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Competitive Enterprise Institute
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202.331.1010 • www.cei.org
Advancing Liberty – From the Economy to Ecology

April 14, 2009 **No. 8**

Why Florida Should Not Receive a Pre-Funded Federal Bailout

By Eli Lehrer*

Since early 2009, Florida state officials—both elected and appointed—have repeatedly called on the federal government to provide Florida with loan guarantees, lines of credit, and outright loans from the U.S. Treasury in order to help the state manage the risk of hurricanes, both before and after a major disaster. This short paper argues that Florida should not receive federal loans or loan guarantees and explains why.

The Requests and their Flaws. In February 2009, Insurance Commissioner Kevin McCarty lobbied Congress to pass legislation to provide guarantees to the Florida Hurricane Catastrophe Fund.[1] In addition, Florida Senator Bill Nelson (D) wrote to Treasury Secretary Tim Geithner to ask about the extent of Treasury's authority to provide loans to a state like Florida under existing statutes.[2] In early April 2009, however, media outlets reported that Treasury had denied Nelson's request. The Senator, nonetheless, vowed to try additional federal avenues.[3] And Rep. Ron Klein (D-Fla.) has proposed legislation that would mandate that the Treasury lend money to Florida and other states to help deal with catastrophes.[4]

In Florida, any federal money very likely would flow to the Florida Hurricane Catastrophe Fund (known as the Cat Fund) and the Florida Citizens' Property Insurance Corporation (though Florida can always change its insurance regulatory structure). The Cat Fund is a state-run reinsurance facility and Citizens' is a state agency that sells property insurance to consumers. Citizens' sells more property insurance than any insurer in Florida and ranks among America's 100 largest homeowner insurers. The Cat Fund is the only state fund of its type in the United States.[5] Providing funding to this system—however the funding flows—would:

- Support a broken insurance system;
- Have a large chance of placing a significant burden on the U.S. Treasury; and
- Encourage unnecessarily risky, possibly environmentally destructive development.

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* *Eli Lehrer is a Senior Fellow at the Competitive Enterprise Institute*

Florida's Current System Does Not Work. Florida's current insurance system, which the governor and legislature created in order to reduce prices, simply does not work. It has no way to fund its liabilities and has resulted in nearly all large private insurers leaving the state.

The Cat Fund, the most likely recipient of federal funds, has potential liabilities of at least $28 billion but only $3 billion in assets.[6] It plans to fund its operations by selling bonds and then paying off those bonds by imposing enormous special taxes called "assessments" on nearly all insurance policies in the state. Although Florida could sell *some* Cat Fund bonds, it is almost inconceivable that it could sell anything close to the $25 billion it might need—no state has ever sold more than $12.3 billion in bonds all at the same time.[7] Moreover, unlike private insurers, Citizens' buys its own reinsurance only from the Cat Fund—so any problems arising in the Cat Fund would almost immediately spill over onto Citizens'. Federal loans would reinforce this badly designed system.

Even by its own standards, the system has not worked. Rather than help restore the private market by cutting reinsurance costs for large insurers, the system has actually driven them out of the state. Since the system's creation, most large private insurers have cut back on writing new coverage in the state—State Farm, previously the state's largest insurer, has even announced plans to withdraw from the state altogether. In their place, small companies have emerged that bring in practically no new capital from outside the state.[8] In fact, only one multi-state company has decided to enter the Florida market since the current system was enacted.

Florida has only itself to blame. The legislature and governor brought the current system into existence in early 2007, when they simultaneously expanded the Cat Fund and allowed Florida Citizens' to compete directly with private insurers for most business. Trying to reduce rates may have proven popular, but it created the demand for the loan guarantees and loans that Florida now wants. The system has not even achieved its nominal purpose—lower rates. Nearly all insurers filed for large rate *increases* in the wake of the system's creation.

Abolishing the system would remove the need for loan guarantees intended to lower individual property owners' insurance premiums. (Florida remains eligible for all manner of federal disaster assistance, including programs that finance rebuilding and retrofitting.) Florida can solve this problem, which is of its own making, and should not look to the federal government for help.

Loans Would Burden the Federal Treasury. If Federal loans to Florida are intended to be paid back, then they will have little advantage over private lending. Although the federal government might offer slightly lower rates than the private sector, federal loans would still have to be paid off or forgiven. Florida does not have a practical plan or the proper tools to pay them back, so all U.S. taxpayers would end up footing the bill for whatever Florida borrows.

The facts are these: Florida has no state income tax, a state-wide cap on property taxes, and a roughly average state sales tax. While the merits of Florida's tax policies are beyond the scope of this paper, Florida simply does not have many revenue-producing tools at its disposal (If it did, it could sell debt on the private market). If it wants to retain the current system for property insurance—which it should not—Florida will have to raise taxes. Federal loans would require additional revenue from private loans if Florida seriously intends to repay the principal. Even if federal loans were to save the state 200 basis points (2 percentage points) in interest over what it could get in the private market, the savings in interest on $25 billion—$500 million a year the first year and less thereafter—pale in comparison with the costs of $2.5 billion in yearly principal payments that Florida would have to make if it borrowed the money on a 10-year term.

Quite simply, loans would become grants unless Florida raises taxes. Eventually, it is possible for the federal government to forgive the entire debt—since it would never be repaid anyway—leaving taxpayers stuck with the bill. Even in the context of an enormous federal budget and deficit, $25 billion is a lot—more than the budget of NASA (slightly under $20 billion in 2009) and more than the total cost of maintaining every American embassy around the world. If the loans, loan guarantees, or bond purchases did not burden the federal Treasury, then private investors would snap them up themselves without government help. The only reason to offer them is to provide a subsidy to Florida.

Loans Would Encourage Unwise Development. Florida's insurance system is designed to keep rates lower than the market would determine. This makes it less expensive to build houses in hurricane-prone areas. Many of these areas are also environmentally sensitive or particularly beautiful. Environmental groups like the Florida Wildlife Federation and the Sierra Club have joined efforts calling for insurance reform.[9]

There should not be any law prohibiting people from building what they want on property they own, but the government should not do anything to support private construction, especially in areas that are at high risk of natural disasters or environmentally sensitive. Providing insurance at below-market rates encourages environmental destruction and puts residents at greater risk.

Conclusion. Providing loans or loan guarantees to Florida would support a broken insurance system. It would make the state less safe and harm the environment. When Florida politicians come begging to Washington, Congress and Treasury should answer with a polite, firm, "No."

Notes

[11] Jennifer Libretto, "Florida insurance regulator Kevin McCarty lobbies Congress for help with catastrophe fund," *St. Petersburg Times,* February 10, 2009.

[2] Sen. Bill Nelson, "Request for Legal Opinion Regarding the Legal Authority of the Treasury Department to Issue a Standby Line of Credit to the State of Florida for the Florida Hurricane Catastrophe Fund," March 4, 2009.

[3] Beatrice Garcia, "Florida Seeks U.S. Help to Back up Hurricane Catastrophe Fund," *The Miami Herald*, April 10, 2009.

[4] H.R. 3355, "The Homeowners' Defense Act of 2007." Rep. Klein has made clear his intentions to reintroduce the bill during 2009.

[5] For a review of the workings of Citizens' and the Cat Fund, see Eli Lehrer. *Restoring Florida's Insurance Market to Reduce Florida's Risk of Financial Insolvency*, The James Madison Institute, March, 2009, http://www.jamesmadison.org/pdf/materials/671.pdf.

[6] Ibid.

[7] In 2004, California issued $12.3 billion in bonds. California's economy and population are roughly twice that of Florida's and it has a state income tax that offers a larger revenue lever to repay bonds. See Mark Schwanhausser. "Huge California Municipal Bond Issue Approaches," *San Jose Mercury News*, April 30, 2004.

[8] Lehrer, 2009.

[9] Julie Patel, "Home insurance prices rising under new Florida legislation," South Florida *Sun-Sentinel*, April 3, 2009.