Formalize the Process for Declaration of Disasters and Financing Contingent Liabilities

Towards effective post-disaster public financial management

Background

In the aftermath of a natural disaster, governments can face immense spending needs for the recovery and reconstruction of damaged public assets. While in many countries the law defines the potential financial responsibility of the government on damages incurred on public assets, the specific details or criteria of these financial responsibilities are often unclear.

Defining ex-ante when, where, and for what damages the government will be financially responsible is an effective way to manage and reduce the explicit contingent liabilities of the government. It can help to prioritize funding needs and minimize discretionary spending given limited public resources. Moreover, setting clear criteria on what damages can receive government funding also encourages agencies or local governments to insure certain assets and transfer the risk to third parties.

This note discusses how the government can define its financial responsibilities for post-disaster reconstruction activities. It is the second of a series of six notes that, together, review the process of establishing an institutional mechanism to finance post-disaster recovery and reconstruction.

General Principles

Clarifying explicit contingent liabilities can allow better prioritization and targeting of limited public resources. Fiscal risk assessments allow governments to understand the total potential losses and associated funding gaps for a given disaster scenario (See Note “Risk Assessment and Fiscal Disaster Risk Profile”). Taking into account scarce public resources and the funding needs in the aftermath of a natural disaster, it may not be prudent for central governments to provide financial support to address all damaged public assets for all sizes of adverse natural events.

One way to clarify explicit contingent liabilities is to establish transparent criteria regarding when, where, and for what kinds of damages central government financial support would be available. This could help to streamline the funding request, allocation, and disbursement process.

Highlights

- Formalizing a process for declaring disasters can (i) clarify the government’s explicit contingent liabilities, and (ii) allow better prioritization of limited public resources.
- Governments can decide threshold severity levels of natural events that will trigger financial support as a way to systematize the process for declaring disasters.
- Governments can also delineate the damaged areas and prioritize the types of assets within its explicit financial responsibilities to limit its contingent liabilities.

Considerations for Implementation

There are generally three components to address when clarifying explicit contingent liabilities: (i) formalizing a process for declaring a disaster; (ii) designating the damaged area; and (iii) determining what assets would be eligible for government funding.

Formalizing a process for declaring a disaster helps to clarify after which events affected agencies or local governments receive financial support from the central government. This can be achieved by determining ex-ante the types of adverse events and their threshold levels above which the government will provide financial support. If an event exceeds this designated threshold, a declaration of disaster would be issued, after which affected government agencies or local governments could submit their request for funds to the central government.

It is not cost-efficient for governments to provide specific post-disaster funding for all events. In fact, small scale events are more cost-efficiently addressed through existing programs or budgets of the affected agencies or local governments. A clear process for declaring a disaster helps to ensure that public expenditure is better-targeted towards events that are beyond the capacity of the government agencies or local governments to manage.

The severity of adverse natural events should be defined and measured through objective scientific parameters (e.g., wind speeds for hurricanes, Richter magnitude scale for earthquakes). Together with available historical data, this information can help governments decide the
threshold severity level per disaster type above which it will issue a national declaration of emergency or disaster.

A second component to consider is how to delineate the damaged area. When financial support is targeted for the hardest-hit areas with the highest funding needs, governments can minimize unnecessary expenditures in resources and time. The damaged area could be measured by units of municipalities, provinces, states, or regions. For greater granularity in measurement, Geographic Information System (GIS)-based models can lend precision to determine the exact areas. Technological innovations can help to minimize certain damaged areas from being excluded from the government’s support, or a wide range of little or un-damaged areas being provided funding.

Governments may also find it useful to prioritize the types of assets within its explicit financial responsibilities. The number of sectors and types of assets and infrastructure eligible for government financial support would directly impact the size of public expenditures for post-disaster recovery and reconstruction. It could also potentially increase the ‘multiple-window problem’ where one government agency’s request for funds may exhaust the resources available for another, given the budgetary constraints of the government.

The following (non-exhaustive) list includes assets that could be taken into account:

- Public assets: roads, bridges, public schools, hospitals, hydraulic, electric and urban infrastructure, etc.
- Private assets: (i) houses of low-income population\(^1\); (ii) small businesses and some types of medium businesses.
- Agricultural sector: crops and livestock. Governments should have pre-determined criteria regarding which farmers should be able to receive support (e.g., depending on annual income, amount of planting acres, number of cattle, region) and the amount of support depending on type of crop, cattle, etc.
- Other: (i) household items (e.g., fridge, stove, bed, furniture); (ii) aid supplies to the affected population (e.g., food, water, shelter, blankets, mattresses, medicines); (iii) vector control against epidemic outbreaks.

International Experience

The process of declaring a disaster, which could potentially be a political decision, is made as technical as possible in Mexico. The country’s Civil Protection Law provides a technical and comprehensive definition of a natural disaster. Technical agencies confirm the severity level of an adverse natural event, which is followed by an official declaration of disaster from the Ministry of Interior. The Government of Mexico (GoM) has a predetermined list of natural events eligible for government financing through FONDEN, Mexico’s Natural Disaster Fund (Figure 1).

Figure 1. Events eligible for FONDEN support

<table>
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<tr>
<th>Main types of adverse natural events eligible for FONDEN support:</th>
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<tr>
<td>Geological</td>
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<tr>
<td>Avalanche</td>
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<tr>
<td>Volcanic eruption</td>
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<tr>
<td>Tsunami</td>
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<tr>
<td>Slope movement</td>
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<tr>
<td>Extreme wave</td>
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<td>Earthquake</td>
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<td>Subsidence</td>
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Damage resulting from any other natural phenomenon or weather situation with characteristics similar to the phenomena listed above, in terms of origin, frequency and severity of impact, can also be considered for FONDEN resources.

Source: FONDEN (2012)

Damaged assets that are not listed under the FONDEN operating guidelines are made ineligible for post-disaster funding support.

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\(^1\) While in practice, low-income housing is generally covered by the government, not all governments are willing to take it on as explicit liability, and the definition of what qualifies as “low-income” can be politically sensitive.