November 30, 2001

Statement on Terrorism Reinsurance Legislation

Mr. Speaker, no one doubts that the government has a role to play in compensating American citizens who are victimized by terrorist attacks. However, Congress should not lose sight of fundamental economic and constitutional principles when considering how best to provide the victims of terrorist attacks just compensation. I am afraid that HR 3210, the Terrorism Risk Protection Act, violates several of those principles and therefore passage of this bill is not in the best interests of the American people.

Under HR 3210, taxpayers are responsible for paying 90% of the costs of a terrorist incident when the total cost of that incident exceeds a certain threshold. While insurance companies technically are responsible under the bill for paying back monies received from the Treasury, the administrator of this program may defer repayment of the majority of the subsidy in order to "avoid the likely insolvency of the commercial insurer," or avoid "unreasonable economic disruption and market instability." This language may cause administrators to defer indefinitely the repayment of the loans, thus causing taxpayers to permanently bear the loss. This scenario is especially likely when one considers that terms such as "likely insolvency," "unreasonable economic disruption", and "market instability" are highly subjective, and that any administrator who attempts to enforce a strict repayment schedule likely will come under heavy political pressure to be more "flexible" in collecting debts owed to the taxpayers.

The drafters of HR 3210 claim that this creates a temporary government program. However, Mr. Speaker, what happens in three years if industry lobbyists come to Capitol Hill to explain that there is still a need for this program because of the continuing threat of terrorist attacks? Does anyone seriously believe that Congress will refuse to reauthorize this "temporary" insurance program or provide some other form of taxpayer help to the insurance industry? I would like to remind my colleagues that the federal budget is full of expenditures for long-lasting programs that were originally intended to be temporary.

HR 3210 compounds the danger to taxpayers because of what economists call the "moral hazard" problem. A moral hazard is created when individuals have the costs incurred from a risky action subsidized by a third party. In such a case individuals may engage in unnecessary risks or fail to take steps to minimize their risks. After all, if a third party will bear the costs of negative consequences of risky behavior, why should individuals invest their resources in avoiding or minimizing risk?

While no one can plan for terrorist attacks, individuals and businesses can take steps to enhance security. For example, I think we would all agree that industrial plants in the United States enjoy reasonably good security. They are protected not by the local police, but by owners putting up barbed wire fences, hiring guards with guns, and requiring identification cards to enter. One reason private firms put these security measures in place is because insurance companies provide them with incentives, in the form of lower premiums, to adopt security measures. HR 3210 contains no incentives for this private activity. The bill does not even recognize the important role insurance plays in providing incentives to minimize risks. By removing an incentive for private parties to avoid or at least mitigate the damage from a future terrorist attack, the government inadvertently increases the damage that will be inflicted by future attacks!

Instead of forcing taxpayers to subsidize the costs of terrorism insurance, Congress should consider creating a tax credit or deduction for premiums paid for terrorism insurance, as well as a deduction for claims and other costs borne by the insurance industry connected with offering terrorism insurance. A tax credit approach reduces government's control over the insurance market. Furthermore, since a tax credit approach encourages people to devote more of their own resources to terrorism insurance, the moral hazard problems associated with federally-funded insurance are avoided.

The version of HR 3210 passed by the Financial Services committee took a good first step in this direction by repealing the tax penalty which prevents insurance companies from properly reserving funds for human-created catastrophes. I am disappointed that this sensible provision was removed from the final bill. Instead, HR 3210 instructs the Treasury department to study the benefits of allowing insurers to establish tax-free reserves to cover losses from terrorist events. The perceived need to study the wisdom of cutting taxes while expanding the federal government without hesitation demonstrates much that is wrong with Washington.

In conclusion, Mr. Speaker, HR 3210 may reduce the risk to insurance companies from future losses, but it increases the costs incurred by American taxpayers. More significantly, by ignoring the moral hazard problem this bill may have the unintended consequence of increasing the

losses suffered in any future terrorist attacks. Therefore, passage of this bill is not in the long-term interests of the American people.