



## Rebuild? Or Give Money to Residents?

Yes.

John S. Irons\*

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It is becoming clear that the mismanagement of the immediate response to Hurricane Katrina is also continuing in the broader aftermath. Millions of dollars have been spent already on no-bid contracts, and much has already gone to companies previously suspected of mismanagement of contracts in Iraq (such as Halliburton). The high-profile case of millions being spent on under-utilized cruise-ship leases and the creation of trailer-park mini-cities are two examples of poor decision-making at the highest levels.

As we move forward, we need to insist that the federal response be corrected before millions more are wasted. As part of this effort, we should think seriously about putting rebuilding aid directly into the hands of those affected.

If significant amounts of money are not directed to individuals, too much of it will wind up in the profit column of out-of-town federal contractors. Under current leadership in the federal government, we have already seen waste, fraud and cronyism take a large chunk out of federal dollars that were meant to go to more productive uses. USA Today reported that a “politically linked” company from Alaska has already been given a no-bid, \$39.5 million contract to rebuild schools in New Orleans.<sup>1</sup> A recent Wall Street Journal article highlighted lobbyists from a wide range of interests—from timber to telecommunications industries, and

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\*Director of Tax and Budget Policy, Center for American Progress

<sup>1</sup>Kevin McCoy, “Alaska firm gets Gulf rebuilding job” *USA Today*, September 29, 2005, available at [http://www.usatoday.com/money/economy/employment/2005-09-29-katrina-contract-usat\\_x.htm](http://www.usatoday.com/money/economy/employment/2005-09-29-katrina-contract-usat_x.htm).

from individual companies—lining up to pitch their pet projects and tax breaks to be included in a Katrina aid package.<sup>2</sup>

We must also bear in mind that this is no cheap exercise. Estimates center around \$200 billion as the final price tag for rebuilding in New Orleans and other Gulf areas.<sup>3</sup> The Louisiana Senatorial delegation has asked for \$250 billion in aid. Private estimates suggest that economic losses to businesses and individuals are expected to exceed \$125 billion, with less than half of that insured.<sup>4</sup> The Commerce Department estimates reduced income due to uninsured losses of residential and business property at \$100 billion.<sup>5</sup>

If we take \$200 billion as the amount that will eventually be spent on recovery efforts, and we divide this amount by the number of just the New Orleans residents—about half a million in the city proper—we’re talking about spending approximately \$400,000 per person. Supposing the number of people affected in the broader region is twice that number, we’re still talking about \$200,000 per person.<sup>6</sup> However you count it, we’re talking about significant spending per person.

Policymakers should strive to enable the local residents, as much as possible, to make the decisions that will determine the new character of their cities and towns. And that means New Orleans and other Gulf Coast residents should receive significant direct assistance for reconstruction.

The Enterprise Foundation estimates the total cost of rebuilding and repairing the nearly 1 million homes in the affected regions at \$87.6 billion. Since some of the rebuilding costs will be covered by insurance, the total amount

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<sup>2</sup>M. Schroeder and B. Mullins, “Industries Angle for Share in Relief Package” *Wall Street Journal*, September 28, 2005, Page A4.

<sup>3</sup>Estimates have ranged from \$150 to \$250 billion, but will depend upon the final package.

<sup>4</sup>See Risk Management Solutions, “Great New Orleans Flood to Contribute Additional \$15-\$25 Billion in Private Sector Insured Losses for Hurricane Katrina, Bringing Estimated Insured Losses to \$40-\$60 Billion,” accessed October 4, 2005, available at [http://www.rms.com/NewsPress/PR\\_090205\\_HUKatrina\\_insured\\_update.asp](http://www.rms.com/NewsPress/PR_090205_HUKatrina_insured_update.asp).

<sup>5</sup>The \$100 billion estimate is a decline in incomes expressed at an annual rate from uninsured losses. See Bureau of Economic Analysis, “News Release: Personal Income and Outlays,” September 30, 2005, available at <http://www.bea.gov/bea/newsrel/pinewsrelease.htm>.

<sup>6</sup>The population of the New Orleans region is slightly greater than 1.3 million.

needed for rebuilding will be less.<sup>7</sup> Using this figure as a guide, the federal government should set aside \$75 billion, or at least a third of the total rebuilding aid, whichever is greater, for direct assistance to affected individuals. And, of this amount, two thirds, or \$50 billion, should be allocated to a new Rebuilding Assistance Program that would provide funding for rebuilding directly to individuals. Such a policy would put at least \$25,000 cash and \$50,000 rebuilding aid into the hands of 1 million of those most directly involved in rebuilding their lives.

## 1 Why direct assistance?

Cash transfers or other direct assistance can be justified by noting that the federal government often plays the role of providing insurance (at least implicitly) for large catastrophic events. Payments to the families of 9/11 victims is the most obvious and recent example. But the federal government has provided aid to many individuals for a wide range of damaging events—both man-made and natural.<sup>8</sup>

Also, the federal government ought to bear some responsibility for the events that led to the devastation and the inept response. The fact that New Orleans was at risk for major flooding was no secret to anyone who knew anything about the geography of the region. There was a failure at all levels of government, including the federal level, to provide adequate flood protection and to respond to the crisis in an effective manner.

While many of the rebuilding projects in the city will require large sums of

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<sup>7</sup>See The Enterprise Foundation, “Enterprise Analysis of Federal Funding Needed for Housing in Hardest Hit Areas” available at [http://www.enterprisefoundation.org/katrina/federal\\_funding.asp](http://www.enterprisefoundation.org/katrina/federal_funding.asp). An estimate for required federal funding (derived in part from the amount not covered by insurance or other resources) was \$32.7 billion, but it did not cover the cost of temporary housing. Also, it assumes that the uninsured gap is filled by the federal government for poorest families, but is phased out for families with higher income.

<sup>8</sup>Another example is the Savings and Loan crisis and bailout of the 1980’s. Whether the government should be providing this insurance is an interesting question, since individuals may engage in riskier behavior (such as living in flood plains, or making risk loans) that they might not have without the implicit promise.

money and the support of broader communities—rebuilding and improving the levee system is the most obvious example<sup>9</sup>—much of the reconstruction will be done at the individual and family level. Hundreds of thousands of people will be cleaning out now-useless furniture, conducting home repairs, and restocking small business inventories. They will be replanting trees, buying new tools, and repairing roofs. They will be clearing the parks of debris and rebuilding the neighborhood community centers and playgrounds.

They will also need the time to undertake new projects. And while jobs will be necessary to keep the economy and family finances afloat, time off from the jobs will be needed to get things back in order, placing additional financial strains on those affected.

There is plenty of precedent for cash or other direct assistance from the federal government. Social Security, unemployment insurance and the Earned Income Tax Credit (EITC) are prominent examples of the former. Food stamps and health services (through Medicare and Medicaid) are examples of the later.

We should trust the residents of New Orleans and the broader region to know best how to rebuild their cities, their towns, their communities, and their own lives. And by directing the aid locally, we best ensure that much of the funds will employ local residents and benefit local businesses.

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<sup>9</sup>Some have suggested that people would be better off with a simple cash payment and be allowed to move elsewhere, leaving New Orleans and the rest of the Gulf Coast to be reclaimed by the ocean. Edward Glaeser argues that it is the people of New Orleans that should be supported and that the city itself is in decline, and perhaps does not merit full reconstruction. (E. Glaeser, "Should the Government Rebuild New Orleans, Or Just Give Residents Checks?" *The Economists Voice*, v.2, n.4, article 4.) Steven Landsburg suggests families would be better off with a check and that perhaps no money should be spend on rebuilding. (S. Landsburg, "Hurricane Relief? Or a \$200,000 Check?" *Slate*, September 22, 2005, available at <http://www.slate.com/id/2126715/>.)

These views, however, dismisses the notion that a city's demographics, geography, culture, history, and infrastructure might form an irreplaceable whole. A major U.S. city should not simply be abandoned in a time of crisis. New Orleans, like many other places in the U.S., is unique for its culture, its history, and its communities; and, as a major industrial port, it is economically significant as well. The nation as a whole is richer for having New Orleans and New Orleanians—the city should be rebuilt and its communities renewed. The new, New Orleans will likely be different in many ways, and we should strive to improve, but we cannot abandon it altogether. Similar things can be said about other communities around the Gulf Coast that were affected as well.

## 2 What form direct assistance?

Many economists feel that cold, hard cash is the best way to provide assistance since it provides individuals with the most freedom to decide how to spend the funds. This allows those who are most directly impacted to have the most direct say on how to allocate the money. It also allows people to put the money to its best use by more directly matching people's individual preferences without having to make guesses as to what those preferences are.

There are also sound arguments for providing in-kind assistance as well—for example, food stamps allow provision of aid in the form of a specific kind of good. This in-kind aid assures the public that the money is being used in the way it was intended. Many think that for the immediate recovery, some assistance in the form of housing vouchers would be a useful addition to the temporary relief effort, and an expansion of Medicaid would be useful in providing health services for affected families.<sup>10</sup>

When it comes to rebuilding, it makes sense to follow a mixed strategy. Some cash assistance would be welcome and useful, but the bulk of it should be provided explicitly for rebuilding. In particular, two-thirds of the money should be provided as in-kind aid for rebuilding.

To do this, a Rebuilding Assistance Program (RAP) should be established to provide hurricane-affected residents with vouchers to purchase building supplies from accredited hardware and building supply retailers, to hire approved contractors, or to put a down payment on a new home.

The RAP project would develop a list of approved hardware and building supply retailers and would issue vouchers—perhaps administered like the popular “gift cards”—redeemable for a wide range of hardware needs. These RAP cards could also be used to finance construction from accredited builders and remodeling contractors.

For those who were renting prior to Katrina or for those who want to relocate within the region and start anew, the RAP program would allow the rebuilding

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<sup>10</sup>The Bush administration, however, has opposed both measures.

Table 1: KATRINA AID BREAKDOWN

Total Aid Package	\$200 billion
Reserve \$75 billion for direct assistance	\$75 billion
Direct aid per person (assuming pop. 1 million)	\$75,000
Direct cash assistance	\$25,000
Rebuilding Assistance Program	\$50,000

funds to be applied towards purchasing or building a new home. With the median home price in the New Orleans area, prior to Katrina, at just over \$150,000,<sup>11</sup> this assistance would provide one heck of a down payment on a new home.

Devoting \$75 billion to direct aid would put \$25,000 cash and \$50,000 in rebuilding aid into the hands of 1 million of those most directly involved in rebuilding their lives. Arguments could be made about adjusting the 1/3 - 2/3 split in aid—and a political process might very well alter this share—however, since part of the goal is to rebuild the region, a majority of the direct aid money ought to be reserved for this purpose.

The direct cash assistance would allow people to finance everything from temporary support to higher education or new job training. And it would allow people to decide for themselves how best to use the aid.

### 3 Loose ends

As with any other major initiative, there are myriad related issues to consider.

<sup>11</sup>National Association of Realtors, as reported in CNN.com “Home Prices Post Record Gains,” available at <http://money.cnn.com/pf/features/lists/nar-2q05/>.

Since a large share of resources should be devoted to Katrina reconstruction, the assistance program should provide greater aid to those looking to rebuild in the region. However, there will also be many people who will decide simply not to return. For these people, the best policy may be to provide the same amount of cash assistance, but reduce the construction and down payment aid available by half, to \$25,000. This reduction would recognize that the aid is partially designed to rebuild the region, but it could still provide a significant jump-start to those wishing to establish a new home in a new location.

The 9/11 Victim Compensation Fund explicitly linked the amount of compensation to the future earning potential of those who were killed by the attacks—families received a base amount and then were awarded additional money based on a number of factors including projected income levels.

The current situation, however, is different in that most of the people affected have survived the hurricane, and will continue to earn money in the future. In addition, private insurance will aid those with higher incomes and wealth to a greater extent than those with lower incomes and wealth.

While there are good arguments to be made that those with higher incomes or wealth should receive more, there are equally good arguments for the reverse. For example, lower-income families were disproportionately harmed by the inadequate response; and these families are also the most in need. Providing equal assistance strikes a natural balance—treating all those affected equally.

Issues such as eligibility for individuals and accreditation for building suppliers are, of course, important considerations to prevent misuse of the program; however, these problems will exist no matter how the government decides to proceed. Getting resources into the hands of those who will rebuild should be the top priority.

## 4 Conclusion

The success of free markets shows that relying on individual decisions is often the best way to achieve good results. At the same time, there is a significant

role for collective action through government to build infrastructure, and more generally to provide goods that the free market cannot or will not produce in sufficient quantity or quality.

Policymakers must take into account this balance when providing resources to the region. While support must be given to states and localities to rebuild infrastructure, we also need to recognize that the affected individuals themselves should not be left out of the rebuilding process.

A Rebuilding Assistance Program would put resources directly into the hands of those best suited to make the day-to-day decisions about how to spend the money, would invigorate the local economy by creating local jobs, and would keep money out of the hands of non-local contractors.