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Should the Government Rebuild New Orleans, Or Just Give Residents Checks?

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Summary

Should government rebuild New Orleans? Edward Glaeser asks whether the residents would be better off with $200,000 in their pockets than to have $200 billion spent on infrastructure: shouldn't we be insuring the people, not the place? New Orleans has been declining and its people mired in poverty for decades; its port and pipelines cannot employ a large city, and $200 billion is unlikely to change that.

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In the wake of Hurricane Katrina, President Bush declared that a "Great City Will Rise Again." He promised, "Throughout the area hit by the hurricane, we will do what it takes—we will stay as long as it takes—to help citizens rebuild their communities and their lives."

Lawmakers have stumbled over each other to suggest greater and greater public spending to rebuild New Orleans. While details remain to be settled, the current estimates are that federal spending will be close to $200 billion.

Senator Edward Kennedy has proposed a $150 billion agency specifically dedicated to Gulf area infrastructure. This spending is being justified as federal insurance against disaster.

But the concept of insurance, hardly leads inexorably to the conclusion that the government must spend money directly to rebuild New Orleans. To the contrary, if there is disaster insurance, then it is, presumably, the people of New Orleans who are insured, not the place itself. After all, people (or corporations) hold insurance; places don't.

It Seems Clear The Government Will Pay to Rebuild. But How, Exactly?

Economists emphasize the moral hazard problems in providing free disaster insurance to high risk areas. Gary Becker has argued, for example, that free insurance creates a "Good Samaritan" problem that encourages bad location decisions.

As a matter of economic principle, Becker is surely right. Going forward, residents of high risk areas should—from an economic efficiency perspective—be charged for the implicit federal insurance that they receive. But politically, given Florida's status as a battleground state, this isn't likely.

Moreover, even if we agree that in the future we should not distort location decisions by providing free insurance, we should presumably still fulfill the current obligations to the residents of New Orleans. And politicians have promised to do just that.

So for the moment, let's accept the principle that the federal government has—wisely or not— insured against disasters. That principle still tells us little about how, exactly, these insurance claims should be paid out.

Should the Government Rebuild, Or Should Residents Get Checks or Vouchers?

We could try to make good on the idea that the government provides insurance by rebuilding the city. Alternatively, we could provide residents with checks or vouchers, and let them make their own decisions about how to spend that money—including the decision about where to locate, or relocate, themselves.

When your car is damaged you can often "cash out" and receive cash to do with as you wish instead of having your car repaired. And, when your car is "totaled," the insurance company generally won't fix your car at all, it will only provide cash compensation, and you decide how to spend it.

In the context of the President's comments, there is a big difference between rebuilding lives and rebuilding communities. Given limited funds, the two objectives may well conflict, and the usual lesson from economics is that people are better off if they are given money and allowed to make their own decisions, much as they are with car insurance.

The case for rebuilding New Orleans, then, depends on whether the residents of New Orleans will be made better off by this spending, than by being given checks or vouchers.

Vouchers or Checks Would Be Life-Changing For Poor New Orleans Residents

To put the numbers in context, imagine that we were to spend $100 billion dollars on infrastructure for the residents of the city. An alternative to this spending is to give each one of the city of New Orleans' residents a check for more than $200,000.

Annual per capita income in that city is less than $20,000, so this check would amount to ten years' income, on average—a hefty, and potentially life-changing sum. That is enough to send several children to college, to buy a modest home, and/or to relocate and start a dreamed-of business.

If this money were spread over the 1.33 million residents in the New Orleans metropolitan area, each resident would still receive $75,000, still enough to pay for a home in many areas of the country.

Can the benefits to the residents' of local infrastructure possibly equal the benefits for receiving three or ten years' income as a lump sum? One has to wonder.

Could Public Spending Possibly Benefit Residents More than Checks or Vouchers Could?

Indeed, there are many reasons to suspect that spending vast sums to rebuild the city may not make sense. New Orleans is like many great American cities that were built during previous eras and have become somewhat obsolete.

Before 1900, moving goods by water was much cheaper than moving goods by land. As a result, all of the great American cities were built on rivers, or where an important river meets the sea. From that perspective, the location of New Orleans was unbeatable: it is the port at the mouth of America's greatest river system.

New Orleans reached its peak of economic importance relative to the U.S. in 1840. But the Civil War and the relative decline of water-based transportation relative to rail caused the city to lose ground, relative to Northern cities, through much of the Nineteenth century.

In 1840, New Orleans was America's third largest city (after New York and Baltimore); by 1920, it had dropped to being only its *seventeenth* largest city. Still, the city's edge as a port continued to ensure that its population increased until the 1950s.

New Orleans began to decline, in absolute terms, in 1960. The port remains important, but increasing mechanization and containerization, together meant that fewer and fewer people were needed to work in that port. Today, according to the 2003 County Business Patterns, less than one-twentieth of the employees in New Orleans are in transportation industries, and more than a quarter of these aren't even working in the port or pipelines.

Even the vaunted energy industry employs a remarkably small number of people. County Business Patterns reports that there are fewer than 2,000 people in New Orleans working in oil and gas extraction, and fewer than 100 people working on pipeline transportation.

While there are fewer than 7500 people working in the port, there are 32,000 employees in health care and social assistance. New Orleans' biggest industry is tourism, and there are 37,000 employees working in food services and accommodation.

New Orleans remains an important port, but this port doesn't need a large city, and over time, the city has contracted. New Orleans' population has declined steadily—from 627,000 residents in 1960 to 485,000 residents in 2000.

If the American Community Survey is to be believed (this is based on a smallish sample), New Orleans has lost another 40,000 inhabitants between 2000 and 2004. The 4.1 percent growth of the New Orleans metropolitan area in the 1990s put it far below the average U.S. population growth. It is hard to find a sunbelt city that is doing as badly as New Orleans.

All of this information cuts strongly against any claim that the rebuilding of New Orleans would be more beneficial for its residents, than their receiving a large check or voucher that would enable them not only to rebuild, but to transform, their lives.

Could New Orleans, with Spending, Somehow Return to Its Long-Past Glory?

Granted, some previously great ports have managed to rebuild themselves around new industries. New York is now devoted to finance. San Francisco is the center for information technology.

But New Orleans was never able to reinvent itself, perhaps because it lacked the human capital that has been so heavily correlated with urban success over the past 50 years.

Moreover, New Orleans' port locale raises construction costs, relative to, say, the flat, featureless plains of Las Vegas. And New Orleans' climate is problematic relative to California. My own guess is that the city would have declined by more than it has, if it were not for the durability of its housing stock and other infrastructure. And now, thanks to Hurricane Katrina, that last asset has been decimated.

Nor was New Orleans' housing stock very valuable, in the market, to begin with. The decline in New Orleans' population has been accompanied by economic distress and by low housing prices.

The 2000 Census reported that more than 27 percent of New Orleans residents were in poverty (relative to 12 percent for the U.S. as a whole). Median family income was only 64 percent of the median family income in the U.S.

In 2004, according to the American Community Survey, the unemployment rate for the city was over 11 percent. And New Orleans' housing prices, pre-hurricane, remained far below those of the nation as a whole, providing further evidence of weak pre-existing demand for living in the city.

By most objective measures, the city, pre-hurricane, was not doing a good job of taking care of its poorer residents. For most students of urban distress, New Orleans was a problem, not an ideal. Poverty and continuing economic decline fed upon each other, delivering despair to many of the city's residents.

More Limited Rebuilding, Combined with Aid to Residents, May Be Wiser

New Orleans' decline suggests that spending huge sums betting on the future of the city makes little sense. Perhaps there are externalities or coordination failures that argue for rebuilding, but they do not immediately come to mind.

Most sensible theories about externalities suggest that giving checks to impacted residents, who then will move to Houston or Atlanta or Las Vegas, will actually reduce the negative spillovers from dysfunctional neighborhoods—not increase them.

None of this means, of course, that we shouldn't rebuild New Orleans' port or its pipelines. But rebuilding this basic infrastructure doesn't mean rebuilding the entire city, and it doesn't necessarily require federal funding.

The port and the energy sector are thriving economic entities. Their users can be charged for the costs of this infrastructure. We will all eventually pay those costs in the form of higher prices, but this is surely more efficient than funding reconstruction with tax dollars.

Rebuilding New Orleans requires a cost-benefit analysis that is far behind the scope of this essay. At this point, the only thing that I strongly endorse is having an open-minded national debate about costs and benefits. However, I suspect that for much of the proposed rebuilding, the costs will greatly outweigh the benefits.

One of the biggest problems of urban decline is how to help those residents caught in a declining city. Perhaps, if significant funds are given to New Orleans residents to help them start life anew in some more vibrant city, then there will be a silver lining to Katrina after all.

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