual health care premiums ($1.3 billion in 2004) with the Treasury (25%) and retirees (30%) paying the remainder. The Postal Accountability and Enhancement Act (S.662), which is on the Senate calendar awaiting floor action, would eliminate the current pay-as-you-go payment and instead require the Postal Service to prefund the cost of its future retirees' health benefits and make regular payments to reduce its outstanding health care liabilities for its current retirees.

- Through 2030, the net impact of this increased health cost under S.662 on the Postal Service would be relatively small because the bill would also eliminate some existing costs of the Postal Service. The bill would shift responsibility for paying a retirement cost (the cost of its employees' military service in calculating retirement benefits) to the taxpayer, generating savings for the Postal Service and nearly offsetting the cost of prefunding its health care costs.

- Between 2026 and 2030, the savings generated by the bill gradually phase out due to changing demographics, but the cost of prefunding health care benefits continue. CBO's analysis suggests, but does not enumerate, that continuing to prefund retiree health benefits after 2030 will be a significant source of cost pressure on the overall expenditures of the Postal Service.

- Under both current law and the provisions of S.662, CBO estimates that the Postal Service's revenue will fall short of its expenses by 2030. Assuming the Postal Service finds a way to maintain the current revenue level adjusted for inflation, CBO assumes the Postal Service will accumulate a deficit of about $40 billion by 2030. If revenue growth is 1.0% slower as a result of declining mail volume, then the Postal Service's costs will exceed its revenues by roughly $150 billion.

- Despite its monopoly, the Postal Service still faces stiff competition from Federal Express, UPS and, increasingly, electronic commerce. In addition, as economy-wide healthcare costs rise, so too will the Postal Service's cost of providing those benefits to its own employees. Unless more is done to put the Postal Service on firmer financial footing over the long-term, taxpayers and postal ratepayers can expect a combination of less service, higher postage rates and taxes.