

LOCAL

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KNOWLEDGE



IS THE GULF COAST
OPEN FOR BUSINESS?

MERCATUS CENTER
GEORGE MASON UNIVERSITY

About the Mercatus Center

The Mercatus Center at George Mason University is a research, education, and outreach organization that works with scholars, policy experts, and government officials to connect academic learning and real world practice.

The mission of Mercatus is to promote sound interdisciplinary research and application in the humane sciences that integrates theory and practice to produce solutions that advance in a sustainable way a free, prosperous, and civil society. Mercatus's research and outreach programs, Capitol Hill Campus, Government Accountability Project, Regulatory Studies Program, Social Change Project, and Global Prosperity Initiative, support this mission.

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CRISIS AND RESPONSE IN THE WAKE OF HURRICANE KATRINA

THE MERCATUS CENTER at George Mason University is conducting a five-year project to follow the rebuilding of the Gulf Coast in the wake of the terrible destruction wrought by Hurricane Katrina. We are focusing our efforts in Orleans and St. Bernard Parishes, Louisiana and Harrison and Hancock Counties, Mississippi to examine what works and what does not. We are interested in how different social, legal, political, and economic institutions engender different types of response, and how they may have affected different communities before, during, and after the hurricane.

The purpose of our inquiry is to examine the role in the rebuilding process played by three groups:

- **for-profit businesses:** small, local businesses as well as larger, national businesses;
- **non-profit organizations:** local, regional, national, and international relief organizations, charities, and faith-based groups; and
- **governments:** local, state, and federal, including emergency relief and recovery agencies.

Our goal is to determine where—and why—each sector has its greatest successes. Further, we seek to examine how each of these sectors interact, where they build synergies, and where they work at cross purposes.

Our purpose is not merely scholarly but is grounded in the real world and in the realities of the policy making community.

The Mercatus Center specializes in integrating theory and practice, standing at the crossroads of academia and the policy world. Harnessing the methodologies of **economics, political science, and sociology**, we seek to bring fresh insight to the question of disaster response and recovery and make our findings known to those who can make a difference.

In order to inform both academic research and decision makers at all levels of government and society, we disseminate our results through a variety of means, including:

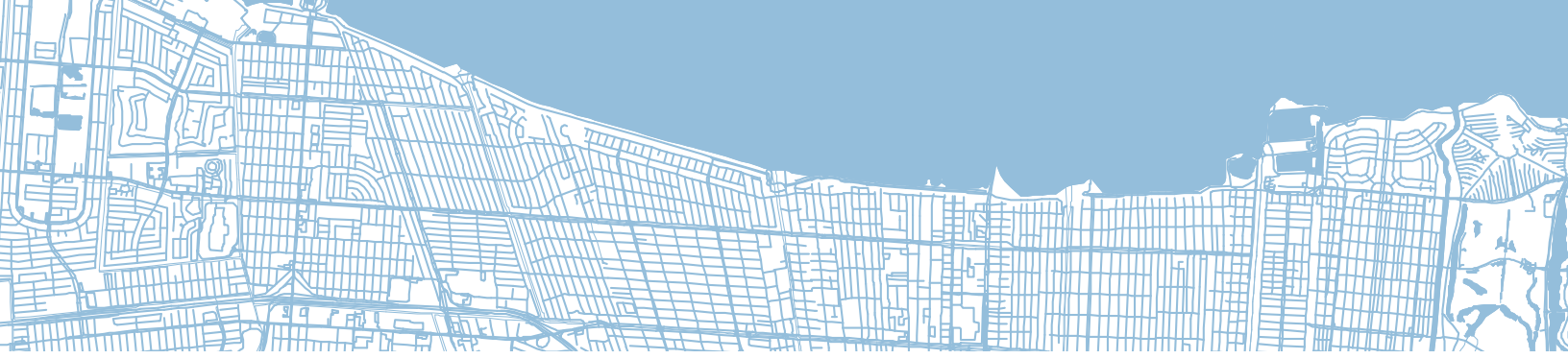
- academic research papers in economics, political science, and interdisciplinary journals;
- the popular press in both Gulf Coast and national publications; and
- the policy community through the *Mercatus Policy Series* and our Capitol Hill Campus education and outreach programs.

The results of our research will inform policy makers, businesspeople, and community leaders about better ways to prevent and respond to future natural and man-made disasters and incorporate the strengths of the for-profit, non-profit, and public sectors.

Our team includes over one-dozen researchers, and Mercatus scholars are available for consultation regarding the findings of their research.

The importance of this line of inquiry could not be more significant: Hurricane Katrina was neither the first nor the last major disaster to hit the United States. Preparations and response were clearly inadequate; hundreds were left dead; and hundreds of thousands left homeless. The reaction of the policy community to the failures evident from Katrina will have far reaching implications. In order to prepare for the next disaster, it is imperative that we undertake a critical analysis of the institutions and policies that succeeded and that failed. By better understanding the findings of this research, we can keep our next disaster from becoming a tragedy.

For more information about this project or the Mercatus Center, please contact Daniel Rothschild at 703-993-4898 (office), 202-558-0248 (cell), or drothsch@gmu.edu.



FOREWORD

IN 2005 HURRICANE Katrina shook the Gulf Coast and entered our shared lexicon as a proxy for deeper discussions about a host of critical questions in public policy, from the capabilities of first responders to the causes of child poverty. We viewed first hand the inadequacy of the government's response. We watched our citizens trapped helplessly on rooftops for days and countries from Bangladesh to Uganda, moved by the images of suffering, volunteer aid to the United States.

In the three years that followed, Americans have learned a great deal about our country, institutions, and fellow citizens. We've learned that the American people are generous and giving. Americans have contributed over \$4 billion to rebuilding the Gulf Coast, and more than 1.1 million Americans have donated tens of millions of hours in selfless service to their fellow citizens.

We've learned that all communities possess an incredible degree of resilience. Neighborhoods, religious communities, civic groups, and grassroots non-profits all across the Gulf Coast have taken leadership over their own destinies and announced that they're not just rebuilding—they have dreams of coming back stronger and better than ever.

We've learned that businesses, from the mom-and-pop stores that dot the corners of New Orleans's Central City to retail giants like Wal-Mart and Home Depot with international supply chains and distribution systems, play critical roles in a community's recovery. They contribute not just goods

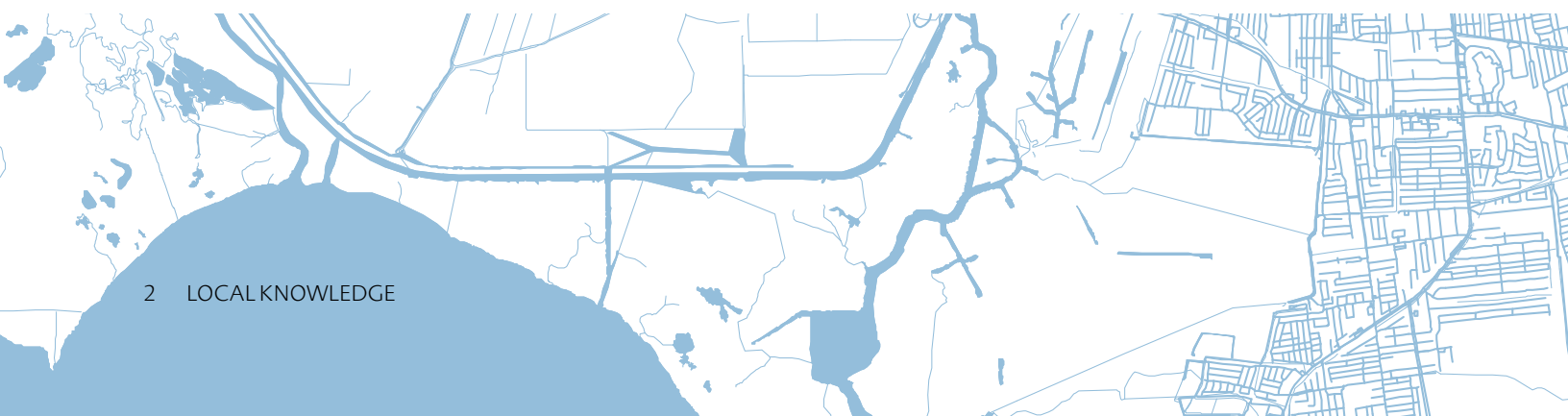
and services to struggling communities, but also signals—signals that both jobs and normalcy are returning and hopes for a way to full recovery.

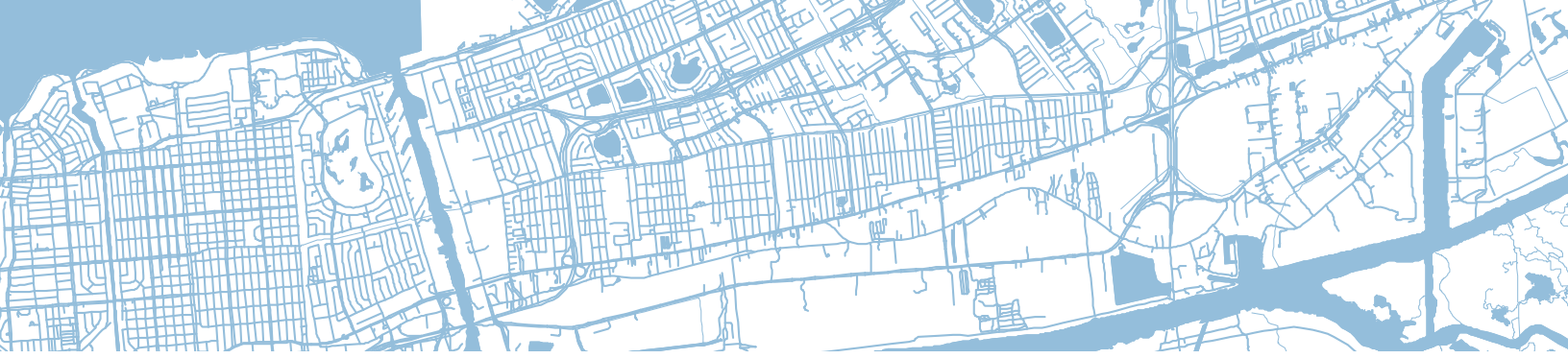
And we've learned that government response at all levels can either support or hinder the return and revitalization of families and communities affected by disaster. We've seen heroes like Doris Voitier, superintendent of the St. Bernard Parish Schools, work to restore critical services to their communities. Ms. Voitier even received national recognition for her efforts, earning a "Profiles in Courage" award from the John F. Kennedy Library.

But despite the successes and valiant efforts of Louisianans, the federal government has yet to make good on its initial failures. The Road Home program has not proved up to the task of providing needed temporary assistance to the displaced. Those fortunate enough to find shelter in FEMA trailers now worry about the health effects of living in potentially toxic structures. These and the many unpublicized bureaucratic obstacles continue to impede New Orleans's regrowth.

The lessons we can draw from a careful, scholarly examination of the rebuilding of the Gulf Coast are not liberal or conservative, Democrat or Republican, left or right. They're not about politics or ideology. They're not sticks to wield against our political opponents. They're about making America more secure and efficient in responding to emergencies in a compassionate, timely, and effective manner.

This is why it is critical that we understand what works in preventing, responding to, and rebuilding after disas-





ters. We cannot tell what works simply by propounding an ivory-tower theory, or examining an organizational diagram, or viewing graphics on a laptop computer. Rather, we must look to and learn from the people of the Gulf Coast and their successes and challenges in their response to Hurricane Katrina. They possess great knowledge and experience, and it is incumbent upon us to learn from them.

America is a great country, diverse in every sense of the word. But with great diversity come great challenges. Our Gulf and Atlantic coasts are threatened by hurricanes. Our Pacific Coast is subject to earthquakes in the south and volcanoes up in the north. The Midwest is prone to tornadoes in the summer and ice storms in the winter. And the whole country must remain vigilant to the threat of terrorism.

This is the first of three annual reports that the Mercatus Center at George Mason University is issuing to outline the research on the rebuilding of Louisiana and Mississippi after Hurricane Katrina. While reasonable people may disagree about some of the conclusions drawn by these and other studies of post-Katrina rebuilding, it is only through scholarly research and discussion that we can better understand the lessons of Katrina and other disasters. Honest and open debate is the key to advancing knowledge on how society functions, and these studies provide an excellent framework through which such a debate may advance.

This year's publication focuses on what works for disaster response by businesses and entrepreneurs. The 2009 edition will cover social networks, grassroots activism, and the non-profit community, while the 2010 issue will pay parti-

cular attention to how governments at the federal, state, and local levels can better support effective disaster preparedness, response, and recovery.

As the Commission on Terrorist Attacks against the United States, of which I was a member, noted in its final report, the private sector controls over 85 percent of America's critical infrastructure, and civilians are the first responders in any disaster, be it man-made or natural. Effective disaster response requires appropriate contributions by the for-profit, non-profit, and public sectors. No one sector can go it alone.

I hope that this report and the volumes that follow continue to promote a national dialogue, based in sound scholarly research, about how our nation can best meet the challenge of future disasters. This job is not finished, and the answers have not been fully provided. United efforts to rebuild a treasured American city and the lives of its citizens must continue. We owe it to ourselves and to the generations that follow to learn from past tragedies so that mistakes can be avoided in the future.

The Greek mathematician Archimedes once said, "Give me a lever and a place to stand and I will move the world." The ideas and lessons contained in these reports might provide the leverage to help move and improve conditions in a vital part of our world. All they need is a place to stand.

Timothy J. Roemer, PhD
Former Member, U.S. House of Representatives
Distinguished Senior Scholar, Mercatus Center





INTRODUCTION

DISASTERS SUCH AS Hurricane Katrina unfortunately provide those in the social and policy sciences with a chance to learn about how communities respond to and rebuild after disasters, what makes some communities more resilient than others, and the institutions that support response and rebuilding efforts. The question goes directly to the Mercatus Center's mission of advancing scholarship that seeks to understand the institutions, policies, and habits that support a free, prosperous, and civil society.

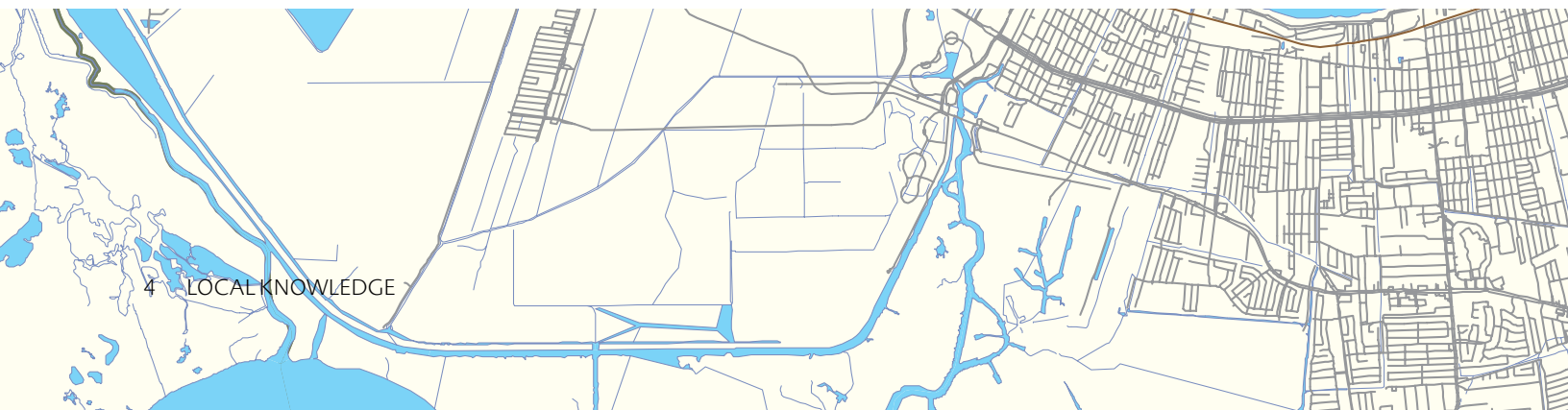
A number of challenges have plagued recovery efforts in the Gulf Coast. First, the magnitude of the storm—damage estimates range from \$100 billion to \$200 billion, debris totaled some thirty-five times that generated by the September 11 attacks in Manhattan, and the area affected is twice the size of England—is a major factor. Second, neither Louisiana nor Mississippi are models of excellent government. Both states have suffered from decades of poor public institutions and the resulting poverty, and both states are dependent on Washington DC, taking substantially more from federal coffers than they put into them. And finally, the folly of man compounded the fury of nature as a variety of well-intentioned state and federal policies encouraged risky building practices, increasing the number of people in harm's way.

Politics, economics, and society are embedded and inexo-

rably connected. In order to understand how any of these sectors function, we must understand the others; the study of the commercial sector, non-profit sector, and public sector must be taken together since the actions of each sector affect the others. To that end, we are examining the responses of all three sectors since Katrina, trying to better understand how, why, and where each sector is succeeding and failing.

This volume brings together the work of a team of scholars that addresses these questions: What's working in the commercial sector in post-Katrina recovery? Why is it working? How can public policy better support the critical role that commercial actors, from small entrepreneurs to large companies, play in responding to disasters and rebuilding communities? The studies contained in this volume, which are based on academic research conducted as part of our five-year project in the Gulf Coast, speak not just to the particular questions associated with Katrina, but to larger implications for future disasters—and to human society as a whole.

In the immediate aftermath of Hurricane Katrina, entrepreneurs and the commercial sector played a critical role in bringing much-needed supplies into the hardest hit areas. Through the lens of Wal-Mart's response to the hurricane, Steven Horwitz discusses what the commercial sector can do in disaster response and how government policy can support the commercial sector's strengths. In a similar vein, Russell Sobel and Peter Leeson apply Nobel laureate F.A. Hayek's insights about the role of knowledge in society to disaster response and look at the institutions that create and





communicate knowledge in the chaotic hours and days after a disaster strikes.

In the over 350 interviews we have conducted with people in Louisiana and Mississippi, we have seen no want of entrepreneurial spirit. What is lacking is an institutional framework that supports these entrepreneurs who are improving their communities by creating jobs and wealth, signaling the return of vibrant neighborhoods, and seeking ways to bring new ideas, energy, and resources to bear. Bruce Yandle and Jody Lipford offer insights as to how Louisiana can improve its economic climate and public policies to encourage more entrepreneurship. Frederic Sautet explains more broadly the important role that entrepreneurs play in post-disaster rebuilding as coordinators of energies and resources.

But getting right the policies and institutions that offer critical support to these entrepreneurs is tricky. Veronique de Rugy evaluates the Small Business Administration's disaster business loan program and looks at the ways the public policy can best support entrepreneurs in communities affected by disaster.

Preparing for disaster is also critical to unleashing a vigorous response. Daniel Sutter explains the unique role of insurance in encouraging resiliency, examines the role that insurance regulations play in disaster, and suggests how state and federal regulations can encourage smarter development and more resilient societies. The volume concludes with policy recommendations that our research suggests will increase social resilience and create the conditions for the most rapid

and robust recovery possible after future disasters.

In 1848, the great British economist, philosopher, and parliamentarian John Stuart Mill observed in his *Principles of Political Economy* that the energies of the people in area affected by disasters, when combined with access to capital and labor, spearheaded quick recoveries. He writes:

This perpetual consumption and reproduction of capital afford the explanation of what has so often excited wonder, the great rapidity with which countries recover from a state of devastation; the disappearance, in a short time, of all traces of the mischiefs done by earthquakes, floods, hurricanes, and the ravages of war.

Our task, then, is to test Mill's hypothesis that the rapidity of a recovery depends most of all on the know-how of the population. As the title of this volume suggests, local knowledge is critical to rebuilding the Gulf Coast and promoting sustainable recoveries. We hope this volume explains why this is so and what it tells us about how to better protect ourselves from future threats.

Peter J. Boettke, PhD
University Professor and Professor of Economics,
George Mason University
BB&T Professor for the Study of Capitalism and Research
Director, Mercatus Center



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REBUILDING THE GULF COAST: ENTREPRENEURS

Throughout Louisiana and Mississippi, entrepreneurs are rebuilding their communities. In this volume, you will read research that draws on interviews with over 400 people of all walks of life in Louisiana and Mississippi. This research explains *what* entrepreneurship is. It discusses *how* entrepreneurs and their businesses play a critical role in the response to and recovery after disasters. It details *where* and *when* they have played key parts.

In this volume, you will also meet six people who are using entrepreneurship to rebuild their communities. These case studies give the entrepreneurs themselves the opportunity to explain *who* they are and *why* they do what they do.

These six entrepreneurs could not differ more. Two are in New Orleans; three are in Chalmette; and one is in Mississippi. Four are men; two are women. Two are immigrants to the United States. Five had their businesses before Katrina; one discovered his opportunity after the storm. Some have families; some do not. Some are serial entrepreneurs; others have poured their heart and soul into their current work for years, even decades.

These six entrepreneurs could not be more similar. They share a talent for discovering opportunities, a passion for their work, and a love of their communities. They play critical roles in helping their neighborhoods and cities rebound after the most costly natural disaster in American history.

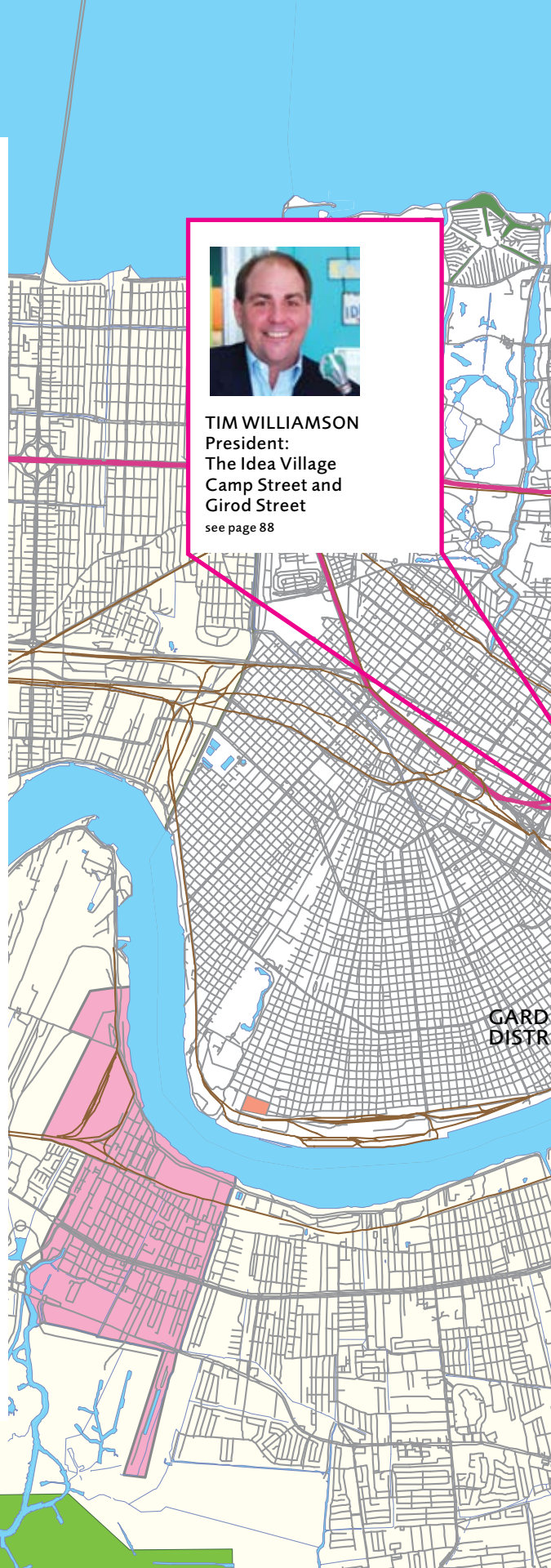
There is no one-size-fits-all plan for disaster recovery. A successful recovery is as unique as the disaster that precipitated it. All disaster recoveries are different.

But one crucial aspect that all successful disaster recoveries share is entrepreneurship, people acting within their communities and local economies to identify and address the needs of their fellow citizens. The entrepreneurs profiled here embody six examples of what is working in post-Katrina recovery and offer insights for fellow entrepreneurs facing other disasters.

Daniel M. Rothschild
Project Director



TIM WILLIAMSON
President:
The Idea Village
Camp Street and
Girod Street
see page 88





CASEY KASIM
Owner: Discount Zone
St. Claude Avenue and
Reynes Street
see page 36



RONDA DEFOREST
Owner: Flour Power
Paris Road and East
Moreau Street
see page 72



BEN CICEK
Owner: Da Parish
Coffee House
Judge Perez Drive
and Paris Road
see page 56

FRENCH
QUARTER

LOWER
NINTH
WARD

ST. BERNARD
PARISH



LUIS COLMENARES
Artist
Jean Lafitte Parkway
see page 100



ALICIA COOL
Owner: Bloomers Flowers
Highway 90, Bay St.
Louis, MS
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NORTH




Ventures in Rebuilding: The Role of Entrepreneurship in the Post-Disaster Context



Disasters radically change people's lives and an area's economic environment. Policy makers must decide which policies are most likely to help people rebuild their lives and the area's infrastructure and economy. The best option for policy makers is to unleash the forces of entrepreneurship. The ingenuity of entrepreneurs can make a significant difference in whether a disaster-stricken area rebounds or stagnates.

Frederic Sautet



A FEW DAYS after Hurricane Katrina wiped out her store, Alicia Cool returned, cleaned out her shop, replaced the walls and carpets, and purchased new merchandise. Six months later, her sales were double what they were a year earlier. Given her success in a post-disaster environment, one might think that Ms. Cool is in the business of home repair or construction or that she sells food. Actually, she is a florist. She thought that in the chaotic world that followed the Gulf Coast hurricanes of 2005, people would still want flowers in their lives, and she was right.

Ms. Cool is not just a florist. She is one from the legions of entrepreneurs who are putting commercial life back together in the Gulf Coast after Hurricane Katrina. Disasters radically change people's lives and an area's economic environment. Some people lose their sources of income while simultaneously facing huge expenditures to make their homes habitable again. Others lose parts of their customer bases as people decide to leave the disaster-stricken area.

In such situations, policy makers must decide which policies are most likely to help people rebuild their lives and the area's infrastructure and economy. The best option for policy makers is to unleash the forces of entrepreneurship. Because entrepreneurs have better incentives than government officials do to identify problems and provide solutions, the more

chaotic a society is, the more it needs entrepreneurs to put it back on track. While post-disaster communities present institutional and policy challenges, the ingenuity of entrepreneurs can make a significant difference in whether a disaster-stricken area rebounds or stagnates.

What is Entrepreneurship?

ALTHOUGH IT IS often associated with the creation of new businesses, entrepreneurship encompasses more than just business start-ups. Fundamentally, entrepreneurship is the discovery of novelty. Entrepreneurs are those who develop new views and ideas and introduce them to society. As economists put it, entrepreneurial discovery is the discovery of gains from trade that were hitherto unknown to market participants. The entrepreneur offers new possibilities for trading in the market that no one previously knew.

To get a better sense of what entrepreneurial discovery means, consider an example from a situation without markets.¹ Crusoe goes fishing every morning with a line he salvaged from the shipwreck. This fishing method is not very productive: He spends two hours on average before he catches a fish. As he ponders his plight, Crusoe notices that there are vines around the island. Some of them are very big, but others are thin and quite sturdy. He realizes that, by carefully arranging a number of well-chosen vines, he might be able to make a net and use it to improve his productivity while fishing. Implementing this idea takes a good deal of work and time. He has to find the right vines and assemble them in a way that enables him to catch the size of fish he wants. Also, he is not sure how long the vines will last in the water. They may just dissolve and prove to be inadequate for net building. After a few experiments though, he is in possession of a fully functioning net that enables him to catch on average five fish an hour. In other words, his productivity has gone up tenfold.

Crusoe has deployed available resources (the vines as well as his own time and energy) to increase his productivity. It may be tempting to ascribe his increased productivity

Fundamentally, entrepreneurship is the discovery of novelty. Entrepreneurs are those who develop new views and ideas and introduce them to society.

entirely to the resources used in constructing the net. Yet, in a deeper sense, constructing a net resulted from Crusoe's idea, not from those resources. Without the idea, Crusoe would not have perceived the vines, his time, and his energy as potential resources. It was his initial idea that changed his fishing method and productivity.

Crusoe's idea is an entrepreneurial discovery. Crusoe is an entrepreneur not because he deployed resources to build the net but because he conceived of the idea of a net in the first place. While the crucial aspect of entrepreneurship is the discovery of ideas,² an entrepreneur is seldom only a pure discoverer. Indeed, he is also often a manager who enacts his own ideas, hence the general perception of the entrepreneur as someone who creates businesses.

What is the Role of Entrepreneurship in Society?

THE CRUSOE EXAMPLE illustrates the *function* of entrepreneurship in human action, but it does not illustrate the role of entrepreneurship in society—especially in the context of post-disaster recovery. Understanding the societal role of entrepreneurship starts with recognition of the “knowledge problem” in society. The knowledge necessary to coordinate all human activities (e.g., what needs to be produced and by whom) is dispersed among all the individuals in society and is not known to anyone in its totality.³ Individuals need a way

1. For a lengthier presentation, see Israel Kirzner and Frederic Sautet, *The Nature and Role of Entrepreneurship in Markets: Implications for Policy*, Mercatus Policy Series, Policy Primer 4, (Arlington, VA: Mercatus Center at George Mason University, 2006).
2. This is especially important because of the way in which entrepreneurial discovery links to prices and profit.
3. The reference work on the subject is F. A. Hayek's seminal article on knowledge. See Friedrich A. Hayek, “The Use of Knowledge in Society,” *Individualism and Economic Order* (Chicago: The University of Chicago Press, 1945). On the issue of the knowledge problem as applied to post-disaster situations, see also Steven Horwitz, *Making Hurricane Response More Effective*, Mercatus Policy Series, Policy Comment 17 (Arlington, VA: Mercatus Center at George Mason University, 2008).



to reveal and marshal that knowledge (or parts thereof) to enable coordination within the division of labor.

Within the right institutional context, entrepreneurship is the key element that reveals such knowledge. Entrepreneurs can perform this feat because they are guided by monetary profit within the context of market prices. Prices never contain all the information possible, only part of it; entrepreneurs discover the missing knowledge in the form of opportunities for monetary profit. Monetary profit plays two vital roles in markets: It reveals instances where people would benefit from trading and guides entrepreneurs who otherwise would be in the dark. Profit acts like a magnetic field, attracting entrepreneurial attention to situations where the market is poorly served. By acting upon their discoveries, entrepreneurs help reveal knowledge that benefits society, thereby mitigating the knowledge problem. Consider the following example.

The price of Braeburn apples is \$3 per pound in Arlington, VA and \$1 per pound in Richmond, VA. People do not know about this price difference, but Mr. MacIntosh, a traveler between the two places, notices it. He wonders whether the difference would remain once all the costs are accounted. He gathers information and realizes that his entrepreneurial inkling is right. Transport and other costs amount to \$1.60 per pound. Even with the addition of these costs, there is still a difference of 40 cents between the two locations. MacIntosh can buy apples at \$1 per pound in Richmond, sell them for \$2.90 in Arlington, and make a profit of 30 cents per pound.

This example sheds light on two vital roles of the entrepreneur. First, the entrepreneur lowers the price of goods. If MacIntosh were to try to sell his Braeburn apples for \$3 in Arlington, it would be harder for him to dislodge incumbents. Instead, he uses his lower cost structure to reduce his selling price below the current market price and snatch the market under his competitors' feet. Competition forces entrepreneurs to "do better" in order to pocket the profit they have discovered.

Second, when the entrepreneur lowers the prices of goods, consumers have extra money to use in other activities. Thanks to MacIntosh, Arlington consumers who eat Braeburn apples will save money, freeing their dollars for other consumption or investment. In this sense, entrepreneurial

competition is an ongoing process that enables people to economize on resources and to invest in new production, thereby gradually improving living standards.

If people are free to enter the market and compete to buy and sell apples, eventually the competitive environment will squeeze out the MacIntosh's 30-cents-per-pound profit. New entrepreneurs noticing the profit will take advantage of the price differential and push down the retail price in Arlington toward \$2.60 per pound. At this price, no profit is left, but competition will keep the market going. For instance, to keep earning a profit on Braeburn apples, entrepreneurs will use new and cheaper means of transport between Richmond and Arlington or improve the way in which farmers grow the apples. This competition never stops because profit opportunities can be found everywhere.

This example describes what economists call the entrepreneurial process of competition.⁴ This process is fundamental to the way markets work to mitigate the knowledge problem. Through competition, innovation spreads throughout markets, new capital is put to use, and productivity increases. This whole process leads to economic growth (i.e., higher income per capita) and rests entirely on entrepreneurial discovery.

The Conditions for Entrepreneurial Discovery

ENTREPRENEURSHIP CAN OCCUR in many different contexts. The motivation to discover and resolve needs is not linked solely to the desire for financial gain. People can discover things for multiple reasons, starting with the sheer desire to help others, like the social entrepreneurs in post-Katrina New Orleans who are volunteering their time and money to

4. On this subject, see Israel Kirzner, *Competition and Entrepreneurship* (Chicago: University of Chicago Press, 1973).



help rebuild the city.⁵ This article, however, makes the point that only with monetary profit as motivation and guide will entrepreneurs *systematically* discover situations where people could benefit from trade. In that sense, for-profit entrepreneurship is essential to markets in general and to recovery in post-disaster situations in particular. For-profit entrepreneurs are needed to recreate the economic backbone from which social entrepreneurs can operate.

The U.S. economy is a very entrepreneurial economy by any measure (e.g., the number of start-ups, the amount of intellectual property).⁶ Indeed, the American population is, by and large, entrepreneurially minded. Yet, the salient fact about the U.S. economy is not so much that there are many entrepreneurs, but that there is plenty of socially beneficial entrepreneurship.

Socially beneficial entrepreneurship creates net value for all the parties involved and beyond.⁷ Whether entrepreneurial discovery is socially beneficial depends largely on the conditions within which it takes place.⁸ Entrepreneurs are never in short supply. There are always creative individuals who discover new ways of doing things. The question is one of channeling entrepreneurial activity in the right direction. Society's institutions, as well as its norms, determine to a large extent the nature of the entrepreneurial outcome.⁹ For instance, if a society's institutions do not adequately punish

theft, fraud, corruption, or other illicit transfers, some entrepreneurs will use those avenues to acquire resources. However, if these institutions punish illicit transfers and protect trade and commerce, the latter will flourish. Moreover, socially beneficial entrepreneurship exists when entrepreneurs believe that gains from trade are safe from predation. Only when they can safeguard monetary profits will entrepreneurs reallocate resources to exploit their discoveries. Thus, the socially beneficial entrepreneurial discovery process rests on the existence and enforcement of property rights and contracts.

The U.S. economy is rich in socially beneficial entrepreneurship because U.S. institutions and policies enable entrepreneurs to exploit their discoveries and to benefit from them. This is thanks to the clear definition and enforcement of private property, contract, and tort law, as well as other laws and social norms that facilitate trade. Indeed, while the fundamental laws of the land matter immensely, society only works if people follow the laws. In the United States, most people are law-abiding citizens who hold cultural norms conducive to market exchange and the introduction of novelty.

Government policies can also play an important part in the type of entrepreneurship that emerges in society. Taxes and regulation can affect entrepreneurial discovery negatively. By imposing extra costs on a given activity, taxes and regulation can divert entrepreneurial discoveries to less socially valuable outcomes. Gains from trade that could have been realized are left unexploited. Imagine in the Braeburn example above that Arlington County decides to levy a special sales tax of 40 cents per pound on all apples sold in the county (in addition to other taxes). In such a scenario, the profit that MacIntosh discovered has suddenly disappeared. Gains from trade that could have come into existence vanish, and apple consumers are worse off as a result.

These same scenarios also occur when the government regulates prices or the economy is highly inflationary. More-

5. On this theme, see Emily Chamlee-Wright and Virgil Storr, *The Entrepreneur's Role in Post-Disaster Community Recovery: Implications for Post-Disaster Recovery Policy*, Mercatus Policy Series, Policy Primer 6 (Arlington, VA: Mercatus at George Mason University, 2008).

6. There are many ways to attempt to measure entrepreneurial activity. See for instance, *The Global Entrepreneurship Monitor* (<http://www.gemconsortium.org>) which focuses on start-ups and the reasons why people engage in the process of starting a business.

7. Not all entrepreneurial activities are socially beneficial. Some entrepreneurial discoveries do not create value for everyone, such as in cases of fraud or theft. A thief can discover new ways of stealing goods or money, but these methods create value only for the thief himself and not for those from whom he steals the resources.

8. See William Baumol, "Entrepreneurship: Productive, Unproductive, and Destructive," *Journal of Political Economy* 98, no.5 (1990): 893–921.

9. The notion of "institutions" is taken to mean social rules (including Common Law and statutes) and their enforcement.

over, when institutions do not compel entrepreneurs to bear the costs of their activities themselves—through subsidies that they receive, for example—entrepreneurial activities may not be as socially beneficial as they could have been had entrepreneurs had to bear all of the costs of their projects.¹⁰

As the Crusoe and MacIntosh examples show, the potential gains of their discoveries motivate entrepreneurs. Moreover, it is the motivation of the entrepreneur to make a profit that leads him to play a socially beneficial role (e.g., selling the same apple for a lower price). In a modern economy, institutions and policies that negatively affect financial gains may reduce the entrepreneur's likelihood of discovering new gains from trade. This means that the coordination of human activity and the gains people derive from engaging in exchange will be lower.

The quality of the institutional framework is vital to the nature of the entrepreneurship that takes place. While it is increasingly regulated, the U.S. economy offers a relatively good environment in which entrepreneurs may exploit their discoveries. The availability of loans and credit through the United States' well-developed financial markets enables entrepreneurs to try all sorts of ventures and test all kinds of ideas. This environment wherein one has great freedom to act upon one's entrepreneurial inklings about the future is what makes the U.S. economy one of the best places to pursue entrepreneurial ideas.

The Economic Conditions of a Post-Disaster Society

WHAT HAPPENS TO the entrepreneurial environment following a disaster? Do post-disaster conditions disrupt it or does it continue to function? The answer to these questions depends first on whether the institutions and norms that enabled socially beneficial entrepreneurial activity to exist before the disaster are still in place after it.

The disaster may have weakened or destroyed some institutions necessary to the smooth functioning of an entrepreneurial society. Overwhelmed with more urgent issues such as deterring looting and keeping crime down, the police

may not be able to enforce property rights everywhere in the immediate aftermath of a disaster. If it is difficult to get access to the courts in the months following a disaster, the enforcement of contracts becomes problematic and may influence the way people contract out for services. These are serious issues because a large part of entrepreneurial activity concerns buying and selling rights over assets using contracts. The weakening of these institutions and norms may shift entrepreneurship towards activities that are less contract-intensive. Moreover, alternative mechanisms that facilitate trade may play a greater role, such as a heavier reliance on reputation.

Financing new entrepreneurial ventures or the rebuilding of one's own destroyed business can be very difficult. Entrepreneurs in a post-disaster situation face different financial constraints. Because of the potential lack of capital, the size of ventures will be smaller. Moreover, it will take time to rebuild and get things back up to speed. Rather than having grand plans for reconstruction, local entrepreneurs will generally cater to the needs of the communities they live in, thereby slowly rebuilding their asset bases.

Many of the entrepreneurs the Mercatus team interviewed in Louisiana and Mississippi used personal savings to refinance their businesses.¹¹ Obtaining outside funding was difficult, even from the federal Small Business Administration (SBA). Many also sought funds from family and business networks outside the devastated area. Some borrowed money from banks and credit card companies, although at much higher interest rates than in normal circumstances. Various government agencies helped recapitalizing businesses with various degrees of success.¹² For instance, Casey Kasim encountered many difficulties in trying to obtain a loan from the SBA to reopen his gas station and build a laundromat.

There seems to be evidence that the institutional environment in post-Katrina New Orleans has weakened and that this weakness affects entrepreneurs. Various people with whom the Mercatus team spoke told stories that showed that the cost of enforcing contracts had gone up. For instance, Lynn Nguyen, a restaurateur, leased a space before Katrina hit the city. After the storm, her landlord told her

10. Subsidies may transfer resources into the hands of entrepreneurs who would not have had otherwise access to them, thereby superseding the market discovery process and potentially misallocating resources.

11. The examples in this article are taken from the fieldwork research Mercatus's scholars and students have done in Louisiana and Mississippi in 2006 and 2007.

12. For a discussion of the role the government may play in financing entrepreneurial ventures in a post-disaster context, see Veronique de Rugy, "Drowning in Bureaucracy" in this volume.



that she could not rent the space anymore. He considered the contract null and void as the result of the hurricane. Ms. Nguyen still considered the contract valid. She wanted to continue running the restaurant in the same location, but she couldn't obtain enforcement of the contract by local courts because the courts were unavailable.¹³ In the end, Ms. Nguyen had to move to a different location.

Ms. Nguyen's situation may not seem like much of a problem, but this kind of behavior creates uncertainty, the effects of which are felt throughout the community. If no one knows how landlords and tenants will act, renting a space for business becomes even more difficult than it already is following a disaster. This uncertainty may cripple recovery.

Other examples point to the difficulty of doing business in the poor regulatory environment that is likely to occur post-disaster. In New Orleans's Ninth Ward, Mr. Kasim reopened his gas station within a few months after Hurri-

cane Katrina, a bold entrepreneurial move considering how much uncertainty there was regarding future population figures. Realizing that many people still did not have electricity and water in the months following the storm (many of his potential customers lived in FEMA trailers), Mr. Kasim decided that cleaning clothes could be a profitable service. He built a laundromat next to his gas station.

Unfortunately, after the laundromat was completed, Mr. Kasim spent weeks waiting for an inspector to sign off on the store's piping. Without the inspector's authorization, the gas company would not deliver the gas that Mr. Kasim needed to supply hot water and run the dryers. As a result, his laundromat sat idle for several weeks when people were in dire need of its services.

Rebuilding is a major economic activity in a post-disaster society. It attracts many entrepreneurs who see opportunities to make money from people who desperately need a roof. In a

13. Immediately after Hurricane Katrina, the Civil District Court records were soaked in water and sewage. The Court didn't reopen until October 2005 and was relocated in Gonzalez, which is 50 miles away.



society with weakened contract enforcement, some contractors may feel free to take money from desperate people and not finish the jobs they have agreed to perform. However, evidence shows that the frequency of fraudulent activity does not increase much in post-disaster situations.¹⁴ While more complaints may be recorded, more jobs are also being performed. Moreover, roofers and other contractors often face severe supply shortages and price volatility. This makes the completion of jobs more difficult and customers less happy.¹⁵

While the institutional environment may worsen in some areas, it may also become friendlier to entrepreneurs in others. Regulations that represented some form of barrier to entry in the market prior to a disaster may not be consis-

tently enforced or may be lifted in the post-disaster situation. This can enable more entrepreneurial activity. Louisiana Governor Kathleen Blanco issued executive orders after the 2005 hurricane season that reduced regulation of entry to various fields such as medical professionals and personnel, towing operators, charter and proprietary schools, and veterinarians. Many new entrants in those markets have contributed to lower prices and increased quality of goods and services.¹⁶

Entrepreneurs as the Coordinating Agents in a Post-Disaster Society

A POST-DISASTER SOCIETY is a chaotic place. Houses and infrastructure may be partially or totally damaged. People's expectations about their everyday lives have changed. Normal things that everyone takes for granted, such as driving on certain roads or perusing the phone book to find a needed company or service, are no longer possible. In other words, the coordination of human activities that existed before the disaster is gone. Instead, people experience a sense of chaos.

The coordination of human activities is necessary in both normal and post-disaster situations. Entrepreneurs are the agents that enable greater coordination to take place.¹⁷ External observers, such as policy makers, have little incentive to accurately identify the problems that people face on the ground because they do not operate on the basis of profit. Entrepreneurs, on the other hand, are motivated by the gains they could obtain identifying problems and finding swift and efficient solutions. They are also sanctioned when they misjudge the situation by losing money. Entrepreneurs act as coordinating agents, bringing society back into a more harmonious situation in the wake of disaster. Thus, the more chaotic the situation is, the more opportunities for entrepreneurs to discover ways to improve everyone's life. Provided some institutions and social norms are still operating, a post-disaster society offers ample scope for entrepreneurship.

14. See David Skarbek, "Occupational Licensing and Asymmetric Information: Post-Hurricane Evidence from Florida," *Cato Journal* 28, no.1 (2008): 73-82.

15. Ibid. Skarbek shows that in spite of the reduction in occupational licensing after the 2004 and 2005 hurricane seasons in Florida, there is no evidence that the quality of jobs decreased.

16. Although not strictly for-profit entrepreneurship, the enormous development of various public and private chartered schools in post-Katrina New Orleans is a very telling example of entrepreneurship.

17. For more on this subject, see Kirzner, *Competition and Entrepreneurship* and Israel Kirzner, *How Markets Work: Disequilibrium, Entrepreneurship, and Discovery* 133 (London: IEA Hobart Paper, 1997).

Indeed, the evidence highlights the vital role of entrepreneurship in post-disaster recovery.¹⁸

One characteristic of a post-disaster society that might affect entrepreneurship is declining population, which can curtail some opportunities for entrepreneurs. The market will be “thinner,” meaning that some of the economies of scale available with a large population are gone. Some businesses will close down (or not be started in the first place) because they are viable with a large customer base.

However, other businesses may emerge to cater to the needs of thinner markets. Following a disaster, people may have greater demand for basic needs.¹⁹ While stores that sell luxury and tourist-oriented goods and services might close, do-it-yourself stores are likely to reopen and develop. For instance, many in St. Bernard Parish credit the reopening of the Home Depot store in Chalmette as critical to community recovery. Because the store had been entirely damaged by water, it reopened aisle by aisle until it was fully cleaned, enabling people in the community to receive needed goods quickly and efficiently.

The problem-solving nature of entrepreneurial activity is what makes it vital to post-disaster recovery. Entrepreneurs will discover opportunities in reconstruction or food retail or whatever is needed on the ground. Entrepreneurs will allocate resources to offer goods and services according to the on-the-ground needs they observe. When they make mistakes in their assessment of the situation, the feedback will be immediate, as they will lose money. This differs from those who operate outside profit, such as government and non-government organizations, and thus lack such immediate feedback.

Many people in New Orleans who were not previously entrepreneurs have started businesses post-Katrina. The changed conditions they faced after the hurricane led them to begin offering products or services to others. Some people,

for instance, have lost their jobs and must find a new way to make a living. Others have no other choice but to develop skills to fix their house and discover they can make a living (at least temporarily) selling their skills to others.²⁰ Take mold remediation. In the weeks that followed Hurricane Katrina, people with experience in dry walling started businesses to cater to others with this problem. In many cases, these entrepreneurs hired Latino immigrants who had come to New Orleans looking for work. Moreover, the price of hiring dry-wall laborers decreased over time, as more and more entrepreneurs entered the market.²¹

The food business has also been very busy. Ben Cicek opened a coffee shop in St. Bernard Parish because he noticed increased traffic in the Parish due to children going to school in a new area. He decided to open a place to offer coffee and breakfast to people on their morning commutes. Mr. Cicek told us that opening his business was simple even though it was located in a place that, prior to Katrina, was not friendly to foreigners (Mr. Cicek is of Turkish origin). This example shows that in dire situations social norms may evolve because the need to trade and rebuild is greater than that of, say, ethnic exclusion. The same is true with Mr. Kasim, who is originally from Iraq. He told us that people in his community were very pleased with his decision to stay and provide gas after the hurricane.²²

As touched upon above, whether and how much of the pre-storm population will return places a limit on the activities of entrepreneurs (and those of the government as well). Indeed, it may be the case, as in New Orleans, that no one really knows whether people are going to stay or leave and if they have left, whether they will return. Migration largely depends on the alternatives that are available elsewhere, the extent of the disaster, and the quality of government policies set in place after the event. However, entrepreneurs can help a community achieve a critical mass of people by reopening

18. Two important examples in which entrepreneurs played an important role are the Great Fire of Chicago in 1871 and the 1906 San Francisco Earthquake.

19. Note that the example of Ms. Cool shows that it is difficult for an external observer to know what these “basic needs” are.

20. While the net change in total employers has been negative in the New Orleans region since the disaster (i.e. there are more employers leaving the region than opening businesses), data also show that more and more new employers have moved in and old ones have returned. See *New Orleans Index*, (2008), Table 24, <http://www.gnocdc.org>.

21. Data on average weekly wages by industry sectors in New Orleans seem to corroborate this view. In the construction sector, the average weekly wage jumped in the last quarter of 2005 to \$1,118 and then progressively went down to \$989 in the third quarter of 2007. As of April 2008, it is not yet back to pre-Katrina level, but the labor market is less tight in 2008 than it was at the end of 2005. See *New Orleans Index*, Table 23

22. For another intriguing example of the need to trade and rebuild overcoming previously held social norms, see Karol Boudreaux, *State Power, Entrepreneurship, and Coffee: The Rwandan Experience*, Mercatus Policy Series, Policy Comment 15 (Arlington, VA: Mercatus Center at George Mason University, 2007).



businesses and providing speedy rebuilding. Because they put their capital on the line, they tend to judge the future state of the economy better than government officials do.

Furthermore, a post-disaster situation wherein entrepreneurs actively reopen businesses and provide new goods and services sends the rest of the population a strong signal: People are committed to living in the place again, and it makes economic sense to come back. This is a much stronger signal when it comes from entrepreneurs than when it comes from government because entrepreneurs are committing their own assets to the future of the area. They are literally putting their money where their mouth is. Moreover, entrepreneurs create jobs, and jobs and businesses strengthen the sense that normalcy can return to an area devastated by disaster.

Conclusion

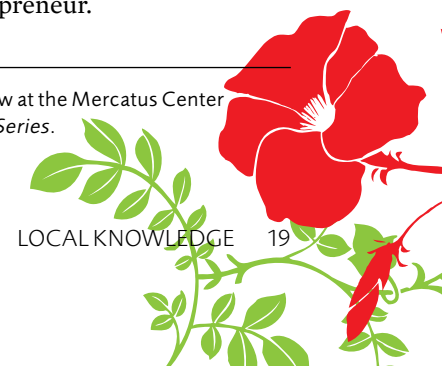
ENTREPRENEURSHIP DERIVES FROM the creative power of the human mind and is the engine of prosperity. In order to foster socially beneficial entrepreneurship in a post-disaster society, policy makers must pay attention to the quality of the institutional framework, as a disaster can affect the functioning of institutions and thus the level of socially desirable entrepreneurship.

However, the paradox is that, barring a complete breakdown in institutions and social norms, profit-driven entrepreneurship is vital to rebuilding post-disaster societies.

Entrepreneurs have access to knowledge on the ground, face strong incentives to identify problems, and provide better solutions than governments (or even non-governmental organizations) do. Reconstruction after a disaster cannot take place without for-profit entrepreneurs. Empowered members of civil society—especially entrepreneurs—increase the chance that successful rebuilding will occur following a disaster, because, among other things, entrepreneurial action signals a return to life as it was.

In the aftermath of a disaster, people thirst for normalcy. They want to buy mundane things that give them a sense that life is back as it was, like flowers. Alicia Cool understood this desire. It was a large part of the reason why she decided to reopen her flower shop. “It was very important for me to get the shop opened,” she said, “since I wanted things to get back to normal, not only for myself, but for the community.” Policy makers might not have imagined that reopening a flower shop was something that the community needed. They would not have intuited that the intangible benefits of a florist’s shop would help revive a community. But the entrepreneurial Ms. Cool did. She discovered the needs of people on the ground and built upon this knowledge in a way that was unavailable to more remote decision makers. She unleashed the power of the entrepreneur.

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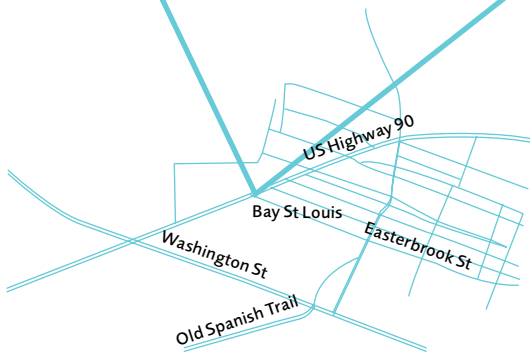




CASE STUDY #1

ALICIA COOL

Owner: Bloomers Flowers
Highway 90, Bay St. Louis, MS



Alicia Cool moved to the Gulf Coast from Atlanta, Georgia. She started her floral design company, Bloomers Flowers, in 1996, and in her words, “it’s been all over the entire Gulf Coast.” After her third child, she reduced her three stores down to one in Bay St. Louis, Mississippi. We interviewed her there in January 2007.

Tell us about your hurricane experience.

I was not here. We chose to leave because . . . we went through George, and that was enough for me to know that I wanted to get out. So we left. We went to Tunica. That’s normally where we evacuate to.

We didn’t know exactly [what had happened] until a couple days afterwards. As soon as the storm had passed, my husband came back down here. We pretty much knew that it was going to be bad just from everything we were hearing on the news.

We did get some water in my neighborhood, but our house is up on a hill. We’re up on a crawl space too, so we got probably a couple of inches. So we were able to offer some shelter to some neighbors that were down below us that got eight foot of water.

I think we fared pretty well and that was a blessing. The business here got about three and a half feet of water. It came in and left, and it was kind of strange. There were high area water marks. There were low area water marks, and so we’re not exactly sure what the final count was. But it was strange. Everything got water.

So essentially, everything in your business was wiped out?

Yeah, just about everything. Things that were up relatively high on the walls, we were able to salvage but for the most part everything was destroyed. By the time we got here to clean up, several weeks had gone by. My husband said just don’t come back. There was just a state of chaos—for lack of a better word—here so he said, “Don’t bother coming back. I’ll call you when you can come back.” So probably about six, seven weeks later, my mother-in-law who owns the store with me came back and started cleaning. By that time the mold had taken over—it was pretty disgusting.

Again, so you came back, and did you focus on building both the business and home at the same time?

Well, we started on the business first. Because I think without business you can’t have people wanting to come back and stay here so we focused primarily on business—getting it up and running so that we would also have an income to live and build our house back. And then we started on the house. We were also waiting for a FEMA trailer for a couple of weeks. So we just hopped right in and got in here.

Tell me a little bit about your recovery period. What did you have? Were you adequately insured?

We [thought we had] adequate insurance. We didn’t need flood insurance because we weren’t in a flood zone. But because it was a hurricane, nothing was covered. We were caught in the rigamarole of that whole battle over what’s covered, what’s not covered, what are we going to pay, what are we not going to pay. We wound up getting about \$15,000 total, and that was because we had a fence and an outside structure and things like that that were covered. So that helped us get back on our feet again a little bit. The business itself here got nothing. We fought with the insu-

rance company just to get \$1,000 out of business coverage and so the total coverage that we got paid for this shop was \$1,000. We did everything else ourselves.

So did you apply for any SBA loans? Or federal assistance?

We applied. We got a bridge loan through a bank that was to buy some supplies to get us going again and that was enough just to start. You know, elbow grease and a lot of effort is worth more than money is.

How do you think government is handling the situation?

Our local leaders did an excellent job. I wasn't a huge fan of Eddie Favre, the mayor [of Bay St. Louis], before the storm because I wasn't from here. He's a good old boy, and that's great here because this is a good old boy town. But I'm not from here so I didn't connect with that. But after the storm I realized that he probably was the best man for the job when all this happened, and I'm impressed with how he handled everything and is still handling things. So now I'm an Eddie Favre fan.

What about the state and federal level?

I think that before the storm he [Mississippi governor, Haley Barbour] made a great call, putting us on notice early enough to get help as soon as we could. It would have been nice to have it earlier. It took about a week to get some real help in here. But I understand that things happen, and this was an experience for everybody, so maybe next time help will get here a little faster.

As far as the national level, I think there's a lot of bureaucratic crap. There's just entirely too much red tape to go through to get funds to the people immediately. I think the biggest thing that I kept hearing over and over again after the storm was that we can go and rebuild Iraq but we can't rebuild our own country. That's true, and that's disturbing to me.

You've said that this was a very competitive business environment before. What's the competition like now?

There isn't a whole lot of competition right now. There is another flower shop that has opened in town, and we try to send him business to kind of keep him going because I do like some competition. I don't want to be the only name in town. I'm hoping more will come.

After the storm, a few [stores] were the first names back. Everybody was drawn to you just because you were the first back. We were the first retail store so people would just come in here. A *lot* of people came in here. Not always to shop. But just to see some normalcy. To feel that things were getting back to normal. We opened in the end of October [2005]. It was really pretty quick after the storm, and it was nice because we redid our walls green and pink. It was bright. People would come in here and say, "Thank God, something looks normal around here." So that was nice. And with that happening, we became the only flower shop, the only boutique in town. So we made a name for ourselves and are very busy now.

What do you think is keeping the other competition away?

They're scared to open up. It's tough for someone just to open up. It's a different market now. You don't have the same types of purchases. We've had to kind of re-invent ourselves in some different areas. We have a party room here that we're going to be closing down and going to a gift basket division in a corporate level because it just seems to be where the market is taking us. So we're trying to reinvent some things to stay ahead of the game, and I think for the average Joe, that's difficult. Even if you're in business to do it—but to come into a community and kind of judge where things are going, it's difficult.

How has your business grown?

The corporate aspect has just gone through the roof. With us being the only store here, nobody really had anybody else to go to. So now we handle a lot of casino accounts, a lot of amenity baskets. We handle the flowers now of a lot of big names corporations. We actually formed a different company to encompass this, and that's lots of different employees.

How did your corporate accounts find you?

DuPont was our first corporate client after the storm. They are a big-time proponent of local business—a requirement for doing business with them is that you are local. They found that we were open; they used us; they loved us. We got on their list.

We had a caterer friend that was doing some things for Harrah's. He recommended us. We did a job for Harrah's, and then they stopped using their out-of-town people and started using us primarily.

It just built from there because we started getting references and word-of-mouth advertising.

We've talked to people who work with a lot of small businesses, and one of the things they talked about is how important a network is. Tell me about your network in terms of who your network was before, what happened, how you pieced it back together.

Of course, I had friends that had been in the floral industry with me for years, but right after the storm I couldn't find them and really had no way of getting in touch with them. The wholesaler that I used, that we have here locally, I couldn't even get in touch with him to find out where people were.

[For example,] we live an hour from Ocean Springs. If I have an order coming in [for Ocean Springs], and I can't find the lady that I normally would send that order to, that order just doesn't get taken. That's frustrating because normally I'm able to help clients regardless of what they need.

So losing touch with people was probably one of the hardest things. I kind of just threw up my hands and said, "I'm sorry I can't help you." I'm not used to doing that.

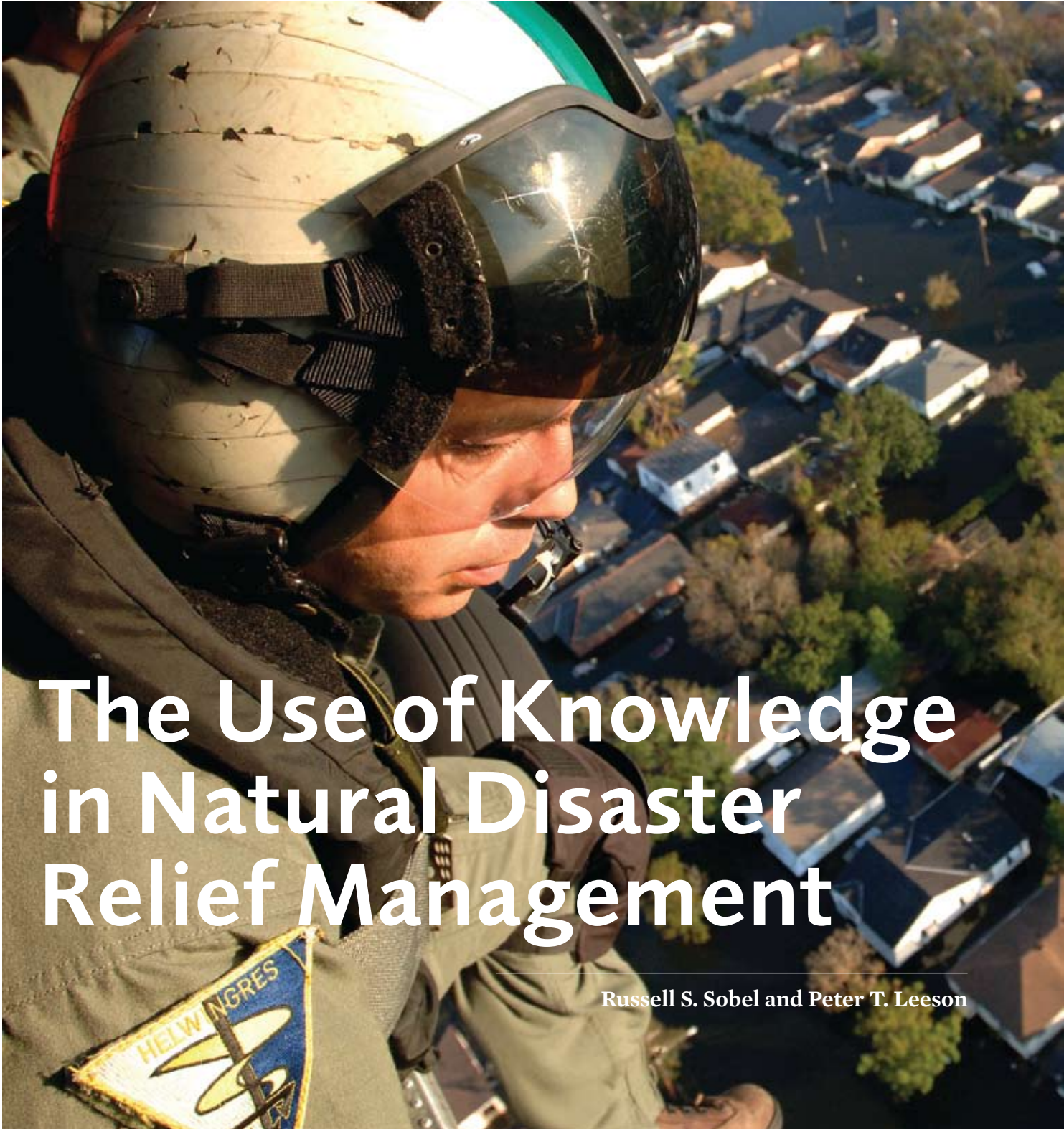
[The situation changed when] the wholesaler that was in Gulfport came back. As he started coming back, local florists started getting in touch with him. Then I was able to contact him and see who was going to open back up and whom I could send my clients to.

Has your business helped you with getting some normalcy in other areas of your life, like your family?

Wow, I would think that my family was probably insane until we got back into our house. I don't think that work offered any sort of stability for us because it was so busy and so—we were just all over the place between me trying to work here in the shop, handle the corporate clients, try and rebuild our house, try and keep the family together. It was absolute chaos and insanity for months.


Photo: Billy Herron





The Use of Knowledge in Natural Disaster Relief Management

Russell S. Sobel and Peter T. Leeson



The provision of effective natural disaster relief has three key components: (1) identifying a disaster; (2) determining who needs what relief; and (3) evaluating on-going relief efforts. Given these components, we wonder who does a better job of providing disaster relief: the government or the private sector?

MORE THAN SIXTY years ago, F. A. Hayek identified the problem of social coordination in his seminal article, “The Use of Knowledge in Society.”

The peculiar character of the problem of a rational economic order is determined precisely by the fact that the knowledge of the circumstances of which we must make use never exists in concentrated or integrated form, but solely as the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess. The economic problem of society is thus not merely a problem of how to allocate “given” resources—if “given” is taken to mean given to a single mind which deliberately solves the problem set by these “data.” It is rather a problem of how to secure the best use of resources known to any of the members of society, for ends whose relative importance only those individuals know. Or, to put it briefly, it is a problem of the utilization of knowledge not given to anyone in its totality.¹

Hayek’s critical insight, later called “the knowledge problem,” highlighted two central features of social organization. First, every society confronts a “division of knowledge” analogous in many respects to the “division of labor.” Information is fragmented, diverse, and often contained in inarticulate forms, held separately and locally by the many individuals who compose society. Second, the foremost obstacle that every effort at social coordination must overcome is somehow tapping into this dispersed information and processing it in forms that individuals can use to achieve their ends mutually.

In this article, we investigate natural-disaster management, using Hayek’s key insight about the fundamental “knowledge problem” that all efforts to coordinate social activity must solve. We argue that natural-disaster manage-

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1. F. A. Hayek, “The Use of Knowledge in Society,” *American Economic Review* 35, no. 4 (1945): 519–20.

ment is no different in this regard than the coordination of individuals in “normal” economic contexts.

Following a natural disaster, on the one side, there are “relief demanders”—individuals who desperately need disaster-relief supplies, including evacuation, food, shelter, medical attention, and so forth. On the other side, there are “relief suppliers”—individuals ready and willing to bring their supplies and expertise to bear in meeting the relief demanders’ needs. On both sides of this “market,” information is decentralized, local, and often inarticulate. Relief demanders know when relief is needed, what they need, and in what quantities, but they do not necessarily know who has the relief supplies they require or how to obtain them. Similarly, relief suppliers know what relief supplies they

We find that decentralized, private decision making effectively generates the appropriate knowledge at each stage. Centralized, political decision making, in contrast, by its very nature cannot do so.

have and how they can help, but they may be largely unaware of whether relief is required and, if it is, what is needed, by whom, and in what locations and quantities.

We argue that effective natural-disaster relief management, just like successful social coordination in “normal” circumstances, must solve Hayek’s knowledge problem. Specifically, effective disaster management requires efficient information generation at three critical stages. The first is the recognition stage: Has a disaster occurred, how severe is it, and is relief needed? The second is the needs assessment and allocation stage: What relief supplies are needed, who has them readily available, and what areas and individuals need them the most? The third stage is the feedback and evaluation stage: Are our disaster-relief activities working, and what—if anything—needs modification?

Hayek suggested a solution to the knowledge problem in

the context of economic decision-making in general. Given information’s decentralized nature and its importance in achieving social coordination, he argued that it was important to allow decentralized private actors, such as those participating in markets, to direct the bulk of economic decision-making. Unlike markets, central planning has no way of tapping into this information in a productive way, as Hayek argued.

If we can agree that the economic problem of society is mainly one of rapid adaptation to changes in the particular circumstances of time and place, it would seem to follow that the ultimate decisions must be left to the people who are familiar with these circumstances, who know directly of the relevant changes, and of the resources immediately available to meet them. We cannot expect that this problem will be solved by first communicating all this knowledge to a central board which, after integrating all knowledge, issues its orders. We must solve it by some form of decentralization.²

Using Hayek’s insight, we compare the government’s ability and the private sector’s ability to generate the appropriate knowledge at each of the three critical disaster-management information stages.³ Consistent with Hayek’s argument, we find that decentralized, private decision making effectively generates the appropriate knowledge at each stage. Centralized, political decision making, in contrast, by its very nature cannot do so.

Our analysis points to information acquisition and exploitation as the fundamental failures of government’s disaster-relief management. Government’s informational deficit in the disaster-relief context is an unavoidable outcome of the centralization of disaster-relief management when relief is provided by the state. Disaster-relief reforms that leave government as the primary manager of natural disasters are thus bound to fail. Correcting government’s information failure in the context of disaster relief requires eliminating its root cause: government involvement itself. Although our discussion focuses specifically on Hurricane Katrina, the information issues we analyze provide important general lessons about disaster-relief management.

2. Hayek, “The Use of Knowledge in Society,” 524.

3. The arguments in this article build on and extend discussions in Russell S. Sobel, and Peter T. Leeson, “Flirting with Disaster: The Inherent Problems with FEMA,” *Policy Analysis*, no. 573 (2006) and Russell S. Sobel and Peter T. Leeson, “Government’s Response to Hurricane Katrina: A Public Choice Analysis,” *Public Choice* 127, nos. 1–2 (2000): 55–73.



Information Stage One: What Disaster?

INFORMATION DEPENDS FUNDAMENTALLY on the institutional context in which it is created. All institutional contexts develop some kind of information, but very few generate the kind needed to coordinate spatially and temporally separated suppliers and demanders. In the context of disaster relief, the first piece of critical information involves whether a disaster has occurred and thus whether relief assistance is needed.

Information about the occurrence of a disaster and the need for disaster relief might seem straightforward. However, when disaster-relief management is politically centralized, it is often not. Perhaps surprisingly, the vast majority of disasters declared over the past decade have been for weather events that most people would not consider disasters at all, such as severe thunderstorms, wind, and snow.⁴ However, some seemingly major disasters have gone undeclared. The disaster declaration process is clearly more complex and subjective than it first appears.

When disaster relief is centralized and managed by government, it necessarily becomes bureaucratized. Government agencies such as the Federal Emergency Management Agency (FEMA) are created to oversee and administer relief.

These agencies, in turn, are overseen by other government agencies, each with its own internal bureaucracies, and so on. Following organizational changes after 9/11, for example, FEMA was placed under the umbrella of the Department of Homeland Security, adding new political decision-makers to the mix. The layers of bureaucracy ultimately end at some key administrative figure—the president, in the case of disaster relief—who must declare a disaster before FEMA can act. At each level of the bureaucratic process, a key political decision-maker must give his approval before a proposed action may be considered at the next layer of the bureaucracy.

Bureaucracy is a necessary and unavoidable outgrowth of state-run activities. It is necessary because government agencies, unlike private firms, whose activities are guided by profit seeking, have no such guide.⁵ Private firms seek profits and consequently have but one rule for their managers: maximize profits. Managers who contribute to the firm's goal and make profits can be rewarded and retained, whereas those who do not contribute can be punished or released. Owners' ability to measure managers' contribution to this goal rests on monetary profits and losses.

Government agencies, in contrast, cannot make do with one rule for their "political managers." Because these agencies do not seek to make profits and do not sell anything, they

4. Thomas A. Garrett, and Russell S. Sobel, "The Political Economy of FEMA Disaster Payments," *Economic Inquiry* 41, no. 3 (2003): 496–509.

5. Ludwig von Mises, *Bureaucracy* (New Haven, CT: Yale University Press, 1944).



cracy. In lieu of the profit objective, detailed procedures and protocols must be used to guide and check political managers' behavior.

Although bureaucracy is inherent and essential to government agencies for this purpose, it does not follow that all of its effects are positive. Detailed protocols that involve multiple layers of approval before action may be undertaken prevent political agents from engaging in activities at odds with the agency's ends and substantially slow government activities and information revelation. In the declaration of a natural disaster, for example, information that a disaster that requires relief attention has occurred does not emerge, from government's perspective, until the protocol for disaster declaration has been carried to its conclusion.

For political actors charged with relieving disaster, no disaster exists until the president, who is reached in the final stage of the bureaucratic procedure, has officially

cannot use profits or losses to direct managers' activities and to ensure that managers contribute to the agency's goal. Therefore, some other guide for manager decisions and some other mechanism for checking political agents' behavior must be employed. As Gordon Tullock puts it, in the absence of the profit-and-loss system to measure and ensure that political managers undertake activities that contribute to their agency's goal, "The central problem . . . is organizing subordinate politicians so that they, to the greatest degree possible, will behave as their superiors want them to behave."⁶ The political mechanism for achieving this objective is bureau-

declared it, even if a disaster that requires public assistance has already struck and is readily acknowledged and visible in the news media. Unavoidable bureaucracy inherent to government management creates a separation between what might be called "private knowledge" of disaster and "political knowledge" of the same disaster.

This bureaucracy-spawned "knowledge wedge" severely limits the goals that government can achieve successfully. According to Tullock, "These limits, it should be emphasized, are limits on what can be done, not on the size of the bureaucracies that can be built. Furthermore, these limits

6. Charles Rowley, ed., "Bureaucracy," *The Selected Works of Gordon Tullock* (Indianapolis: Liberty Fund, 2005), 6:132.

are much lower if the task to be accomplished requires a high degree of coordination than if it does not.”⁷ The more monumental the task in terms of coordination, the bigger the bureaucratic knowledge wedge becomes and thus, the less likely government is to complete the task effectively.

The knowledge wedge explains why key government relief management figures, it appears, were not aware of the impending and eventual disaster caused by Hurricane Katrina—at least, they did not officially acknowledge such an awareness—although the citizens of New Orleans, the news media, and countless others were. The secretary of the Department of Homeland Security, Michael Chertoff, for example, did not declare Hurricane Katrina an “incident of national significance” until thirty-six hours after it made landfall, even though on August 27—two days before Katrina’s arrival—the National Hurricane Center had predicted the powerful storm would hit the Gulf Coast.⁸

Government was also painfully unaware of major and fundamental developments in the relief process after Katrina hit land. FEMA director Michael Brown, for instance, became aware that hurricane victims in New Orleans had been moved to one of the city’s convention centers only after a television journalist informed him of this fact. On *Nightline*, Brown admitted, “We just learned of the Convention Center—we being the federal government—today.”⁹

Predictably, but perhaps ironically, the real success stories in the relief effort therefore came from those who ignored FEMA, flouted the bureaucratic decision-making process, and took action without approval. The U.S. Coast Guard, for example, began its helicopter rescue efforts without waiting for any other government agency’s approval or coordination. Its efforts were so successful that the person who led them, Vice Admiral Thad Allen, was chosen as the replacement FEMA director when Michael Brown was relieved of his duties. A Canadian search-and-rescue team from Vancouver, without seeking FEMA permission, arrived in New Orleans days before any FEMA-coordinated units, giving rise to slightly inaccurate but amusing media

accounts of how the Royal Canadian Mounted Police beat the U.S. government into New Orleans.¹⁰

One of the best examples of this voluntary initiative is what we call “the tale of two sheriffs”: Sheriff Warren Evans of Wayne County, Michigan, and Sheriff Dennis Randle of Carroll County, Indiana. Both sheriffs were eager to assist the hurricane victims, and both had control over the necessary resources. Sheriff Evans, on the one hand, ignored both FEMA and his governor’s instructions to wait for FEMA approval and went to New Orleans with nine truckloads of supplies and thirty-three deputies to help.¹¹ Sheriff Randle, on the other hand, followed procedure, was buried under mounds of FEMA paperwork, and faced an un-navigable approval process. He never made it to New Orleans.¹²

Contrasting the government’s ability to learn about disaster with the private sector’s information about the impending situation in New Orleans makes a useful point.

The private-sector planning began before Katrina hit. Home Depot’s “war room” had transferred high-demand items—generators, flashlights, batteries and lumber—to distribution areas surrounding the strike area. Phone companies readied mobile cell towers and sent in generators and fuel. Insurers flew in special teams and set up hotlines to process claims. This planning allowed the firms to resume serving customers in record time. . . . [T]he Business Roundtable had by August of this year arranged for each of its 160 member companies to designate a disaster-relief point man. These folks were in place and ready to help before Katrina made landfall.¹³

Why were private disaster-relief suppliers, such as Home Depot, so much quicker to identify the disaster of Hurricane Katrina and to begin attempting to remedy it? Why did insurance companies, such as State Farm, rent hotel rooms in nearby cities and send insurance agents to the affected areas even before the hurricane hit? Unlike government, private

7. Ibid., 170.

8. Jonathan Landay, Alison Young, and Shannon McCaffrey, “Chertoff Delayed Federal Response, Memo Shows,” *Knight Ridder Newspapers*, September 13, 2005.

9. Tina Susman, “Effort Mired in Bureaucratic Hash,” *Newsday*, September 11, 2005, <http://www.newsday.com>.

10. “What Went Wrong in Hurricane Crisis,” interview by Stone Phillips, *Dateline NBC*, September 9, 2005.

11. Ibid.

12. Ibid.

13. “Private FEMA,” *Wall Street Journal*, September 10, 2005, <http://www.wsj.com>.

organizations are constrained by only one rule: make profits. If a profit opportunity emerges in expectation of or following a natural disaster, private firms such as Home Depot have an incentive to respond immediately to the disaster, and they have the flexibility to do so effectively.

Further, private actors have a much greater incentive to learn about the potential for a disaster in the first place. The first business firm to arrive at a disaster area with provisions for victims stands to benefit handsomely. Even private nonprofit organizations have a strong incentive to identify disasters quickly. The faster they are in place to help those in need, the more likely are potential charitable contributors to give additional money to them.

In markets, a consumer's ability to "exit" and take his business (or charitable donation) elsewhere makes him "king." When a private nonprofit agency fails to respond, its future donations suffer. When a private for-profit firm fails to respond, it loses profit. In government, however, such incentives do not exist. FEMA will continue to use coercive taxation to finance its activities regardless of its performance in any specific relief effort. Dissatisfied taxpayers have no exit option. Within government, the "voice" option of negative media publicity and lost votes for incumbent politicians are the only incentives; there is no threat of bankruptcy.

Information Stage Two: What's Needed and Who Needs it?

AFTER A DISASTER has been identified, the most important information pertains to what's needed, who needs it, and who has the means to meet these needs. Some disaster victims need water, others need shelter, and still others need food. Do the needs differ in various geographic areas? All disaster victims will probably require basic necessities, but the extent to which different individuals need these things will vary. Moreover, not all disaster victims will have an equally critical need for these items. Specific areas may need specific kinds of help, such as rooftop rescues or massive bus evacuations, which are unique and unexpected. Finally, individuals have specialized resources that only they know can solve the diverse problems that emerge in the wake of a disaster.

Consider first how private participants come to discover this information. In the marketplace, the interactions of suppliers and demanders generate market prices for various goods and services. As Hayek pointed out, these prices convey information about localized supply-and-demand conditions, indicating to suppliers where supplies are needed most and communicating to demanders when they may expand consumption (because supplies have become more abundant relative to demand) or curtail consumption (because supplies have become less abundant relative to demand).

Even the charitable activities of private individuals and nonprofit organizations, which suffer somewhat from the absence of market prices to guide them, are likely to be directed toward satisfying the most highly valued needs. Individuals making donations have an incentive and desire to make sure their donations are used effectively and an incentive to search for information about the best use of their donated resources. Nonprofit organizations that are not careful stewards of their donated resources soon find that they have fewer donations to allocate. For-profit firms that choose to be charitable are careful to allocate their resources in a way that generates value because the allocation produces the highest return to the firms in terms of reputation and thus future profits.

Private suppliers of disaster-relief essentials, such as Wal-Mart, were able to bring necessities such as water quickly to relieve the plight of Katrina victims who had been hit the hardest. While FEMA was still busy trying to distinguish between its head and its tail, Wal-Mart was already back in business, providing the items that rescue workers and victims needed, in the right quantities, at their everyday low prices, and sometimes even without charge. Wal-Mart, which has donated more than \$20 million to Hurricane Katrina relief efforts, supplied the essential items hurricane victims and disaster-relief providers needed. "Over \$3 million in supplies were given directly to shelters, providing a lifeline for stranded residents."¹⁴ These supplies included chain saws, boots, sheets, clothes, water, and ice.¹⁵ As one hurricane victim put it, "[Wal-Mart] was the only place we could find water in those first days. . . . I still haven't managed to get through to FEMA. It's hard to say, but you get more justice at Wal-Mart."¹⁶ Wal-Mart's amazing capacity to bring

14. Sean Higgins, "Wal-Mart Is Lauded for Fast Relief Aid to Katrina Victims," *Investor's Business Daily*, September 9, 2005.

15. John Tierney, "Let Wal-Mart Take Over Emergency Management," *New York Times*, September 21, 2005.

16. *Ibid.*



the needed supplies after Hurricane Katrina's devastation had even the staunchest critics of the company praising it.¹⁷

Consider, in contrast, how political decision-makers come to know how to allocate disaster-relief supplies. Unlike the market, the political process does not generate market prices, nor does government have the incentive to be as careful a steward of the resources it hands out to needy victims. For market prices to emerge, goods and services must be bought and sold. However, the government is not selling anything, so political decision-makers do not have market prices directing them to where expenditures are needed most.

Further, government employees have a much weaker incentive than private individuals to seek information about where resources are most urgently needed and to ensure that the resources they allocate create value, even when compared to cases where private parties give away resources. Individuals are simply not as careful with other people's resources as they are with their own. These simple insights from

basic economic theory go a long way in explaining the chaos, confusion, and ultimate failure of FEMA-provided disaster-relief distribution following Hurricane Katrina.

In the first week of relief activities alone, FEMA refused to ship to Mississippi trailers that could be used as temporary housing for disaster victims, turned away critical generators needed by hospitals and victims for producing electrical power, turned away trucks with water demanded by many, prevented the Coast Guard from delivering fuel critical to facilitating recovery activities, and refused Amtrak's offer to evacuate victims who desperately needed to get out of the disaster zone.¹⁸ The last Amtrak train left New Orleans empty.¹⁹ Even the American Bus Association, which represents Greyhound Bus Lines, offered to help FEMA evacuate the Superdome and the Convention Center, but its offer, like so many other overtures of assistance, fell on deaf ears, and the association never received so much as a reply from FEMA officials.²⁰

FEMA's misallocation of relief labor and supplies seemed

17. Higgins, "Wal-Mart Lauded."

18. Democratic National Committee, "Bush's FEMA Turns Natural Disaster into Bureaucratic Disorder," news release, September 7, 2005.

19. Kathleen Parker, "Three Heroes Outwitted Bureaucracy," *New Hampshire Union Leader*, September 14, 2005.

20. Andrew Martin and Andrew Zajac, "Offers of Buses Fell Between the Cracks," *Chicago Tribune*, September 23, 2005, <http://www.chicagotribune.com>.

to have no limit. It moved a medical team of thirty people capable of treating hundreds of hurricane victims from Alabama to Mississippi and then to Texas. For eleven days, medical team members say, their relief activities were reduced to treating one small cut. FEMA then moved them again—everywhere but where they were needed and could accomplish the most, which was in New Orleans.²¹ As one frustrated member lamented, “We joined the team to help people who need it and we are not helping anybody.”²²

In another case of misallocated medical relief, FEMA director Michael Brown received an e-mail on September 2, 2005, describing the dire state of medical care in New Orleans and urgently inquiring about how offered medical supplies could be employed to help hurricane victims most effectively. “Mike, Mickey, and other medical equipment people have a 42-foot trailer full of beds, wheelchairs, oxygen concentrators, etc. They are wanting to take them where they can be used but need direction.”²³ Because of government’s inherent information deficit, Brown’s only response, four days later, was to forward the message to another FEMA bureaucrat with a note that asked quizzically, “Can we use these people?”²⁴

In other critical areas, resources were diverted to superfluous areas or sat idle and unused. A mobile communications unit, which could have provided much-needed equipment to relief workers and victims, for example, sat in Germany, with a chartered private plane ready to leave, for nine days.²⁵ Despite repeated attempts to contact FEMA to get the required permissions to come to New Orleans, these potential problem solvers, like so many others, got no response and eventually gave up trying to bring their resources into the relief effort. The information problem that plagued FEMA plagued other government officials involved with the disaster relief as well. Louisiana state police, for example, unaware of the dire local need to restore communications systems, delayed for days the technicians sent to repair damaged communications equipment.²⁶

A similar situation occurred in the case of one thousand

firefighters who believed that their much-needed efforts would be put to use in helping hurricane victims. Instead, they were sent to a hotel in Atlanta, forced to take days of sexual harassment courses, and eventually deployed by FEMA with only the job of handing out fliers with FEMA’s phone number on it. As one firefighter astutely observed, “It’s a misallocation of resources . . . completely.”²⁷

Information Stage Three: Is What We're Doing Working?

AFTER ESTABLISHING THAT a disaster has occurred, determining what is needed and who needs it, and taking action to remedy the situation, the final piece of critical information needed for effective disaster-relief management is feedback on whether or not the plan of action being pursued is actually working. Are disaster victims getting what they really need? A contrast with the private sector again reveals government’s inability to generate this feedback information.

In markets, profit-and-loss accounting informs suppliers whether or not they are satisfying demanders’ needs. Those suppliers who are doing so earn profits, which reward them with greater command over resources. Those who are not doing so are punished with losses and lose control of resources. Profits and losses tell suppliers whether they should expand output or alter their activities.²⁸ In the context of relief management, profits and losses tell private providers of essential goods such as water, food, shelter, and even private protection against criminals, whether or not they are effectively fulfilling disaster victims’ needs.

Consider, for example, the numerous private security agencies that protected residents and business owners’ property. These firms satisfied a demand for property-rights protection created by the government’s failure to perform this task in the wake of the disaster. In Louisiana alone, within fourteen days of Katrina’s landfall, the number of private security firms offering their services to disaster victims climbed from 185 to 235.²⁹ This growing number reflected

21. “What Went Wrong,” interview.

22. Lisa Myers and NBC Investigative Unit, “Relief Chaos in Katrina’s Wake,” September 8, 2005, <http://www.msnbc.com>.

23. “‘Can I Quit Now?’ FEMA Chief Wrote as Katrina Raged,” *CNN.com*, November 4, 2005, <http://www.cnn.com>.

24. *Ibid.*

25. Myers, “Relief Chaos.”

26. Kit Roane, “Can’t Reach Out, Can’t Touch,” *USNews.com*, September 19, 2005, <http://www.usnews.com>.

27. Lisa Rosetta, “Frustrated: Fire Crews to Hand Out Fliers for FEMA,” *Salt Lake City Tribune*, September 12, 2005.

28. Ludwig von Mises, *Human Action: A Treatise on Economics*, (New Haven, CT: Yale University Press, 1949).

29. Jeremy Scahill, “Blackwater Down,” *Nation*, October 10, 2005.



As one frustrated member lamented, “We joined the team to help people who need it and we are not helping anybody.”

the heightened profitability of providing this service, which, in turn, reflected consumers’ satisfaction with the services and their demand for additional protection.

Private nonprofit organizations confront a similar feedback mechanism because they rely on voluntary donations. The nonprofits that create the most value for those they help will garner more donations, whereas those that squander their resources will suffer lower future donations. Although this feedback is not as strong as the pure profit-and-loss mechanism, it remains stronger than the feedback for government, which finances its activities through taxation. Lily Duke, for instance, an independent film producer with no previous relief experience, arrived in New Orleans with a single truckload of donated food. Because of her effectiveness in supplying aid to Katrina victims, donations to her operation increased exponentially. Within three months of the disaster’s onset, Duke was operating three distribution centers that served 20,000 people a day.³⁰

Because the resources under government’s control are not affected primarily by performance, government lacks an effective feedback mechanism. Consequently, political actors have little idea of whether they should expand their activities, shift their activities, or drop them altogether. Political actors know only the financial costs of their activities; they have no information in the form of feedback about the desirability of these activities.³¹ This situation makes the economic allocation of resources through the political process and the coordination of the supply of these resources to those who desire them exceedingly difficult, if not outright impossible.

For disaster-relief management, this situation creates a serious problem. A striking example is the provision of temporary, post-Katrina housing. Following the hurricane, cruise lines, such as Carnival, immediately offered their ships for rent to house relief workers. Their profit from this activity depended on whether the ships were docked in the areas where they were needed most. As a result, they put ships in the places that benefited hurricane victims the most. FEMA, in contrast, set up trailer parks that in many cases went virtually unused. It faced the prospect of neither profits nor losses from its decision about where to locate temporary housing. Consequently, trailers were deployed where

30. John Seewer, “Resident Becomes Aid ‘Boss’ in New Orleans,” *Associated Press*, November 13, 2005.

31. Von Mises, *Bureaucracy*.

they were not needed, at an astonishing cost to taxpayers.

Between August and October 2005, for example, FEMA spent \$1.3 billion on 95,000 trailers for hurricane victims, and in some cases, \$38,000 per lot to make parks trailer ready—the total double the cost of the trailers themselves. As of October 2005, only 16,000 of these trailers (less than 17 percent), were occupied. Based on these figures, FEMA was spending an estimated \$125,000 to \$200,000 per family for temporary housing, even though more than one million rental apartments priced at \$700 per month or less were vacant across the region.³² As of August 2006, a much higher percentage of FEMA trailers were occupied, but many still went unused. In Louisiana, for example, 15 percent of FEMA's 95,000 trailers in the state remained unoccupied.³³ If Carnival had misallocated its resources in this fashion, the company would have suffered losses. FEMA's huge misallocation, however, carried little penalty or consequence for FEMA decision-makers, despite the considerable harm done to disaster victims. In fact, FEMA's failure was rewarded with billions of additional dollars for the agency's budget.

When disaster relief is centralized, there is an inability to evaluate effectively the ongoing success or failure of disaster-relief activities. This inability created significant problems for FEMA's Hurricane Katrina relief efforts and led government officials involved in managing the relief, at even the highest levels, to assess FEMA's success incorrectly and arbitrarily. Department of Homeland Security Secretary Michael Chertoff, for example, stated: "We are extremely pleased with the response that every element of the federal government, all of our federal partners, have made to this terrible tragedy."³⁴

President Bush was equally unable to evaluate the effectiveness of the government's relief activities. Commending FEMA director Michael Brown on the agency's efforts, Bush made the now-infamous remark, "Brownie, you're doing a heck of a job."³⁵ He later changed his tune, calling FEMA's response to Katrina "unacceptable."³⁶ Though political decision-makers' assessment of government's actions eventually hit the mark, it was too late—only after changing the government's relief strategy had become a nonissue, well after the situation in New Orleans and elsewhere was already improving.

Concluding Remarks

HAYEK'S CRITICAL INSIGHT was that decentralized market activities generate information that coordinates the diverse ends and activities of all those participating in the market. When government substitutes central planning for markets, essential information is generated in an untimely fashion, generated inaccurately, or not generated at all. Hence, central planning cannot effectively coordinate decision-making among numerous and dispersed individuals with different endowments, wants, and needs.

Hayek's point applies to all forms of central planning. The failure of command and control in natural-disaster management is as assured as it is for the creation of five-year development plans. Neither FEMA nor any other government agency that might be charged with FEMA's task is immune to the information problem. Disaster relief, like all other forms of decision making that require coordinated human action, necessitates information about a new constellation of market conditions to be acted upon, information that directs activities so that certain needs are economically satisfied, and finally information about whether the activities undertaken toward this end are succeeding. Without this information, coordination is impossible.

We have discussed how markets create both this information and the incentives to act upon it and how government, by its nature, cannot create either the information or the incentives. This condition has radical implications for disaster-management policy: Government must be removed from disaster management to the same extent that it is removed from all other successful market activities. This conclusion means that government's near-monopoly control of disaster relief and its role as a centralized "clearinghouse" of relief activities must be relinquished if disaster management is to be effective. Tinkering with government disaster management at the margins is no more likely to make government disaster relief effective than tinkering with the Soviet Union's centrally planned economy was likely to improve its effectiveness.

In government's place, the market should be allowed to coordinate relief activities, as it did to a limited extent following Hurricane Katrina despite government restrictions, when private for-profit and nonprofit actors were remark-

32. Aaron Davis, "FEMA Trailer Parks Subject to Criticism from All Sides," *San Jose Mercury News*, October 31, 2005.

33. "Katrina by the Numbers," *Shreveport Times*, August 27, 2006.

34. "What Went Wrong," interview.

35. Ibid.

36. Stephen Bainbridge, "The Invisible Helping Hand," *Tech Central Station*, September 8, 2005.

ably successful in relieving victims' plight, especially in those areas hit hardest. The private sector proved itself capable, as it does under "normal" circumstances, of generating the relevant information at each of the critical stages of disaster response. The public sector, in contrast, did not demonstrate effectiveness, again as in "normal" circumstances.

Our finding that an inability to overcome the information problem is the root cause of government's failure to manage natural-disaster relief effectively casts doubt on recent explanations of FEMA's failure following Hurricane Katrina. One strand of argument, for example, suggests that an unfortunate succession of "bad directors," culminating in Michael Brown, explains this failure. Our analysis suggests that although incompetent leadership may exacerbate government's inability to manage natural disasters effectively, it is of minor importance in comparison to Hayek's knowledge problem.

Even the most benevolent and effective director cannot overcome this problem, which stems intrinsically from centralized, governmental management. Thus, optimism about the future success of FEMA or of other possible agencies in providing disaster relief is unwarranted. The "bad directors" argument is analogous to the "bad rulers" argument some have used to explain the Soviet Union's failure. In the latter case, bad leadership contributed to the problem, but it did not create the system's core failure. Replacing Stalin with Mother Theresa or Albert Einstein would have been no more helpful for the Soviet economy than replacing Michael Brown or the current FEMA director with one of these individuals would be.

Likewise, our discussion casts doubt on the argument that FEMA's recent reorganization, under the Department of Homeland Security following 9/11 is responsible for its failure on the Gulf Coast. Again, although it is true that following this reorganization additional resources were channeled to fighting terrorism instead of, for example, rebuilding levees, the fundamental issue is why government directed resources to the specific uses it did (an information problem) instead of to alternative uses, given the substantial overlap between the ends involved in fighting domestic terrorism and preparing for natural disaster. A weak levee that, if destroyed, might wipe out an entire metropolitan area is both a natural-disaster concern and a terrorism concern, given such a target's clear vulnerability to attack.

Finally, our focus on the information problem calls into question arguments that FEMA per se is somehow to blame for government's failed response to Hurricane Katrina.



Photo: DOD/USN

The May 2006 report of the Senate Committee on Homeland Security and Governmental Affairs, for example, suggests abolishing FEMA and replacing it with an even larger government agency for disaster-relief management, to be called the National Preparedness and Response Authority. Such proposals misconstrue the root failure of government disaster management, which is informational in nature and inherent in government itself. Any government agency for disaster management will be subject to the same information failures as FEMA and thus cannot be relied on to prevent failures such as those that characterized government's response to Hurricane Katrina.

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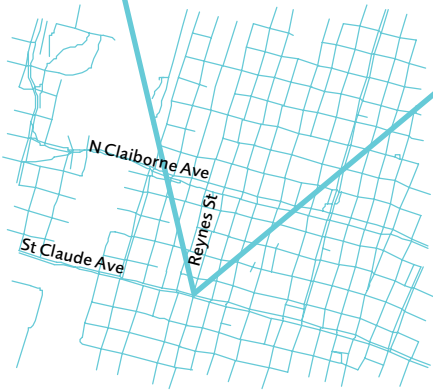
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CASE STUDY #2

CASEY KASIM

Owner: Discount Zone
St. Claude Avenue and
Reynes Street



An Iraqi immigrant, Casey Kasim opened the Discount Zone Gas Station in the Lower Ninth Ward of New Orleans, Louisiana in 2003. While he spends much of his time in the Ninth Ward, working at his store ten hours a day, seven days a week, Mr. Kasim lives in Jefferson Parish with his wife and six children. Before Katrina, the Kasims sent their children to stay with relatives in Houston, but he and his wife chose to stay and ride out the storm.

What happened when Katrina hit?

I was here during Katrina 'cause I didn't want to leave the business. I noticed the night before Katrina hit here there was a lot of breaking into businesses and gas stations so I decided to stay here. I brought my boat with me over here just in case, thinking, you know, I'm gonna need it and I got everything up. I thought the water probably going to come about a foot or two maximum. So I put everything up on the shelf.

At one o'clock in the morning, the winds started blowing here, and we started feeling the force of the wind of Katrina. Around five forty-five, six o'clock in the morning, I came down to the store just to check on everything, and all of a sudden I saw water was coming from the street and rising up. So I say it's no big deal. I expected the water going to be probably coming about a foot or two. And in probably about seven or six minutes, the water came up all the way and covered the whole—I almost got stuck. I was trying to open the door to get out, but see the door opens to the outside and the force of the water [made it hard] to open it. So I had to go and struggle to open the back door and went upstairs—[that's] where I was staying that evening, in my office upstairs—and then I noticed my boat was sinking 'cause it was tied to the trailer. I had to jump in the water and [release] the tie down for the boat. I stayed on the boat until like four o'clock that afternoon when everything kinda calmed down.

So tell me about the first couple of days then after the hurricane.

[It was] something I can hardly believe. This area looked like a lake and never . . . like I said, I was expecting probably maximum we'd get a foot or two of water, but when you see that much high water . . . I stayed here for four days after Katrina and water was up [so] high, I couldn't see the pumps.

When the water was coming up, I was able to get a few people from behind the station. They were calling for help, and I was able to bring them and had them sit upstairs waiting for the wind to go away.

After the rain and the wind stopped, [I heard] people from the neighborhood calling for help. I [went out] in my boat and start picking up a few people and brought them here. An hour later the NOPD [New Orleans Police Department] came with one boat. It was two officers and one boat. They saw me with my boat outside there so they asked me to follow them to the bridge. I just followed the instruction, and I followed [them] to the bridge. There they told me that they going to take my boat away, commandeer my boat. [I] told them, "You can do whatever you wanna do, but at least take me back to the gas station." They said, "Well right now you just go ahead with one of the officers." [I went] with him, and we went around picking up people, and we brought them to the bridge—six or seven families.



Around five-thirty, quarter to six, more enforcement came to the bridge from the NOPD [New Orleans Police Department]. They told me, “Now we don’t need you; you have to evacuate.” I told them, “Well, I cannot evacuate because I have my wife and my family up in the gas station’s second floor, plus there’s about seven or eight families upstairs too.” He says, “You have to leave.”

[I demanded again that the police officer] give me a ride back to the gas station so I can stay. He pulled his gun, and he said, “Leave or I’ll shoot you.”

I said, “I [am] not scared of your gun; I [am] not scared, and I [am] not asking something for pleasure. You take my boat, fine. Just take me back to the gas station.”

[There were] some people from CNN escorting that officer. He saw that they were recording [this], and so he told me, “Okay.” [He] told the other officers, “Okay, go ahead and give him a ride back to the gas station.” So they gave me a

ride to the gas station, and they took my boat, and they were helping other people in the neighborhood, picking up more people, and that was it.

That night we stayed here and slept. [It] was very hot, and there was no food . . . [A] lot of my food and groceries were floating up on the water. I decided to come in the evening and pick up a lot of salvageable food. We kept it upstairs for next few days. We salvaged a lot of food and candy and drink and water, and we started giving that to people the next day.

We stayed here [until] Thursday because we didn’t have no radio, no communication, no phone, so we didn’t know where to go. I thought at that time that the whole New Orleans community was underwater. That’s why we stayed here. We said it’s safe, and at least we have some food. But by Thursday we learned that the West Bank was not flooded so we decided to leave here. We had to walk all the way to the West Bank to get to our house.

So when did you come back?

It took probably about two weeks to get all the water out of the area, and it took another two weeks for them to open the road. So I was coming in and out this area like two weeks after Katrina. It took a year and a half to reopen this gas station. [It was] May of 2007 before I was able to open.

What did your reopening mean to your community?

It helped. . . . From talking to the customers a lot of them got the courage [to come back] when they saw that I am open. They say, “Okay, let’s go back, and things are going to get back again to normal one day.” They need my facility to provide gas, drink, food. So it helped a lot people to come back to this area when they see that business is open.

How has the Lower Ninth Ward changed since before Katrina?

It’s changed. . . . It was a very active community before Katrina. It had a lot of activity and businesses, and quite a few industries like Domino Sugar and seaports here on the river. A lot of people were living in this area. [Now] I see probably 20 percent of the people that we served before Katrina. Some people never left this area before Katrina. Katrina came and forced them to move and see another area. A lot of people decided not to come back because they found benefit in [living in] another state, like better work.

But those who came back, they're struggling. There's not much work in this area other than construction and cleaning and anything related to construction, but other than that. . . .

I see a lot of problems coming back in this area. There is a lot of drug activity—because the police are very reluctant to enforce the law in this area. There are a lot of abandoned houses around here right now, so it's become a trading place for buying and selling drugs. Before Katrina there used to be some drugs, but right now [I think there's more]. I feel sad about it, but what can you do?

Who are the people and groups who have helped you rebuild your business?

Capital One Bank was very helpful. They were very patient; they are just waiting to see things get better in my business. That's a big help when you get a break from the bank.

The other one is the SBA. I didn't have flood insurance, and the wind insurance I had did not cover the damage. So I had to go to the SBA and borrow money [about \$2 million].

[It] took some time, about a year, for SBA to process my paperwork, and they turned me down twice, probably [because of] the inexperience of the people that were handling the paperwork. There is a lot of red tape in the processing of the papers. The people sitting in Houston or somewhere doing the paperwork for your application don't know how bad it is and how much Katrina affected

you and how much damage you have. There were so many people applying and the loss is so big here that the amount of money I requested was probably something scary [to them]. But in the end, we got it. Without it, I wouldn't be able to open the place.

The community is also very supportive. They come here, bring their business. It is like a kind of family. I know everyone in the neighborhood because there are so few of them—so I know them by name and ask about them. Before Katrina I didn't know many customers. I just know them by face. But now I know them personally.

What do you think is keeping this community from coming back?

I believe people are scared of the future. They don't believe that [it's worth repairing] their houses if another Katrina comes and they lose them again. That's one reason.

Another reason is people probably found another job, in another state or another city. Also a lot of people living here were low-income. They were renting, so when they evacuated this area, there was nothing for them to come back to, especially because now the rent is going to be more than a thousand or twelve hundred dollars a month. It used to be two hundred or three hundred dollars a month.

If you could say one thing to the President about how government should help following a disaster, what would you say?

It's the people, not the government. The government can only do so much for the people in this area or another city. They [the people] have to do the work. They have to be more patient, more vigilant. They have to work hard to bring back the area.

The government—what can it do if I'm not willing to work? A lot of people, they got the money and they left. They went somewhere else. They got the money; they went and spent it on gambling or traveling.

We need [government] help, but the people, the community, they have to do the majority of the work.

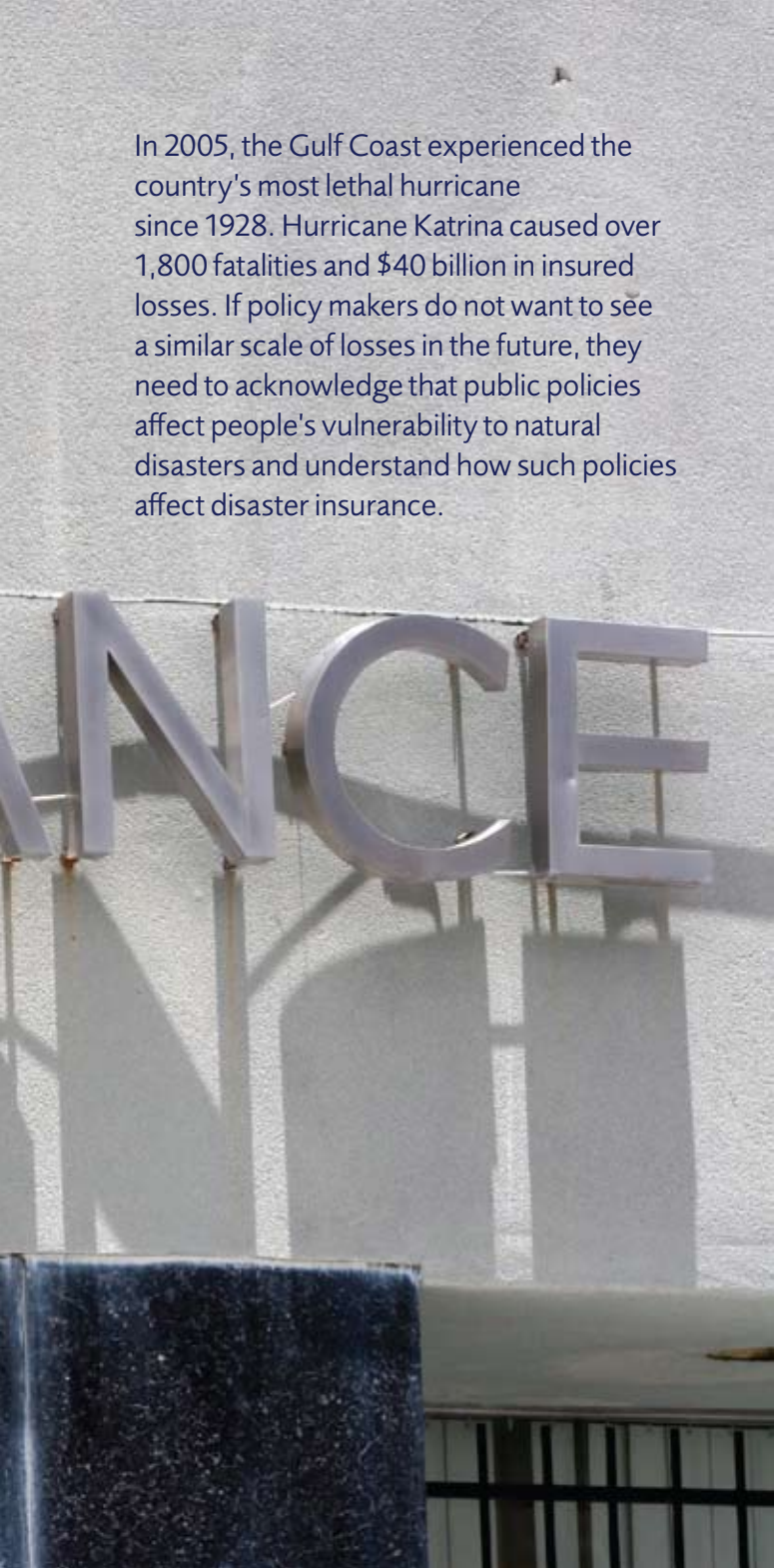
Photo: Carrie Conko



Ensuring Disaster

Daniel Sutter





In 2005, the Gulf Coast experienced the country's most lethal hurricane since 1928. Hurricane Katrina caused over 1,800 fatalities and \$40 billion in insured losses. If policy makers do not want to see a similar scale of losses in the future, they need to acknowledge that public policies affect people's vulnerability to natural disasters and understand how such policies affect disaster insurance.

NATURAL DISASTERS MAY be pure “acts of God,” but the amount of damage they do is anything but. Of course, no one can stop a hurricane from ravaging a vulnerable coastline, as Hurricane Katrina did to the Gulf Coast. However, individuals and businesses ultimately choose where and

how to build in different areas of varying risk, which means much of a natural disaster’s destruction can be avoided altogether. Of all the tragedies that befell the Gulf region owing to Katrina, this may be the most upsetting: much of the loss of life and property were ultimately avoidable.

Many factors influence people’s decisions about where to build and live (i.e., assume risk). From a public policy point of view, it may not be appropriate to try to control or eliminate all the risks associated with those factors. A more subtle, yet key, factor is insurance, which U.S. public policy plays an integral part in regulating. Insurance is a voluntary contractual means of securing relief in the event of a loss. In a robust and perfectly competitive market, insurance premiums reflect the true risk of whatever is being insured against, and thus the true expected cost of undertaking the activity in question. However, because insurance is a highly regulated industry in the United States, the outcome is significantly different. In particular, state regulation of wind, hail, fire, and other types of property and casualty insurance affect the vulnerability of U.S. society to hurricanes.

In 2005, the country observed its most lethal hurricane since 1928. With over 1,800 fatalities, \$40 billion in insured losses, and 90,000 square miles affected, it behooves policy makers to understand how they can affect vulnerability to such natural disasters. Understanding how public policies affect disaster insurance is one major step in avoiding the scale of losses seen in the wake of Hurricane Katrina.

What Does Vulnerability Mean to Society?

RISK, OR VULNERABILITY, is not a state of the world that comes in a binary flavor—either something is risky or it is not. Risk is a continuum with an often uncountable number of factors that determine its degree. Risk is also not, by itself, a bad thing. A complete elimination of risk would paralyze society. For example, the use of automobiles presents an underlying level of risk that everybody is familiar with, but a complete

elimination of that risk would mean the complete elimination of cars. Certainly most would agree this would do more harm than good. To do away with all home fires, we could simply do away with homes. With respect to Hurricane Katrina and similar future hurricanes, an analogous (though seemingly less ridiculous) solution proposed by some would entail limiting coastal development. Eliminating risk does away with the potential harms of certain choices while completely sacrificing the benefits associated with them. In most cases, the risk of a car accident or a home fire is outweighed by the benefit of driving or living in a house. Society is thus made better off by allowing such choices and seeking to balance the risk and the benefit. In the same way, society

With respect to Hurricane Katrina and similar future hurricanes, an analogous (though seemingly less ridiculous) solution proposed by some would entail limiting coastal development.

is better off when people are allowed to live, build, vacation, and invest in coastal areas that may have an obvious threat of disaster. In doing so, they express their preference for the unique bundle of attributes offered by a coastal residence or workplace (views, weather, recreation, etc.). Indeed, the preference for such a location is entirely subjective, but where the individually perceived benefits exceed the costs, a person is better off being allowed to make that choice.

By spreading the costs across many people, insurance provides a mechanism by which individuals can afford to assume these risks. In an unregulated market, this sharing of risk between an insurer and many policyholders represents a net gain to all involved parties because they have all agreed to the terms of the insurance, and the premiums paid reflect the true risk of being insured. In a regulated or subsidized market, however, costs may be shifted to individuals or parties who have not taken on such risk (such as the cost of coastal wind damage shifted to those who live nowhere near a coastal area).

When this shifting occurs, then coastal residents undertake inefficient risk—through excess assumption of risk. When the cost is shifted, some people who do not value living by the ocean more than the total costs of doing so will find it beneficial to move there, leading to a net loss for society. An issue of fairness also arises as those who do not benefit from the oceanside residences must help pay for them nonetheless.

The pooling of risk is a necessary component for the financing of large-scale investments like an individual's home or an oil company's platforms. Insurance allows investors to be compensated in the case of damage from disaster, like the more than one hundred offshore oil platforms that were destroyed by Hurricanes Katrina and Rita, and is indispensable for the modern economy.

Insurance Problems

INSURANCE CONTRACTS CAN be complicated by several factors. Insurance companies go to great lengths to avoid these problems, control costs, and keep their premiums competitively priced.

Moral Hazard

THIS REFERS TO a situation where a person increases the likelihood of damage once they become insured. For example, a person who knows that they will be compensated in the event of an accident may not exercise as much caution as they would if they were not insured.

Adverse Selection

ADVERSE SELECTION APPLIES to situations of asymmetrical information. When an insurer does not have as much information as the insured, the contract cannot be priced appropriately. If a homeowner knows there is some faulty wiring in the home that is likely to spark and cause a fire at some point but the insurer does not know this, the insurer will underprice the insurance premiums compared to how much they are likely to pay out. When this kind of information imbalance exists over a wide group of potential customers, it can cause significant disruptions in the market.



Problems Particular to Catastrophe Coverage

Correlation of Losses

FOR THE TYPICAL insured loss, there is a similar but independent chance that any two policies will require payment in a given year. In other words, the odds that one policyholder will get into a car accident has no effect on whether another policyholder will as well. Pooling risks becomes possible

when this is the case. For instance, if 5 percent of drivers have an accident each year, a company with 100,000 auto insurance policies can expect 5,000 claims in a year, with 6,000 claims being highly unlikely. Thus, each year's premiums can usually cover each year's losses, and the risk of the insurance company becoming financially insolvent is low.

In contrast to these independent risks, after Hurricane Katrina, instead of a small proportion of policyholders having a claim, virtually all policyholders along the Louisiana and Mississippi coasts had claims. Catastrophic disasters thus pose a greater risk of insolvency for insurance companies. In response, insurance companies must accumulate larger reserves or purchase reinsurance (an insurance policy for insurance companies). Either option will raise the price of insurance for disasters such as hurricanes.¹

Ambiguity

AS OPPOSED TO car or life insurance, where millions of previous events help to accurately predict the number of likely claims, hurricanes and other natural disasters are not nearly as common, making it difficult to do the same. This ambiguity in risk, in either the likelihood of the event occurring or the amount of

the loss, can lead to a 20–60 percent increase in premiums.² This ambiguity can stem from multiple sources, including government. Prior to Hurricane Andrew, insurers took into account that South Florida had one of the strictest building codes in the country. After the storm, it was discovered that code enforcement had been severely inadequate, and 25 percent of losses were due to the failure to build to code.³ Lawsuits stemming from Katrina have also contributed to ambiguity in the disaster insurance markets.⁴

This ambiguity leads to higher rates, which is the proper

1. It should be noted that the taxation of those reserves can substantially raise the cost of providing disaster insurance. Scott E. Harrington, "Rethinking Disaster Policy," *Regulation* 23, no. 1 (2000): 40–46.

2. Howard Kunreuther et al., "Ambiguity and Underwriter Decision Processes," *Journal of Economic Behavior and Organization* 26 (1995): 337–52.

3. Dennis J. Mileti, *Disasters by Design* (Washington, DC: Joseph Henry Press, 1999); Paul Fronstin and Alphonse G. Holtmann, "The Determinants of Residential Property Damage Caused by Hurricane Andrew," *Southern Economic Journal* 61, no. 2 (1994): 387–97.

4. The State of Mississippi has initiated a lawsuit to force insurance companies to pay for flood damage under wind damage policies that explicitly excluded flood losses.

response and not a market failure. This uncertainty would prompt any typical person to charge more for a policy, with their own wealth being at substantial risk should prices turn out to be too low. But because no single political policy maker is at risk of insolvency, especially over the long term, governments can assume such risks at a price that might be too low.

Higher premiums due to ambiguity will increase the cost of coastal development, which will slow growth in such areas. For this kind of irreversible long-term investment, reducing investment because of higher prices is the proper, efficient response to uncertain losses.⁵ Suppressing price increases due to ambiguity will put more property (and lives) at risk. State regulators often restrict insurance companies from raising rates based on newly revised loss estimates after a hurricane. But the government-imposed price ceiling then leads to a shortage, with companies canceling coverage or abstaining from creating new policies in a high-risk area. This, in turn, increases pressure on politicians to intervene in the market by creating publicly subsidized insurance pools.

State Involvement in Hurricane Insurance

STATES REGULATE INSURERS similarly to how they regulate utility companies. States license insurance companies and regulate rates, contracts, and conduct to prevent insolvency. Because most insurance companies provide multiple types of insurance and attempt to divide potential customers into groupings based on risk, the potential exists for cross-subsidization. Cross-subsidization involves some customers of a regulated, multi-product firm paying extra so that other customers can receive a product for less than cost.⁶ A simple example in a non-insurance context is the price of first-class postage, which is the same for every letter even though the cost clearly varies by distance.

State Insurance Pools

IN CONTRAST TO traditional cross-subsidization schemes, high-risk hurricane states have created state-run insurance pools called wind or beach pools. Federal legislation in the 1960s authorized states to create Fair Access to Insurance Requirements (FAIR) plans after urban riots, and seven states have used this authority to establish hurricane insurance pools. These pools insure high-risk properties at below-market rates. All licensed companies within the state must be members of the pool as a condition of their license, and they are assessed based on their share of premiums in the market when the pool experiences losses in excess of its own revenues. Under a state pool, the only way an insurance company can avoid exposure to high-risk areas is to exit the state completely, which it may understandably be hesitant to do because of long-term investments in brand awareness, customer loyalty, and so on. Even this last-resort exit option may not be possible since states may severely restrict non-renewal or cancellation of policies after a hurricane. In most cases, the state pool assessments are passed on to policyholders, so that the assessments essentially act like an excise tax on insurance.

Table 1: State Wind and Beach Pools

STATE	CURRENT NAME	YEAR ESTABLISHED	POLICIES IN FORCE	TOTAL LIABILITY
Alabama	Alabama Insurance Underwriting Association	1970	7,499	\$1.313 Billion
Florida	Citizens Property Insurance Corporation	1970	1,298,922	\$408.8 Billion
Louisiana	Louisiana Citizens	1968	129,203	\$21.13 Billion
Mississippi	Mississippi Underwriting Association	1987	30,962	\$5.370 Billion
North Carolina	NC Insurance Underwriting Association	1969	141,843	\$57.27 Billion
South Carolina	SC Wind and Hail Underwriting Association	1970	30,091	\$12.17 Billion
Texas	Texas Windstorm Insurance Association	1971	160,281	\$50.23 Billion

Source: Daniel Sutter, *Insuring Disaster*, Mercatus Policy Series, Policy Comment 14 (Arlington, VA: Mercatus Center at George Mason University, 2007).

5. Kenneth J. Arrow and Robert C. Lind, "Uncertainty and Evaluation of Public Investment Decisions," *American Economic Review* 60, no. 3 (1970): 364-78.
 6. Richard Posner, "Taxation by Regulation," *Bell Journal of Economics & Management Science* 22 (1971).



State Guaranty Funds

ANOTHER FORM OF regulatory subsidy for high-risk properties are state guaranty funds which pay claims for the policies of insolvent insurance companies. Forty-nine states currently have guaranty funds.⁷ Of course, ensuring solvency is the primary goal of insurance regulation.⁸ Before a company actually fails (or is “impaired” in regulators’ parlance), the state commission will often step in and attempt to combine the distressed company with another company or otherwise smooth over any financial woes. If a company does eventually fail, guaranty funds can impose assessments on the

state’s other insurers to cover the now insolvent company’s claims. Since 1978, state guaranty funds have imposed more than \$11 billion for this purpose.⁹ Were there no guaranty funds, more potential customers would instead diligently rely upon market ratings (such as A.M. Best) to judge the financial soundness of various insurers. The existence of a guaranty fund reduces the incentive of customers to consider financial stability and possibly pay extra for a more financially secure company. There is also evidence that guaranty funds cause insurers to engage in their own form of moral hazard, writing more policies than they would otherwise, especially for those near insolvency.¹⁰

7. New York is the one exception, but has its own form of insurance insolvency coverage: “a pre-assessment system, which requires insurers to contribute to a permanent insolvency fund.” Insurance Information Institute, “Issues Update: Insolvencies/Guaranty Funds,” May 2007, <http://iii.org/media/hottopics/insurance/insolvencies/>.

8. Kenneth J. Meier, “The Politics of Insurance Regulation,” *Journal of Risk and Insurance* 58, no. 4 (1991): 700-13.

9. Ibid.

10. James G. Bohn and Brian J. Hall, “The Costs of Insurance Company Failures,” in *The Economics of Property-Casualty Insurance*, David F. Bradford, ed. (Chicago: University of Chicago Press, 1998), 139-166.

Insurance Pools, Affordable Insurance, and Hurricane Vulnerability

FOR STATES, PROVIDING affordable insurance is the overarching goal of wind or beach pools, whether stated explicitly or not. But affordability is subjective and certainly there are some cases where most people would agree it is not a legitimate policy aim. Rising fuel prices may make fuel for private jets “unaffordable” for those rich enough to own one, but no one would argue that this merits a subsidy.

By looking at the 2000 census, one finds that coastal counties are not particularly poor when compared to their states as a whole. In most states, per capita income on the coast is actually very similar or even higher than state averages. House prices also can be significantly higher on the coast than elsewhere. This indicates that the properties receiving the highest subsidies are unlikely to be any poorer—and thus any more deserving of a subsidy—than their entire state population. In fact, much like private jet owners facing rising fuel prices, coastal homeowners may be less deserving of a subsidy.

When looking at only the census tracts most affected by Hurricane Katrina in Mississippi, Alabama, and Louisiana, the results are similar. The poverty rate, median incomes, and share of high-priced homes all indicate an advantaged coastal population when compared to inland populations. This contrast would likely become more dramatic without an insurance subsidy. In the absence of below-market insurance rates, some lower-income residents would certainly move out of the area, or even never move into the area at all. But because hurricanes have a disproportionate impact on poor residents, this would be a desirable outcome.¹¹

State hurricane pools are also offered as a way to accomplish policy goals other than affordability, such as inducing economic development in coastal regions. As mentioned above, at full insurance costs, individuals and businesses will only choose to live in a high-risk area if the benefits of doing so outweigh the costs. Thus, location-based economic development policy is often questionable no matter where it occurs, but especially so in coastal areas. Again, subsidizing the cost of living in a coastal area ultimately creates more potential for harm by making it more attractive for people to live and build there than would otherwise.

The extent to which insurance pools have increased

the number of people affected by hurricanes is difficult to calculate precisely, but a rough estimate is possible. Looking at censuses between 1950 and 2000, coastal counties in states with beach pools grew an average of 413,000 persons per decade, compared with growth of 154,000 persons per decade for states without a beach pool. Another way

For state insurance pools, the problems are numerous. . . . [S]tate policy makers should seriously reconsider these pools and their role in regulating insurance markets.

to determine the impact is to look at coastal county population growth in the seven states with wind pools during the decades immediately prior to and after establishment of the pool. These counties experienced an average 41.5 percent growth in the decade after the pool was established compared with 25.5 percent average growth in the prior decade.

Implications for Policy

FOR STATE INSURANCE pools, the problems are numerous. With premiums that do not cover costs and must be imposed onto others, cross-subsidies from low-risk to high-risk policyholders, and subsidies going to relatively more wealthy populations, state policy makers should seriously reconsider these pools and their role in regulating insurance markets.

Policy makers should start by introducing a moratorium on the creation of new or expansion of existing hurricane pools. They could go further by phasing out the existing subsidies over a given period (such as ten years). As subsidies phase out and premiums rise to market-determined levels, states could continue to maintain affordability for low-income residents by offering tax credits or vouchers to existing residents. Short of eliminating state pools, states should

11. Nicole Dash and Hugh Gladwin, “Evacuation Decision Making and Behavioral Responses in Individual and Household,” *Natural Hazards Review* 8 (2007): 69-77.



purchase reinsurance or issue catastrophe bonds to cover excess losses rather than continue to make assessments against insurers. Fortunately, elimination of these kinds of subsidies may prove to be quite popular. A recent survey indicated that 84 percent of respondents were unaware of subsidies for coastal properties, but 64 percent opposed them.¹²

Conclusion

INSURANCE AS A contract and a financial instrument can be very complex. The nature of natural disasters further complicates it. Without insurance, much of life's risk would be insurmountable, and many of society's greatest investments would never be made. Certain realities apply to any kind of insurance, such as moral hazard and adverse selection. Other factors, like ambiguity and correlation, also apply in the case of hurricane insurance and make risk trickier for insurers to calculate. But because this insurance is tricky does not necessarily merit intrusive state regulation. State regulation through pools and guaranty funds introduces its own set of complications and unintended consequences.

Policy makers must start with determining what their

underlying goal really is. It should not be making insurance for the riskiest types of investments affordable for all people. Only those people for whom the benefits from living in coastal and other high-risk areas exceed the costs should live and build there. The way to minimize damage and irreplaceable losses, and ultimately the disruption to the way of life of hurricane-prone regions, is to ensure that everyone assumes the full cost of the risks they choose. In this way, decisions will follow their most efficient path and future catastrophes, like the one experienced by the Gulf Coast in 2005, will not be followed by such unthinkable tolls.

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For more on this topic, read Daniel Sutter, *Ensuring Disaster: State Insurance Regulation, Coastal Development, and Hurricanes*, Mercatus Policy Series, Policy Comment 14, (Arlington, VA: Mercatus Center at George Mason University, September 12, 2007), http://mercatus.org/publications/pubid.4329/pub_detail.asp.

12. Stephen Pociask, *Consumer Opinions on Insurance Price Regulation* (Reston, Virginia: American Consumer Institute, 2007), 2.

Hurricane Recovery Comes Out of a Box

Photo: Joanna Andreasson



The private-sector response to Hurricane Katrina is often overlooked when reviewing and drawing lessons from the catastrophe that followed. But any community responding to future disaster, whether in the Gulf Coast or elsewhere, must learn from the successful relief efforts of for-profit companies in order to avoid the mistakes the public has come to know so well.

Steven Horwitz



ON AUGUST 26, 2005, three days before Hurricane Katrina made landfall, a team of people nearly 500 miles away in Atlanta was hard at work getting needed supplies staged into the hurricane zone. Two days before that on August 24, in the northwest corner of Arkansas, a different center usually staffed by six to ten people was augmented to over fifty people tracking the storm and making plans to dispatch necessary items to the area once the storm had passed. They coordinated the delivery of what would amount to 2,500 truckloads over the next two-and-a-half weeks,¹ none of which was handled by FEMA.

The story of Katrina, as commonly understood, is one of dramatic failure: an unprepared emergency response, uncoordinated recovery efforts, a clumsy federal bureaucracy, and, ultimately, more than 1,400 dead. But a complete telling of the Katrina story does include some significant successes—lesser-known actions that saved hundreds and improved quality of life for thousands in the aftermath of disaster.

The private-sector response to Hurricane Katrina—particularly the response of Wal-Mart, which will be the focus here—is often overlooked when reviewing and drawing lessons from the catastrophe that followed. But any community responding to future disaster, whether in the Gulf Coast or elsewhere, must learn from the successful relief efforts of for-profit companies like Wal-Mart in order to avoid the mistakes the public has come to know so well.

Wal-Mart's Response

THOSE FAMILIAR with the situation on the ground in New Orleans and the surrounding area generally agree that Wal-Mart's response was admirable and, perhaps more importantly, effective. Jefferson Parish sheriff Harry Lee said on *Meet the Press* that, "if [the] American government would have responded like Wal-Mart has responded, we wouldn't be in this crisis." On the same show, Jefferson Parish president Aaron Broussard pointed out that, in perhaps one of the starkest contrasts between private- and public-sector

1. Ann Zimmerman and Valerie Bauerlein, "At Wal-Mart, Emergency Plan Has Big Payoff," *Wall Street Journal*, September 15, 2005, B1; Andrew Ward, "Home Depot Prepares for Katrina," *Financial Times*, August 29, 2005, 18.



responses, Wal-Mart attempted to provide three trailers of water to people in New Orleans, only to be turned away by FEMA. Joseph Capitano, mayor of Kenner, explained that, “the only lifeline in Kenner was the Wal-Mart stores. We didn’t have looting on a mass scale because Wal-Mart showed up with food and water so our people could survive.”²

Perhaps most striking about the private, for-profit sector response to Katrina is not only how well-received were its efforts, but just how much better it was than a publicly funded government agency explicitly tasked “to reduce the loss of life and property and protect the Nation from all hazards, including natural disasters.”³ The difference between the two responses can broadly be separated into “how” and “why.” That is, how did Wal-Mart manage to respond effectively where the government couldn’t, and why did it choose to do so?

Business Continuity

THE ANSWER TO the first question begins with Wal-Mart’s fidelity to a little-known piece of business school jargon: business continuity—the practice of preparing for and responding to unforeseen (or at least unavoidable) disruptions in operations.

For Wal-Mart, business continuity begins with its team of six to ten full-time staff at its emergency command center, a team that can be quickly complemented by individuals from other divisions as needed. With respect to natural disasters, Hurricane Katrina in particular, this team does its own weather monitoring and contracts with private forecasters to augment its own in-house capabilities. Run by Jason Jackson, Wal-Mart’s director of business continuity, the office may grow to include as many as sixty employees, a structure which “drives the ability to be agile and flexible.”⁴ As John Harrald, director of the Institute for Crisis, Disaster and Risk

“The only lifeline in Kenner was the Wal-Mart stores.”

–Philip Capitano, Mayor of Kenner,
a suburb of New Orleans

Management at George Washington University, noted in a 2006 study, agility is one of the two crucial aspects of a successful disaster response (the other being discipline).⁵ Wal-Mart’s level of preparation was further enhanced by the fact that it had already dealt with hurricanes, albeit smaller-scale ones than Katrina. Because the company operates a number of stores along the Gulf Coast and in Florida, it had already developed a protocol to deal with such emergencies.

An early part of the disaster protocol is opening a two-way channel of communication from senior management to regional, district, and store management. While company-wide objectives are communicated down the ladder, on-the-ground management can relay information on changing conditions at stores back up the chain of command to the emergency command center.⁶

As another step in the protocol, in the days immediately preceding landfall, essential supplies such as generators, dry ice, and bottled water are moved “to designated staging areas so that company stores would be able to open up quickly,” according to the *Wall Street Journal*. Located just outside the areas that are likely to be worst hit, the staging areas are strategically placed and aggressively supplied to facilitate a quick response with minimal danger of damage. In fact, one distribution center in Mississippi had as many as forty-five trucks in place before landfall.⁷

With Wal-Mart’s “senior representatives from each of the company’s functional areas”⁸ in the emergency command

2. Devin Leonard, “The Only Lifeline was the Wal-Mart,” *Fortune*, October 3, 2005, 7; Susan Rosegrant, *Wal-Mart’s Response to Hurricane Katrina: Striving for a Public-Private Partnership*, The Kennedy School of Government Case Program C16-07-1876.0 (Cambridge, MA: Kennedy School of Government Case Studies in Public Policy & Management, 2007).

3. Federal Emergency Management Agency, “About FEMA: FEMA Mission,” FEMA, <http://www.fema.gov/about/index.shtm>.

4. Ben Worthen, “How Wal-Mart Beat the Feds to New Orleans,” *CIO Magazine*, November 1, 2005, http://www.cio.com/article/How_Wal-Mart_Beat_Feds_to_New_Orleans; Rosegrant, *Wal-Mart’s Response*.

5. John Harrald, “Agility and Discipline: Critical Success Factors for Disaster Response,” *Annals of the American Academy of Political and Social Sciences* 604 (2006): 256-72.

6. Rosegrant, *Wal-Mart’s Response*.

7. Leonard, “Only Lifeline;” Rosegrant, *Wal-Mart’s Response*.

8. Worthen, “How Wal-Mart Beat the Feds;” Rosegrant, *Wal-Mart’s Response*.



center and its team in New Orleans supplemented by senior management (including a regional vice president), information sharing was coupled with quick decision-making.⁹ Once Jackson, at the emergency command center, became aware of the damage and the extensive flooding at some stores, he was able to facilitate the replenishment of mops, bleach, and similar products into affected areas.

Local Knowledge

ANOTHER ASPECT OF Wal-Mart's response is flexibility. Because local conditions required different decisions at different times, the company gave district and store managers a great degree of discretion. This discretion, manifest in a directive handed down by company CEO Lee Scott, communicated through the chain of command down to store managers: "A lot of you are going to have to make decisions above your level. Make the best decision that you can with the information that's available to you at the time, and, above all, do the right thing."¹⁰

Examples abound of local store managers doing just that. In Kenner, Louisiana, an employee knocked open a warehouse door with a forklift in order to get water for a nearby retirement home; in Marrero, Louisiana, a store was used as a makeshift headquarters and residence for displaced local police officers; in Waveland, Mississippi, an assistant manager, using a bulldozer in her store, collected whatever basic items that were not damaged and put them in the parking lot to give away to residents. This same Waveland employee, Jessica Lewis, also broke into her store's pharmacy to supply critical drugs to a local hospital. Lewis' actions met with upper management's approval, with Wal-Mart's Jason Jackson commenting that, "what [she] did is a good example of autonomy."¹¹

Wal-Mart's approach of emphasizing decision making at the ground level takes advantage of what economists refer to as "local knowledge." For several decades, economists have emphasized the use of knowledge of specific time and place as a necessary condition for firms to respond efficiently to dynamic environments. That is, no centralized authority or bureaucracy can possibly possess all the pieces of infor-

9. Rosegrant, *Wal-Mart's Response*.

10. *Ibid.*

11. *Ibid.*

mation necessary to make effective decisions. Often, such knowledge is separated among too many people to be easily aggregated through an autocratic management structure. Sometimes the knowledge is tacit, embodied by individuals without them actually knowing they possess it. Much of what one might refer to as culture or customs qualifies as tacit knowledge—rules, heuristics, and experience that are implicit. In traditional market systems, prices are often the most effective mechanism to capture as much information as possible and to communicate changing preferences and conditions throughout the system. Wal-Mart is able to use another method of exploiting local knowledge that is even more crucial in a crisis situation by shifting authority to as local a level as possible.¹²

It's the Incentives

WAL-MART'S EFFECTIVE RESPONSE to disaster might lead to the questions of why the company was so well suited to the task and, further, why it so resolutely involved itself in the recovery to begin with. The answer to both questions has to do with incentives.

Whereas government agencies are most often motivated by political constraints—aiming to expand their own budgets and respond to the electoral concerns of their appropriators—private-sector companies wishing to turn a profit have an incentive to serve their customers by creating real value. Additionally, these companies must successfully meet customers' needs if they hope to succeed in a competitive environment. Because Wal-Mart knew that customers would likely resent a company that chose not to assist customers in dire need, company managers elected to help whenever possible, often giving away items at a loss. In the final calculation, Wal-Mart's effort to maximize profits through customer retention and satisfaction actually met critical needs in the post-Katrina environment, though taken alone it was a profit-losing endeavor. The same long-term interests motivated the company's policy of region-wide price freezes during the hurricane.¹³ Both demonstrated that socially beneficial



results often originate from self-interested actions.¹⁴

Private firms like Wal-Mart also have an incentive to reopen as quickly as possible after a natural disaster because every day their stores are closed they forgo revenue. This provides the motivation for business continuity protocols. Wal-Mart provided aid and necessary items while stores were damaged and the region in crisis, but it also did what it could to restore normalcy and regular operation to its stores. At the peak of the storm, 126 stores were closed, with “more than half . . . losing power . . . and 89 . . . report[ing] damage.” Within ten days, only the 15 stores having sustained the most flooding and structural damage remain closed.¹⁵

12. For an expanded discussion of the concepts outlined here, see F. A. Hayek, “The Use of Knowledge in Society,” *Individualism and Economic Order* (Chicago: University of Chicago Press, 1948).

13. Ibid; Terri Langford, “Disaster Plan Teams State and Retailers,” *Houston Chronicle*, July 15, 2007, <http://www.chron.com/disp/story.mpl/hurricane/4967735.html>.

14. James M. Buchanan and Gordon Tullock, *The Calculus of Consent* (Ann Arbor: University of Michigan Press, 1962).

15. Zimmerman and Bauerlein, “Wal-Mart Emergency Plan.”



Photo: Joanna Andresson

Incentives also play a role in the type of risks organizations are likely to take. As Hurricane Katrina approached the coast, Wal-Mart and other retailers staged supplies outside dangerous areas to minimize the transport time required once the storm subsided. This was an inherently risky proposition because, had the course of the storm progressed differently, the companies would have wasted valuable manpower and inventory. But given what they knew, the frequent updates they were receiving, and what was at stake, they decided it was a necessary risk. Their institutional environments, which determine the incentives they face, do not bias them towards taking or not taking a particular action. Rather, incentives to act or not act are shaped by expected costs and benefits.¹⁶

FEMA, on the other hand, has less incentive to make a similar gamble. Had it done so and the storm changed

course, officials could easily have been blamed for wasting resources. FEMA incentives push officials to make *errors of omission*. That is, its incentives are biased towards inaction—even if an action could be the right one. The counterpart to error of omission is an *error of commission*, which is a mistake once action has been taken. The latter errors can be easily spotted and identified as such, and they pose a greater fear for public agencies. Why? Errors stemming from failure to take a particular action are often hidden and less likely to be criticized by the public or oversight entities.

Private firms, all else being equal, are less likely to wait when they should act or to preemptively act when they should wait. As mentioned above, their actions are determined by calculating the costs and benefits associated with each course and judging, based on available information, which is preferable. Company management and

16. Russell Sobel and Peter Leeson, *Flirting with Disaster: The Inherent Problems with FEMA*, Cato Policy Analysis no. 573 (Washington, DC: Cato Institute, 2006).

shareholders will ultimately see both types of errors as being costly. Wal-Mart in particular, because of innovations in just-in-time inventory management, is especially suited to making determinations about when, where, and how many supplies should be deployed to satisfy needs while avoiding a surplus of goods.¹⁷

The Culture of Everyday Low Prices

THE LACK OF a competitive environment within government agencies also means that they are less likely to develop organizational structures, such as decentralized models, that respond efficiently to information. Wal-Mart, a leader in the highly competitive retail sector, has all but perfected logistical operations by adopting an information-maximizing decentralized operation structure. Private firms' decentralized structures, and the profit-maximizing competitive market environment in which they function, ensure that private-sector actors are much more likely than their uncompetitive, centralized government agency counterparts to make efficient and timely decisions.

In the case of Wal-Mart, the organizational structure's effectiveness is deeper than just decentralization. Wal-Mart has undertaken great efforts to instill and support a powerful culture, which runs from top to bottom of the corporate chain.¹⁸ In addition to encouraging and celebrating employee successes, this shared value system among employees allows senior management to give on-scene associates discretion to deal with situations as they see fit. When CEO Lee Scott directed employees to "do the right thing" in his pre-Katrina memo, he was using that four word phrase to invoke this corporate culture. As much of this knowledge is tacit, employees knew instinctively what they needed to do, and used both local knowledge of and intuitions about on-scene conditions to make the best decisions available to them.¹⁹

Implications for Policy

IN THE WAKE of Hurricane Katrina's destruction, private firms like Wal-Mart were busily aiding those in need and

those needing to rebuild. Most observers in both the private and public sectors agree that the former performed very successfully while the latter failed miserably. Without having been told to do so and without official direction from a central agency, companies such as Wal-Mart assessed the situation and acted as best they could, taking advantage of the same tools, structure, and resources that have made them a retail success.

Americans will continue to confront the risk of natural disaster, and hurricanes will be part of that ongoing threat—especially along the Gulf Coast. Thus, it behooves policy makers to take note of the successes and failures of this highly publicized disaster response to ensure future disasters are met with a more effective response.

The Hippocratic Oath of Disaster Policy

PUBLIC AGENCIES AT the federal, state, and local levels should ensure that the private sector is a recognized actor in disaster protocols. As Hurricane Katrina highlighted, the private sector is a necessary part of providing relief and coordinating resources during a time of crisis. Government agencies should recognize and incorporate private-sector strengths when preparing and executing response efforts.

One of the most effective ways to do so is by reducing barriers to private-sector efforts. Though public entities tend to be slow in making decisions and unlikely to take calculated risks, they should avoid requiring private-sector firms involved in response to be mired in bureaucratic approvals and regulation. Just as the Hippocratic Oath compels doctors to "first, do no harm," public agencies should endeavor to do so when executing disaster-response plans. The best way to encourage this among private-sector responders is to remain hands off.

Regarding specific actions that support efficient private-sector involvement, governments should explicitly include local firms when designing communication protocols. Who should be notified about disaster declarations? Who has particular authorities? Who will liaise between particular public agencies and private firms? Additionally, a list of private firms included in the protocols should be shared across

17. Ibid.

18. An entire section of the Wal-Mart web site is devoted to issues of corporate culture, such as its "Three Basic Beliefs," founder Sam Walton's "Ten Rules for Building Business," and the "Wal-Mart Cheer," which every employee is familiar with. For more examples see, Wal-Mart Stores, Inc., "Wal-Mart Culture," <http://www.walmartstores.com/GlobalWMSStoresWeb/navigate.do?catg=251>.

19. Frederic Sautet, *An Entrepreneurial Theory of the Firm* (New York: Routledge, 2000); Wal-Mart Stores, Inc., "Wal-Mart Culture."

all levels of government and relevant agencies. During Katrina, supplies were stranded, resources turned away, and workers diverted because public agencies were not aware of who these private entities were and how they were trying to help. Even relevant private-sector calls to local agency offices (among them the New Orleans mayor's office and the Homeland Security outpost) were largely ignored during Katrina.²⁰ To avoid such confusion and "do no harm" to private-sector relief efforts, protocol designers should harmonize public relief efforts with private assistance—authorizing private firms to act and taking the time to become familiar with local resources.

Decentralize Government Relief

DURING ITS RESPONSE to Hurricane Katrina, Wal-Mart's non-hierarchical structure demonstrated the power of decentralized effort in response to a crisis. Conditions change on a very local level, often in ways that cannot be anticipated. Government relief agencies (especially FEMA) should engage a decentralized structure. FEMA could route money and resources to local government and non-governmental organizations for use and distribution that align with perceived on-the-ground needs and on-the-spot knowledge. Local employees of federal agencies like FEMA could themselves also be empowered to take on more responsibility and authority.

In the years following Katrina, however, disaster relief authorities within the federal government have actually moved towards further centralization (i.e., moving FEMA into the Department of Homeland Security) and more inflexible missions and bureaucracy.

Revise Good Samaritan Laws

GOOD SAMARITAN LAWS are generally designed to provide those offering help in an emergency situation a "safe harbor" from civil liability. The effect is to encourage good faith attempts to help, thereby promoting a culture of civic responsibility and increasing the likelihood of people receiving the help they need at a time of peril.

However, these laws are generally intended to apply in

individual situations, not widespread disasters like a hurricane. They often exempt individuals who are in a compensated capacity for their actions from protection. As they stand, poorly worded Good Samaritan laws can severely discourage private-sector assistance in a time of crisis. Moreover, these laws vary in often subtle and ambiguous ways from state to state, creating a different liability environment for every natural disaster. Local, state, and federal governments should reform Good Samaritan laws so that they explicitly cover those who provide assistance while being paid as employees of a firm. The American Public Health Association has even developed model legislation that incorporates such lessons learned from the Katrina experience.²¹

Conclusion

IN ANY DISASTER situation, the goal is to save lives and relieve suffering as quickly and effectively as possible. With that in mind, policy makers should be indifferent to who provides assistance or what organization supplies it, as long as it meets the above criteria. In the case of Hurricane Katrina and the devastation it wreaked in the Gulf Coast region, the private sector, though not part of any official disaster response plan, offered a timely and efficient response. Lessons learned from the Wal-Mart response in particular can help policy makers understand why the private-sector effort was so much more effective than the lethargic and delayed public-sector response.

In addition to recognizing the crucial role private firms can and should play in disaster relief, government agencies—insofar as they must be involved—should mirror those aspects of the successful disaster response exhibited during Katrina. The bungled government reaction to disaster is well known, amounting to something of a disaster itself. But the less well-known narrative—private companies exploiting their own resources and advantages to help an untold number of people survive and rebuild—could very well save an untold number of lives in future disasters, if its lessons are learned.

Steven Horwitz is a professor of economics at St. Lawrence University and a senior scholar at the Mercatus Center. For more information see *Making Hurricane Response More Effective*, Mercatus Policy Series 17, (Arlington, VA: Mercatus Center at George Mason University, 2008).

20. FEMA's blocking of relief efforts has been well documented; see, for instance, Scott Shane, "After Failures, Government Officials Play Blame Game," *New York Times*, September 5, 2005, A1.

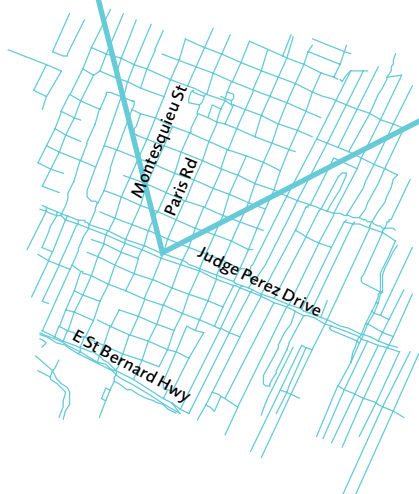
21. See North Carolina Institute for Public Health, "Leadership Discussion of Good Samaritan Legislative Initiative," *Public/Private Legal Preparedness Initiative*, <http://nciph.sph.unc.edu/law/apha.pdf>.



CASE STUDY #3

BULENT "BEN" CICEK

Owner: Da Parish Coffee House
Judge Perez Drive and
Paris Road



Even though he only knew a few words of English, Ben Cicek emigrated from Turkey to the United States seven years ago. Based on a conversation with "a friend of a friend" who lived in the French Quarter, he ended up in New Orleans.

For two years before Katrina, he ran a coffee shop in the Uptown area of New Orleans. Having learned about the coffee business, he saw an opportunity after Katrina to start a business for himself. He and his partner opened Da Parish Coffee House in Chalmette, Louisiana in 2006 and another coffee shop on St. Charles in 2008.

Tell me how you got started opening your coffee shop.

My ex-partner decided to open it up, but had no idea about [how] a coffee shop [works]. We talked about it, and then we started it together because I know everything about the coffee business. Also, I didn't have a lot of money, and it's a small business. That's the main thing.

What problems did you have?

When I was trying to open it up, I couldn't find any construction people. We built our shop ourselves. We did a lot of stuff. We still have problems [with deliveries]. A lot of people don't want to deliver anything to us because we're in Chalmette. It's also hard to find employees. And [there were some] other issues.

Why did you decide on Chalmette as a place to open a coffee shop?

There was nothing up there, and people, you know, people need the coffee. I used to live in Chalmette before Katrina—actually I was here during Katrina. I lost my house—it was the first coffee shop in Chalmette after storm.

Did you think a lot of people were going to be drinking coffee?

It was kind of risky, but I took it. I didn't know what was going to happen. We have good days, bad days. Sometimes business is real good, but sometimes it's not working. But we're still fighting. We can try to make it. We're doing okay, but we still have a couple issues like the economic situation is not good. In Chalmette, they're still trying to fix the houses—fix the whole city—but it's not happening easily. I think it'll happen, but it just takes time.

Why did you decide to take this risk?

I think it's just my personality. I took a risk and came to the United States seven years ago. I had only a few words in English, and I didn't know anybody. I would say that it's just personality; I like to take a risk and help the community a little bit and make money.

It was just an opportunity to take my money and do my own business. I'm not going to say I really wanted to be in Chalmette, that I wanted to open up the business and live in Chalmette forever. You know, it's just a little different when you're a foreigner. [You're] just trying to build your own life.

You said you wanted to help the community?

Yeah, because I used to live here, and they had nothing [after the storm]. I'm trying to make a nice shop and bring in a lot of nice stuff for the community.

I have good friendships [with some people here]. They're loyal people. So, in the future I'm going to open up the other business in Chalmette because the people need a lot



of stuff. We still don't have Wal-Mart. We still don't have a hospital. It's tough to live in Chalmette; it's really tough whether doing a business or just living. But they're fighting, so I'm trying to do my best.

[You said you have friendships with people here.](#)

Yeah, I really didn't know a lot of people in Chalmette when I used to live there about four years ago, but with my business, I became friends with my customers. So I don't have any problem over here.

[Tell me about your customers.](#)

Right now, I would say 90 percent are local. Some construction people are from out of town, I think [around] 10 percent. My first year I had a lot of workers from out of state or construction people. We had very few local customers.

Now they're gone, so mostly, I have local customers. They have a lot of problems, you know, but they're coming back; they're fighting, or so I see it. We just talk about it everyday, so it's good to be there [for them]. It's an experience for me also to watch the development of the new city. It's sometimes exciting.

[Tell me about the problems that they talk about.](#)

Mostly they are fighting over insurance companies, or they are still waiting on Road Home monies, or trying to get rid

of the FEMA trailers, and they're talking about the politics. They're not making enough money. It's too hard to [experience] life. They don't have a hospital—they're always complaining about it. A lot of people want to come back, but we don't have any hospital, we don't have any department stores. These are like biggest problems that I see or that I know of.

[Did you apply for Road Home money?](#)

No, I was in a rental house. But we lost everything, so we got some money from FEMA.

[How did you finance the business?](#)

I had like almost \$10,000 that was my own money, and my partner added another 15 grand into the business. That's how we started. It wasn't really a coffee shop, but we were serving coffee, so we started to make a little bit of money and then improved the business. I remodeled the shop twice, and hopefully I'm gonna try to remodel again after this month, just a little bit.

[So tell me about Luis \[Colmenares\]. \(See page 100.\)](#)

Luis? He's a good guy; he's a good artist. I didn't know him, until he walked in, we started talking. He said, he owned his business, and he does artwork. He did a couple things for my coffee shop and became one of my regular customers.

Everybody knows him. [He's] a nice guy, a local guy; he helps everybody. I like to sit with him and talk about our own problems or business problems. We're good friends now.

Are you in touch with a lot of other business people in Chalmette?

Not really because it's a little local. It's Chalmette: everybody knows each other. I'm a foreign guy. I moved to Chalmette; it takes time to build friendships with them, but right now I think I have several friends there who all own their own business and live in Chalmette, but not a lot.

What do you think Chalmette is going to look like in five years?

Maybe we're going to have another 10 or 15 thousand people: everybody tells the same number, but it won't be more than 40 thousand people; We have pretty much 25 thousand people living here, and we're going to have another 10 or 15 thousand people in, four, five years, I believe. We're going to need to have Wal-Mart or like department stores and especially a hospital, because it's still like disaster area. You have to go to Marrero or Scarsdale for shopping; we have nothing. The people who live in Chalmette, they have been there forever, so they really want to live in the same spot, the same neighborhood. It's not gonna happen like it used to be, but it'll be close, I believe. Everybody has some hope. We'll see.

What can government do to help New Orleans, or to help Chalmette?

I really can't say . . . because everyone's expectations are different. For me, the government did a lot of things, but for the other people, the government did nothing. They're still complaining about living in a FEMA trailer, for almost three years, and they're still waiting and fighting with insurance companies: they've got nothing. But some people are happy, because they got money from Road Home and FEMA took care of them.

What did the government do to help you?

I didn't apply for anything. I didn't . . . I don't know—I just never thought about it. Never thought to try to get SBA loan



Photo: Joanna Andreasson

or get some help from government. It's not me; I'm just trying to do everything by myself.

What can government do to help small business people, especially?

Just for Chalmette? Or national?

In areas hit by Katrina.

I would say they can give us some loan or offer some extra money to make us happy and try to enjoy life, especially these days, because it's really hard. We're not making enough money, but we're just trying to be open. We're not looking for extra money, or trying to make some profit, we're just trying to survive right now.

If you could say anything to the incoming president about what it's like to be a small business person after Katrina, what would you say?

I don't know. I never thought about it, because as I said, I'm looking for a different way. I'm still a new guy in the country. I really don't know what they can do for small business. All I can say is just give us some loan, with a little percentage rate. It could be like very low, two or three percent that we can pay back, five, ten years from now.

DROWNING IN

Theoretically, government disaster relief programs—particularly the chief program run by the Small Business Administration (SBA)—should be efficient, consistent, and equitable. In reality, the SBA's response to the Gulf Coast hurricanes has been a disaster. Unfortunately, the reforms proposed by Congress might bring little or no improvement to the process.

Veronique de Rugy

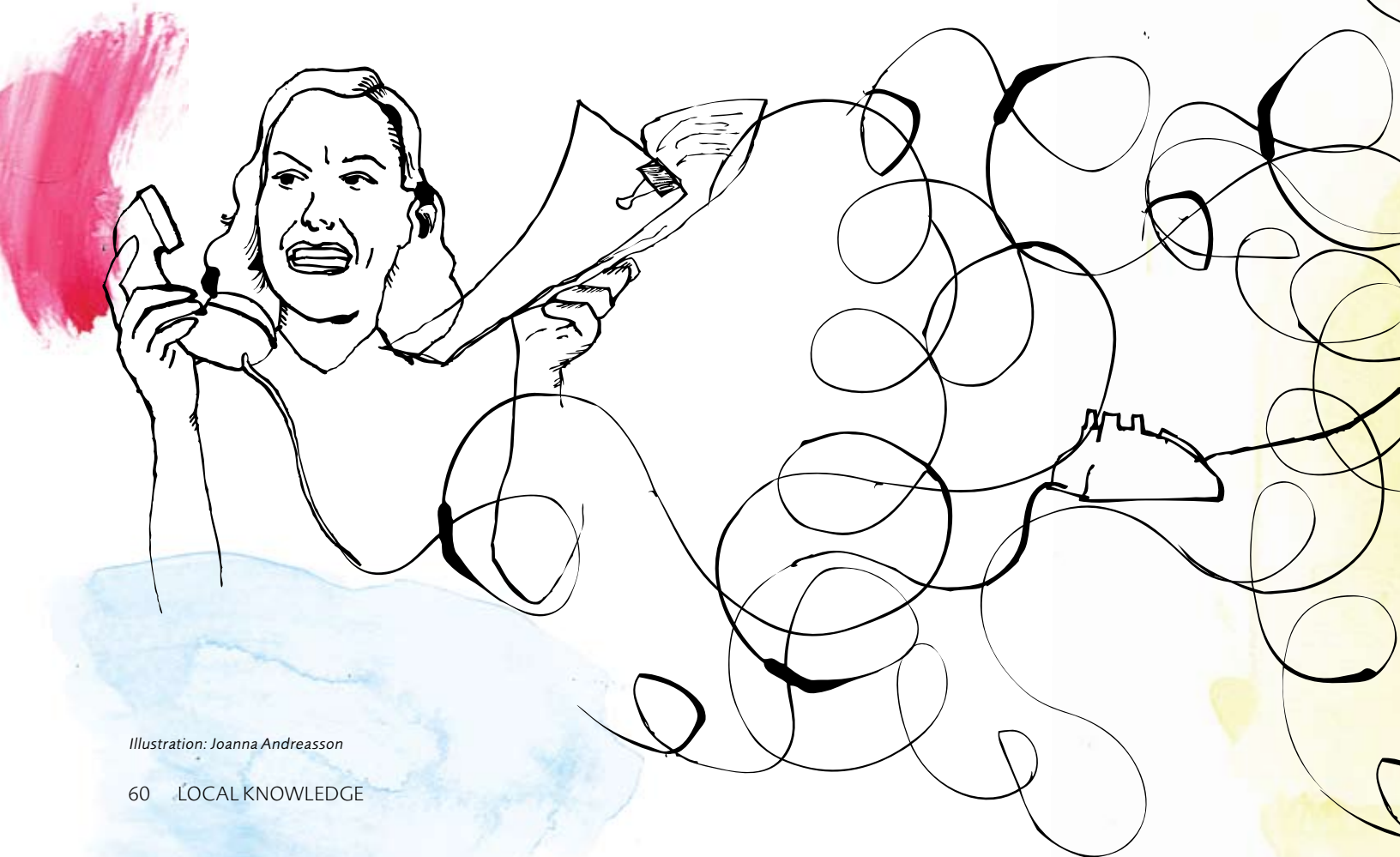


Illustration: Joanna Andreasson

BUREAUCRACY



“Working with the SBA (Small Business Administration) after a disaster is like having a second job. It takes a toll on your time, your resources, and your well-being,”¹ testified Donna Colosino, New Orleans resident and co-owner of Crescent Power Systems, to the House Committee on Small Business about the SBA’s response to the 2005 Gulf Coast hurricanes. Her testimony is but one of many that tells the story of a natural disaster followed by a government-made disaster.

After the levees broke in New Orleans, there was nothing left of the Colosinos’ electrical equipment business. Twelve feet of water flooded the building that housed their company in the Lakeview neighborhood of New Orleans and swept away everything they had worked to build.

“We lost everything. We lost our inventory. We lost all parts of our business, including all business documentation that we had for thirteen years,” said Colosino.

Eager to restart their business, the couple quickly applied for a loan from the SBA. Rather than receiving the speedy help they needed to get back on their feet, though, the Colosinos found themselves awash in a sea of bureaucratic incompetence. Katrina had flooded them out, but the federal government was holding their heads underwater.

1. The House Committee on Small Business, *Statement of Donna Colosino, Co-owner, Crescent Power Systems*, 110th Cong., 1st sess., February 14, 2007, serial 110-03, 41.

The Rationale Behind SBA Disaster Loans

AN IMPORTANT COMPONENT of how quickly recovery can occur following a natural disaster is access to capital that enables those affected by a disaster to rebuild, relocate, and go back to their regular lives. Small businesses, for instance, are very sensitive to cash-flow interruption, so a lack of access to capital for their recovery can have serious consequences on their ability to survive.² In fact, it has been estimated that over 40 percent of businesses damaged during a disaster go out of business within two years.³ Thus, the speed with which people can access capital will correlate to the speed of any recovery effort and affect its success.

Federal disaster assistance has a long history. According to the Congressional Research Service, Congress appropriated \$2.5 million in 1906 to speed recovery from the San Francisco earthquake and subsequent fires.⁴ Today, SBA disaster loans are the federal government's main disaster-relief program. As such, they are available not only to small businesses but also to individuals, businesses of all sizes, and nonprofits.

The common argument behind the federal provision of disaster loans is that after a disaster, small businesses and individuals have a very hard time getting banks to lend them capital to rebuild their houses or businesses because the disaster has destroyed or damaged most of the collateral's value. Moreover, even if banks agreed to lend money to disaster victims, the terms of those loans would likely be very disadvantageous to the borrowers, as banks would charge high interest rates and expensive fees to cover the higher risk of default. The failure of the capital market to provide disaster loans at low rates, taxpayers are told, is a market failure that requires the intervention of the federal government.

If banks did charge high interest rates and expensive fees to cover a high risk of default, that would not actually be a market failure. It would be the market responding to the perceived risk, but it is hard for people to accept that, in the eyes of banks, disaster victims are now high-risk borrowers. Furthermore, data confirm that commercial banks do not

Thus, the speed with which people can access capital will correlate to the speed of any recovery effort and affect its success.

step up lending after disasters. However, it is possible that strong federal intervention over the years has effectively crowded out the private provision of disaster funds, fundamentally changing the nature of disaster relief.

Nonetheless, there are two factors that may make government intervention almost unavoidable. First, the disaster-relief system encourages individuals to stay, rebuild, and start over in the same area rather than to relocate. In economic speak, the American people seem to think that there is a positive externality for us all if New Orleans, for instance, recovers from a disaster rather than disappears. As a result, federal disaster loans are designed to go to individuals or firms who want to rebuild rather than relocate. Such restrictions on who has access to disaster loans or what borrowers can do with the money are likely to lead to serious distortions.

Many argue, however, that some public-policy objectives require the sacrifice of marketplace efficiency. It is an accepted feature of modern American government that some public interests or social policy gains can outweigh economic losses and hence are worth selected override of free-market values. A preference for rebuilding would certainly be one example since, as a nation, we are likely to incur higher costs—monetary and otherwise—by encouraging people to stay in a flood-prone area such as New Orleans rather than encouraging them to move to a lower-risk environment.

Second, the disaster-relief system is designed to return victims to their pre-disaster conditions even though most assets have been destroyed and accumulated capital is significantly reduced. Of course, the goal of rebuilding as things were before requires a large amount of capital. Yet, this is not

2. Rodney C. Runyan, "Small Business in the Face of Crisis: Identifying Barriers to Recovery from a Natural Disaster," *Journal of Contingencies and Crisis Management* 14, no. 1 (March 2006): 19.

3. U.S. House Small Business Committee, *Trends and Analysis of SBA Disaster Loan Program, 1992-2006* (March 2006), <http://www.house.gov/smbiz/Reports/disasterloan2006.pdf>.

4. N. Eric Weiss, *Changes to the SBA Disaster Loan Program: Proposed Legislation in the 110th Congress*, RL34058 (Washington, DC: Congressional Research Service, February 12, 2008), 1, http://assets.opencrs.com/rpts/RL34058_20080212.pdf.



a necessary requirement for recovery as many entrepreneurs can take advantage of the new conditions to start fresh with very little capital.⁵

These two constraints placed on our disaster-relief policy are possibly the largest obstacles in the private provision of disaster loans. Commercial banks, in theory, could provide the large amount of capital required to meet our policy objectives. However, banks want to lend only when loans have a high likelihood of repayment. Borrowers' ability to repay depends on the economic health of the local economy, but the economy has been devastated by the disaster itself. Lending money to any single borrower does not materially improve the economy, so one borrower would have a high likelihood of default, but if banks all agree to lend money widely, then the economy would likely improve overall. Homeowners who borrowed would be more likely to find jobs, and businesses that borrowed would be more likely to find consumers with funds to buy goods and services. In this environment, with all banks lending widely, the improved economic conditions would improve the odds of each loan

being repaid. Thus, this is a problem of getting all banks to coordinate, to agree to work in concert to lend widely.

The coordination problem can be resolved if the federal government gives banks an incentive to lend money at a reduced interest rate to firms or individuals in a devastated area by guaranteeing part of a loan. Alternatively, the federal government can invest resources by lending money directly to firms and individuals to rebuild their homes and businesses.

And this is what the federal government does. Congress authorizes the SBA to provide low-interest loans to disaster victims contingent upon a disaster declaration from the president or the SBA administrator and a demonstrable ability to repay the loans. These loans are for the purposes of repairing or replacing real estate (up to \$200,000), personal property (up to \$40,000), or businesses and nonprofits, regardless of size (up to \$1.5 million).⁶ Loans can be for a period of up to thirty years.

Reduced interest rates to disaster victims amount to a federal grant to those receiving disaster loans. All disaster

5. See Frederic Sautet, "Ventures in Rebuilding: The Role of Entrepreneurship in the Post-Disaster Context" in this volume.

6. Weiss, "Changes to SBA Disaster Loan Program," 5.

loans carry a below-market interest rate, and borrowers who are unable to obtain credit on similar terms elsewhere pay a lower rate than borrowers who can obtain loans from other sources. For example, following Hurricane Katrina in 2005, SBA disaster loans to homeowners for home repair charged interest rates of 2.687 and 5.375 percent.⁷ In comparison, the rates on a private sector, thirty-year fixed-rate mortgage in the fourth quarter of 2005 ranged from 5.77 to 6.33 percent. On an average SBA homeowner disaster loan of \$45,000, this difference could save the borrower between \$100 and \$1,000 over the thirty-year life of the loan.⁸ According to the SBA, more than 97 percent of the disaster loans made for the 2005 hurricanes were at the lower rate; very few loans were at the statutory maximum. In addition, the SBA has more relaxed underwriting standards than private-sector lenders, which allow it to lend money to riskier borrowers.

However, government intervention, even if potentially warranted, always introduces distortions. In fact, sometimes the cure can be worse than the disease. In the case of federal disaster relief, for instance, it appears that over the years, interest rate subsidies and liberal forgiveness provisions have contributed to increased federal relief costs for every major disaster.⁹ The availability of low-interest loans or grants allows individuals to pay less than the cost associated with their risky activities (in this case, living in a flood-prone area below sea level). Since taxpayers bear the remainder of the cost, individuals make risky decisions based only on the portion of their potential losses that is unlikely to be covered by government relief. At this point, disaster relief becomes self-perpetuating since people never get the proper signals about their exposure to losses caused by natural disasters.

Without these signals, resources are repeatedly misallocated and individuals repeatedly put themselves in harm's way—especially if relief programs are designed to encourage people to stay rather than relocate. In addition, although disaster loans are not meant to replace disaster insurance, evidence shows that repeatedly shifting the costs of disaster relief to the federal government leads homeowners to consider disaster loans a substitute for flood insurance.¹⁰

Another argument for federal intervention in disaster relief is that many low-income individuals live in high-risk areas simply because they cannot afford to live elsewhere. Program advocates then argue that this fact alone commands government assistance in the wake of a disaster. However, it seems difficult to argue that government anti-poverty programs should be tied to disaster relief ones.

Private Sector Intervention

THE ECONOMIC JUSTIFICATION for any government-lending or loan-guarantee program must rest on a well-established private-sector failure to allocate loans efficiently. Absent such a private-sector deficiency, government's activities would simply be a wasteful, politically motivated subsidy to this sector of the economy. In the case of disaster relief policy, the argument can be made that federal disaster loans provision might be necessary especially if the goal—right or wrong—is to encourage people to stay in disaster zones rather than to relocate. However, as mentioned earlier, it is very possible that the government's intervention itself or the constraints placed on the form the disaster relief should take are getting in the way of commercial banks providing disaster loans.

There are, in fact, many private sources that do provide quick access to capital following a disaster. These institutions already have mechanisms to deal with the problems caused by natural disasters—such as complete loss of property—and have proven remarkably effective in the aftermath of the 2005 hurricanes.

Credit cards were one avenue to capital for individuals and small businesses following Katrina.¹¹ Due to the extent of the damage, most people depleted their savings quickly. Many then turned to credit cards to close the gap because of the cards' ease of use, widespread acceptance, and immediate access to funds. In response to the heavy usage of credit cards following Katrina, many companies suspended minimum payments and late payment fees.¹² While credit cards are probably not a viable long-term solution since their inter-

7. *Ibid.*, 2.

8. *Ibid.*

9. Michael Rettger and Richard Boisvert, "Flood Insurance or Disaster Loans: An Economic Evaluation," *American Journal of Agricultural Economics* 61, no. 3 (August 1979): 496-505; N. Eric Weiss, *Changes to the SBA Disaster Loan Program*, 5.

10. N. Eric Weiss, *Changes to the SBA Disaster Loan Program*, 1.

11. "Gulf Coast Small Business Owners Optimistic About Hurricane Recovery, Study Says." *The Times-Picayune*, August 29, 2007, http://blog.nola.com/tpmoney/2007/08/gulf_coast_small_business_owne.html.

12. Laura Bruce, "Hurricane Katrina Bill Payment Relief," *Bankrate.com*, September 5, 2005, <http://www.bankrate.com/brm/news/pf/story1.asp>.



est rates are generally high, this instant access to capital proved to be highly valuable to those displaced by Katrina.

Many micro-credit lending institutions also can provide access to capital in a quick and efficient manner. Prosper, an online peer-to-peer lending institution, makes it quick and easy to access loans. According to its website, Prosper is an online community where borrowers can request three-year, unsecured, fully amortized loans up to \$25,000.¹³ Lending institutions like Prosper help bridge a gap between charity and more traditional financial institutions. In this peer-to-peer setting, borrowers can pass unique information to lenders looking for an efficient and secure way to help.

There was also a large response from private non-profit organizations, such as the Enterprise Corporation of the Delta Hope Community Credit Union (ECD/HOPE). These organizations used their knowledge and social networks to provide help quickly and efficiently to those most in need. After Katrina, ECD/HOPE lent roughly \$2.3 million to some 4,000 victims.¹⁴ Many of ECD/HOPE's borrowers had no or very low credit scores, demonstrating that some finan-

cial institutions are willing to lift their strict underwriting requirements in the wake of catastrophic circumstances. According to ECD/HOPE's 2008 impact report, 40 percent of Katrina victim borrowers had no credit scores and 12 percent scored below 500 on their credit reports.¹⁵ Only 3 percent of borrowers had a credit score that commercial banks would consider acceptable.

Christine Cameron provides one example of an ECD/HOPE success story. After falling trees, torrential rain, and a mudslide from a nearby hill damaged her home, Cameron went to stay with her daughter in Jackson, Mississippi. There, she was introduced to ECD/HOPE.¹⁶ As she waited for her insurance settlement and a check from FEMA, ECD/HOPE provided a loan to help her recovery begin.

"With my loan from HOPE, I was able to get the debris cleaned up and get my roof fixed," she says. "I was able to get the process started," which sometimes is all it takes to set a community on its way to recovery.¹⁷

While these are the observable paths to disaster recovery capital, there are potentially a large number of unobservable

13. Prosper Marketplace, Inc., *Prosper.com*, <http://www.prosper.com>.

14. Enterprise Corporation of the Delta Hope Community Credit Union, *ECD/HOPE Impact Report*, 2005, 17-19, <http://www.ecd.org/Documents/2005ECD-HOPEImpactReport-HighResolution.pdf>.

15. *Ibid.*, 21.

16. *Ibid.*

17. *Ibid.*

or unreported channels to capital. It is not a far stretch to assume that countless family and friends provided help to those affected through direct transfers that were not reported or counted. These immeasurable connections are certainly a valuable post-disaster resource to many and should not be overlooked.

Keeping Disaster Victims' Heads under Water

AMERICAN TAXPAYERS PROBABLY expect the disaster programs they fund to be delivered in an efficient manner. Following Hurricane Katrina, private and nonprofit institutions provided capital quickly and efficiently. Very few of these institutions have or had developed a plan for responding to natural disasters. Yet, they provided capital quickly and efficiently because the key to their businesses' success is the ability to provide quick and easy credit on reasonable terms all of the time, not just in special cases.

By contrast, the SBA is in the business of responding to disasters and should have a plan for delivering disaster loans when needed. However, when the 2005 hurricanes hit the Gulf region, damaging communities throughout Mississippi, Louisiana, and Alabama, the SBA's response left thousands of businesses and homeowners stranded.

In July 2007, the Senate Small Business Committee held a hearing to evaluate the SBA's progress in responding to the 2005 Gulf Coast hurricanes.¹⁸ It found that the SBA was not delivering disaster loans. Two years after Katrina destroyed New Orleans and devastated the Gulf region, the SBA still faced a huge backlog of loans, revealing its inability to process applications in a timely matter. Also, the SBA's loan-approval rate dropped from an average of 60 percent for previous hurricanes—including destructive Andrew in 1992—to 33 percent.¹⁹ According to the House Committee on Small Business, the size of the disaster only partially explains the decline in loan approval during the 2005 hurricane season, as Congress immediately made large levels of funding available to respond to the disasters and large demographic and geographic similarities exist between the 2005 hurricanes and previous ones.

However, loan approvals are only one measure for



Photo: Joanna Andresson

18. U.S. Senate Committee on Small Business and Entrepreneurship, *Oversight: Gulf Coast Disaster Loans and the Future of the Disaster Assistance Program*, 110th Cong., 1st sess., July 25, 2007, <http://sbc.senate.gov/hearings/20070725.cfm>.

19. *House Small Business Committee, Trends and Analysis*, 3.

determining the SBA's impact on recovery. Once it grants approval, the SBA must also close the loans. In most post-Katrina cases, it didn't.

Remember the Colosinos, whose electrical equipment business was destroyed by Katrina? The SBA finally approved them for a \$250,000 loan in January 2006. After the long months of waiting for approval, the couple had to wait another four months to receive \$10,000.²⁰ They never received another penny from the agency. With the partial disbursement of funds, the SBA could mark the loan as "completed," which it promptly did. Did the Colosinos want the remaining \$240,000? SBA staffers told them that they would have to start the application process all over again.

"It was agonizing. It was—frustrating isn't the right word—it was horrific," confessed Donna. The horror only increased. A year later, the SBA announced that the \$250,000 loan became due in full even though the Colosinos had received only \$10,000.

The Colosinos telephoned the SBA repeatedly, re-sent all documentation and previous written exchanges, and received new documents to sign wherein nearly every detail was incorrect. Finally, the SBA asked them to provide receipts for about \$250,000 in expenses in order to receive a loan that they should have received 18 months before. In other words, the SBA told the Colosinos they had to spend their loan before they could receive it.²¹ In the end, the family had to sell their house and liquidate their savings in order to save their business.

According to the data, the Colosinos were not alone in their nightmare. Of the nearly 423,000 applications submitted, some 160,000 were approved, and yet two years after Katrina, the SBA had fully funded only 22 percent of these approved loans.²² In other words, many people received only a small portion of the loan for which the SBA had approved them. Maybe worse, in some cases, the agency did not disburse any of the money. According to the SBA's own Inspector General (IG), at the end of 2006, the SBA had accumu-

lated a backlog of more than 90,000 undisbursed loans.²³

But things got worse. Faced with growing criticism, the SBA launched a "90-in-45" campaign meant to expedite disbursement of \$6 billion in excess allocated funds to resolve the 90,000-loan backlog within 45 days.²⁴ But how sincere was this effort?

Before the Senate Committee on Small Business, former SBA loan officer Gale Martin testified, "I have brought with me the written testimony of eight other loan officers. We join together and we all agree that we were being forced by management to cancel, decline, and withdraw applications unnecessarily and unjustly in order to make the numbers look good to the public, the press, and Congress."²⁵

Ms. Martin explained that it takes almost no time to decline, withdraw, or cancel a file, and there were many reasons to do so, especially after the SBA changed the criteria for declining or canceling a loan. So SBA loan officers under deadline did just that. They began to decline, withdraw, and cancel loans.

According to the SBA's IG office, as of January 25, 2008, the SBA had withdrawn 68,456 loan applications, many of them inappropriately.²⁶ The Inspector General (IG) notes, "We believe the lack of contact with applicants and hasty withdrawals occurred due to production goals, set forth in a directive issued by the Director of Disaster Loan Processing. In order to meet these goals, loan officers told us they were aware that some officers would withdraw incomplete applications as doing so was easier than getting them approved."²⁷

At the end of her testimony, Martin said, "I could go on, and on, for hours here, but the truth is that only the wealthy moved through the system easily. People with credit issues, who owed the government even a little bit of money, who had lost their documents, or who just moved around, would probably not be given a loan, and if they were, they would have to fight to keep it."

20. The House Committee on Small Business, *Statement of Donna Colosino*.

21. *Ibid.*, 43.

22. U.S. Small Business Administration, Office of the Inspector General, *Withdrawal of Disaster Loan Applications to Individuals and Businesses Impacted by the Gulf Coast Hurricanes*, oral testimony by Debra S. Ritt, 110th Cong., March 28, 2008, report 08-11, 2; U.S. Senate Committee on Small Business and Entrepreneurship, *Oversight: Gulf Coast Disaster Loans and the Future of the Disaster Assistance Program*, oral testimony by Gale B. Martin, 110th Cong., 1st sess., July 25, 2007, <http://sbc.senate.gov/hearings/testimony/072507-Martin-testimony.pdf>.

23. U.S. Small Business Administration, Office of the Inspector General, *Withdrawal of Disaster Loan Applications*, 2.

24. *Ibid.*

25. U.S. Senate Committee, *Oversight: Gulf Coast Disaster Loans*.

26. U.S. Small Business Administration, Office of the Inspector General, *Withdrawal of Disaster Loan Applications*, 2.

27. *Ibid.*, 4.

The Recent Reforms: Progress or More of the Same?

DURING THE JULY 2007 hearing before the Senate Committee on Small Business, the Government Accountability Office (GAO) released a report that questioned whether the SBA was prepared to handle another Katrina.²⁸ Congress must not think so, for it included a major overhaul of the SBA's disaster loan program in the recently passed Farm Bill. The new legislation allows private-sector lenders to make short-term "bridge loans" to businesses damaged by disasters. Businesses could use bridge loans while they await processing of their regular SBA disaster loans or insurance payments. In the event of a catastrophic disaster, lenders as well as the SBA could make disaster loans. All lenders could make disaster loans to small businesses, and preferred lenders in the SBA's 7(a) business loan program could make disaster loans to individuals.

The bill also authorizes the SBA to pay lenders to process disaster loans when applications overwhelm the agency, as was the case in 2005. The bill makes businesses anywhere in the U.S. eligible for disaster loans if they suffer economic injury as a direct result of the disaster, a measure similar to one enacted by Congress following the September 11, 2001, terrorist attacks. Finally, the legislation increases the maximum amount of a disaster loan from \$1.5 million to \$2 million and requires the SBA to create disaster response plans for various scenarios and conduct disaster simulation exercises every other year. While the bill provides some improvements over the current system—such as preventing disaster victims from receiving payments from multiple agencies—the bill also contains serious flaws.

First, the bill authorizes billions of dollars for use during a disaster, but the cost is not offset. Supporters of the bill claim that most of the bill's costs cannot be offset because no one can plan on spending disaster-related funds. But the truth is that the only thing getting in the way of offsetting the cost of disasters is Congress. Congress *chooses* not to plan better for disasters in the budget process. It might not know precisely

when or where the next disaster will occur, but it knows that disasters will occur. Hence, Congress could and should carve out a disaster fund from the budget on the assumption that it will have to spend money on future disasters.

Second, supporters of the bill claim that the government should provide services to any and all businesses that are "adversely affected." While it may be true that disasters can affect large areas, this fact alone hardly justifies government intervention in the economy at nearly any time and in almost any way it wishes. Government can only reasonably provide assistance to those *immediately* affected by a disaster, not to those affected indirectly. It is impractical to deliver services to everyone who claims to have been affected because it is impossible to measure the indirect costs of disasters.

Moreover, the provision is based on the outdated economic notion that the government is able to provide a "stimulus" to the economy through increased federal spending. Such a notion fails to understand that government spending is not productive, but simply redistributive.

Third, Congress models the revised disaster loan program on the Supplemental Terrorist Activity Relief Program (STAR). Enacted following the 9/11 terrorist attacks, the STAR program was supposed to provide federal loans to businesses around the country who were affected by 9/11. Run by the SBA, the program was intended to provide an economic stimulus to the nation through government spending.

Modeling disaster loan programs after the STAR Program is irresponsible to say the least. A detailed report by the SBA's IG showed that both lenders and loan recipients abused the STAR program widely.²⁹ Testifying before the Committee on Homeland Security Subcommittee on Management, Integration, and Oversight, the IG reported, "Most lender files did not contain sufficient information to demonstrate that borrowers were adversely affected by the September 11th terrorist attacks and their aftermath. As a result, eligibility could not be determined for 85 percent of STAR loans reviewed."³⁰

As it turned out, lenders wrongfully advertised the loans

28. U.S. Senate Committee on Small Business and Entrepreneurship, *Response to the Gulf Coast Hurricanes Highlights Needs for Enhanced Disaster Preparedness*, oral testimony by William Shear, 110th Cong., 1st sess., July 25, 2007, GAO07-1124T, <http://sbc.senate.gov/hearings/testimony/072507-Shear-testimony.pdf>.

29. Robert G. Seabrooks, U.S. Small Business Administration Office of Inspector General, *Audit of SBA's Administration of the Supplemental Terrorist Activity Relief Loan Program*, December 23, 2005, report 6-09, <http://www.sba.gov/IG/6-09.pdf>.

30. U.S. House Committee on Homeland Security, *Federal Assistance to New York: Lessons Learned in Fraud Detection, Prevention, and Control*, statement by Eric M. Thorson, 109th Cong., July 13, 2006, <http://www.sba.gov/IG/WrittenStatement-7-13-06Hearingon9-11Response.pdf>.

to customers as an opportunity to receive lower interest rates rather than as a loan program intended for 9/11 victims. According to the IG report, many recipients had no idea they were receiving 9/11 loans rather than regular SBA loans. For instance, in 2002, Nevada Construction Cleanup received a \$1.53 million STAR loan through the Henderson, Nevada-based Silver State Bank to expand its business.³¹ The 15-year-old company removes debris that subcontractors leave at job sites. But David Marino, the company's controller, told the *Las Vegas Review Journal* that he has no idea how Nevada Construction Cleanup landed on the list of terrorism-relief loan recipients.

Modeling disaster loan programs after the STAR Program is irresponsible to say the least. A detailed report by the SBA's Inspector General showed that both lenders and loan recipients abused the STAR program widely.

"This loan was way before 9/11," Marino said. Marino was unable to pinpoint a precise borrowing date, but he said Nevada Construction Cleanup had had its SBA loan for at least 4½ years. Terrorism recovery "wasn't even a thought in anybody's mind at that time," Marino said. According to the *Journal*, officials with the various banks that handled the loans told investigators they only qualified businesses for the anti-terror loans after SBA officials aggressively marketed the program to "mean that every small business could claim

it was somehow impacted by the attacks, and therefore, eligible to receive a STAR loan."³²

The SBA inspector general's report confirms this statement and blames top agency officials for the way the SBA promoted the program "by advising lenders that virtually any small business qualified and assuring them that SBA would not second guess their justifications."³³ The report cites other abuses of the STAR program. A Texas golf course owner received a \$480,000 STAR loan under the justification that "people were more interested in staying home and watching the attack on television than playing golf."³⁴ That the course had a different owner when the attacks took place and the justification for loan guarantees did not apply to the new owner did not prevent the lender from disbursing the loan.³⁵ A Las Vegas tanning salon received a \$583,500 loan on December 3, 2002.³⁶ A company representative told investigators the business was not harmed by the terrorist attacks, but investigators ignored the statement because "many of the customers who use tanning salons are performers in casinos and work in various capacities in the casino industry," and "Las Vegas tourism was hit hard by 9/11, and many casino workers lost their jobs or had their hours scaled back. . . . This is a large part of (the borrower's) customer base."³⁷ Better yet, according to the same report, "the lender's credit memorandum showed the borrower experienced a 51.6 percent sales growth for 2001 and an annualized 2002 sales growth of 31.6 percent."³⁸ In the end, the STAR program became just another way for lenders to make money by leveraging a government guarantee. It did not serve the people it was intended to help.³⁹

The fourth major problem with the bill is that it does not lay down solid rules for what constitutes a disaster. This lack of clarity opens the door for massive increased federal intervention on behalf of businesses that are affected by snowfall or rising fuel prices.

Finally, the bill encourages private-sector lenders to

31. Samantha Young Stephens, "Loans Went Here, There: Audit Questions Post-9/11 Aid," *Las Vegas Review Journal* (December 30, 2005), http://www.reviewjournal.com/lvrj_home/2005/Dec-30-Fri-2005/news/5132430.html.

32. *Ibid.*

33. Seabrooks, *Audit of SBA's Administration of the STAR Loan Program*, 10.

34. *Ibid.*, app. B, 1 and app. C, 4, sampled loan no. 19.

35. *Ibid.*, app. C, 4.

36. *Ibid.*, app. B, 2, sampled loan no. 50.

37. *Ibid.*, app. C, 7, sampled loan no. 50.

38. *Ibid.*

39. See Veronique de Rugy, "Big Banks, Not Small Businesses, Benefit from the SBA," *Regulation Magazine*, Winter 2008, 10-11, http://www.mercatus.org/repository/docLib/200801251_regulation_magazine_-_winter_2007.pdf.

make short-term “bridge loans” to businesses damaged by disasters. While giving an incentive to the private sector to make disaster loans is a good idea, it has the potential to become nothing more than corporate welfare for banks and lenders.⁴⁰ The new program would rely heavily on the SBA’s main small business lending program, the 7(a) program. 7(a) authorizes selected banks and preferred lenders to make loans to small businesses that cannot receive credit elsewhere. The government guarantees up to 85 percent of the loans, greatly reducing the risk to lenders. Similarly, under the new lending program, the government would guarantee up to 85 percent of any loans private banks would make to victims of a disaster.

The program’s purpose is to give lenders an incentive to loan money to individuals on whom lenders would not ordinarily take a risk. Though the intentions of this new program are good, the chances are high that the program will ultimately serve big lenders rather than disaster victims. After all, the 7(a) program has become the benefactor of primarily large corporations and investors rather than of small businesses.⁴¹

Look at how the program works. First, lenders agree to make loans that they otherwise would not make, knowing that the taxpayer will pay the most of the cost of a default. Second, through the SBA’s Secondary Market Program, lenders have another way to reduce their risk even further and also to increase their lending capability.⁴² Lenders pool the guaranteed portions of SBA loans and then sell to investors trust certificates that represent claims to the cash flows. In other words, the guaranteed portions of the loans are turned into tradable securities, or “securitized.” Ultimately, lenders and investors alike can make a steady and large income off of this investment because it is backed by taxpayer money. If the loan recipient defaults, the investor does not lose anything because the taxpayer foots the bill.

Perhaps that is why Bank of America is the single largest SBA loan provider in the country, with J.P. Morgan and Wells Fargo not far behind. After all, as David Bartram, president of the National Association of Government Guaranteed Lenders (banks that make SBA loans), said in a 2006 hearing on the SBA, lenders “can be as profitable in a 7(a) loan program as we are in our conventional lending if done correctly.”⁴³

The provisions in the Farm Bill open the disaster loan program to private lenders in a similar fashion. Not surprisingly, the lending industry supports the program: they are likely to gain from it financially. But if lenders are not scrupulous in how they make disaster loans, this program could cost taxpayers dearly. Sixteen to eighteen percent of all regular 7(a) small business loans default.⁴⁴ Further, despite a thirty-year maturity period, “an unpublished Small Business Administration report estimates that up to a quarter of Louisianans who took out SBA loans after Katrina may default on them within the next two years.”⁴⁵ High default rates are expected when the government makes disaster-related loans, but if lenders do not guard taxpayer dollars, the problem could get out of control. For instance, as of 2007, guarantees on SBA loans represented some \$83 billion in potential taxpayer liabilities, a risk that banks would otherwise assume.⁴⁶ Irresponsible lending practices increase the probability that this money will come to be due by taxpayers and that the federal government will end up owning many disaster victims’ homes and businesses.

Conclusion

BY ALL ACCOUNTS, the 2005 hurricane season was the one of the worst the United States has ever seen. It devastated the Gulf Coast, and thousands of people lost all they had—their homes, their businesses, and even their lives. If this were

40. Veronique de Rugy, “Banking on the SBA,” *Mercatus on Policy*, no. 2 (Arlington, VA: Mercatus Center, August 2007). http://www.mercatus.org/repository/docLib/20070924_onpolicyno2.pdf.

41. *Ibid.*

42. House Subcommittee on Government Programs and Oversight, Small Business Committee, *Secondary Market for Guaranteed Portions of 7(a) Loans*, testimony by Thomas McCool, 105th Cong., 2nd sess., September 23, 1998, GAO/T-GGD-98-184, 5, <http://www.gao.gov/archive/1998/gg98184t.pdf>.

43. Senate Committee on Homeland Security and Governmental Affairs, *The Effectiveness of the Small Business Administration*, oral testimony by David Bartram, 109th Cong., 2nd sess., April 6, 2006, 38.

44. Veronique de Rugy, “A Guaranteed Success? Why the SBA should not Guarantee Loans,” *Mercatus on Policy*, 1 (Arlington, VA: Mercatus Center, August 2007), http://www.mercatus.org/repository/docLib/20070924_onpolicyno1.pdf.

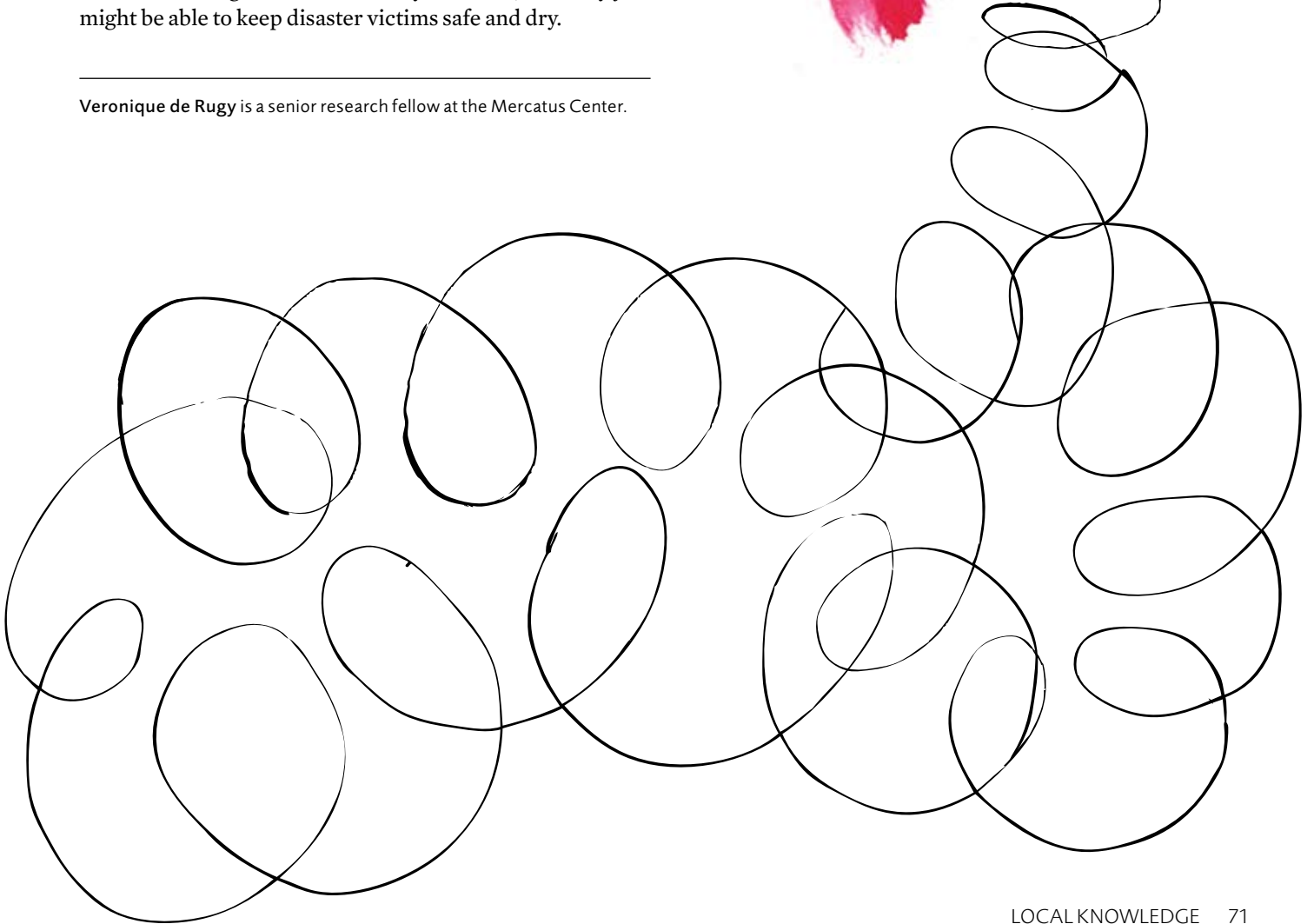
45. Daniel M. Rothschild, “The Myths of Hurricane Katrina,” *Reason Online*, August 29, 2007 <http://www.reason.com/news/show/122221.html>.

46. Zachary Kalman and Douglas J. Elliott, *The Small Business Administration: A Primer* (Washington, DC: The Center on Federal Financial Institutions, 2006), 11.

not enough, one of the agencies tasked with helping victims recover from this tragedy made the situation much worse. The SBA's response to the hurricanes' devastation has been disastrous. And unfortunately, the reforms Congress has proposed to address this issue—even though replete with good intentions—might bring little or no improvement to the disaster recovery process.

Disaster relief has traditionally been a function of the federal government. In light of the tremendous amount of data about the government's inability to deliver proper assistance to disaster victims, it might be time to think of more radical reforms. It is very possible that government intervention has crowded out the private provision of disaster relief. Perhaps it is time to give the private sector a chance to provide disaster victims with the help they are waiting for. It is hard to imagine that the private sector could do any worse than the government already has done, and they just might be able to keep disaster victims safe and dry.

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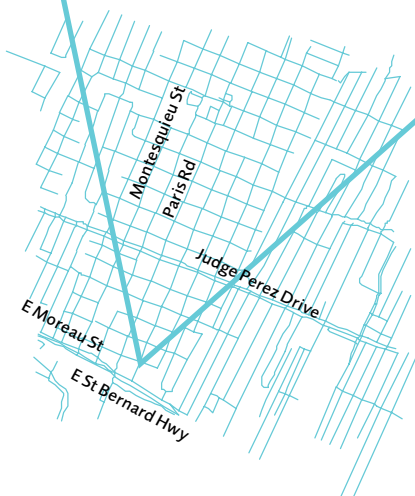




CASE STUDY #4

RONDA DEFOREST

Owner: Flour Power
Paris Road and
East Moreau Street



Ronda DeForest was born and raised in St. Bernard Parish. After a short stint out of state during college, she returned to the area and married her husband, Doyle, a North Louisiana native, who had come to New Orleans for culinary school. While raising two children, they started Flour Power, a bakery and café, in 1998 in Chalmette, Louisiana, near Ronda's family.

Tell me about your business.

Flour Power started out of our home. We expanded to a bakery and then expanded a second time three years before the storm to include a storefront with seating and a deli/café type feel. We offer coffee, pastries, wedding cakes, grooms' cakes, and three dimensional work, as well as healthy alternatives—salads with lots of fresh fruits and vegetables—to the local cuisine.

So tell me your post-Katrina life. What have you been up to since then?

We came back and opened the business within six months after the storm. We had very little water compared to everyone else so we were able to get in relatively quickly, by Katrina standards at least.

So we were back here in February of '06 and opened, but obviously there wasn't a big need for three-dimensional dog groom's cakes. There was a need for food, so we were basically throwing down on the hearty meatloaf and mashed potatoes. Also, there was no other place to eat and sit down. Everything was in Styrofoam containers to go, or it was the Red Cross coming around delivering in the trucks. So we kind of offered out whatever people wanted at the time. If they would come in and say, "You know, I haven't had a good stewed chicken," well, we'll cook it tomorrow. So we kind of just threw it out there and took whatever people wanted at the time or needed at the time. It wasn't until November of '06 that we took our first wedding cake [order] after the storm, and that was very exciting.

Why did you decide to return to Chalmette?

We were living in North Louisiana with my husband's family. The people there were wonderful, but it was still a hard adjustment for us. We came back in October [of '05] for my daughter's best friend's birthday.

We actually dropped the kids off at the party and headed in to see what was happening. We ran into my daughter and son's principal at their old grammar school, and she talked and talked and talked about the new unified school. So we decided to stay an extra day, until Monday, because that was [going to be] the opening of the unified school. And so we popped in with the kids.

When we walked in there, we knew we needed to come back. Just the vibe coming from what was going on: what they had accomplished, what they had done; their goals; what they had set out to do . . . it was an AMAZING thing that they were able to get the school system up and running in such a short amount of time and just looking around at all the things that were missing down here. . . . That was definitely the catalyst. We said, "We need to be here. Our kids need to be with people who have been through the same thing as they have been." I think it was important to bring our kids back to see that we could be part of the process . . .



That was it. It wasn't because we got a trailer. It wasn't because we got money from FEMA. It wasn't because there was a small business loan. There was nothing like that. We did it because we thought we needed to.

Did you get any assistance in coming back, or did you do this on your own?

We were able to procure a trailer through the Economic Department of Louisiana. They pushed really hard to get FEMA to release trailers to them so that they could dole them out as they saw fit. So we were able to get one through the Economic Department. To go through FEMA—I probably would still be waiting.

We decided to come back in the middle of October, and December 5th we had a trailer on the side of our building. Now no one told us, however, that if we got a trailer through that avenue that we were responsible for the electrical hook up and all the gas lines and all the things that were needed for that. If we had had the heads up, it probably would have been a little better, because we drove just blind on in from North Louisiana on a Sunday night, and we got here were all excited and then we had no water, no electricity.

So we did some primitive camping for a few days until we could get an electrician out here. . . . Other than that we had the initial monies from [FEMA]. They gave out \$2,500 and then another \$2,000. But [we had] no rental assistance because we had the trailer, no SBA loan because we were told that since we were both employees of the business and neither of us had jobs, there would be no way for us to pay it back. No grants, no Road Home funds. We had applied for small business loans; we had applied for GO loans and

bridge loans. Everything that was out there, I put in for. I applied for grants though Entergy and at least four or five other grants, and it just wasn't fast enough. It just wasn't. We had to move forward.

The building did not have flood insurance, just wind. . . . I think we got \$3,000 in insurance from this. . . . So we actually used the contents' money (amount insurance pays to compensate for damaged household goods) of our home for this [the business]. We were able to pay off our home with our flood insurance on that, and then we used the \$15,000 from the contents to get this place back up and running.

My father-in-law came down from North Louisiana, and my husband, father-in-law, and I gutted this place ourselves with shovels and wheelbarrows. It wasn't fun. It was disgusting. I don't even like to think about it because it was vile, but at the same time we weren't able to cook here. There were no other restaurants open. There was no place to get food or gas or anything. There was a FEMA tent, but [it was] very crowded and a lot of people staying here had nowhere else to go.

The place that I credit the most with helping us to recover is Emergency Communities. I believe they were originally in Bay St. Louis but then they moved up here. Emergency Communities fed us, really good food too—fun, creative food. They were so caring and wanting so desperately to help in anyway that they could. They had such a great vibe, not only just welcoming, but making us feel like there was someone out there who really cared for us and who came here specifically to do nothing but help us get to where we needed to be.

What has gotten Chalmette this far and what will help get Chalmette back to normal?

The people. Just the resiliency of the people coming back who are determined regardless that they are going to rebuild and be here. It's just an amazing community with an amazing group of people. Whether they've got money or they don't have money they're going to make it work. Whether the government is helping them or whether it's not, they're going to figure out a way to do it.

What did people say when they saw your business open?

I cannot tell you the tears that I watched fall when they walked in front of our case and I think one of the things about our business . . . we were fortunate that we didn't have a whole bunch of water in front so everything was the same: same chairs, same tables, same draperies, everything looked exactly the same. We had a lot of people come in and say, "If you'd just close the curtains, I can pretend like the whole thing never happened, because this looks exactly like it did before."

What's the larger role small businesses play in rebuilding a community?

They're almost essential personnel really. You can't have people back without a grocery store. Especially with gas at \$5 a gallon. People can't drive a half hour every couple days to pick up groceries. Certainly restaurants or just someplace to get out of a trailer and get away from everything [helps].

Right now we're hurting because there's no Wal-Mart. There's no Target, there's no big chain out there, and there aren't enough small businesses to fill that niche. There's no clothing store other than a Family Dollar. There's no mall. And that hurts not only our parish because there are no tax dollars coming in, but it also hurts financially because we have to drive all over to get to these places.

People need haircuts, people need groceries . . . gas stations, convenience stores, all the little things, even down to a little jewelry store to pick up something rather than having to drive miles to get it. I think that's what brings people back to have those there.

Why do you need these little things?

It brings you back to some sense of normalcy. It gets really emotionally draining to live in a place where there is

nothing, and it's hard to wake up every day and throw all your energy into something and there's nothing there. So if you can go across the street or two blocks over and pick up a bouquet of flowers to brighten up your day or not have to worry, "Oh dear, I just used the last of the milk. Where can I get some without having to drive a half hour?" . . . It's just normal. It's normalcy. It's not absolutely essential to living, but if you want people to come back to what it was before—and that's the goal I think if what you had there before was a good thing. And I think that if you have a community like ours who are screaming and telling that they want to come back then obviously we had a good thing—you have to replicate what was here before. Without those small businesses you don't have what was here before.

What can government do to make it easier for businesses to reopen?

I think that government could make it easier to access funds. I'm not saying, "Give us money." We don't want money for free, because we wouldn't be entrepreneurs if we thought that we could just get handouts. We're used to working for money. We're used to making our way in the world by ourselves without any help, but when something like this happens you can't possibly do it on your own. It makes it really hard and really draining and easy to give up a lot sooner than we would have before. Even to say "Here's some money. Pay us back when you can." Something that is not two days of filling out paperwork and then waiting in lines to turn in forms for a \$10,000 grant.



Photo: Carrie Conko

In the wake of Hurricane Katrina, Louisiana's economy is shifting from one based largely on manufacturing and oil extraction and refining to a knowledge-based economy that emphasizes entrepreneurship, creativity, and the commercialization of new technologies. This new economy brings many challenges, but also many rewards for those who are successful in it. This article presents a two-part analysis of Louisiana's prospects.

IN AUGUST 2005, Hurricane Katrina dealt the low-lying regions of Louisiana and Mississippi a devastating blow. In the aftermath of one of the worst natural disasters in U.S. history, people have questioned whether Louisiana's economy can rebound from such a catastrophe.

Even before Katrina, however, Louisiana faced a new world of competitive forces as a global economy—a knowledge-based economy that emphasizes entrepreneurship, creativity, and the commercialization of new technologies—reshaped the economic landscape. This new economy demands a highly educated workforce and close interaction between research universities and the communities and enterprises they serve. This economy demands a reexamination of the critical role played by government in providing services and infrastructure to citizens and organizations that will form a future economic base.

This changing economy begs two questions in the aftermath of Hurricane Katrina. First, how is Louisiana positioned as a player in this rapidly evolving knowledge economy? Second, in terms of attracting creative people and new capital, how do Louisiana's critical public policies compare with those of other states and regions?

In considering these questions, this article focuses on entrepreneurship and the emerging knowledge economy and compares Louisiana's evolving economy with the econo-





Louisiana's Performance in the New Knowledge Economy

Jody Lipford and Bruce Yandle



mies of other states in the region as well as the United States as a whole. After analyzing data on taxes, regulation, liability risk, education and other services, and government transparency and corruption, this article offers policy recommendations that would strengthen Louisiana's economy.

Louisiana and the Evolving Knowledge Economy

SINCE 1960, THE U.S. economy has undergone a dramatic change. Once a smokestack economy with heavy employment in manufacturing, the national economy is now knowledge-based. In a smokestack economy, workers were trained largely on the job, and their skills were good for years. In a knowledge economy, however, fewer workers are needed to produce goods, change is rapid, and knowledge is king.

Driven by globalization, this new economy calls for a better-educated workforce with higher reading and math skills. It places a premium on abstract thinking, reasoning, and communication. These new skills are replacing the earlier skill set that rewarded manual dexterity and physical strength.¹ States and regions that specialized in activities that fit the previous skill set must now alter their strategies if they wish to compete in the emerging knowledge economy. One such state that must alter its strategy is Louisiana.

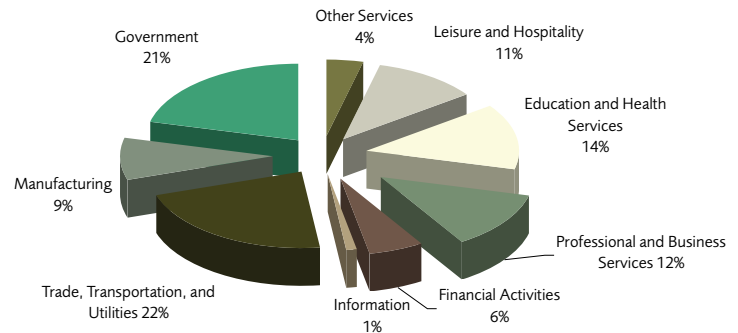
Louisiana's Evolving Economy

THE SHIFT FROM manufacturing to services in the United States and Louisiana vividly illustrates the emergence of the new knowledge economy. In 1960, 21 percent of Louisiana's non-farm labor was employed in manufacturing and 15 percent in services. For the United States that year, the shares were 30 percent in manufacturing and 22 percent in services. By 1990, Louisiana's services sector had grown to 33 percent, while manufacturing had dropped to 12 percent. That year, the shares for the nation were 34 percent in services and 17 percent in manufacturing.²

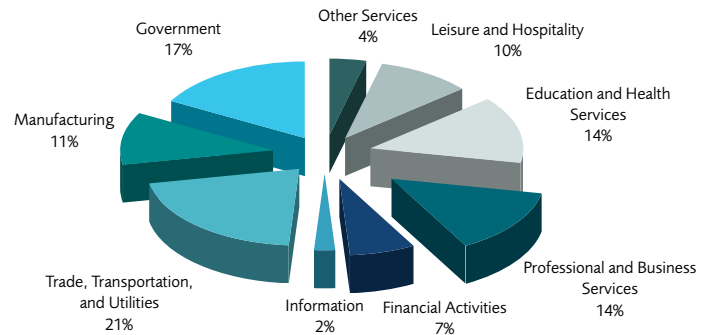
In 2007, Louisiana employment in services accounted for 41 percent of the labor force while just 9 percent was employed in manufacturing. Nationwide, services took 42

Figure 1: Piecing out the Pies: U.S. and Louisiana Employment Shares, 2007

LOUISIANA EMPLOYMENT SECTORS, 2007



U.S. EMPLOYMENT SECTORS, 2007



Source: U.S. Bureau of Labor Statistics

percent and manufacturing employed 11 percent of the labor force.³ Figure 1 shows a detailed breakdown of total non-agricultural employment in Louisiana and the United States for 2007. Two slices on each chart are extended to emphasize the relative amounts of employment in manufacturing, the old economy, and professional and business services, the proxy for the size of the knowledge economy. We will return to this key point later.

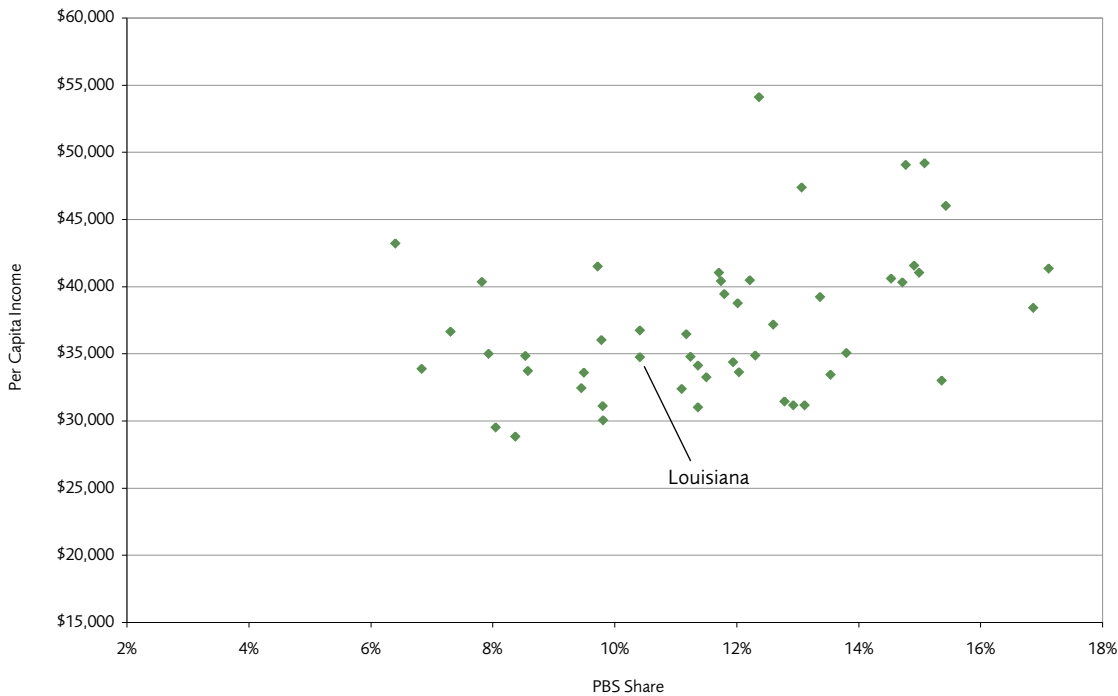
This shift from manufacturing to services has delivered higher per capita income, partly because hourly wages in the

1. Michael Cox and Richard Alm, *Myths of Rich and Poor* (New York: Basic Books, 1999), 170-173.

2. Bureau of Labor Statistics, U.S. Department of Labor, and authors' calculations.

3. Ibid.

Figure 2: State Per Capita Income and the Professional and Business Services Share, 2007



Source: U.S. Bureau of Labor Statistics and author's calculations

services sector are higher than in manufacturing, and the gap is widening.⁴ While Louisiana's per capita income has risen across several decades, it still lags behind the national average, standing at roughly 80 percent of U.S. per capita income. One reason for Louisiana's weaker performance relates to the smaller size of Louisiana's business and professional services sector. This sector, which is just one part of the services sector, serves as an indicator for the health of the knowledge economy and entrepreneurship activities. The larger this specialized service sector, the healthier the emerging new economy.

The Importance of the Professional and Business Services Sector

HIGHER INCOME SPRINGS from a larger services sector because this sector encompasses education and health, lei-

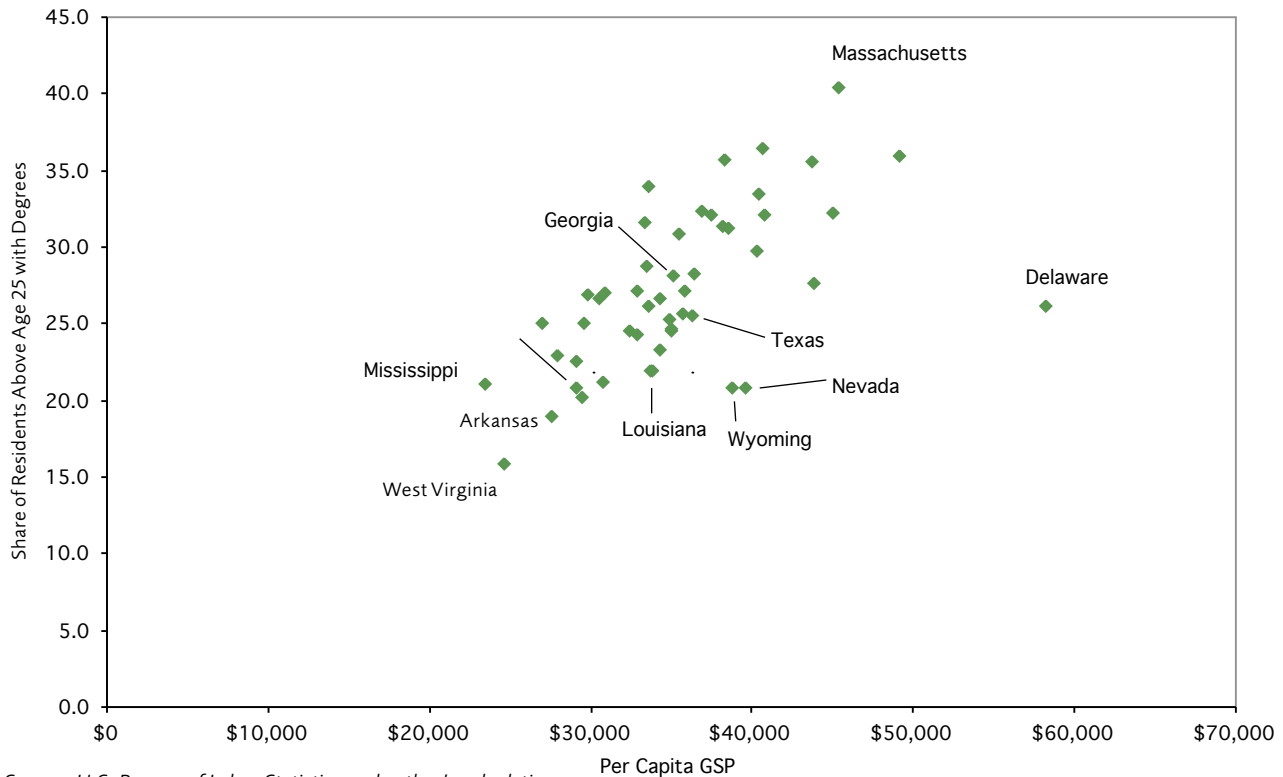
sure and hospitality, professional and business, and other services.⁵ As lucrative as those other subsectors might be, it is the professional and business services sector that predicts the size of and is critical to a knowledge economy. This sector encompasses fields like research, law, accounting and financial management, software design, engineering, and construction management. While Louisiana's growing knowledge sector now accounts for 12 percent of the labor force, it is still 14 percent smaller than its national counterpart. To become a force within the nation, this sector will need to become larger than the nation's.

Figure 2 shows the relationship between the share of workers in the professional and business services and state per capita income. Examination of the data reveals that in order to raise per capita income, professional and business services employment—that is, the knowledge economy—must expand.

4. Bureau of Labor Statistics, wages in various U.S. sectors, <http://data.bls.gov/PDQ/servlet/SurveyOutputServlet> (last visited June 18, 2008).

5. Contrary to popular belief, this sector does not include fast food restaurants.

Figure 3: Per Capita GSP and Share of Population with Bachelor's Degrees, 2006



Source: U.S. Bureau of Labor Statistics and author's calculations

Expanding the Knowledge Economy

EXPANDING LOUISIANA'S (or any state's) knowledge economy is a tall order. Part of the challenge relates to expanding the number of knowledgeable people living in the state and then getting them connected to wealth-creating activities. When compared to the adult population of the other 49 states, Louisiana's adult population ranks 42nd in college degrees, and only Texas has a smaller share of the adults with high school diplomas.⁶

States that have an exceptionally high share of high school graduates, such as Colorado, Idaho, Montana, Utah, and Wyoming, also have extraordinarily high growth in entrepreneurship and per capita gross state product (GSP). As might be expected, the share of population with bachelor's degrees also maps closely to state per capita GSP (Figure 3).

In Figure 3, Louisiana is located along a horizontal that includes Alabama, Mississippi, Wyoming, and Nevada.

Notice that Arkansas is below and to the left of Louisiana. Georgia and Texas are well above Louisiana. Those states to the left of Louisiana have about the same level of educational attainment but have not produced as much GSP per capita given their attainment. Those to the right of Louisiana have produced more GSP per capita for about the same level of educational attainment. Producing more GSP per capita can come from two forces: increasing the level of educational attainment and improving knowledge economy opportunities for the educated population in the state.

How Louisiana Ranks as a Knowledge Economy

IN RECENT YEARS, researchers at think tanks and universities have focused considerable attention on state activities related to building a knowledge economy and encouraging entre-

6. Larry Swanson, "Education Matters," *Center News* (Missoula, MT: O'Connor Center for the Rocky Mountain West, June/July 2007), <http://www.crmw.org/newsletter/CenterJuneJuly2007NewsletterGraphic.htm>. While Texas has the smallest share of the population with high school diplomas, the state ranks much higher in the college-educated share. In other words, Texas is attracting and keeping a larger share of people with bachelor's degrees.

Despite their different approaches, all three rankings place Louisiana near the bottom of the 50-state stack. Louisiana is not a knowledge-economy contender, but neither are the other states in the region. The state outline map of the SCRA Index (Figure 5) shows that Louisiana is nested in a group of states with lower knowledge-economy rankings. The challenge for Louisiana is to pull away from the pack.

Comparing Louisiana's 2007 SCRA and ITIF rankings to those of several regional states provides a more useful picture.

Table 2: Comparing SCRA and ITIF Indices for Regional States

STATE	LA	AL	AR	GA	MS	TX
SCRA	48	44	49	18	46	25
ITIF	44	46	47	18	49	14

Sources: ITIF; SCRA

Georgia and Texas stand out in this six-state ranking. In both cases, education and entrepreneurship make a large difference. Making progress on any of the three fronts—education, research and development, and fast firm entry—is not easy, but education is where the state and state-corporate partnerships might make the greatest difference.

Louisiana's relative weakness is found in all three components of the SCRA index. Louisiana ranked 49th among the states in private sector R&D; 42nd in fast-growth firms; and 46th in educated workforce. However, there is hope for Louisiana: Research by Mark Henry and David Barkley shows that Louisiana's urban areas, particularly Baton Rouge but also New Orleans, rank competitively with other southern cities.¹⁰

Where Louisiana Ranks on Entrepreneurship

FOR SEVERAL YEARS, the Kauffman Foundation has produced an entrepreneurship index for the fifty states.¹¹ The index shows the percent of the adult population that started a new firm in the year examined. Table 3 summarizes a portion of that data for the United States, Louisiana, and states in Louisiana's region. Louisiana's 0.44 index indicates that

there were 440 new firms for every 100,000 adults in 2007. This was substantially higher than the ratio for the U.S. and a number of neighboring states.

Table 3: Ranking Entrepreneurial Strength

YEAR(S)	U.S.	LA	AL	AR	GA	MS	TX
1996-98	0.29	0.32	0.23	0.31	0.31	0.27	0.30
2007	0.30	0.44	0.10	0.34	0.40	0.30	0.29

Source: Kauffman Entrepreneurship Index

Can Louisiana Become a Contender?

OUR REVIEW OF Louisiana's competitive position in the evolving knowledge economy identifies several significant weaknesses. While Louisiana has a rapidly evolving economy, the state is not a contender in the knowledge economy arena as is demonstrated by the relative size of the professional and business services sector, its weak ability to attract and keep college-educated people, and the state's low rating in each of the three composite knowledge economy indices. There are bright spots within the overall picture, however, in Louisiana's metro areas and surging entrepreneurship activity. These data suggest that a strong knowledge economy is emerging in urban areas, but the supply of knowledgeable people will limit the pace of progress.

Public Policy And Economic Competitiveness

AS THOMAS FRIEDMAN points out, unprecedented resource mobility characterizes the 21st century economy.¹² Capital crosses international borders with ease. Labor migrates with fewer and fewer obstacles, and technology spills across all artificial barriers. Lines drawn on maps no longer mean what they once did, and if these realities apply to international resource movement, they apply all the more to U.S. states.

In this fluid economy, public policies that minimize the burden on the private sector and produce valued public goods attract resources and technology and enable a state's

10. Robert L. Barkley and Mark S. Henry, "Innovative Metropolitan Areas of the South: How Competitive are South Carolina Cities?" (research report, Regional Economic Development Research Laboratory, Department of Agricultural and Applied Economics, Clemson University, Clemson, NC, October 2005).

11. Robert W. Fairlie, *Kauffman Index of Entrepreneurial Activity: 1996-2007* (Kansas City, MO: Ewing Marion Kauffman Foundation, 2008).

12. Thomas L. Friedman, *The World is Flat: A Brief History of the Twenty-first Century* (New York: Farrar, Straus, and Giroux, 2005).

current resources to thrive and prosper. Public policies that overly burden the private sector and fail to produce valued public goods discourage the in-migration of resources and technology as well as their development.¹³ This section evaluates how Louisiana's public policies measure up in this new economy and whether they encourage the accumulation of the increasingly mobile resources and technology that fuel economic growth.

Taxes, Regulation, and Corruption: The Role of Institutions

IT IS COMMONLY said that death and taxes are life's two inevitabilities. Businesses today might add regulation, corruption, and liability to this list. To determine if Louisiana provides a healthy business climate, it is necessary to consider Louisiana's tax and regulatory structures and whether its political and legal climates give appropriate incentives to entrepreneurs.

Taxes

LOUISIANA'S TAX STRUCTURE does affect Louisiana's entrepreneurial rank. While Louisiana's marginal tax rates are lower than those of most states and in line with those in the region, Louisiana ranks poorly in terms of its sales tax burden (sales taxes paid per \$1,000 of personal income), because it permits localities to charge high sales taxes despite low resident incomes statewide.¹⁴ To improve state competitiveness and encourage the formation of new businesses, Louisiana should lower its local option sales taxes, exempt sales taxes on business-to-business transactions for manufacturing equipment, utilities, and farm machinery (as most states do), or cut the marginal income tax rates faced by corporations and individuals.¹⁵

Regulation

LIKE TAXES, REGULATION can take resources from businesses and influence resource allocation. Unlike taxes, quantifying regulations is problematic, but it is possible to obtain a reasonable evaluation of a state's regulatory system by examining some key regulations important to business decision makers; specifically, property rights, labor markets, and business regulations.

The security of private property is the foundation of a capitalist economy. When private property rights are secure, businesses invest with the confidence that their investments and earnings are safe. Without secure property rights, businesses are reluctant to invest and will seek locales that promise greater security. Measured by the willingness of a government to take private property for private use, property rights in Louisiana are relatively secure.¹⁶

Secure property rights are essential to attracting capital, but flexible labor markets also help by lowering costs for businesses and ensuring that labor moves to its most highly valued uses. Louisiana's labor markets are relatively free and competitive. The state has no minimum wage law, and workers are free to join or not join unions.

The source of Louisiana's trouble in its regulatory regime is business regulation. Business regulations can be critical to attracting new businesses, especially the small businesses and entrepreneurs that are such an important part of the 21st century economy. One indicator, the Small Business Survival Index, ranks Louisiana 31st among the states. This ranking, mediocre nationally and poor regionally, is in part due to a significant number of health-care mandates and a lack of a regulatory flexibility statutes.¹⁷

Corruption and Legal Liability Risk

HOWEVER, WHAT REALLY holds Louisiana back in the new economy is rampant corruption and a skewed legal liability system. A corrupt and legally risky business environment discourages business formation and slows economic growth.

13. It is important to note here that public sector resource constraints affect policy choices and their implementation.

14. Curtis Dubay, ed., *Facts & Figures: How Does Your State Compare?* (Washington: Tax Foundation, 2007) and Arthur B. Laffer and Stephen Moore, *Rich States/Poor States: ALEC-Laffer State Economic Competitiveness Index* (Washington: American Legislative Exchange Council, 2007).

15. Curtis Dubay and Chris Atkins, *2008 State Business Tax Climate Index* (Washington: Tax Foundation, October 2007).

16. Castle Coalition, *50 State Report Card: Tracking Eminent Domain Reform Legislation Since Kelo* (Washington: Institute for Justice, August 2007), 22.

17. Raymond Keating, *Small Business Survival Index, 2007: Ranking the Policy Environment for Entrepreneurship Across the Nation*, 12th ed. (Oakton, VA: Small Business & Entrepreneurial Council, November 2007).

Businesses facing corruption and potential liability risk must alter their business practices to deal with these threats. Distrust, uncertainty, and unfairness are not favorable business settings.

Quantifying corruption and legal system risk is admittedly difficult. However, the Better Government Association (BGA) assesses state laws that “promote integrity” on the basis of transparency, accountability, and limits. Transparency measures the openness of government operations through the adequacy of freedom of information laws. Accountability assesses the penalties for violating statutory limitations and restrictions on campaign contributions, gifts, or honoraria.¹⁸

Taking a different approach, Corporate Crime Reporter calculates a corruption rate for each state by tallying the number of public corruption convictions per 100,000 people between 1993 and 2002.¹⁹ While these measures do not perfectly assess corruption or the laws that seek to prevent it, Louisiana’s ratings are not favorable in either case. As shown in Table 4, the Integrity Index of the BGA ranks Louisiana a poor 46th, and the Corporate Crime Reporter’s corruption index ranks Louisiana as the 3rd most corrupt state. Other states in the region also rank poorly, but this is cold comfort for a population that seeks to be a strong knowledge-economy contender.

Table 4: Integrity and Corruption: Comparative Analysis

STATE	LA	AL	AR	GA	MS	TX
BGA Integrity Rank	46th	47th	31st	26th	33rd	9th
Corruption Rate (Rank)	7.05 (3rd)	3.67 (15th)	1.32 (42nd)	2.76 (23rd)	7.48 (1st)	2.41 (29th)
Note: The Better Government Association gives high rankings to states with the best laws, while Corporate Crime Reporter gives high rankings to states with the most corruption.						

Sources: Better Government Association, 2002, www.bettergov.org and Public Corruption in the United States, 2004, www.corporatecrimereporter.com/corruptreport.pdf

Louisiana fares no better in an examination of liability risk. In an attempt to “explore how reasonable and balanced the tort liability system [of a state] is perceived to be by U.S. business,” the U.S. Chamber of Commerce surveyed senior attorneys of companies with at least \$100 million in annual revenues. These attorneys were asked to rate the following criteria: overall treatment of tort and contract litigation, having and enforcing meaningful venue requirements, treatment of class action suits and mass consolidation suits, punitive damages, timeliness of summary judgment/dismissal, discovery, scientific and technical evidence, non-economic damages, judges’ impartiality and competence, and juries’ predictability and fairness.²⁰

According to this survey, Louisiana has the 49th worst tort liability system in the United States, ranking in the bottom three of all categories. Its largest city, New Orleans, is ranked as the 9th “least fair and reasonable jurisdiction in the nation.” Hedonic damages, a lack of reliance on credible science and experts, and a proliferation of asbestos lawsuits warn businesses that Louisiana’s legal environment is hostile to them.²¹ What is particularly disturbing is that 64 percent of survey respondents said the litigation environment was either “very likely” or “somewhat likely” to affect important business decisions, including where to locate or do business.²² The poor rankings of neighboring states—Georgia at 28, Arkansas at 34, Texas at 41, Alabama at 47, and Mississippi at 48—should again be cold comfort to Louisiana. If Louisiana wishes to attract businesses and spur economic growth, it must substantially reduce both its systemic corruption and legal liability risk.

Public Services

THOUGH TAXES, REGULATION, corruption, and liability risk are important, they are not the only factors that determine a state’s economic competitiveness. Public services are also important to business. We focus on two vital functions: law and order and education.

18. Better Government Association, *The BGA Integrity Index* (Chicago: Better Government Association, 2002), 2.
 19. Corporate Crime Reporter, *Public Corruption in the United States* (Washington: National Press Club, January 2004), 5.
 20. U.S. Chamber of Commerce, *Lawsuit Climate, 2008 Ranking the States* (Washington: Harris Interactive, Inc., 2008), 1, 12-14, 27.
 21. U.S. Chamber of Commerce, *Lawsuit Climate*. Hedonic damages compensate for “the loss of enjoyment of life.”
 22. *Ibid.*, 6.

Law and Order

DATING BACK TO Adam Smith, the maintenance of law and order has been recognized as an essential function of sound government, and this function remains relevant whether an economy produces “old” or “new” goods and services. Neither businesses nor their employees want to locate where lawlessness threatens their property or persons. Louisiana’s crime rates, 9th for violent crime and 20th for property crime in the United States, are clearly too high and are a strong disincentive to new businesses and their prospective employees.²³

Education

EDUCATION IS A critical element in the emerging knowledge economy. Is Louisiana’s education system positioning its workers well for the challenges of this economy? The answer is a resounding “no.”

While Louisiana is generous in its support of higher education, the state of its K-12 programs is lamentable. The following table presents comparative proficiency percentages for Louisiana and the nation as measured by the U.S. Department of Education.

Table 5: State Achievement, National Assessment of Educational Progress Scores, 2007

	LOUISIANA AVERAGE	LOUISIANA RANK	NATIONAL AVERAGE
4th Graders: Reading, Percent Proficient	20.4	49	31.7
4th Graders: Math, Percent Proficient	24.4	49	38.6
8th Graders: Reading, Percent Proficient	19.4	48	29.2
8th Graders: Math, Percent Proficient	19.0	46	31.0

Source: *Quality Counts, 2008, Editorial Projects in Education Research Center, www.edweek.org/ew/toc/2008/01/10/index.html.*

These low-proficiency percentages do not bode well for a state seeking to be a contender in the new economy and facing national and global competition. Graduation rates tell a similar story.

Table 6: High School Graduation Rates, Class of 2004: Comparative Analysis

	U.S.	LA	AL	AR	GA	MS	TX
Graduation Rate / (Rank)	69.9	61.4 (44th)	59.0 (46th)	72.2 (26th)	56.1 (48th)	62.1 (42nd)	67.3 (36th)
Note: Rankings are for public high schools and are modified from the original source by omitting the District of Columbia.							

Sources: *Quality Counts, 2008, Editorial Projects in Education Research Center, www.edweek.org/ew/toc/2008/01/10/index.html.*

Louisiana’s poor educational performance suggests that more than public policy is the problem, particularly because relative to other states, Louisiana does not underfund its education system, especially in light of its national rank.

Table 7: Louisiana's Education Spending, 2005

	LOUISIANA AVERAGE	LOUISIANA RANK	NATIONAL AVERAGE
Per Pupil Expenditures	\$8,582	29	\$8,973
Percent of Students Funded At or Above the U.S. Average	36.7	26	46.1

Source: *Quality Counts, 2008, Editorial Projects in Education Research Center, www.edweek.org/ew/toc/2008/01/10/index.html.*

Whatever the source of the problem, Louisiana must remedy this severe problem if the state is to gain competitive ground.

Public Policy: Its Possibilities and Limitations

LOUISIANA’S PUBLIC POLICIES that influence its place in the new economy of the 21st century are neither all good nor

23. U.S. Census Bureau, *Statistical Abstract of the United States* (Washington: U.S. Government Printing Office, October 2008), Table 301.

all bad. But being good or average will not make Louisiana a knowledge-economy leader.

Thriving in the new economy requires government to perform some very traditional functions, such as law and order, and Louisiana needs substantial improvement. In particular, rates of violent and property crime are too high, and Louisiana must root out systemic corruption and reform its tort liability system.

Thriving in the new economy also requires a skilled, educated workforce. Louisiana does well in providing college and university students with opportunity, but this opportunity is not reaching K–12 students. Despite funding that is in line with national averages, K–12 students perform poorly. Louisiana must find a way to improve their performances.

Louisiana: Its Current Position and Future Potential

THE AFTERMATH OF Hurricane Katrina awoke Louisiana not only to the devastating consequences of a natural disaster, but also to the realities of an underperforming economy. There are bright spots, including innovative metropolitan areas and a thriving entrepreneurial sector, yet overall, Louisiana's economy lags that of the nation and many regional states. Per capita income is low, the professional and business service sector is underrepresented in the employment mix, and educational attainment is sub-par. Louisiana can improve its economic fortunes. However, improvement will require the state to embrace fully the knowledge economy of the 21st century, a step the state as a whole has not taken despite the progress in its metropolitan areas. To attract new businesses and bright workers, and to ensure that current businesses and talented workers not only stay in the state, but also thrive, Louisiana should:

1. Create a more hospitable tax environment by cutting local option sales taxes and sales taxes on certain business-to-business transactions.

Lower marginal income tax rates would also make the state more competitive.

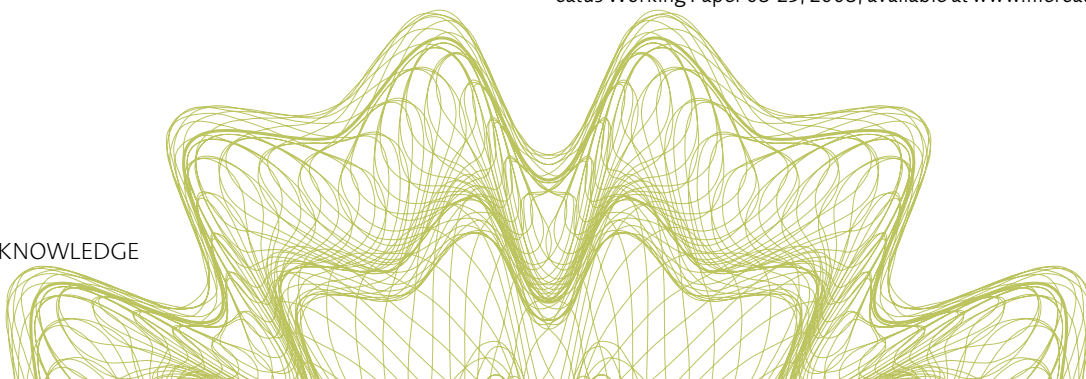
2. Create a more hospitable regulatory environment by reducing health care mandates and increasing overall regulatory flexibility.
3. Create a more hospitable legal environment by passing and enforcing statutes that root out systemic corruption. Revamp the state's legal system, which the private business sector perceives as unbalanced and unfair, to reduce tort liability risk.
4. Reduce the rates of violent and property crimes.
5. Strive to raise educational performance in grades K–12.

Changing public policy is not easy, but the consequences of contentment with the status quo can be devastating. By adopting changes now, Louisiana can attract and retain the resources it needs and develop the flexibility required to meet the economic challenges of the years to come.

Jody Lipford is a professor of economics and business administration at Presbyterian College, Clinton, South Carolina. His articles have appeared in such journals as the *Journal of Economic Behavior and Organization*, *Independent Review*, and the *European Journal of Law and Economics*. Dr. Lipford's research focuses on public finance, public choice, and property rights.

Bruce Yandle is the dean emeritus of the Clemson College of Business and Behavioral Sciences and a distinguished adjunct professor for the Mercatus Center at George Mason University. The author or co-author of numerous books, including *Taking the Environment Seriously*, *The Political Limits of Environmental Regulation*, *Environmental Use and the Market*, *Land Rights*, *The Economics of Environmental Quality*, and *Common Sense and Common Law for the Environment*, Dr. Yandle is a member of the South Carolina State Board of Economic Advisors.

For a more complete analysis on the state of Louisiana's economy and further public policy recommendations, please see the genesis of this article, "Louisiana's Performance in the New Knowledge Economy," Mercatus Working Paper 08-25, 2008, available at www.mercatus.org.



WILLIAM FRANTZ PUBLIC SCHOOL



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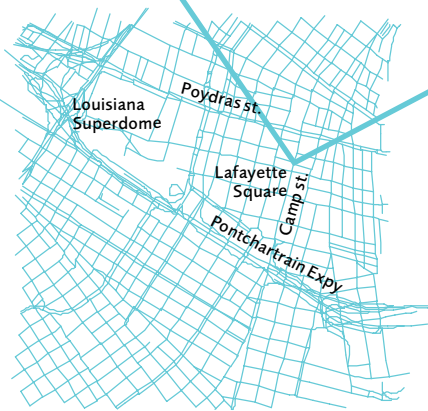




CASE STUDY #5

TIM WILLIAMSON

President:
The Idea Village
Camp Street and Girod Street



Tim Williamson is president of The Idea Village, a non-profit based in New Orleans's Warehouse Arts District, that works with entrepreneurs to "ignite innovation by providing strategy, talent and resources to entrepreneurial ventures." A native New Orleanian who lived around the United States before coming home in the 1990s, Tim's mission is bold: make New Orleans America's headquarters of entrepreneurial innovation.

What is The Idea Village?

The Idea Village is an independent non-profit started by local entrepreneurs. Fundamentally, we believe that innovators are the catalyst for social and economic change in New Orleans.

We believe that the key challenge in New Orleans was the exodus of innovative talent. We realized the need to focus

on creating a vibrant environment where entrepreneurial talent could grow ideas into viable businesses. This entrepreneurial vibrancy, in turn, would attract, retain and engage more individuals that would start and grow new ventures.

Building an entrepreneurial ecosystem is critical. Not just providing capital, nor incubators. It is about building open networks that will allow access to expertise and resources to help these entrepreneurs stay here.

How did The Idea Village get started?

The Idea Village was started in 2000 by five local entrepreneurs who left New Orleans and decided to return home.

Collectively, we realized that the city needed more entrepreneurs and a community to believe in them. There weren't a lot of people like us. There wasn't a lot of capital, a lot of support.

The concept of The Idea Village started in a bar. We decided that rather than just talk—and everybody's talking—let's put money on the table and create action. So we each put up two thousand dollars for a \$10,000 business plan contest and said, "Who's got the best idea in town?" This was a challenge to the community. . . .

Three weeks after announcing the challenge, over \$125,000 worth of resources and services were donated to the winning entrepreneur. We had about 70 business plans submitted and thought we hit a nerve as there really wasn't a lot of focus on entrepreneurship. . . . But obviously there was a desire.

We selected a contest winner and the issue was that the entrepreneur needed \$10 million to start a local company. We liked the idea but realized that these guys weren't ready for money, they needed business strategy. So we went to the city and the chamber but neither was in a position to support the work of entrepreneurs. As a group, we decided to help them with a business strategy, raised risk capital and connected them to key people in the community. After people heard about our efforts, entrepreneurs began coming to us for assistance. . . .

We did not plan to start a new organization. But how come all these people don't have a place to go? We decided to

research other markets, Austin, Atlanta, North Carolina, Minnesota, San Francisco, and we wrote this strategic plan for the city of New Orleans: “the Idea Village-Making New Orleans a world-class entrepreneurial community” .

What are New Orleans' strengths vis-à-vis entrepreneurship?

New Orleans is one of the greatest cities in the world. New Orleans has the assets to create a culture of innovation: The university system, the creative culture, our brand.

The good news about New Orleans is that we create and attract talented people. The guys who started Yahoo! and Netscape went to Tulane and UNO. The challenge is that we have trouble keeping these people in New Orleans. We felt one critical reason was there was not a culture that actually nurtured innovation.

A challenge is our economy is like a “driftwood economy.” The analogy is that we are at the mouth of the river with all opportunities drifting to us. Our community spends time fighting over who gets the resources. Some will win, some will lose—a zero sum game. We need to focus on creating new ideas and opportunities and grow the pie.

Another issue is that we have a very closed culture socially and economically. For these young, innovative people, it really was a hard place to get started. We saw the best and the brightest leave New Orleans and head to New York, Boston, San Francisco, and Atlanta. We wanted to create an environment that grows quality jobs. We felt innovation and entrepreneurship was the answer.

New Orleans has the natural assets to develop talent and The Idea Village was created to cultivate those assets and to have a singular focus on retaining and recruiting talent.

How has Katrina changed The Idea Village?

Pre-Katrina, our focus was high-growth businesses which had the ability to scale to at least ten million dollars in sales. These were primarily technology based companies that were either in tourism, food or music—the natural assets in New Orleans. We had a company that sold tables in restaurants, one that provided a technology solution for the hotel industry, and another that started a business targeted to children’s music.

Post-Katrina, our focus went towards businesses necessary to revitalize our community. The high-growth businesses left. They picked up their servers and their teams, and went back to New York or Austin or San Francisco. The first entrepreneurs back were really the lifestyle, retail, and small businesses. When the story is going to be written, I think that people will realize that the entrepreneurs restarted New Orleans. When all the universities were gone, half the politicians were gone and no city services existed the business owners came back to re-open. They had to open up their food places. They had to open the dry cleaning. But they did it basically on their own spirit and [with] their own funds.

We came back two weeks after the storm. . . . Very few people were here, so the first people back [sold] food. Whether or not they sold food before, they opened up and started selling food. . . . People were opening up supply stores. Women and children came back in December because everybody was in school. So, you saw the small businesses targeting kids. It became a natural progression of opening up a community.

It was critical that you had to sell something that people needed. It is sort of basic, but this was a new economy. People were coming back and they needed stuff now. So, if you were selling golf balls [before Katrina], you had to adjust your business model and you had to . . . open up and sell something relevant to the community.

What does The Idea Village do that's different from what other non-profits or government agencies do?

Our goal is to build relationships with these entrepreneurs. This is not just giving them money. This is not just processing a loan. What we do is build a relationship, to really go through the whole cycle of their businesses, and so money is just one small component of assisting a business. . . . We go through the highs and lows, and participate in the cycle of innovation with the entrepreneur.

So, pre-Katrina, we had all of these relationships. I think that SBA [Small Business Administration] was here to provide loans, which was okay, but what these businesses needed was a network of people to really help them figure out how to react and evolve their businesses. Should I apply for a loan? Or should I hire this person?

So, we are more of a very localized, locally connected organization that really wants to build relationships—long-term relationships—with these businesses.

What have been your biggest challenges in coming back, and what lessons should we learn for future disasters?

As a CEO, my networks are fractured. What I needed [immediately after Katrina] was access to information, and I needed someone who can quickly deliver.

So, I think, some lessons learned that if there were another disaster, every community should probably do an audit of these organizations working directly with small businesses. . . . Because they are really the ones directly working with

these companies, but have that long-term relationship. The day after the storm, we were talking to all of our clients, and we knew exactly where they were and what they needed.

The problem these entrepreneurs or business owners had was that they went through an application process where the new person from the SBA passed to this person, and this person passed to that person, and then six months later, the application was denied. So I would ask, “Look, audit your community to find those organizations that directly touch [entrepreneurs]. Are they credible? Are they transparent? Do they have the capacity to take this on?” Then provide very flexible resources that allow market driven decisions.

Photo: Idea Village



An Artful Recovery

Are there entrepreneurs in the arts?
M.Z. Hemingway investigates.





M.Z. Hemingway



AS AN ASPIRING writer, Joshua Clark came to New Orleans ten years ago to bartend and collect stories. He fell in love with the romance of the city, the sensual way people live and communicate, the unique cuisine, the architecture, the fascinating stories of the residents—the very air of the place.

So he never left, even when Hurricane Katrina bore down, the levees broke, and chaos descended on the town.

From his perch in one of the block-long, red brick Pontalba Buildings in the heart of the French Quarter—built in the 1840s and rented as apartments ever since—Clark was one of the few, hardy inhabitants who stayed through the storm and avoided the mandatory evacuation of the city in its deadly aftermath. The morning after Katrina hit the city, he looked out on historic Jackson Square to find 75 percent of the trees gone. Yet, he thought the city had dodged a bullet. Then, as the levees failed and waters from Lake Pontchartrain flooded the city, he realized it was only the beginning.

OFFBEAT



In the days that followed, he worked as a correspondent for National Public Radio using his phone line that never went out. He also filed a diary with *Salon* and teamed up with fellow holdouts in the Quarter. They pooled their resources to save their neighborhood, cleaning up the litter-strewn streets, sharing valuable information, and lifting the morale of its citizens. As police began forcefully kicking inhabitants out of their homes, Clark and other holdouts managed to stay by passing themselves off as an official cleaning crew. They all wore red t-shirts turned inside out and used his old reporter lanyards to fashion official-looking IDs.

For the ten weeks of Katrina's aftermath, Clark chronicled the impressions of other victims in the Gulf region in hundreds of hours of tape-recorded interviews. History had

never hit him in the face like that, and he knew he had to do something with the experience.

He turned their stories and his own tales of chaos, kindness, anguish, and mercy into *Heart Like Water: Surviving Katrina and Life in its Disaster Zone*, published in 2007 by Simon & Schuster's Free Press. "I had to do the book because I was the only writer here the whole time," Clark said.

The memoir, which combines gritty reportage of the devastation with a novelistic narrative, was nominated for a National Book Critics Circle award. "Clark's narrative rises to the level of being a crucial witness to the city itself—an indictment, indeed, but also a reveling, an elegy, a light forward to survival," said Pulitzer Prize-winning novelist and former New Orleans resident Richard Ford.



Ford's praise only serves to highlight how Clark embodies the resilience and entrepreneurial spirit of New Orleans's artistic community. It is this commitment to the arts that has helped the city rebuild and fight back against unthinkable devastation.

"Every artist is an entrepreneur," says Dr. Elliot McGucken who founded and taught the Arts Entrepreneurship class at University of North Carolina at Chapel Hill.

Clark is no exception. Not just a writer, the Yale graduate is also a successful independent publisher and editor. As soon as the power returned to the city, he started a fund to help area writers negatively affected by the storm and reprinted *French Quarter Fiction*, the anthology he published through his Light of New Orleans press. He lost an entire printing of

the book in the storm. A portion of the proceeds from this book, as well as from *Heart Like Water*, went to the writers' fund, which has provided grants to dozens of writers.

THE CITY OF New Orleans has long fostered a thriving culture known for its literature, music, and cuisine. The southern gothic master William Faulkner wrote his first novel there, jazz was birthed there, and it's the only place in the country to get authentic beignets, muffalettas, and po' boys.

But what happens when computers, instruments, and restaurants are under water or blown away in the wind? Not only is daily life rent asunder, but the creative process also.

In 2005, Hurricane Katrina led to the forced exile of

almost every artist from New Orleans. Three years later, the city's artist community is vibrant and creating art that responds to and helps the city process their experience of Hurricane Katrina.

FROM VIBRANT ZYDECO, Cajun, and jazz, to smoky blues bars and the brass bands that march in jazz funerals, New Orleans is steeped in music. In fact, when Katrina hit, the stories of displaced musicians gripped the nation as much as anything else.

Rock and Roll legend Fats Domino was reported missing when floodwaters deluged his Ninth Ward neighborhood. Fans and family feared that the “Blueberry Hill” and “Ain’t That A Shame” singer had perished, but he was rescued and transported to dry land. The next year he released *Alive and Kicking*, his first album in nearly two decades.

Producer, arranger, songwriter, and musician Allen Toussaint was also missing during the Katrina aftermath. Best known for his hit “Working in the Coalmine,” Toussaint wrote “Right Place, Wrong Time” for Dr. John and other hits for the Meters and Patti LaBelle. Toussaint survived the storm and has spent the years since playing and recording music to help his city heal and rebuild. After making his way to New York City, he staged benefits and worked on a collaboration with Elvis Costello called *The River in Reverse* that was issued in May 2006.

Whether they're visiting during Jazz Fest or Mardi Gras, people come from all over the world to hear New Orleans' talented musicians. New Orleans is a top cultural destination for tourists, and the cultural economy generates jobs and revenue for the city. Before Katrina, the cultural economy accounted for more than 100,000 jobs in Louisiana. But after Katrina, the cultural economy lost more than 75 percent of its business and 66 percent of its workforce, according to the Bring New Orleans Back Commission.

The cultural industry has long been underappreciated, ignored, and not viewed as a business, said *offBeat* Magazine publisher Jan Ramsey. Thus, she found it particularly ironic that much of the attention paid to New Orleans in Katrina's aftermath was because of its rich musical heritage.

Twenty years ago, Ramsey was working for a small consulting firm when it struck her that she was well-positioned to tap into the huge but underdeveloped music industry in her hometown.

“I felt I was an entrepreneur but I didn't know exactly what I wanted to do,” she said. A music junky, she hung out with a lot of creative people and used her business skills to

help them out. Because of her consulting background, she could see that the music scene in New Orleans wasn't just culturally rich but also a significant industry.

“Nobody ever paid attention to musicians as part of a culture or business,” she said.

For the next twenty years, she built up an international subscriber base for her print magazine and, later, daily Web site featuring the best in local jazz, blues, r&b, funk, gospel, rock, alternative rock, and jazz. As the floodwaters came in, subscribers from around the country rushed to the *offBeat* Web site to get information. Ramsey and her partner had fled the city for what they thought would be a couple of days. They ended up living with her sister for two months. One of their most surreal moments in exile came when they were

“Katrina will provide fodder for creative output for many years.”

Jan Ramsey

watching television at a restaurant as CNN showed looters running wild on a city block. She and her husband realized that they were watching their own block.

At first Ramsey thought she might have to give up the magazine. The latest issue had gone to press but there was no way it would be delivered. And advertisers wouldn't pay for ads that no one saw. The situation looked bleak. As Ramsey realized she couldn't leave New Orleans, she asked subscribers and supporters for help. Money flowed in.

“The fact that people gave us money and wanted to keep the magazine going—it wasn't just financial—it was moral support,” she said.

The full effect on musicians remains to be seen, Ramsey said. Everyone has a story to write, to sing, to perform. But it's unclear how many musicians were displaced from their neighborhoods or the city.

A significant number of musicians lived in New Orleans East, Gentilly, and the Lower Ninth Ward—areas Katrina devastated. The temporary and permanent closings of music venues decreased the number of available gigs.

“What concerned me was the street culture that produces the unique New Orleans sounds—the second lines, Mardi Gras Indians, and brass bands. I worried about losing them,” said Ramsey.

But within a few months of Katrina's devastation, it was clear that the musicians should not be counted out. New Orleans hosted a raucous Mardi Gras celebration in 2006 that attracted 700,000 revelers. The event served as a family reunion for the town and also provided a national image as a city that was rebuilding.

Since then, Ramsey has been doing what she has been doing for years—supporting New Orleans' music industry and promoting it through festivals that bring together musicians, chefs, and other artisans to bring people back to the city.

And it's been working. Musicians have been returning to the city, playing in the bars and festivals, and releasing new music.

"Katrina will provide fodder for creative output for many years," she said.

NEW ORLEANS IS well-known as the birthplace of jazz, but it's also the birthplace of the only indigenous urban cuisine in the country. While other American cities have culinary specialties, New Orleans cuisine is distinctive. The Louisiana flavor and style are formed from melding Creole, French, Spanish, Italian, African, Native American, Cajun, and Cuban traditions.

World-renowned, New Orleans-based chefs, such as Paul Prudhomme and John Besh, reopened their kitchens as quickly as possible after Katrina. Many have even added new restaurants.

Besh bought out his investor in his flagship Restaurant August just prior to Katrina. When the storm hit, he wasn't sure how he'd cover his expenses. The James Beard award winner decided to aggressively expand, doubling the number of restaurants he had to four including Lüke, a brasserie with its own line of beer, and La Provence, a rustic French restaurant on the North Shore. Besh is writing a book and working with a local dairy to design a line of flavored butters for Whole Foods.

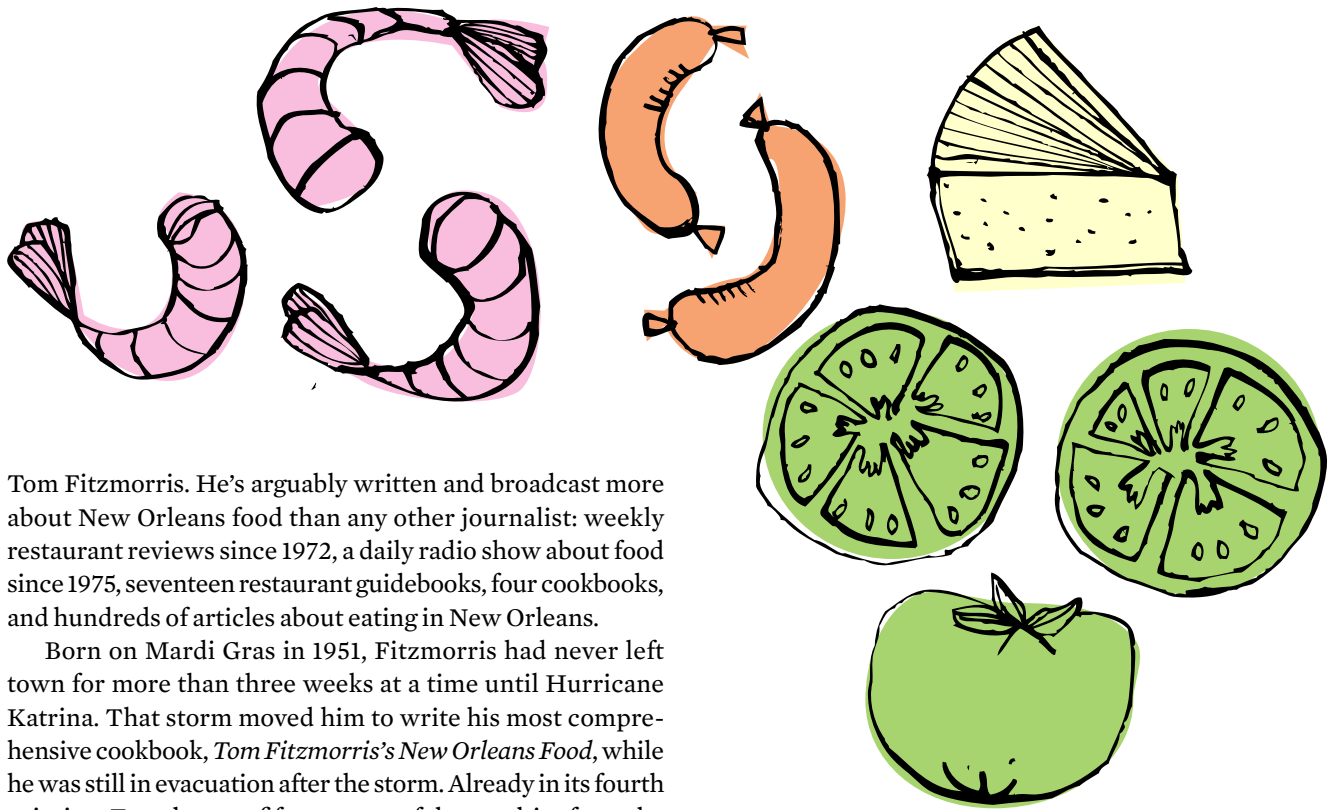
As one of the celebrated guardians of New Orleans's cuisine, Besh feels an obligation to preserve the city's culinary traditions. "Our culture is so very unique in that all of the people that settled here assimilated into one, rich culture, which happens to be one of the most unique and recognizable cultures in the country," Besh told the Louisiana Office of Tourism.

Before the hurricane, New Orleans had 809 restaurants. Every single one of them closed for at least a week when Katrina struck. By April 2008, 809 restaurants had opened again. And as of press time, 938 restaurants had opened for business—without government assistance.

Keeping the tally on the restaurants and covering the resurgence is foodie

Photo: RickLordPhotography/istockphoto





Tom Fitzmorris. He's arguably written and broadcast more about New Orleans food than any other journalist: weekly restaurant reviews since 1972, a daily radio show about food since 1975, seventeen restaurant guidebooks, four cookbooks, and hundreds of articles about eating in New Orleans.

Born on Mardi Gras in 1951, Fitzmorris had never left town for more than three weeks at a time until Hurricane Katrina. That storm moved him to write his most comprehensive cookbook, *Tom Fitzmorris's New Orleans Food*, while he was still in evacuation after the storm. Already in its fourth printing, Tom donates fifty percent of the royalties from the book to the recovery efforts of Habitat for Humanity.

"The power of the local culinary culture is as strong as anything in this town. Even though many public goals that are far more important than where we will dine tonight remain to be solved, we need what we get from our unique food in order to soldier on," said Fitzsimmons.

While a few iconic restaurants such as Bella Luna, Cha-teaubriand, and Christian's have yet to return, new restaurants open at a record pace. One of those new restaurants, *Mélange*, demonstrates the way in which New Orleans restaurants are adapting after Katrina and Rita.

Located in the luxurious Ritz-Carlton, *Mélange* has its own interpretations of New Orleans classics like blackened redfish. But the menu also lists a substantial number of dishes apparently cribbed from popular New Orleans restaurants. In one meal at *Mélange*, diners could try Upperline's Fried Green Tomatoes, Jacques-Imo's Alligator Sausage and Shrimp Cheesecake, and the Palace Café's Pepper Crusted Duck confit.

However, *Mélange*'s Executive Chef Matt Murphy is not the Jean Lafitte of the culinary Gulf Coast. What seems like piracy is actually an experiment in post-Katrina camaraderie. *Mélange* reproduces the signature recipes with the bles-

sing and instruction of the named chefs. Those chefs also occasionally appear in the kitchen at *Mélange* as the Chef de Cuisine du Jour. In addition, the Ritz-Carlton scatters books filled with the bios of the participating chefs and the complete menus of their restaurants throughout the hotel.

The Ritz-Carlton says it has created this restaurant as "a celebration of New Orleans and of its reputation as one of the best destinations for food in the world." But the Ritz-Carlton also knows the habits and practices of its guests. A guest in New Orleans for only two days might well find the ability to eat at three or more restaurants in one meal enticingly efficient. So might the participating restaurateurs, who are banking on the genius of their recipes. If a guest loved the Alligator Sausage and Shrimp Cheesecake she had on her first night, she might well venture out to Jacques-Imo's Café for a Blackened Sirloin of Lamb on her second.

Lorin Gaudin, who hosts a radio program about the local culinary scene, said that entrepreneurial experimentation like *Mélange* is vital not just for recovery, but also more broadly for the future of food in New Orleans. And the result is that the culinary scene is much more dynamic and interesting than it was before the storm, she said.

“There’s this intense desire now to be urban pioneers. People who long wanted to be involved in the culinary realm have found new opportunities and taken advantage of them,” she said, citing more restaurants focused on casual dining and the fresh, seasonal, local foods movement.

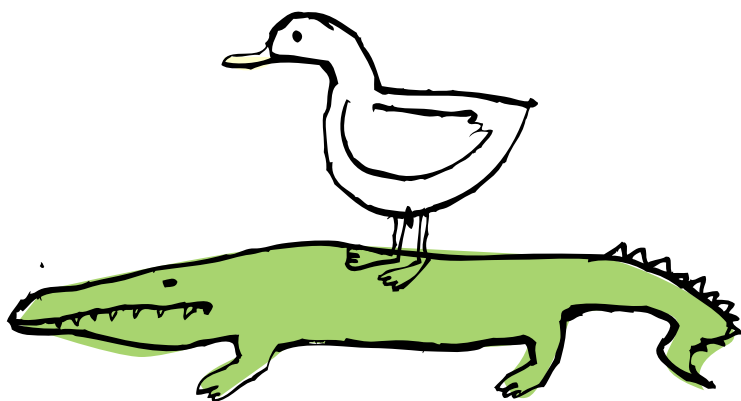
Take Allison and Slade Rushing, married chefs who met in New Orleans, went to New York, and returned after the storm. After a failed restaurant in the country, they gave it another shot in downtown New Orleans with MiLa, which focuses on rustic food prepared with the highest-quality ingredients. One favorite dish is lemonfish, a Gulf species, served with baby artichokes and other savory vegetables with a pureed parsley sauce.

“We’re seeing this interesting twist toward fresher and lighter fare without losing our grip—by which I mean our vice grip of death—on gumbos and po’boys,” said Gaudin.

As the members of the New Orleans arts community channel abundant creative energy into running their businesses and practicing their crafts, they provide some of the best examples of how entrepreneurship strengthens culture and how culture can help a society recover from a disaster even as large as Katrina.

“We had nothing but our culture. And our culture has always put a smile on death,” said Clark.

M.Z. Hemingway is a journalist and writer in Washington, DC. For more information about New Orleans’ cultural entrepreneurs, please visit:
www.frenchquarterfiction.com/LONO.html
www.offbeat.com/
www.restaurantaugust.com/restaurants.html
www.nomenu.com/



Upperline's Fried Green Tomatoes with Shrimp Remoulade

Makes 4 servings (as appetizer)

1 cup buttermilk
1 egg
4 to 6 tablespoons vegetable oil
8 slices green tomato (completely green if possible), approximately 1/2-inch thick
1 cup corn flour, lightly seasoned with salt, and black or white pepper
24 medium shrimp, poached, peeled and chilled
1 cup (approximately) chilled remoulade sauce (recipe follows)
Mixed greens

In a medium bowl, whisk together buttermilk and egg.

Heat oil in a large saute pan over moderate heat. Meanwhile, dip tomato slices in egg mixture, then coat with corn flour. Place tomato slices in pan in a single layer. Do not crowd. Cook over moderate heat until golden brown on bottom. Turn and brown on other side. (Total cooking time is 3 to 4 minutes.) Tomato should be cooked all the way through but not mushy. Exterior should be golden brown.

On individual serving plates, place 2 slices of tomato next to each other and top each slice with 3 chilled shrimp. Spoon 1 1/2 tablespoons remoulade sauce over the shrimp on each slice and garnish plate with a few mixed greens. The tomatoes are served warm or hot. The shrimp and remoulade sauce should be cold.

Variations: Eliminate the shrimp and put the remoulade sauce directly on the tomato slice. Crawfish, scallops or lobster may be substituted for the shrimp.

REMOULADE SAUCE

Group A Ingredients

1/2 cup Creole mustard or other spicy mustard
2 tablespoons ketchup
1 teaspoon Worcestershire sauce
2 teaspoons prepared horseradish
1 teaspoon finely chopped garlic
1 teaspoon fresh lemon juice
1 1/2 teaspoons paprika
1/4 teaspoon ground white pepper
1/8 teaspoon finely ground black pepper
1/8 teaspoon cayenne pepper, or to taste
Salt, to taste

Group B Ingredients

1/2 cup olive oil
1/4 cup finely chopped heart of celery
1 1/2 teaspoons finely chopped parsley
1 tablespoon grated white or yellow onion
1 tablespoon finely chopped green onion, white only
Hot sauce, optional

Combine ingredients in Group A except salt and mix well. Add salt to taste.

Add olive oil in slow stream while whisking mixture. Add rest of Group B and mix well. Add a few drops of hot sauce if a spicier flavor is desired. Sauce should be spicy and tangy. Cover and chill before use. Covered and refrigerated, the sauce should keep about 3 weeks.

www.npr.org/templates/story/story.php?storyId=5692200



CASE STUDY #6

LUIS COLMENARES

Artist

Jean Lafitte Parkway



A native New Orleanian, Luis Colmenares designed and built restaurants and their interiors in New Orleans, restaurants like Emeril's, Nola's, K. Paul's, Red Fish Grill. Before Katrina, he had 25 artists working for him in his City Art Studios. After Katrina, he had a devastated studio, destroyed equipment, and scattered workers. He went to Chalmette and started doing roofing, so he could start building up his art business again.

How did you first get into art to begin with?

Oh gosh, I've been doing art all my life. I kid people I don't have a job: I just do art.

Tell me about what the artistic community was like before Katrina.

It was incredible. We had a wonderful art community here. Pretty much all of Julia Street was really popping; a lot of the artists were doing incredible art. But you know, something changed, too. When some of these artists left and they came back, a lot of them came back with a different look to their art. A lot of the artists put in Katrina into their artwork, and I think more, maybe, more soul to it or more thought into some of their pieces. Look at J'Renee's pieces before: she painted these beautiful people of color. Then when she came back, she was doing more of—not voodoo scenes, but more New Orleans devastation and people in the background and broken houses, but beautiful paintings. With everything, my art has changed too. I was doing just very cute decorative stuff, and now I'm trying to do more serious pieces.

When did you first get back to your studio after Katrina?

I think about two and a half weeks, maybe three weeks, I got back to my studio. It was totally devastated. We took a bulldozer, took everything out on the street, and then cleaned as much as we could, put whatever we could save inside. It's really hard going from a studio that could produce everything to having one welding machine—not even gloves—and having to try to work with that. I had a little bit of savings, so I decided to invest it into getting roofing equipment. And then we started doing roofing.

I did roofing for about a year and a half in mid-city Chalmette and some in Uptown area. I did 56 roofs all together and helped rebuild about three houses.

Who were you working with?

Well, I had a crew. I had a crew before the storm that was building my studio spaces for me, and when the water came in and took all their tools away, I basically purchased their tools again so that they wouldn't have any hardship. And then they came to work for me, and it was just a crew of five kids—five young guys.

So you were doing roofing for a year and a half, and was it your intention to keep doing that?

No. Roofing and doing construction was something that my father in a sense taught me. My father was a very hands-on man. He taught me a lot of things, so construction was very easy for me. I just went in and decided that I would do a



little construction work. I kept it under small amounts of money so I wouldn't have to get a lot of licenses and things like that.

So tell me, when did you restart your studio?

What happened was I found one of my art patrons, and he owned about 40 properties that were all down here, that were devastated. And he owns a lot of leases on bars and restaurants. What I did was I made a deal with him to help me purchase a building and re-tool me—give me twenty-something thousand dollars to be able to re-tool.

What I do is I go in when he leases a building and I talk to the owners. The owners might have a theme . . . like Wimpy's Tavern was a New Orleans theme. I took [it] and did the New Orleans look in there. I crumbled the walls, and I did the barstools, and rosined the bar top, and I did everything very New Orleans-like.

Now all of a sudden I have a beautiful little place in Chalmette. Then he gets to put his poker machines in there and his cigarette machines. (He has an amusement company.) That way it's a win-win situation. So now, a lot of people say I only work for one person, but in a sense I don't. I work for one person, but I work for the people that are leasing the buildings, too. I do a lot of artwork out here.

So how did you come to that deal?

It was a strange thing. He needed somebody to help him and I needed work. So I think it was a symbiosis, trying to get both of us together to do something that we both needed. Right now I've done eight restaurants, three bars, two daiquiri shops, and one coffee shop in the Parish out of the year and a half that I've been doing this.

Why did you decide to move to St. Bernard Parish rather than stay in New Orleans?

Well, a friend of mine, Charles, that brought me here, he says that there are only two types of people in the world: people that live in Chalmette and people that want to live in Chalmette. But I came down here because I felt like New Orleans already had all the restaurants in the French Quarter done, and there wasn't going to be a lot of restaurant work for me to do. I knew I had to go somewhere where there was total devastation.

There's a little pizza place [here] that's called The Home of the Gorilla. I walked in there, did a few little things for him [the owner], and he feeds me. We did it for free for him because we knew that we're gonna end up buying a few thousand dollars worth of pizzas in the next two years, so we go in there and we get fed.

Also the coffee shop, Ben was the first person with a coffee shop in the neighborhood, and we'd been looking for one because we had to go to New Orleans to get good coffee. When he opened, I was on his doorstep, and we talked for a few minutes. He needed a menu board, so I made him a menu board, and I got fed a lot of coffee and a few croissants, and then I started making other pieces for him and we just became friends.

It's a wonderful, small community where they've embraced me, and I'm helping, hopefully, to bring art and beautify Chalmette.

Now a lot of people in Washington or elsewhere would say, "You know this is an area that's just been devastated. You need construction workers down here; you need medical personnel; you need people to pave the roads. Artists, florists, yoga studios, stuff like that, that's silly, you don't need that in a post-disaster area."

Wow. To me, I see a piece of art, and it makes me smile. I think it gives you a little bit of joy. In a place where you walk down the block and you see devastation, hopefully one day there'll be a piece of art in that park. I think you have to beautify at the same time you're rebuilding, but a lot of these places that aren't being rebuilt and that are being knocked down to slab level are an eyesore. I don't know how you bring art into that, but you have to bring art back into the community somehow to beautify, I think.

You've been working a lot with small business entrepreneurs. What's the role that they play in rebuilding?

We have two or three little construction places here. We have Home Depot, too. They were a blessing because they came back so early. But these mom-and-pop little operations that sell building supplies and things like that when I was doing sheetrock, I could go to them and say, "Look, here's a check. Can you hold the check for three or four days? I need this much sheetrock to hang." And then I got paid by the end of the week, and I went and paid them.

So, they're working with us. You can't do that at Home Depot. It's very hard to have cash flow because of the situation. Labor, you have lots of labor; you can get labor almost anywhere. You can get it in front of Home Depot; you can get it from a newspaper; you can hire locals, labor is easy. But being able to fund the job before the job is done—a lot of people don't want to give you any money up front for you

to build their roof or fix something for them—that was my biggest hardship of doing construction. But I got over it by using all the mom-and-pop operations. If I needed nails, if I needed roofing materials, I went to a little mom-and-pop one, and they were fabulous.

Do you consider yourself an entrepreneur?

Ah yes, I like innovation. I like to do things that are very innovative. What I like to do when I design a restaurant or bar is make one piece of each. I'll make a bar stool; I'll make a chair; I'll make a table; I'll do a chandelier; and then I'll hand it to other artists to make 20 or 30 pieces for me. Because I just don't have the time to produce big amounts of stuff, I'll take those pieces, bring them to another machine shop, and they'll make all the frames. Then I'll bring those to another place, to another artist that has worked for me, and he'll do all the leaves and vines that are on them. And then I'll get them back, and I'll get to touch them by painting them.

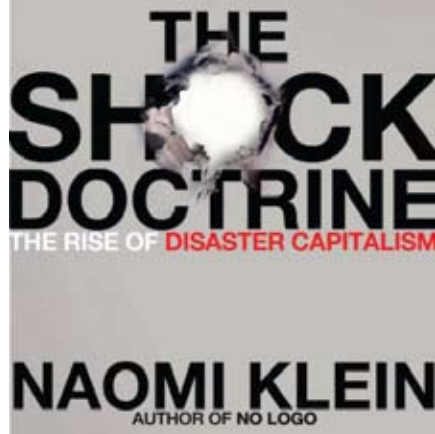
What do you think is the future of St. Bernard Parish and of New Orleans?

Well, the people from St. Bernard are very, very hearty people. They put on their shrimp boots, and they got to work after the storm. If you look down a lot of the streets, you don't see any FEMA trailers. The people in St. Bernard have gotten back and just started working as hard as they could to get this back and that going.

Why do people in St. Bernard, as you say, "Put on their shrimp boots and get going?"

These people, they're Isleños. They were people that had boats and worked with the water, and shrimp, and all these different industries. And I think these people, they don't care about a storm. They care about a storm; they care about losing things, but they want to rebuild like they had it before, so they're not thinking of taking that big lot and building a high-rise on it.

I know a lot of people didn't build their houses like they were supposed to, but if it floods again, they'll do the same thing. They'll cut out their sheetrock; they'll slap it back on; and they'll go back in and live in it again. They just want to keep their little cottage that they had before and live the life they were living, a peaceful life. It's wonderful.



A SHOCKING IDEOLOGY

The Shock Doctrine: The Rise of Disaster Capitalism

Naomi Klein. Metropolitan Books, 576p, \$28

Curtis Melvin

In *Crisis and Leviathan*, Robert Higgs argues governments tend to grow rapidly in response to a crisis, such as a war or an economic depression. When the crisis subsides, the government shrinks—but not to the pre-crisis level. Thus, over time, the size of government “ratchets up” as it takes on more and more response capacities.

New York Times best-selling author Naomi Klein disagrees. In her book, *The Shock Doctrine: The Rise of Disaster Capitalism*, Klein argues that the most recent economic shocks and disasters have not increased the size and scope of government. Rather, they have precipitated a startling “hollowing out” of government’s core functions to international corporations and politically connected independent contractors. At the center of this transformation in public service is a small group of “free-market ideologues” who take advantage of political and economic crises to push privatization and deregulation onto unsuspecting populations “distracted” in the chaos.

Ms. Klein attempts to prove her “hollowing-out” theory through a series

of case studies that ambitiously span the last 30 years of economic change across the globe. What emerges from her narrative, however, is not a thoughtful, informed theory of social change, but a misguided ideological crusade against deregulation and privatization that ignores basic facts.

Ms. Klein’s factually-challenged crusade is on full display in her analysis of education reform in post-Katrina New Orleans. As she tells it, the story of education reform in the ravaged city is one of simple conspiracy. Hurricane Katrina devastates New Orleans, leaving the population scattered, distracted, and confused. Seeing this as a pivotal time to act, Milton Friedman pens a *Wall Street Journal* opinion piece suggesting that New Orleans should convert its public schools into voucher-funded charter schools. Following the op-ed, swarms of well-funded, right-wing policy advocates descend on the city to ensure the necessary legislation is passed over local opposition.

School reform passes, and the incumbent Orleans Parish School District is put on the chopping block. According

to Ms. Klein, the reforms reduce the district’s pre-Katrina portfolio of 123 schools to just four and decimate the teachers’ union through the firing of over 7,000 members.

This scenario sounds like validation of Ms. Klein’s “hollowing out” hypothesis, but the actual situation was far more democratic and complex than the conspiracy theory she peddles. First, the corrupt Orleans Parish School District, which was \$450 million in debt, had failed for years to educate students. Those parents who could pulled their children out of the system long before Katrina hit. The remaining parents, along with locally- and nationally-based organizations, lobbied to reform the system for years, but political pressure from the powerful teachers’ union repeatedly squashed their efforts.

Katrina scattered the teachers’ union. Grass-roots education reform efforts finally took hold. Far from being imposed immediately and undemocratically by outsiders, New Orleans’s education reform policies enjoyed widespread local support upon implementation, and they have delivered results.

In 2007, the first year in which meaningful comparative performance data is available, charter schools posted higher Louisiana Educational Assessment Program (LEAP) scores than traditional public schools at every grade level. Some even outperformed their pre-Katrina, pre-charter scores. In 2008, the number of fourth graders who passed the LEAP exam increased a further 12 percentage points over 2007, and eighth graders improved by 4 percentage points. Though students have a long way to go before they reach national averages, New Orleans is beating average state exam scores, a feat rarely accomplished. Improvements in English, math, science, social studies, and reading are a welcome change from decades of stagnation and decline. Ms. Klein's preference for a failed bureaucracy over these results demonstrates that she herself is guilty of the dangerous ideological purity she ascribes to her book's capitalist villains.

Ms. Klein's poor grasp of democratic decision-making, however, is only eclipsed by her abysmal knowledge of basic economics. Besides lamenting the destruction of New Orleans's failed public school system, she places the incompetent post-storm performance of FEMA and other government agencies firmly at the feet of capitalist contractors who have "hollowed out" the bureaucracies, leaving people with no social safety net when the storm hit.

Ms. Klein's diagnosis of this particular problem is not without merit. Government contracting is not particularly effective. First, the government typically hires contractors on a cost-plus basis, meaning the contractors can pass all of their costs onto the govern-

ment yet still be guaranteed a profit. Second, cost-plus financial management combined with weak oversight means the more contractors spend, the higher their profits will be, even if they exceed their budgets. Third, the government often awards contracts

Ms. Klein's poor grasp of democratic decision-making, however, is only eclipsed by her abysmal knowledge of basic economics.

on a no-bid basis. This might expedite implementation, but as many recipients of federal contracts donate to political campaigns, this practice raises the fear that public officials are using contractors to shuffle public money into their own election campaigns.

But Ms. Klein's indictment of capitalism via government contracting condemns apples while examining oranges. The awarding of government contracts is an inherently political decision made by public officials with public funds for (ostensibly) public purposes. The conditions under which these decisions are made and executed bear little resemblance to the private, profit and loss, pay-for-performance characteristics of private sector contracting. In fact, what is needed to solve these problems is more capitalism in the political process: establishing goals in a contract rather than procedures, establishing penalties for not meeting delivery, transparency of awards, bonuses for coming in under

budget, and even giving agencies the flexibility to compete for contracts against private companies.

With her ideological blinders on, however, Ms. Klein never sees any of these solutions, just as she doesn't see the thousands of social entrepreneurs in New Orleans who struggle each day to improve their neighborhoods. Trapped in a world of conspiracy and ideology, Ms. Klein advocates policies that punish these entrepreneurs and those least able to protect themselves, and that is the most shocking aspect of her doctrine.

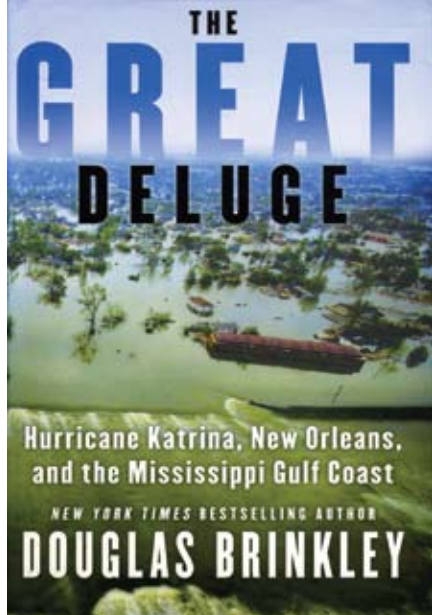
Curtis Melvin is a program developer for the Mercatus Center's Global Prosperity Initiative and *Enterprise Africa!* project.

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THE GREAT DEBACLE

The Great Deluge: Hurricane Katrina, New Orleans, and the Mississippi Gulf Coast

Douglas Brinkley. Harper Perennial, 768p, \$17.95

Daniel Sacks

"A HISTORY OF a single week in the summer of 2005: August 27 (Saturday) to September 3 (Saturday)," the week Hurricane Katrina struck New Orleans and the Mississippi Gulf Coast, causing massive amounts of damage and trapping thousands, is the focus of Douglas Brinkley's book, *The Great Deluge*. *The Great Deluge* tells the stories of many individuals in New Orleans and the Gulf Coast who struggled to prepare for and survive the storm and its aftermath.

Brinkley shows the devastating impact of the hurricane by tracing the stories of many different people, from all walks of life, living across the Gulf Coast. He highlights the different levels of apprehension that preceded the storm and the varied responses in the aftermath. The captivating individual narratives plunge readers into history and force us to consider how we would have handled such tumultuous circumstances.

Focusing on individuals also highlights how failures in planning, preparation, and action dramatically affected people's lives. Brinkley juxtaposes the decisions of the individuals who could have reduced the storm's human impact or hastened rescue efforts once the storm passed. He shows how many people—many of whom represented important organizations and bureaucracies—made poor decisions, ultimately failing the people of New Orleans. From New Orleans Mayor Ray Nagin's lack of leadership and forethought, to Louisiana Governor Kathleen Blanco's clashes with Nagin and President Bush, to the federal government's inability to recognize the problems on the ground, Brinkley makes a strong case that people at all levels of government did not heed significant warnings and failed to respond properly.

Though Brinkley does credit several government agencies for their commitment in responding to the crisis—particularly the Coast Guard, to whom he dedicates the book—many of the "success" stories on which he focuses come from civil society.

The "Cajun Navy" is one of these stories. In Cajun country, north of New

Orleans, R & R Construction owners Ronny and Ruth Lovett asked their employees to drive down to New Orleans and contribute their boats and time to helping stranded New Orleanians escape the flooded city. Out of their own pockets, the Lovetts paid all their employees triple-time for time spent in New Orleans with the "Navy."

Richard Zuschlag and his company, Acadian Ambulance Services (the nation's largest privately held ambulance service at the time), also played a key role in evacuating people and saving lives after the storm struck. Using the company's two hundred ambulances and seven helicopters, Zuschlag and Acadian employees evacuated people from hospitals before FEMA and the Department of Homeland Security even arrived. Acadian succeeded in part because it had tools many others lacked: thousands of satellite phones and its own communications tower. Though government agencies were not prepared for widespread communication failures despite simulations that had warned of the possibility, Acadian was.

Brinkley's strongest example of civil society's superior response to the storm, however, may be the Louisiana Society for the Prevention of Cruelty to Animals (LSPCA). Two days before the storm hit, the LSPCA safely evacuated all of the animals under its care to Houston. The LSPCA and its animals had left the city when Mayor Ray Nagin announced the possibility of a voluntary evacuation within the next 36 hours.

To be sure, the LSPCA is a miniscule entity compared to New Orleans. It's much easier to move 263 animals than

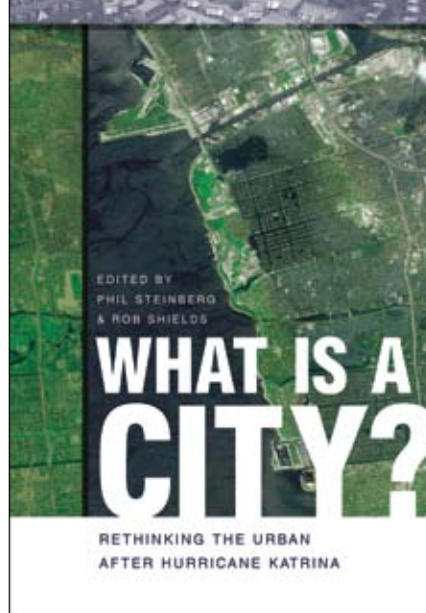
it is to relocate a city full of people. However, although they had the same or indeed superior information, city and state governments did not make the same decisions as the LSPCA. For example, the LSPCA had a standing policy to evacuate in the face of a possible Category 5 storm which it promptly heeded. Though New Orleans had survived hurricanes in the past, the LSPCA recognized it had a responsibility to the animals under its care.

In contrast, the city of New Orleans failed to recognize its responsibility to its citizens—particularly to the 112,000 residents who had no means to leave the city on their own. New Orleans “did not possess a realistic hurricane plan . . . [it] devoted about a page and a half to evacuation but backed away from substantive directives” (19).

Brinkley powerfully relates the stories of the heroism and bravery exhibited during the storm and its aftermath. He forces the reader to wonder what would one’s own response have been in a similar situation.

As one reads about people’s failure to act, lead, plan, or respond to such an enormous threat, it is only natural to be appalled and feel that someone must have been able to do better. By the end of the book, the reader cannot help but ask why 263 animals in the LSPCA were better protected and better cared for than thousands of people in New Orleans.

Daniel Sacks is a program associate with the Mercatus Center’s Global Prosperity Initiative and *Enterprise Africa!* project.



TALES OF THE CITY

What Is a City?: Rethinking the Urban after Hurricane Katrina

Phil Steinberg and Rob Shields.
University of Georgia Press,
233p, \$19.95

Randal O’Toole

WHEN TERRY GABRIEL lived in New Orleans, she had no car, minimal income, and two of her three children were statistically likely to drop out of high school before graduating. Now, as one of 90,000 Katrina evacuees who have permanently settled in Houston, she has a great job, a car, a two-story suburban home, and her children are going to good schools. “I feel like a million bucks,” she says.¹

As the nexus of French, Spanish, Caribbean, African, and Anglo-American cultures, pre-Katrina New Orleans was a unique and fascinating place. But it was also characterized by racism, corruption, and a more-or-less feudal society.

The twelve contributors to *What Is a City?* want New Orleans rebuilt as the cosmopolitan home of jazz and Creole culture that it once was. But, viewing the Katrina tragedy through the lenses of their professions—anthropology, architecture, geography, philosophy, political science, sociology, and urban planning (but not economics)—they fail to see that the institutions they would restore are often the very ones that led to the Crescent City’s downfall.

They blame not only the post-hurricane disaster but also the city’s pre-Katrina problems of poverty and racism on “the nation’s abandonment of New Orleans” (15). Yet, they celebrate New Orleanians’ “resistance” to outside ideas, such as better roads that would have helped more people escape the flooding (105) and school vouchers and charter schools that might have reduced the city’s high-school dropout rate from its pre-Katrina levels of more than 50 percent (41–44).

Nowhere is this contradiction more apparent than in the chapters on mobility. When Katrina hit, about 100,000 New Orleans residents lived in households that lacked an automobile, which, not coincidentally, is about equal to the number of people

1. Wade Goodwyn, “Houston Holds Hope, Despair for Katrina Evacuees,” *All Things Considered*, August 27, 2007, tinyurl.com/3tp3fy.

who failed to evacuate before the flooding. By comparison, when Hurricane Rita hit the Texas Gulf Coast a few weeks later, nearly three million people safely escaped, despite traffic congestion, by auto.²

Instead of lamenting New Orleans' lack of automobility, political scientist Hugh Bartlett rails against the "ideology of mobility" (99) that "privileges the automobile" over other forms of transportation (103). Knowing evacuation would be a problem because

The economist who wasn't asked to contribute to *What Is a City?* might have told the other authors that part of what makes a city work or not work is its institutions.

of low auto-ownership rates, Bartlett observes, the city wrote a detailed public transportation evacuation plan—which it almost completely ignored when Katrina hit (107).

The lesson Bartlett perversely learns is that we should make people even *more* dependent on public transport. He applauds the "New Urban" (i.e., anti-auto) planning taking place in Mississippi, and laments only that "it relies predominantly on voluntary compliance" rather than government

mandates (108–109). Yet, mobility is not an ideology; it is an economic fact that more mobility means greater wealth and less vulnerability to natural disasters.

The economist who wasn't asked to contribute to *What Is a City?* might have told the other authors that part of what makes a city work or not work is its institutions. New Orleans's institutions promoted a culture of dependency, partly because that culture served the oligarchies that ran the city. The book's authors recognize Louisiana has some of the nation's more corrupt governments, yet they miss the point that dependence on such governments might be a bad idea. For example,

- New Orleans families depended on government schools to educate their children, yet the schools were run more for the benefit of the teachers union—"perhaps the strongest in the city"—than the students (42).
- Tens of thousands of New Orleans workers depended on public transportation to get to work, but the city diverted most of its transit dollars into its tourist-oriented streetcar system (107).
- The entire city depended on the U.S. Army Corps of Engineers to maintain levees in case of floods, but Louisiana's congressional delegation diverted funds from

the levees to projects supporting the region's powerful shipping interests.³

- After the devastation, the government itself became an obstacle to reconstruction, delaying the process with endless plans.⁴

Several of the authors lambaste Barbara Bush for suggesting that the evacuation was "working very well for" many poor people displaced by the flood to Houston and other cities (38, 121, 143). While these remarks may have seemed callous at the time, the authors never ask how many Katrina evacuees really are, like Terry Gabriel and her family, better off today living in cities that are less racist, less corrupt, have better schools, and offer more economic opportunities.

It will be sad if the new New Orleans is not as culturally diverse and charming as the old one. But the authors of *What Is a City?* seem to want to restore the very institutions that led to the evils of the old New Orleans, including both government dependency and physical immobility. They have failed to learn the most important lesson of Katrina: that cities work best when they rely on individual initiative instead of government central planners.

Randal O'Toole is a senior fellow with the Cato Institute and author of *The Best-Laid Plans: How Government Planning Harms Your Quality of Life, Your Pocketbook, and Your Future*.

2. "Nearly Three Million Texans Evacuate Coastal Areas," *KWTX News*, September 23, 2005, tinyurl.com/3gaykq.

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4. Emily Chamlee-Wright, "The Long Road Back: Signal Noise in the Post-Katrina Context," *The Independent Review* 12 no.2 (Fall 2007): 235–259.



PICTURE THIS

Holding Out and Hanging on: Surviving Hurricane Katrina

Thomas Neff

University of Missouri Press,
128p, \$29.95

Erin Agemy and Rosemarie Fike

THOMAS NEFF'S BOOK *Holding Out and Hanging On* literally shows how the human spirit, when pushed to its limit, can and will endure the seemingly impossible. Neff, a veteran photographer living in Baton Rouge, volunteered in New Orleans in the days immediately following Hurricane Katrina. Venturing into the areas of devastation as a first responder provided Neff with the unique opportunity to capture the images and stories of New Orleanians who chose to stay and see their city through one of its most difficult times. This book provides insight into a small sample of lives affected by Hurricane Katrina and some of the difficulties that plagued New Orleans as a result of the devastation.

Many of us might be reluctant to stay in a place of such uncertainty. Neff, however, shows that these unwavering individuals have strong ties to their city. Whether it was pride in a family's history, a desire to preserve the legacy of loved ones, a sense of duty to help others in peril, the need to protect a life built over many years, or the inability to dream of going elsewhere, each individual had his or her own reason for choosing to weather the storm. Many of Neff's subjects never even considered leaving.

Neff gives no apparent grouping or order to his subjects. This perhaps intentional disarray speaks to the chaos of the aftermath, giving the reader the unsettling feeling of being there. Along with the photographs, Neff uses first-hand accounts to depict the condition of the city. He paints a picture of government failure, confusion, and blame. Amidst this state of disaster, however, complete strangers came together and helped others in their community. The storm brought people closer together and demonstrated their creativity in the face of limited choices.

Through forced evacuation and prevented returns, the government limited the freedom of residents following Katrina. Such interference reduced people's options and created myriad needs. When the government failed to meet these needs, citizens rose to the challenge, citizens like Ride Hamilton, who seeing the lack of medical care, set up a primitive but effective first-aid post.

Often, however, Neff's portrayals distract the reader from the real stories of these residents and their heroic feats.

Through forced evacuation and prevented returns, the government limited the freedom of residents following Katrina.

His narratives, which were reviewed and clarified by the "holdouts" themselves, presumably articulate each subject's experience, but they risk skewing the bigger picture. "This is Not America" sprawls across the book's back cover as well as on a roof in a picture of New Orleans, conveying the underlying presumption that the government should be taking care of such needs and portraying these individuals as helpless. But these residents took on possibly one of the greatest challenges of their lives. Neff should depict them as more than victims, because they are more: they refused to let themselves be hopeless or helpless.

Neff frequently interjects his opinion about the failures of infrastructure and government agencies, thereby adding bias to the overall nature of the book. For example he asserts that a lack of psychological services caused the tragic demise of French Quarter couple Hall and Bowen. A pivotal part of their community's survival immediately after the storm, Hall and Bowen had difficulty coping with the slow transition to a more normal daily routine. The emotional toll of this situation contributed to their aggression towards one another and their ultimately violent end. Neff suggests that they would not have died if psychological services had been available. But as there is no indication that either Hall or Bowen would have used

these services had they been available, his suggestion is a misleading one. However likely his explanations might seem, they are unnecessary. There is no need for him to nudge the reader in a specific direction: the narratives and photos evidence clearly the failures of public services and government.

They are a special sect, those who stood by New Orleans, and their photos are haunting. Neff poses his subjects in settings that help tell their stories. Melvin Smith stands with the flat boat he used to taxi many scared people to safety. Many other subjects are shown with artifacts central to their survivals. Neff also styles some of the images to the story he wants to tell. The photo of Ashton O'Dwyer, for example, depicts this strong-willed man sitting at a table with his rifle, ammunition, and a strategically placed can of bug-spray showing the words "Hot Shot." While this beautiful photograph effectively conveys Mr. O'Dwyer's character and experience, it leads the viewer to believe that most of these images, though sincere, are less-than-candid.

Even though Neff filters these narratives and photos through the lens of his own beliefs, through his compassion and rapport with his subjects, he communicates well the unique experiences of those witnesses to the city immediately following Katrina. This work serves as a powerful reminder to the rest of America that although Hurricane Katrina hit almost three years ago, it continues to affect a wounded but healing New Orleans.

Erin Agemy and Rosemarie Fike are graduate students in economics at George Mason University and Mercatus Center Masters Fellows.

A SUMMARY OF RESEARCH

Brookings Institution Metropolitan Policy Program

"Created in 1996, the Brookings Institution's Metropolitan Policy Program provides decision makers with cutting-edge research and policy ideas for improving the health and prosperity of cities and metropolitan areas. Our work is designed to help metropolitan areas achieve three goals that are central for success in the new global order: growth in robust, inclusive and sustainable ways." The Brookings Institution's Metropolitan Policy Program works with other research groups to produce the Katrina Reading Room that compiles research on the progress of post-Katrina recovery. The New Orleans Index is a publication, produced in conjunction with the Greater New Orleans Community Data Center (www.gnocdc.org), tracking the progress of the area through empirical data collections and summaries.

www.brookings.edu/metro.aspx

Bureau of Governmental Research

"BGR is a private, non-profit, independent research organization dedicated to informed public policy making and the effective use of public resources for the improvement of government in the New Orleans metropolitan area. BGR also addresses state and national public policy issues that affect the metropolitan area. We are an independent, non-profit, non-partisan organization that is dedicated to gathering information on government and other public issues. Our research professionals analyze government policies, finance, management, and administration, and present the facts to the public."

www.bgr.org

Greater New Orleans Community Data Center

"The Data Center is building sustainable sources of data and information to support nonprofit planning in a rapidly changing post-catastrophe environment. We present this data in a highly usable web format to increase the New Orleans nonprofit sector's access to

this essential information. We work directly with many local organizations to increase their ability to interpret indicators of recovery progress, to act on these indicators to eliminate obstacles to recovery, to identify needed reprioritizations, and to advocate for equity in rebuilding activities."

www.gnocdc.org

Hurricane Katrina Social Science Research Database and Hub

"The Hurricane Katrina Social Science Research Database and Hub is a platform for sharing information and promoting collaboration among social science researchers working on issues surrounding Hurricane Katrina and its aftermath. Projects are conceived as formalized, focused, small-scale collaborative research efforts. Networks are larger, more diffuse collaborations generally organized around broader themes or problems."

katrinaresearchhub.ssrc.org/rdb/katrina-hub

Institute for Southern Studies

"Since 1970, the Institute for Southern Studies has established a reputation as a resource for grassroots activists, community leaders, scholars, policy makers and others working to bring lasting social and economic change to the region. The Institute has maintained a commitment to developing research and publication projects that directly support grassroots organizing, especially efforts for corporate and government accountability. In the wake of Hurricanes Katrina and Rita, the Institute launched Gulf Coast Reconstruction Watch to document and investigate post-storm rebuilding in the South. Reconstruction Watch has become a must-read resource, featuring dozens of pioneering investigative reports, profiles of innovative community leaders, and resources to promote a more democratic and accountable rebuilding process."

www.southernstudies.org/facingsouth

Kaiser Family Foundation – Health Care and Hurricane Katrina

"The Kaiser Family Foundation is a non-profit, private operating foundation focusing on the major health care issues facing the U.S. with a growing role in global health. We serve as

a non-partisan source of facts, information, and analysis for policymakers, the media, the health care community, and the public. As part of the Kaiser Family Foundation's commitment to help respond to the devastation from Hurricane Katrina, we produce resources related to an ongoing effort to monitor and study the health coverage and needs of the victims." Kaiser compiles articles on survivor experiences, surveys, health coverage, state facts and HIV/AIDS issues to inform those affected by Katrina.

www.kff.org/katrina

Louisiana State University – Reconstructing Community: Paths to Recovery in New Orleans Since Hurricane Katrina

"This project is a comparison of communities in New Orleans and surrounding areas since Hurricane Katrina. We conducted surveys of churches and faith-based organizations, neighborhood associations, and other communities. Research includes evaluations of stress, and assessments of damage and re-flooding risk. Research investigates the contributions of community, social networks, and organizations to recovery and rebuilding."

www.lsu.edu/fweil/KatrinaResearch

New York University for Catastrophe Preparedness and Response

"The Center for Catastrophe Preparedness and Response (CCPR) at New York University was founded in 2002 as a university-wide, cross-disciplinary center to improve preparedness and response capabilities to catastrophic events including terrorism, natural disasters, and public health emergencies. CCPR facilitates research projects that address issues from first responder capacity during crises, to public health response, to legal issues relating to security. After seeing Hurricane Katrina unfold in August 2005, CCPR mobilized to engage the NYU community through a university-wide research competition."

www.nyu.edu/ccpr

Public Affairs Research Council of Louisiana and Rockefeller Institute – GulfGov

GulfGov is a partnership of the Public Affairs Research Council of Louisiana and the Rockefeller Institute of Government at the State

University of New York at Albany. "GulfGov Reports assesses how well federal, state, and local institutions including governments, nonprofit organizations, businesses, and civic leaders respond to [the challenges of rebuilding after Hurricane Katrina.] Over three years, GulfGov Reports will examine and issue regular reports on what these institutions are doing (or not doing) to improve and restore the living conditions of the people affected by these disasters. These reports will provide valuable lessons and insights for dealing with future disasters."

www.rockinst.org/gulfgov; www.la-par.org

RAND Gulf States Policy Institute

"RAND conducts research and provides analysis to address challenges that face the United States and the world. Today, RAND emphasizes several areas of research that reflect the changing nature of a global society. The RAND Gulf States Policy Institute (RGSPI) is assisting in long-term recovery efforts [from Hurricanes Rita and Katrina] by providing evidence-based policy guidance to facilitate and speed regional recovery and growth, re-establish services and result in a wise investment in infrastructure. Within a week of Katrina's destruction, RAND researchers were on the ground identifying issues that would benefit from the nonprofit research organization's ability to analyze data and provide policy options."

www.rand.org/rgspi/

Urban Institute

"The Urban Institute gathers data, conducts research, evaluates programs, offers technical assistance overseas, and educates Americans on social and economic issues — to foster sound public policy and effective government. The Institute works to analyze policies, evaluate programs, and inform community development to improve social, civic, and economic well-being. Urban Institute researchers have studied urban blights such as widespread poverty, a failing public education system, low wages, and a weak tax base for nearly 40 years and knew what to reinforce when the storms of September 2005 compounded the old problems and swept in some new in New Orleans."

www.urban.org/afterkatrina

A POLICYMAKER'S GUIDE TO DISASTER PREPAREDNESS AND RESPONSE: LESSONS FROM THE ENTREPRENEUR

How to Prepare for Disasters

- **Prepare your regulations.** Normal regulations can slow the recovery process dramatically. Have an alternative set of “disaster regulations” that recognize the need for flexibility in the recovery process ready to put into play when disaster strikes.
- **Respect the role of the private sector.** Give the private sector freedom to provide resources for relief, and don't try to control or coordinate private sector response. Preparedness plans should remove barriers to private sector action.
- **Promote resilient insurance markets.** Avoid state insurance pools, subsidized insurance schemes, and other policies that encourage people to put themselves in harm's way.
- **Devolve planning.** Responsibility for preparedness should be devolved to as local a level as possible. When possible, neighborhood associations and local groups should address local preparedness and planning needs.
- **Be ready to connect.** Ensure emergency service providers (ESPs) and first responders have compatible communication systems.

How to Respond to Disasters

- **Avoid distorting private sector signals.** Post-disaster decision making depends on signals that individuals, businesses, and non-profits send one another. Policy makers should focus on creating environments that don't distort these signals.
- **Give vouchers rather than in-kind assistance.** Vouchers are easier to distribute and encourage more flexibility and creativity in housing, feeding, and clothing the victims of a disaster.
- **Avoid targeted incentives.** The best tax environment to spur rebuilding is one that is broad and neutral and does not focus on specific locations, industries, or hiring decisions. Do not try to pick economic “winners” or restructure economies.
- **Achieve accountability through transparency.** Ensure that spending on disaster relief is highly transparent and available to scrutiny. Set firm time limits on FEMA involvement in reconstruction to avoid retarding local economic growth.
- **Remove barriers to local solutions.** A variety of institutions are crucial in moving along the rebuilding effort. Ensure that those willing to help are included and encouraged and not kept away by bureaucratic ankle weights.

*For more policy lessons learned from the Mercatus Center's research, please see
“A Policy Maker's Guide to Effective Disaster Preparedness and Response,”
Mercatus On Policy No. 20, May 2008.*

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