

U8216 Microeconomics and Policy Analysis  
Fall 2000  
Group Project 6

As advisors to the new governor of the state of Guerrero, you have been told that you have a fairly free hand in designing a catastrophe policy. As a representative of PRIDAN, a new party that stands for nothing, the governor had campaigned on a campaign of nationalizing the drug industry, privatizing the police, reclaiming Texas and California, and reinstating Nahuatl as the official language. Nothing about hurricanes, typhoons, or earthquakes. But after the devastating hurricanes on the east coast this year, the weak response of the federal government, and the memories of disasters in 1997, she has decided that Guerrero needs its own policy and asked you to recommend one.

“Of course,” she said, “if you decide after everything that we don’t need to do anything, that’s okay too; but we really need to consider the options seriously before that.”

Among the options she has asked you to consider are:

1. Do nothing. If a hurricane happens, it happens. It’s an act of God; so who’s the government of Guerrero that it should interfere? In considering this policy, the governor has asked you to think about whether it is credible: whether she could actually resist all the pressure to respond after a disaster, and whether she could get people to believe that she would resist pressure. After all, the purpose of this policy is to dissuade people from doing things that would be dangerous in the event of a disaster, and if people don’t believe it will be carried out, it won’t dissuade anyone.
2. Do nothing but publicize the odds. Let people who are contemplating moving to Acapulco know precisely the dangers of what they are doing; if they persist in doing so, that’s their problem. Same for those living in Acapulco now.
3. Continue the current policy: if people come and something happens, the government tries (as best it can) to take care of them. If they want to buy insurance they can; but even if they don’t they will be assisted after a disaster. If you recommend something like this, the governor has indicated that she wants to know how to finance it. Should it be paid for only after it happens, or should the overnment set aside money each year in a gradually increasing disaster fund (which would still be inadequate if the next hurricane struck, say, three years from now)? Or should the government appropriate and raise by taxation each year enough money to handle a major disaster in that year? What sort of taxes should be used to raise this money, whenever it is raised?
4. Continue the current policy, but purchase insurance against the costs that would be incurred. If this is your recommendation the governor will want to know: how much insurance? What sort of deductible (if any)? How much to pay above an actuarially fair premium? How to find the actuarially fair premium? How to buy it? How to pay for it?

5. Continue the current policy, but sell Guerrero disaster bonds directly on the world market. What terms would these bonds be offered under?
6. Continue the current policy, but enter into a mutual assistance pact with Yucatan, Jalisco, Baja California, Florida, Turkey, San Francisco, Kobe, Taiwan, Singapore, Scotland and Bangladesh, or some subset thereof, all of whom have made inquiries in the past few months. What would the terms of this mutual assistance pact look like?
7. Require everyone to purchase enough insurance to cover his or her property, medical bills, and funeral expenses in the event of a catastrophe. Prosecute anyone who fails to do so.
8. Require everyone to buy some minimum amount of insurance, sort of like automobile insurance in New Jersey (the governor is very fond of New Jersey). How would you set this minimum?
9. Sell Acapulco to the hotels and let them worry about everything.
10. Forbid new migration to Acapulco.
11. Close Acapulco.

In considering any policy that involves an active Guerrero role, the governor has indicated that she wants you to address two other concerns:

- What's a disaster? How do you draw the line between a thunderstorm, a hurricane, and a hurricane that was mainly out at sea. How do you draw the line between a heavy truck passing by, a mild tremor, and an earthquake? If the temperature in Acapulco stayed below freezing for a month and 20 inches of snow fell, would that constitute a disaster, even though people in Edmonton would describe that as a mild winter? How about a big fire in a hotel, or an outbreak of influenza or cholera? Was the peso devaluation a disaster? Are poor people in Guerrero living in a continuous state of disaster?
- What should the goal of a disaster relief effort be? Should it make everybody whole — and therefore help rich people more than poor people? Should it restore a uniform  $x\%$  of everyone's losses — and therefore still help rich more than poor? How do you determine  $x$ ? How do you determine someone's losses? Or should the relief effort get everyone back to a guaranteed common level and therefore possibly give no help to rich people who lost a lot (but still kept a lot) and a lot of help to poor people who didn't lose much at all? If the common level is higher than the level some people were at before the disaster, do you help people become better off than they were before the disaster?

The governor would like you to make a presentation of around 20 minutes to her cabinet and her. Her experiences in New Jersey have made her pretty sophisticated in microeconomics, although some cabinet members are not. She'd prefer that the presentation be in Nahuatl, but it's

okay for you to do it in English, as long as you're prepared to answer in Nahuatl any question addressed to you in Nahuatl.

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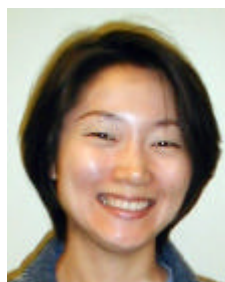
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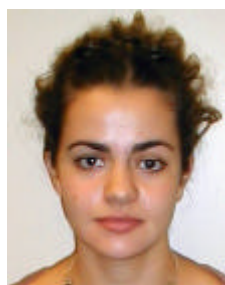
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