Clarify Post-Disaster Financial Responsibilities of the Central and Local Governments

Towards effective post-disaster public financial management

Background

Most decisions impacting physical and financial exposure to disasters are taken at the local level. Available expertise and funding for post-disaster reconstruction, however, is often concentrated at the national level. Recognizing this dynamic, governments may better utilize public funds and limit expenditure by sharing financial responsibilities with local governments.

This note examines how governments can balance post-disaster financial responsibilities with local governments, illustrated by the unique experience of Mexico. This is the third of a series of six notes that, together, reviews the process of developing an institutional mechanism to finance post-disaster recovery and reconstruction.

General Principles

While not all countries have the same degree of centralization, it is useful to consider political economy aspects of post-disaster public expenditure. For instance, when the central government finances the full cost of reconstruction for damaged local assets, local authorities may develop strong incentives to overestimate funding needs and request resources for damages that could be managed within local budgets.

Shared financial responsibilities can incentivize better risk management. Holding local communities and governments accountable to the decisions that affect their exposure can encourage them to reduce their expected losses through territorial planning, safe building standards or investments in drainage or flood protection. Shared financial responsibilities could also encourage local governments to transfer some disaster risk to third parties by purchasing insurance coverage for public assets.

One way to do so is to share costs for damaged local public assets. In many countries, losses incurred on public assets falls under central government responsibilities.1

Highlights

- Sharing reconstruction costs with local governments clarifies the explicit contingent liabilities of the central government. This helps to limit post-disaster expenditure and prioritize public resources.
- Central governments can share financial responsibilities by differentiating the amount of financial support to public assets owned and/or managed at the local level.
- Shared financial responsibilities could also encourage local communities and governments to reduce their exposure to natural disasters.

Differentiating between assets owned and/or managed at the central versus the local level may help to clarify the explicit contingent liabilities of the central government. The contribution of local governments to the total costs may vary by sector, type of asset, type and severity of disaster, and the budget constraints of the municipality, province, state, or region.

Governments may also find it effective to incentivize disaster risk management systems and disaster prevention measures. Much of reducing the contingent liabilities of natural disasters depends on the capacity and level of understanding of the local communities and governments. While there will be differences across countries, in general the federal government may find it effective to make resources available at the local level towards developing disaster risk management systems and even for disaster prevention measures.

International Experience

As a federal republic with a highly centralized political system, the Government of Mexico (GoM) holds local governments responsible for a proportion of reconstruction costs on local public assets through FONDEN rules that limit repeat eligibility for FONDEN resources.

FONDEN finances 50 percent of the recovery and reconstruction cost for eligible uninsured local assets the first time it is damaged by a natural disaster (the remaining 50 percent is financed by the local government). If the same assets remain uninsured, only 25 percent will be financed by FONDEN the second time. For any disasters

---

1 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. See Note “Formalize the Process for Declaration of Disasters and Financing Contingent Liabilities”.
thereafter the uninsured assets are rendered ineligible for FONDEN support.

In contrast, insured assets are eligible for FONDEN funding (covering 100 percent of costs for federal assets and 50 percent for local assets) irrespective of the number of times the assets have received FONDEN support in the past (Figure 1).

**Figure 1. FONDEN’s financing of insured and uninsured assets**

<table>
<thead>
<tr>
<th></th>
<th>Insured federal asset</th>
<th>Insured local asset</th>
<th>Uninsured federal asset</th>
<th>Uninsured local asset</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st disaster</td>
<td>100%</td>
<td>50%</td>
<td>100%</td>
<td>50%</td>
</tr>
<tr>
<td>2nd disaster</td>
<td>100%</td>
<td>50%</td>
<td>50%</td>
<td>25%</td>
</tr>
<tr>
<td>3rd and subsequent disaster</td>
<td>100%</td>
<td>50%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

*Source: FONDEN (2012)*

In 2009, the GoM launched an initiative to improve local governments’ understanding of disaster risks and increase their involvement in the design of risk transfer schemes. FONDEN provides financial support (up to 70 percent of the total cost) to state governments to develop inventories of public assets and low-income housing eligible for insurance. The inventory would include asset attributes such as type of construction, year of construction, replacement cost, geo-coded location, and cost of past damages. With the FONDEN funds, states would also be required to conduct studies such as risk analysis and financial modeling to identify and quantify the vulnerability of inventoried assets to natural disasters.

To further its efforts towards risk financing measures at the local level, the Congress of Mexico passed a new General Civil Protection Law in June 2012, which legally requires state governments to have insurance coverage for their assets and infrastructure (Article 18).

The GoM is also working to introduce state-level natural disaster funds to further improve the financial resilience of state governments against natural disasters. To incentivize individual states to establish a state-level natural disaster fund, the GoM allows states to keep any remaining FONDEN resources upon the completion of a specific post-disaster activity, if the actual total cost is less than the amount that was provided. States may retain these remainder FONDEN resources for use as seed capital towards the establishment of their natural disaster fund.

To ensure that these resources are utilized specifically as seed capital, and not for other priority development programs, states must demonstrate to FONDEN that they have the following: (i) a disaster risk financing strategy, or at least one under progress; and (ii) an established financial instrument with a minimum annual budget allocation from the state budget to address recurrent localized events. FONDEN only provides funds for events the GoM issues a declaration of a disaster. Localized events do not receive financial support from FONDEN.

FONDEN also approves resources for the improvement of damaged assets to strengthen their resilience against future disasters. About 25 percent of approved FONDEN resources for post-disaster works and actions are generally allocated with this purpose to “build back better”.

To complement FONDEN’s reconstruction efforts, the GoM created a new preventive window in 2004. The FONDEN Program for Prevention (FOPREDEN) funds activities related to the broader disaster risk management agenda, such as risk identification and assessment, risk reduction, early warning systems, and capacity building on disaster prevention. Through FOPREDEN, the GoM promotes informed decision making about investment in risk reduction by requiring states to complete a risk assessment (including the development of a risk atlas) before being eligible for resources from FOPREDEN for risk mitigation projects.

FONDEN’s cost-sharing system and initiatives to improve local risk assessment and financing capacity demonstrates how the government can balance shared national and local responsibility. This dynamic empowers local authorities and communities to take ownership of their exposure and reduce their expected disaster losses. Similar policies could promote amicable relations between the federal government and local governments and communities throughout the entire disaster risk management cycle while incentivizing local communities to increase their ownership of disaster risks.

**Contacts**

Olivier Mahul, Program Manager, Disaster Risk Financing & Insurance Program, FCMNB and GFDRR, The World Bank, omahul@worldbank.org

Rubem Hofliger, Senior Policy Advisor, Disaster Risk Financing & Insurance Program, FCMNB and GFDRR, The World Bank

Hannah Yi, Policy Analyst, Disaster Risk Financing & Insurance Program, FCMNB and GFDRR, The World Bank, hyi@worldbank.org