An economic and ethical analysis of the Katrina disaster

Robert W. McGee
Florida International University, Miami, Florida, USA

Abstract

Purpose – The purpose of this paper is to apply economic and ethical analysis to natural disasters such as Hurricane Katrina to determine which approaches to disaster relief work best and which should be abandoned.

Design/methodology/approach – This paper provides a combination of narrative with argument and analysis.

Findings – Government involvement in disaster relief has proven to be economically inefficient and also rights-violating. Private sector initiatives and economic and political freedom provide better solutions.

Practical implications – The findings point to ways that can improve the economic efficiency of providing disaster relief while also safeguarding property and contract rights.

Originality/value – This paper combines economic and ethical analysis and includes discussions from the perspectives of both utilitarian ethics and rights-based ethics, which is not usually done in the economics literature.

Keywords United States of America, Disaster, Licensing, Cost benefit analysis, Prices, Ethics

Paper type Case study

1. Introduction

Hurricane Katrina is a classic example of government failure. The Army Corps of Engineers were guilty of faulty construction. The federal government failed to adequately fund the project before the disaster and deal with the aftermath of the disaster. State and local government (what was left of it) misallocated resources. The Katrina case study provides much evidence that those who continually point out alleged market failure need to consider the possibility that government failure may be a worse alternative (Bhalla, 2001; Cowen, 1988; Ghosh, 2001; Pennington, 2001; Tullock et al., 2002; Wallis and Dollery, 1999; Winston, 2006).

One may arrive at this conclusion a priori, since government makes decisions based on political considerations whereas market decisions are made based on efficient allocation of resources without regard to politics. There is overwhelming evidence to suggest that the market allocates resources more efficiently than government (Bennett and Johnson, 1981; Donahue, 1991; Fitzgerald, 1988; Greene, 2001; Kemp, 2007; Pitcher, 2003; Poole, 1980; Savas, 2005). That being the case, the question becomes what role government should play in the allocation of resources in general, and in the allocation of resources in the event of disasters such as Katrina in particular. Failure to address this issue will result in more mistakes being made in the future. If one cannot learn from mistakes, one is condemned to repeat them.

2. Literature review

A look at the ProQuest database for business and economics found 501 refereed journal articles on various aspects of Katrina. That does not include all the law review articles
and popular press articles (and more than a few books) that have been written about this subject. That being the case, it is impossible to do a thorough and complete literature review in a few hundred words. So, this literature review must be partial and incomplete. However, it is hoped that it is not without value.

One document of interest is the ERP Report, which was published by the American Society of Civil Engineers (2007). This report placed the blame for much of the damage caused by the break in the levees squarely on the shoulders of the Army Corps of Engineers and the US Congress. The Army Corps of Engineers was blamed for faulty construction of the levees. Congress was blamed for sporadic funding, which forced the Army Corps of Engineers to delay or scale back its work. The report provides a fairly detailed analysis of the policy failures that helped make Hurricane Katrina a disaster for New Orleans and the Gulf Coast.

The American Society of Civil Engineers (2006) also published a list of recommendations for preventing future Katrinas. Most of the recommendations had to do with engineering but a few of them addressed policy issues. One suggestion was that local, state and federal leaders should assign a single individual the responsibility for managing critical hurricane and flood protection systems. Another recommendation called for better inter-agency coordination. Practically, all of the recommendations called for top-down government involvement at the federal, state and local level, which is curious, since the evidence is clear that Hurricane Katrina became disaster Katrina precisely because of federal, state and local government policies and involvement. Private sector solutions were not considered.

Burton and Hicks (2005) estimated that Hurricane Katrina resulted in commercial structure damages of $21 billion, commercial equipment damages of $36 billion, residential structure and content damages of almost $75 billion, electric utility damages of $231 million, highway damages of $3 billion, sewer system damages of $1.2 billion and commercial revenue losses of $4.6 billion. They did not attempt to measure losses to the water system or infrastructure or the economic consequences of the loss of life or damage to the environment. Risk management has estimated the total economic losses at $125 billion (Pender, 2005). Estimates from Washington politicians placed the total cost at around $200 billion (Pender, 2005; Associated Press, 2005).

There is a fear that the Katrina catastrophe will give government an excuse to take a blank check approach to rebuilding the Gulf Coast area. Taxpayers for Common Sense (www.taxpayer.net/budget/katrinaspending/index.htm) is one group that has that fear and has posted a great deal of government contract information on its web site to shed light on what is being spent and who is receiving the checks. It appears that they have reason to be concerned. Here are some of the government expenditures they have uncovered:

- $25,078 to purchase a laptop computer;
- $537.04 to clean sidewalks in Memphis (Memphis? That is 400 miles north of New Orleans.);
- $1,249,997 for 383 Panasonic Pen Activated Computer Tablets (that is $3,264 per unit) plus an additional $1,244,395 for accessories (an additional $3,249 per unit);
- $92.28 for each of three steak knives;
- $14,890.86 for a FEMA video;
A virtual plethora of articles have been written on the insurance aspects of disaster coverage. Smith et al. (2006) focused on the results of hurricane Andrew to evaluate how people and housing markets respond to a large disaster. Lessons learned from the Andrew experience could have been used to deal with the aftermath of Katrina but they were not. Kunreuther and Pauly (2006) explore the options to be put in place before a disaster to avoid large and poorly managed post-disaster recovery programs. They explore the possibility of mandatory comprehensive private disaster insurance with risk-based rates. They argue that it may be more efficient to have a pre-existing public program to insure against catastrophic losses and to subsidize low-income residents who are unable to afford coverage rather than to continue to have the very expensive and inefficient post-disaster relief system that is presently in place.

3. Economic and constitutional issues

3.1 Cost-benefit analysis

If one were to apply cost-benefit analysis to Katrina, perhaps the first question that should be asked is whether New Orleans should be rebuilt or abandoned. It is a basic economic question, and cost-benefit analysis should always be considered in cases where government funding is involved, but Dennis Hastert, former Speaker of the House of Representatives, had to apologize for merely asking this question (Becker-Posner Blog, 2005).

It is questionable whether cities should be built on land that is below sea level in locations where the sea is sufficiently close to cause potential problems. But, much of New Orleans is below sea level and it is close to Lake Pontchartrain. That is what caused much of the problem. When Katrina hit, many levees broke and the water came pouring into the streets of New Orleans. Rebuilding the levees could prevent such problems in the future, but at what cost?

If it would be less costly to build a city of similar size somewhere else, cost-benefit analysis suggests that it should be done. Of course, such analysis totally ignores a more important question – should government be in the business of building cities in the first place?

A more important question to ask is what might be done with the money if the government funds that would otherwise be used to rebuild New Orleans were instead used for something else. A subsidiary question is, “Who should decide?” One obvious answer is not the people of New Orleans, since their response would be biased. A less-obvious answer is not politicians. Politicians would be a poor choice for deciding such issues, since politicians make decisions based on political considerations, not economic considerations. They are almost certain to misallocate resources.

The best group to make such decisions is the people whose money would actually be used to rebuild New Orleans. This group would include investors, business people
and home owners. If they decide to invest their own money to rebuild New Orleans, then it should be rebuilt. If they are not willing to invest their own money, then why should others be forced to supply the funds needed for rebuilding?

The argument has been made that the federal government is responsible for the damage, therefore the federal government has a responsibility to rebuild New Orleans (van Heerden and Bryan, 2006). This line of reasoning involves a non sequitur. The conclusion does not follow from the premise. Even if the federal government is responsible for the Katrina disaster, it does not follow that the federal government has an obligation to rebuild New Orleans. Several other options exist. One could merely give each victim a certain cash settlement and let them use the cash to either rebuild in New Orleans or resettle elsewhere. Or the federal government could merely apologize and provide no expenditures for the victims.

The only option that does not involve rights violations is the option whereby the federal government does not provide any relief. It is inherently unfair to force taxpayers in other states to pay for rebuilding New Orleans or relocating people who chose to live in New Orleans.

3.2 Providing for the general welfare

One of the issues that often arises whenever a natural disaster occurs is how to make those who have suffered damage whole again. One option that has been proposed is to have some government – preferably the federal government – come in and pick up the tab. The underlying assumption here is that absorbing the cost of natural disasters is a legitimate role for government to play. Kunreuther and Pauly (2006) discuss the possibility of mandatory private insurance with risk-based rates and subsidies for those who cannot afford to pay for coverage.

There is nothing in the US Constitution that clearly allows this role for the federal government. If one were to justify federal involvement it would be under the General Welfare Clause, which states that the federal government should do things that provide for the general welfare. The General Welfare Clause is based on utilitarian ethics – the greatest good for the greatest number, or stated in economic terms, positive-sum games.

The problem with applying the General Welfare Clause in the case of natural disasters is that the government is not providing for the general welfare by becoming involved. “General” welfare presumably means doing something that benefits some majority of the population, almost certainly some super majority, perhaps at least 75 percent and maybe even higher. According to AreaConnect (Area Connect (New Orleans), http://neworleans.areacodeconnect.com/statistics.htm), the population of New Orleans was slightly less than 500,000 in 2000, a few years before Hurricane Katrina. The total population of the USA is slightly more than 300 million as this paper is being written. That means that the population of New Orleans was about 0.17 percent of the total US population at the time of the Katrina disaster. Even if we assume that all residents of New Orleans suffered damage, which is not the case, and if we inflate the total population of the Gulf Coast that suffered some kind of damage from Katrina to be 1 million, that is still only 0.3 percent of the total US population, which is clearly a very small minority. Thus, if the federal government passes legislation to come to the aid of Katrina victims, it is clearly special interest legislation, which is
unconstitutional, since there is nothing in the constitution that allows the federal
government to come to the aid of any group that is less than a super majority.

This line of reasoning may seem shocking to those who have been indoctrinated to
believe that the resources of the federal government can and should be used to do
anything for anyone. However, such is not the case. Reading or hearing about the
federal government spending its funds to benefit some super small minority reminds
the author of a story about Davy Crockett, a nineteenth century frontiersman and
member of Congress from Tennessee who encountered a similar situation.

In 1828, some members of Congress wanted to appropriate money for the widow of
a distinguished naval officer. As Congress was preparing to vote on the appropriation,
Congressman Crockett gave what has become his now famous “Not yours to give”
speech (Crockett, 1828; Ellis, 1884), in which he pointed out that Congress had no
legitimate authority to expend funds for charity. He pointed out that private
individuals may give as much as they want to charity and offered to donate a week’s
pay, urging other members of Congress to also do so.

The point is that government has no resources of its own. Whatever it has, it first
had to take from someone. Congress may not expend those funds on whatever some
member of Congress thinks might be a worthy cause because there is a fiduciary duty
to those who have provided the funds to spend them on projects that provide for the
general welfare. Providing a pension for a widow can in no way be considered to be an
expenditure for the general welfare. Neither can an expenditure that benefits, at most,
substantially less than 1 percent of the population, which is what federal expenditures
to Katrina victims (and non-victims) did.

Some of the FEMA expenditures for Katrina victims were particularly outrageous.
FEMA issued $2,000 debit cards to some victims, who turned around and used those
debit cards to buy beer (and presumably other things) at strip clubs (Reiland, 2005).
While there is nothing wrong with spending your own money on beer and strip clubs,
it is particularly offensive when the taxpaying public is forced to part with its
hard-earned money to subsidize this kind of activity. It is clearly an abuse of
government power. If the federal government spends $200 billion for Katrina victims
(and others), that amounts to about $2,000 per household (Reiland, 2005). One wonders
whether many American households would voluntarily contribute $2,000 to the
Katrina victims. Whether they decide to do so or not, the real issue is not whether they
are acting sufficiently charitable, but rather whether government has the right to force
us all to make such involuntary sacrifices.

3.3 Price controls
There is a vast body of literature to show that price controls cause economic
dislocation, misallocation of resources, shortages or surpluses, depending on whether
the price control causes the legal price to be below or above the market price. The basic
laws of supply and demand do not take a holiday when a hurricane hits. Yet,
government officials often succumb to public pressure to slap price controls on
the very goods and services that are most needed after a natural disaster. These price
controls sometimes take the form of punishing providers for what is alleged to be price
gouging.

The Office of the Attorney General of Florida (2005) is a case in point. After Katrina,
the Attorney General warned that Florida law prohibits extreme increases in the price
of commodities such as food, water, ice, gasoline, lumber, hotels and equipment that is needed as a direct result of an officially declared emergency. Florida law states that a price is unconscionable if the price represents a “gross disparity” from the average price that existed during the 30-day period immediately before the emergency. Violators are subject to fines of up to $1,000 per violation and up to $25,000 for multiple violations over a 24-hour period.

During the record 2004 hurricane season, Florida’s Attorney General’s office received 8,911 complaints about price gouging. It initiated 58 investigations and filed 13 lawsuits for price gouging against a wide variety of businesses. Other states also instigated price gouging investigations.

The price of gasoline also tends to rise in the aftermath of natural disasters. That was the case after Katrina, partly because several refineries were damaged during the hurricane, thus cutting off a portion of the gasoline that would otherwise be available in the market. But, adopting price gouging legislation to prevent such price rises would be counterproductive. One study found that neither consumers nor the economy benefit by such legislation because the gain to consumers is more than offset by waiting costs or other forms of rationing. Price controls also make matters worse by dampening incentives to provide the needed product. The study estimated that if the proposed federal price control legislation would have been in place when Katrina struck, economic damages would have increased by between $1.5-2.9 billion (Montgomery et al., 2007).

The problem with any kind of price controls is that they cause resources to be allocated inefficiently. In the case of disaster relief, price controls prevent goods and services from flowing to the disaster area, since those who would otherwise provide the goods and services stand to be punished for doing so. Instituting price controls and punishing people for charging market prices in times of disaster only serve to delay relief efforts. A better alternative would be to refrain from enforcing any price restrictions that are already on the books (or, better yet, repeal them), so that relief can come to victims faster and more reliably.

### 3.4 Occupational licensure laws

Occupational licensure laws have been criticized in the economics literature for being overly burdensome or downright anticompetitive (Albon and Lindsay, 1984; Friedman, 1962; Kleiner, 2000, 2006a, b; Rottenberg, 1980; Smith, 1983; Young, 1987). Smith (1776/1937) spoke about it in 1776. He pointed out that the crafts were able to lengthen apprenticeships and prevent entry into the craft trades, thus making it possible to raise their own earnings. Nothing has changed since he wrote his grand treatise in 1776.

Occupational licensure laws have been shown to be economically inefficient and even a danger to health and public safety (Friedman, 1962; Maurizi, 1980; White, 1980). Licensing laws have a disparate impact on minorities and the poor (Bernstein, 1994; Freeman, 1980; Williams, 1982; Young, 1987). They have been shown to actually reduce quality rather than enhance it (Carroll and Gaston, 1981). Authors have been calling for allowing more flexibility regarding occupational licensure in the wake of Katrina and other disasters (Taylor, 2006). But, the real question from an economic and ethical perspective is whether government should be regulating professions in the first place.
The alleged purpose of occupational licensure laws is to protect the public from incompetents or abuse. But in practice, occupational licensure laws often raise the cost of obtaining the service without necessarily protecting the public. Florida law (Office of the Attorney General of Florida, 2005) makes it a second-degree misdemeanor for an unlicensed person to offer goods or services to the public during a declared state of emergency. In Florida, unlicensed contractors can be charged with a third-degree felony when the governor has declared a state of emergency (Summers, 2007, p. 14).

Occupational licensure laws can hamper hurricane repairs. When thousands of homes have their roofs ripped off in a hurricane there is an urgent need to cover the open spaces so that rain does not increase the damage. If the roof cannot be replaced immediately, the next best thing is to cover the open area with plastic. Although doing so is not as effective as replacing the roof, it is better than nothing, and there is a chronic shortage of carpenters in the wake of hurricanes, since the local population of available carpenters is inadequate to cope with the skyrocketing demand for carpentry services.

Here is a case study to illustrate the point of how bad regulation can hamper post-hurricane clean up. After Hurricane Charley hit Florida in 2004, Anthony Howell flew to Florida to help his friend repair his home. Anthony was a licensed contractor in New York. He had years of experience building and repairing homes. Anthony’s friend had first called numerous Florida contractors but none of them could help. They were swamped with work.

Three days after he started repairing the roof, they were visited by two Sheriff’s deputies and two investigators from the Department of Business and Professional Regulation, who issued them a cease-and-desist order. Failure to comply could result in a $5,000 fine and a third-degree felony, which could potentially land Anthony in jail for more than a year (Summers, 2007, p. 14). This case provides a clear example of how occupational licensing laws can make matters worse rather than better.

At its base, occupational licensure laws are an attack on property rights. The body is property (Scott, 1981) and anyone who wants to rent out his brain, his hands or his expertise should be allowed to do so without restriction. It should not be up to some government to determine who can work and who cannot. The right to work is one of the most basic human rights. No government should be able to prevent individuals from selling their labor to anyone who is willing to purchase it. Yet, that is exactly what happens whenever some government requires a license to perform some service or to sell some product.

In the case of natural disasters, it is especially important to allow people who have had their homes damaged to get the help they need to repair their property and to prevent further damage that could otherwise result from rain or wind. In such cases, licensing laws also violate the rights of home owners, since it makes it more difficult, more expensive or even impossible to protect their property.

The best solution would be to abolish licensure laws outright, since that is the only solution that would end the property rights violations. A second-best solution would be to suspend licensure laws whenever there is a disaster. A third-best solution would be to lighten up on the enforcement of licensure laws in the wake of a natural or man-made disaster. That is what Moore and Summers (n.d.) recommend. Their solution may be summarized as follows:
develop a performance-based fast-track contracting system;
• suspend licensing requirements for construction trades; and
• streamline the building permit process.

While their suggestion would improve current practice, it would not stop future property right violations, since government could continue to punish people for attempting to sell their services to willing consumers. Milton and Rose Friedman advocate a constitutional amendment that would prohibit occupational licensure. Their proposed language for the amendment reads as follows:

No state shall make or impose any law which shall abridge the right of any citizen of the United States to follow any occupation or profession of his choice. (Friedman and Friedman, 1979/1980, p. 305 of the hardcover edition, p. 293 of the paperback edition).

While their suggestion would go a long way toward alleviating the problem and would stop many property rights violations in their tracks, the language of their proposed amendment does not go far enough. Their amendment would only prohibit states from abridging the right to work. It would not prohibit the federal government from doing it.

Another weakness with the language in the Friedman proposed amendment is that it only applies to citizens. There are many millions of people in the USA who are not citizens, although they are legal residents. They would not be covered by the Friedman amendment. Although their amendment would be a major step in the right direction, changing the language to include all legal residents and prohibiting both the states and the federal government from infringing on this important property right would make the amendment even better.

4. Ethical issues

One ethical issue that is seldom discussed is the wise spending of tax funds. Governments have a fiduciary duty to taxpayers to spend tax funds wisely. It seems that this has not always been done in the case of Katrina. Spending $92 for a steak knife or $2,950 for a wristwatch or $25,078 for a laptop computer is certainly questionable, as are many of the other expenditures that have been made in the name of Katrina relief.

Another ethical question not often asked is whether the federal government should get involved. Most people merely assume without thinking that the federal government should get involved and do not even see any ethical issue. But, an ethical analysis of this question might easily lead one to conclude that the federal government should not become involved in Katrina-like situations.

There are several ethical reasons why government should not get involved in providing welfare. One reason is because it is inefficient for government to get involved in such activities. The private sector can do just about anything more efficiently than government, as was mentioned above. This argument is utilitarian.

Another ethical approach to take is the property rights approach. Government is force. And government has no resources of its own. Whatever resources it has it must first take from someone. It does not seem fair that the taxpayers of California, Oregon and Michigan should be forced to pay for rebuilding New Orleans. Forcing taxpayers of other states to pay for the reconstruction of New Orleans is a perfect example of
what Bastiat (1964, p. 144) said in the 1840s: “The state is the great fictitious entity by which everyone seeks to live at the expense of everyone else.”

As was previously pointed out, there is no constitutional authority for engaging in this kind of activity, since it is special interest legislation rather than something that provides for the general welfare. If someone who wants to live in a flood zone is not able or willing to pay market rates for insurance coverage, they should move. People who have enough sense not to live in a flood zone should not be forced to pay the insurance premiums of those who do live in such places. It is inherently unfair to force the general public to subsidize this kind of behavior. It is especially unfair to force lower and middle income taxpayers to subsidize paying insurance premiums for the millionaires who live in such flood zones. Yet, that is exactly what has happened in the case of the multi-million dollar homes on the Long Island, New York beaches that get damaged by storms every few years (Kennedy, 1992; Stossel, 2004a, b). Millionaires like television commentator John Stossel and Congressman Richard Gephardt are having their beachfront properties subsidized by the federal government (Stossel, 2004a, b) and low- and middle-income taxpayers in Oregon, Maine and Arizona have to help pay for it.

5. Concluding comments
Natural disasters like Hurricane Katrina will always be with us. So far, science has not found a way to prevent hurricanes. But, economics has found a way to minimize the post-disaster damage. It is called the free market. Government subsidies that encourage people to live in flood zones and government regulations that punish private individuals from coming to the aid of hurricane victims only make matters worse. Damages could be minimized by allowing private individuals to volunteer or sell their services to aid in disaster relief. Government interference with the market process has been shown to make matters worse rather than better.

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Corresponding author
Robert W. McGee can be contacted at: bob414@hotmail.com

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