

Statement  
of  
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before  
Subcommittee on Legislative and Budget Process  
Committee on Rules  
U. S. House of Representatives  
U.S. Congress  
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Building Resilient Communities and Investing in America's Future by  
Budgeting for Disasters

Mr. Chairman, Mr. Woodall, and members of the Subcommittee,

Thank you for this opportunity to speak with you on this important and timely topic. I understand that your specific interest is in promoting resilience from natural disasters including hurricanes, tornadoes, and flooding. I am especially grateful for the chance to discuss the potential contribution of an appropriate budgetary treatment of disaster assistance to improved federal policy for disaster recovery and relief. I think the power of budgeting in strengthening policy is often overlooked and underused.

This statement offers a high-level conceptual framework for assessing the interaction between budgeting for disasters and the effectiveness of federal disaster policy. In preparing this statement, I have not conducted a detailed analysis and evaluation of current legislation governing policy for disaster relief and recovery, notably the Stafford Act and the Budget Control Act of 2011.

In discussing alternative budgetary treatments of spending for disasters it is important to define what we mean by disaster. In this statement I am referring to a sudden, unexpected, loss of resources and productive capacity that results in a reduction of well-being that is large in relation to the resources of the affected area. In the language of economists, disasters reduce welfare by disrupting long-term, life cycle planned consumption. Government can reduce this harm principally through policies that reduce the magnitude of loss by increasing mitigation and by smoothing consumption before and after loss. The ability of government to improve outcomes largely depends of actions taken before the loss.

It is also useful to distinguish two polar extremes of budgeting for disasters. Those are *ex ante* budgeting or recognizing the cost of assistance in the budget before loss and *ex post* budgeting. or budgeting for cost after a loss has occurred. Ex ante budgeting involves planning a policy response and recognizing its budgetary cost in advance of loss events; ex post treatment permits policymakers to defer some decisions on a response until a loss occurs. The cost of that action is effectively excluded from the budget decision process

Sovereign governments facing this choice often seem to prefer the wait-and-see, deferred decision approach, at least initially. There appear to be good reasons for waiting until after a loss event has occurred. For one, it may seem easier to defer a decision than to try to foresee when various disasters will occur and the severity and types of losses that result from each. Proponents of ex post budgeting claim that it is impossible to allocate budget resources to an event whose occurrence and severity can't be predicted. In addition, it is often difficult to allocate scarce resources for losses that may not occur, especially when faced with urgent, but unfunded, needs in the here and now.

The message of my statement, however, is that the advantages of budgeting for disasters before loss likely dominate those of an after-loss approach. I also suggest that the claimed difficulties of ex ante budgeting for disasters are exaggerated.

In my judgement, the current budgetary treatment of disaster spending in the U.S. Is not purely ex post, even though current policy makes heavy use of unbudgeted emergency spending. For example, federal disaster response policy is

sufficiently well-defined that budget analysts can estimate future program outlays under various weather scenarios. In addition, the budget recognizes a base level of spending for disaster relief and recovery. Nonetheless, additional social gains might be realized from a more comprehensive, forward-looking budget process that includes all disaster spending.

### Shortcomings of Ex Post Budgeting for Disasters

Deferring decisions on the content and level of disaster spending until after the loss occurs has major disadvantages compared with pre-loss decision and cost recognition. Those include weak incentives for mitigation, difficulties in repetitively identifying the appropriate level and composition of assistance, a lack of attention to pre-loss smoothing of consumption, and automatic reliance on debt financing.

*Reduced incentives for mitigation.* The losses from a disaster are not fixed. They are determined by the severity of the event, past decisions and efforts at mitigation. An efficient disaster response policy minimizes the sum of losses from the event and spending for mitigation. To achieve efficiency in mitigation, it is necessary to maintain strong incentives for the “right” level of mitigation, i.e. to continue mitigation so long as a dollar spent saves at least a present value dollar in avoided losses, by the government, state and local officials, and private owners of assets subject to loss.

With wait-and see budgeting, once the event has occurred it’s too late to mitigate. Moreover, provisions for pre-loss mitigation have difficulty getting on the legislative agenda. Yet, given a demonstrated federal response to disaster that includes financial assistance, sub-national jurisdictions, firms, and households will have reason to scale back their own mitigation efforts, including saving for emergencies. With diminished mitigation, losses increase.

*Difficulties in Deciding Repetitively How Much and For Whom.* The natural human response to visible suffering and deprivation is to send aid generously now and consider the cost and consequences later. Policymakers who express concern about fiscal restraint or other pressing, unfunded needs are likely to be regarded as mean-spirited. In the urgency of the moment, questions of equitable treatment compared with previous disaster responses and with respect to the distribution of aid among those affected is unlikely to receive much attention.

*Absence of Pre-loss Consumption Smoothing.* An efficient disaster response policy shifts consumption through time from the pre-loss period when income and consumption is high and of lower marginal value to post-loss when consumption is depressed and its marginal value is higher. It does so by increasing saving and investment prior to loss and using the increase in productive capacity to replace the loss. Ex post budgeting policy forgoes this opportunity.

*Default to Debt Financing.* Most federal costs for relief and recovery are treated as emergency spending, which is outside the regular budget process, exempt from budget controls, and financed by increases in federal borrowing.

### Addressing the Difficulties and Gaining the Advantages of Including All Disaster Spending in the Budget Process

Ex ante budgeting for disasters can be cognitively easier than the ex post approach. Pre-loss budgeting does not require policymakers to foresee the specific what, when, how big, or to whom for every future loss from disasters. Initially it requires using historical data on spending for all disaster relief and recovery to estimate a probability distribution of annual outlays. This is a task for which the budget support agencies, the Congressional Budget Office (CBO) and the Office of Management and Budget (OMB), are well-suited and currently perform. With this estimate—updated annually for changes in factors affecting disaster losses—Congress could budget for the mean or expected level of spending for each fiscal year. Those amounts would be paid into a new disaster relief and recovery fund and available for spending by FEMA and other agencies for authorized purposes whenever a disaster occurs. The fund would also need authority to borrow from Treasury, which might be required to finance all authorized payments in years with very high losses.

Saliently recognizing all expected costs of current disaster policy in the budget could increase policymakers' interest in and incentives for managing those costs through mitigation and other means. It would enable policymakers to secure offsetting cost savings for spending bills that were expected to strengthen mitigation and otherwise reduce federal costs. Bills that saved more in federal assistance payments than the cost of mitigation would be scored with net budget saving.

An increased emphasis on managing program cost could also prompt legislative review of the performance of current policy with respect to equity and efficiency. The latter requires that recipients not only have a high level of comfort with the reliability of assistance but also retain appropriate “skin in the game” for copays, deductibles and coverage exclusions.

Recognizing total expected annual cost of disasters in the budget could also encourage the use of alternative means of financing disaster spending, other than using borrowed money. Levying fees and taxes on actions that increase losses could dampen those behaviors, decrease losses, and reduce pre-loss consumption by taxpayers. It is important, however, to avoid identifying those receipts as available for additional spending on other beneficial uses. If spent for non-disaster consumption purposes, the collection of receipts will fail to reduce pre-loss consumption. The mechanics of federal budgetary accounting required to produce this result with a disaster fund are well known to budget technicians.

#### Concluding Comment

The effectiveness and efficiency of federal disaster relief and recovery policy in promoting resilience can be increased by creating strong incentives for mitigation by governments, households and firms, minimizing uncertainty about the timing and coverage of federal assistance; and smoothing consumption over pre- and post-loss periods.

Including total expected annual federal spending for disasters in the Congressional budget could provide robust support for those policy features. Absent comparable downside risks and other disadvantages, doing so appears socially desirable.