



Flood Relief Establishes Perverse Incentives

By Matt Simpson

Summary

The urge to help people who have experienced devastation from floods and other disasters is never misguided. However, the expectation of relief spurs more marginal home and business owners to locate in risky areas in the first place. Ultimately, government-subsidized reconstruction sets people up for more long-run damage.

Main text word count: 635

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I saw my fair share of floods while growing up. During the flood of 1993, I watched the Meramec River slowly creep toward my house and into my basement. A few years earlier, my family and I had to evacuate our home near George Winter Park because of excessive flooding. The severe damage that floods can cause makes living in the flood plain risky. When flood damage occurs, state and federal governments typically subsidize reconstruction through government grants and loans offered at subsidized rates, a practice that unintentionally sets the stage for worse devastation later on.

Government aid to flooded areas isn't necessarily bad. Sending in the National Guard to help people evacuate, for example, fulfills an essential role of the government: protecting the public from real, physical harm. Subsidizing the cleanup and reconstruction, on the other hand, has nefarious long-term consequences.

The intention to help people is never misguided. However, the means used to help people may be ill-advised. So, it's worth asking: Will this sort of flood relief actually relieve the pain that floods cause? In the short term, the answer is simple and obvious: yes. We can all see a farmer rebuilding his barn. Even more concretely, we've seen Chesterfield sprout back up after the 1993 disaster. This isn't the entire story, though. What isn't as obvious is that subsidizing reconstruction actually causes more flood damage over time, undermining the intended goal of relief.

It's not difficult to figure out that lowland areas near rivers have a tendency to flood — or that this can be very costly for home and business owners. To varying degrees, people tend to take these extra costs into account when deciding where to move or set up a new business. But by providing aid to rebuild flood-prone areas, federal and state governments reduce the potential costs of a flood, and thereby the risk associated with living and doing business there. This essentially becomes a subsidy for areas that are likely to be flooded.

Any astute student of economics knows what will happen next. Somewhere in the state, there are people who enjoy the many benefits of living next to a large river like the Mississippi — the boating and

fishing opportunities, for instance. But, all things considered, many of these people would ordinarily consider it just a bit too risky to live in such an area. Economists characterize these people as being “on the margin.” When the costs associated with flooding are mitigated by the expectation of disaster assistance, some of the people on the safe side of the margin cross to the risky side — they now see living by the river as an attractive option. Flood relief spurs some marginal home buyers to move into flood-prone areas.

This happens not only with potential residents, but potential business owners, as well. The decreased risk brought by relief efforts means that businesses on the margin build new facilities in the flood plain rather than somewhere else, while businesses already in the area purchase new equipment and improve their buildings rather than limit possible losses.

As a result, these areas contain not only more potential victims, but also a much greater potential for damage. So, while government assistance for flood reconstruction can certainly help people who have been hurt by flooding, it also encourages some people to set themselves up for disaster. When the next flood comes, the damage will likely be much worse than if there had been no flood relief at all — in terms of both dollars and human suffering.

To answer my original question: Does subsidizing reconstruction actually help ease the pain caused by floods? In the long run, the answer is a most emphatic no. Although this sort of relief does some immediate good, it will only cause a great deal more harm down the road.

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