



## Sovereign Disaster Risk Financing and Insurance for Middle-Income Countries

### Partnership between the World Bank and Switzerland

The World Bank Disaster Risk Financing and Insurance Program (WB) and the State Secretariat for Economic Affairs of Switzerland (SECO) are partnering to advance a joint program on sovereign disaster risk financing and insurance for middle-income countries. This program is part of the broader Swiss-WB partnership on fiscal risk management for middle-income countries, which also includes a component on public debt management.

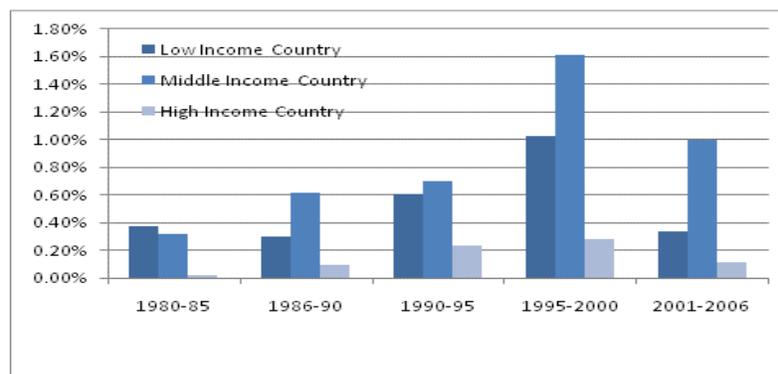
***The Swiss-WB partnership on sovereign disaster risk financing and insurance leverages both institutions' experience and expertise in fiscal risk management and disaster risk financing.*** The WB has developed a methodology and a suite of disaster risk financing and insurance products and services to help governments increase their financial response capacity in the aftermath of natural disasters while protecting their long-term fiscal balance. SECO is an established leader in the promotion of sustainable public finances and the strengthening of financial sector infrastructure.

***The development objective of the program is to reduce the financial vulnerability of the states to natural disasters*** by improving their financial response capacity in the aftermath of natural disasters while protecting their long term fiscal balance.

### Economic and Fiscal Impact of Natural Disasters on the State

***Middle-income countries have been the most adversely economically affected by natural disasters*** (with regard to direct losses as a percentage of GDP) over the last two decades, as shown in Figure 1. The annual average cost (including both disaster and non-disaster years) faced by middle-income countries represents 1.0 percent of GDP over the period 2001–2006, with a peak of 1.6 percent of GDP in 1995–2000. Middle-income countries are particularly impacted because updating laws and regulations (e.g., building codes, land-use zoning, etc) cannot keep pace with their rapidly expanding asset bases (growth in infrastructure and economic activities).

**Figure 1: Average Annual Damage from Natural Disasters Compared to GDP**



Source: Cummins and Mahul (2009).

***Natural disasters represent a significant explicit and implicit contingent liability of the government that is often associated with large fiscal costs.*** The contingent liability of the government due to natural disasters is often implicit, as the law usually does not clearly define the financial responsibility of the government due to a disaster. The government thus acts as a (re)insurer of last resort, without knowing precisely its disaster risk exposure. Understanding the loss potential of natural disasters and the extent of public intervention in recovery and reconstruction efforts can help the government ascertain its contingent liabilities. Sovereign disaster risk financing and insurance can prevent against sudden macroeconomic shocks that negatively impact fiscal performance and, in turn, economic development.

### **Sovereign Disaster Risk Financing Activities under the Swiss-WB Partnership**

***An optimal national disaster risk financing and insurance strategy combines ex ante and ex post financial instruments.*** Ex ante instruments provide immediate injections of liquidity in the aftermath of natural disasters that ensure continuity of government operations and enable critical infrastructure to be quickly restored. Examples of ex ante instruments include reserve funds, contingent financing, and risk transfer. Funding from ex post instruments is nominally greater but arrives later in recovery and reconstruction phases and can be used to finance reconstruction costs. Examples include budget contingencies, budget reallocation, debt, and tax increase.

The program will support the following activities to increase the financial protection of the state against natural disasters:

- ***Catastrophe risk modeling.*** Catastrophe risk modeling assesses the economic and financial impact of natural disasters, using scenario analysis or probabilistic analysis.
- ***Assessment of economic and fiscal impact of natural disasters.*** This assessment reveals the implicit and explicit contingent liability of the state.
- ***Review of fiscal management of natural disasters.*** This review will help identify potential short term resource gaps to finance post-disaster emergency and early recovery as well as longer-term resource gaps to finance post-disaster reconstruction.
- ***Review of catastrophe risk insurance regulatory framework.*** An enabling regulatory framework is critical to ensure the sustainable development of property catastrophe risk insurance markets.
- ***Capacity transfer and training on sovereign disaster risk financing strategy.*** Developing and implementing a sustainable national disaster risk financing strategy is a long-term process that requires extensive capacity building.

***The program focuses on the following countries: South Africa, Ghana, Colombia, Peru, Indonesia, Vietnam and Egypt.*** These countries are already engaged in pro-active disaster risk management. This program will complement their disaster risk management activities by helping them reduce their financial vulnerability to natural disasters. The expected duration of the program is 2011-2016.

### **Contacts**

**Olivier Mahul**, Program Coordinator, Disaster Risk Financing and Insurance, The World Bank,  
omahul@worldbank.org

**Laura Boudreau**, Disaster Risk Financing and Insurance Analyst, The World Bank,  
lboudreau@worldbank.org

**Matthias Feldmann**, Economist, State Secretariat for Economic Affairs, Switzerland,  
matthias.feldmann@seco.admin.ch