FACTSHEET 2

# Building Fiscal and Financial Resilience for Subnational Governments against Natural Disasters


Disaster Risk Financing & Insurance Program

Schweizerische Eidgenossenschaft
Confédération suisse
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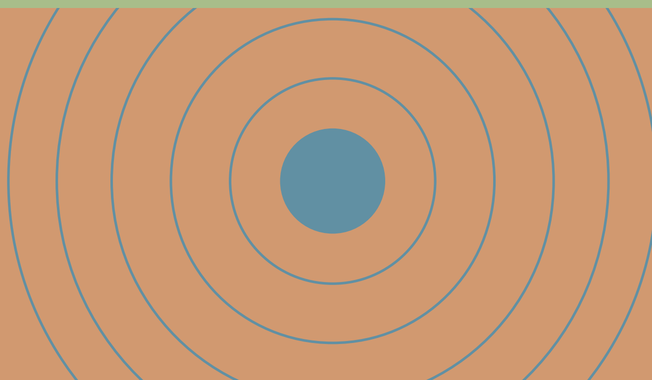
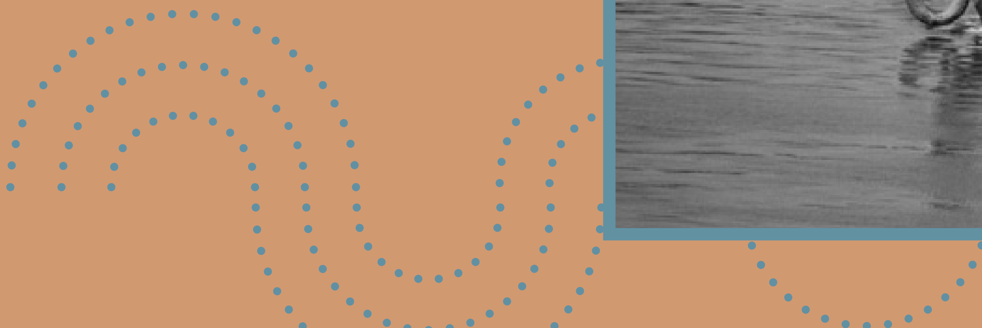
Swiss Confederation

Federal Department of Economic Affairs, Education and Research EAER
**State Secretariat for Economic Affairs SECO**



# Component 1: Policies and Frameworks for Managing Disaster-related Contingent Liabilities

## Topic 2: Fiscal and financial resilience for subnational governments

### Overview

Subnational governments, including cities and municipalities, bear a large share of disaster costs—partly because they act as first responders and partly because they are responsible for maintaining a significant share of affected assets and infrastructure. Importantly, they also deliver most of the public services. Subnational governments may also have to bear additional pressures to support the recovery of local livelihoods, businesses, and the economy. Local governments also play a critical part in both building and rebuilding national resilience to natural disasters, given their more direct service delivery relationships. This can also allow for more efficient implementation of particularised disaster programs (for example, physical and social infrastructure) based on local needs. It also facilitates the coordination and allocation of resources among government agencies and across local jurisdictions.[1]

However, subnational governments often have limited funds at their discretion for disaster response and recovery, or for procurement of risk transfer instruments to mitigate the financial impacts of disasters. This is due to their limited revenue/tax-raising capabilities and fiscal dependence on national governments. The limited financial capacity of local governments in disaster response and recovery may exacerbate the economic and social costs of disasters, both directly and indirectly, particularly when recovery and reconstruction can take years. As a result, national governments bear most of the disaster costs faced by subnational governments, usually as a contingent liability.

This fiscal dynamic between national and subnational governments raises important policy choices, as well as risks and opportunities for both levels of government across a range of issues. These include how the costs of disasters should be shared and funded, with key issues including the level of government best placed to manage natural disaster risks. Also included in the fiscal dynamic are overarching national policies, and national and subnational disaster funding arrangements as well as risk financing capabilities.

These issues are discussed further in conjunction with case studies, primarily drawn from countries included in the Program and beyond.

1 - M. Qing, Risk Management, Economic Analysis of Natural Hazards, Policy and Governance (2018). M. Qing. "The Fiscal Implications of Managing Natural Disasters for National and Subnational Governments." (2018).

# Who owns the risk? Who pays for the risk?

An initial issue for national and subnational governments is to determine which level of government is best placed to manage a particular disaster risk. Factors potentially relevant to this assessment include the ultimate owner of the risk, how it is managed/controlled, its value (economic and social), location, and the funding capacity of the owner to respond and recover from disasters.

Subnational governments often rely on revenues collected or fiscal transfers from national governments, and less so on pre-arranged risk transfer instruments or other ex-ante risk finance mechanisms. Funding capacity is often the most critical issue, usually due to the difference between the share of revenues collected and expended among the various tiers of government (the 'vertical fiscal imbalance' - VFI). In almost all cases, the national government collects the majority of revenues, and then transfers substantial sums back to subnational government levels for service delivery and infrastructure. Many national governments implement these fiscal transfers through complex intergovernmental arrangements with subnational governments. Such arrangements may involve grants or loans provided on certain terms and conditions, which can range from targets set by the national government (building certain infrastructure, such as hospitals and schools, or funding a set number of students or hospital places, to service delivery standards, and so on) to being 'untied' in the sense that the subnational governments have the discretion to allocate the funds consistent with subnational policy priorities.

In relation to disaster funding, the VFI means that natural disasters usually overwhelm subnational and local governments. In the absence of intergovernmental arrangements regarding disaster funding, subnational governments often have little incentive to protect subnational assets from natural disasters due to expectations (based on prior events) that the national government will rebuild/replace the asset due to public pressure and/or subnational fiscal incapacity. As a VFI study noted "transfer-dependent governments face weak incentives to be fiscally responsible, since it is more rewarding to position themselves for a bailout".[2] Subnational governments can also exacerbate these impacts through other policy decisions, such as developing land in flood prone areas and/or failing to mitigate likely disaster damage or building back better.

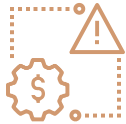
2 - Organisation for Economic Co-operation and Development (OECD). "Local Public Finance and Capacity Building in Asia: Issues and Challenges, Chapter 3. Finding the right balance in the use of conditional grants", Junghun, K., Chair, OECD Network on Fiscal Relations across Levels of Government. (Paris: OECD).

# The importance of having clearly defined post-disaster funding arrangements in national disaster risk-financing policies

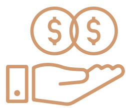
National disaster risk financing policies should clearly define national and subnational post-disaster risk-financing arrangements. Without such a clear definition of risk ownership and funding, national governments would bear most of the fiscal responsibility for the disaster costs of subnational governments. National governments have choices about how these liabilities are dealt with, which can range from ad hoc, reactive, short-term 'wait and see' responses, which lack transparency, to formal intergovernmental arrangements which are transparent. The latter involve clear rules about national and subnational post-disaster fiscal responsibilities and pre-arranged access to finance. This removes uncertainty about risk ownership, and it provides incentives (or limits disincentives) to manage risks and 'build back' better. In addition, such an arrangement assists both levels of government in pro-actively investing in fiscal, physical, and social resilience.

Disaster funding policy settings, like all policy settings, are usually outcomes of particular contexts and environments, which may not be replicable in other countries or within different legal systems. Nonetheless, several useful observations and/or principles can be made and readily applied to other countries as follows:

1. Funding subnational disaster costs should be a part of a nationally coordinated and integrated national fiscal risk management and disaster risk management framework, incorporating social and economic policies across the government.



2. Post-disaster, cost-sharing mechanisms across governmental levels should be clearly defined and applied to ensure certainty and transparency, which may also include a ceiling on disaster recovery costs assumed by the national government.

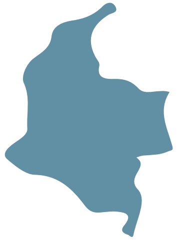


3. National funding should involve a mix of pre- and post-disaster funding approaches, including incentivising pre-disaster initiatives by subnational governments (including risk-transfer products) and communities to reduce/mitigate anticipated disaster events.

Although there are many examples of such arrangements, this fact sheet will focus on the arrangements in place in countries included in the Program.

# NATIONALLY COORDINATED AND INTEGRATED POLICIES

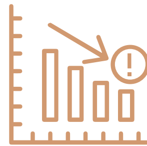
## Colombia



In addition to the national government, Colombia has 31 subnational departments. Since 1991, the national government has progressively decentralised its fiscal responsibilities, with subnational governments now having significant financial resources and spending responsibilities, including undertaking more than half of total public investment. However, as of 2015, over one-third of total national expenditure was provided to subnational governments, with subnational tax revenues providing just 18 percent of overall tax revenues [3].

In the 2000s, Colombia adopted an integrated approach for managing disaster risks, including the approval of the 1523 law by the Congress in 2012. Colombia's disaster risk management strategy was developed based on this law. The national disaster risk financing management (DRFM) strategy (which was issued in 2013 and updated in 2016) adopts a mix of financial instruments following a risk layering approach. The objectives of the strategy are to:

1. Improve risk identification and monitoring and increase awareness of risk,



2. Increase prevention and mitigation measures for risk reduction,

3. Strengthen the national system for disaster management and prevention,

4. Reduce the fiscal vulnerability of the state to natural disasters.

In addition, the Colombian disaster risk management framework also involves public entities such as the National Procurement Agency, the National Planning Department, the National Disaster Risk Management Unit, the National Infrastructure Agency and the Colombian Geological Service that all work together to implement the DRFM strategy.

The subnational level DRFM contributes to and complements the fiscal management at the national level. The Colombian regulations require mandatory insurance for publics buildings including at the subnational level and establish the principle of subsidiarity under which the national level authorities only support the lower tier or subnational authorities when they do not have the resources to face the risk and manage the consequences of disaster events. In addition, the National Development Plan 2018-2022 and the midterm fiscal plans for 2018, 2019 and 2020 established the relevance and the inclusion of the subnational level in the DRFM. As part of these plans, the Colombian Ministry of Finance and Public Credit, supported by the Disaster Risk Management National Unit and the National Planning Department, is providing advice to entities at the subnational level for the development of their own DRFM strategies, implementation of the respective operational plans and capacity building.

3 - G. Bousquet, C. Daude, and C. de la Maisonneuve, "Fiscal Decentralisation in Colombia: New Evidence regarding Sustainability, Risk Sharing and 'Fiscal Fatigue'". Economics Working Papers, No. 1202. (Paris: OECD).

## Indonesia

Indonesia's subnational government is comprised of three layers including 34 provinces, 508 districts, and more than 75,000 villages. Transfers from the central to the provincial and district governments include general allocation funds, special allocation funds, and revenue-sharing funds, which is provided through multiple complex national/state agreements.

Several laws and policies relating to disaster management were implemented in the 2000s. Their aim was to adopt a proactive approach to disaster risk management; refine the roles and responsibilities of line ministries, businesses, and international institutions for disaster management, as well as risk financing;[4] and to improve institutional coordination for all stages of disaster management[5].

In October 2018, a more holistic disaster risk financing framework was implemented, namely, the National Disaster Risk Finance and Insurance Strategy (DRFI Strategy). The DRFI Strategy priorities included protecting the state and subnational assets, protecting households and people, restoring livelihoods of communities, and strengthening the roles of subnational governments in risk financing, among others. The Strategy also paved the way for the establishment of a Pooling Fund for Disasters (Pooling Fund untuk Bencana, PFB) as part of its strategic priorities. The PFB will be a dedicated mechanism to ensure effective access to sufficient resources for disaster responses. It will streamline the execution and transparency of spending, potentially through the pooling of subnational risks, including for subnational governments. **Figure1** outlines Indonesia's DRFI strategy.

4 - Law Number 24 of 2007 on Disaster Management and associated government regulations numbers 21, 22, and 23 of 2008 implementing Law Number 24.
5 - Presidential Regulation 8 of 2008.

FIGURE1: INDONESIA'S DRFI STRATEGY

Central Government

DEBT FINANCING

CONTINGENCY FINANCING

LOAN CONTINGENCY

International Development Partner

Aid

Domestic / International Financial Market

PREMIUM

TRANSFER OF RISK

PAYOUT

Financial Strategy

CAT Insurance (Sovereign)

Contingency Loan

Endowment / Trust Fund

Pooling Fund

STATE BUDGET COMPLEMENTARY

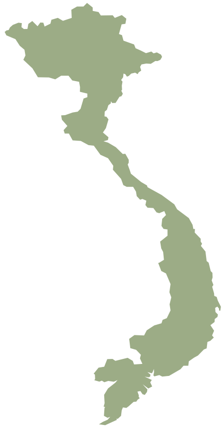
DISTRIBUTION

Budget

| BNPB | Rebuilding Public Housing | Social Security | Line Ministries |
|---|---|---|---|
| Preparedness<br>Risk Reduction<br>Emergency Response | Rebuilding public housing for poor Households | Cash transfer to Poor Households | Rehabilitation and Reconstruction |

NOTE: BNPB = INDONESIAN NATIONAL BOARD FOR DISASTER MANAGEMENT (BADAN NASIONAL PENANGGULANGANBENCANA);
CAT = CATASTROPHE

## Vietnam



Currently, Vietnam has four tiers of government including: (i) the national tier; (ii) the provincial tier (63, including five major cities); (iii) the district and town tier; and (iv) the ward/township/commune tier.[6] The levels of subnational, own-source revenues are relatively low, ranging from 7 to 16 percent.[7] However, since 1989, Vietnam has progressively implemented budget laws and reformed fiscal transfer arrangements to increase fiscal responsibility on the part of the subnational tiers of government.

Key principles, policies, and approaches for national and subnational disaster risk financing in Vietnam follow the Law on Disaster Prevention and Control issued in 2013 and amended in 2020, the State Budget Law of 2015, and a number of associated regulations. The approach for disaster risk management in Vietnam attaches primary responsibilities for disaster response and recovery to local governments.

The current budget system in Vietnam includes the central and local government budgets. Local budgets include provincial, district, and commune budgets. Budget management related to disaster risk finance (DRF) is decentralised at all levels of government, including annual budget appropriations for both recurrent and capital investment expenditures, contingency budgets in the range of 2-4 percent of total annual planned budgets, and financial reserve funds. The central contingency budget can be used to provide support to local governments once the local contingency budget and other revenue resources have been exhausted.

6 - P. Morgan, "Fiscal Decentralisation and Local Budget Deficits in Vietnam: An empirical Analysis." (Asian Development Bank Institute, 2016)
7 - Op. cit.

## Australia

Australia has three layers of government: Commonwealth (national), subnational (six state and two territory governments (collectively called the states), and over 500 local councils. The national government provides the majority of funding for state activities, with some funds being provided to local governments.

Currently around 25 percent of national government expenditures (USD 149 billion) is transferred to state governments each year, comprising 42 percent of total state expenditures.[8]

Regarding disaster funding, over the last 40 years, the Natural Disaster Relief and Recovery Arrangements (NDRRA) has been the primary mechanism used to fund state disaster responses. However, in 2018, the NDRRA was replaced with the Disaster Recovery Funding Arrangements (DRFA)[9].

The DRFA sets out the conditions relating to national reimbursement of state natural disaster expenditures in relation to emergency assistance for individuals, emergency works, essential public asset reconstruction, concessional interests, loans, grants, subsidies, and community recovery funds. The DRFA is also linked to other policies, such as the National Disaster Risk Reduction Framework (the NDRRF), the National Climate Resilience and Adaptation Strategy, the National Drought Agreement, as well as social welfare payment policies. Following the nationwide bushfires in 2019-20, and an inquiry into the national/state disaster response, on May 5, 2021, the government announced the establishment of a National Recovery and Resilience Agency to oversee the DRFA and resilience funding initiatives.[10]

8 - Australian Government Budget 2021-22, Federal Financial Relations, Budget Paper No. 3.

9 - https://www.disasterassist.gov.au/disaster-arrangements/disaster-recovery-funding-arrangements

10 - https://www.pm.gov.au/media/helping-communities-rebuild-and-recover-natural-disasters

## CLEARLY DEFINED COST-SHARING MECHANISMS

Effective cost-sharing arrangements between national and subnational governments are critical to maximising the benefits of scarce funding resources, as well as to ensure transparency and accountability in the expenditure of public funds.

### Australia

Following significant flooding disasters in 2003-04 and 2011 resulting in payments to states totaling USD 6 billion, Australian government and community concerns began to increase about whether these funds were being effectively allocated and spent.

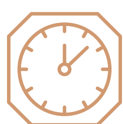
A government inquiry was then launched into the existing natural disaster funding arrangements (the NDRRA) by Australia's Productivity Commission. The findings of that inquiry included[11]:

*Current government natural disaster funding arrangements are not efficient, equitable or sustainable. They are prone to cost shifting, ad hoc responses and short term political opportunism. ...States need to shoulder a greater share of natural disaster recovery costs to sharpen incentives to manage, mitigate and insure against these risks. The Australian Government should provide a base level of support to states commensurate with relative fiscal capacity and the original 'safety net' objective of disaster recovery funding, with the option for states to purchase 'top up' fiscal support...*

In 2018, the DRFA was implemented to address some of these concerns. The payment thresholds remained largely the same as under the NDRRA, ranging from 0 to 75 percent reimbursement. However, significant changes were made to eligibility criteria, reporting, and transparency and accountability requirements.

The payment thresholds require the states to first spend state funds on disaster relief and recovery activities before they are reimbursed by the national government. The first threshold is 0.225 percent of the state's total general government sector revenues and grants in the financial year two years prior to the relevant financial year, and the second threshold is 1.75 times the state's first threshold. The payment thresholds (for 2019-20) and payment mechanisms are outlined in **Figure 2.**

The DRFA's transparency requirements include:



1. Setting time limits to notify the Commonwealth about claims

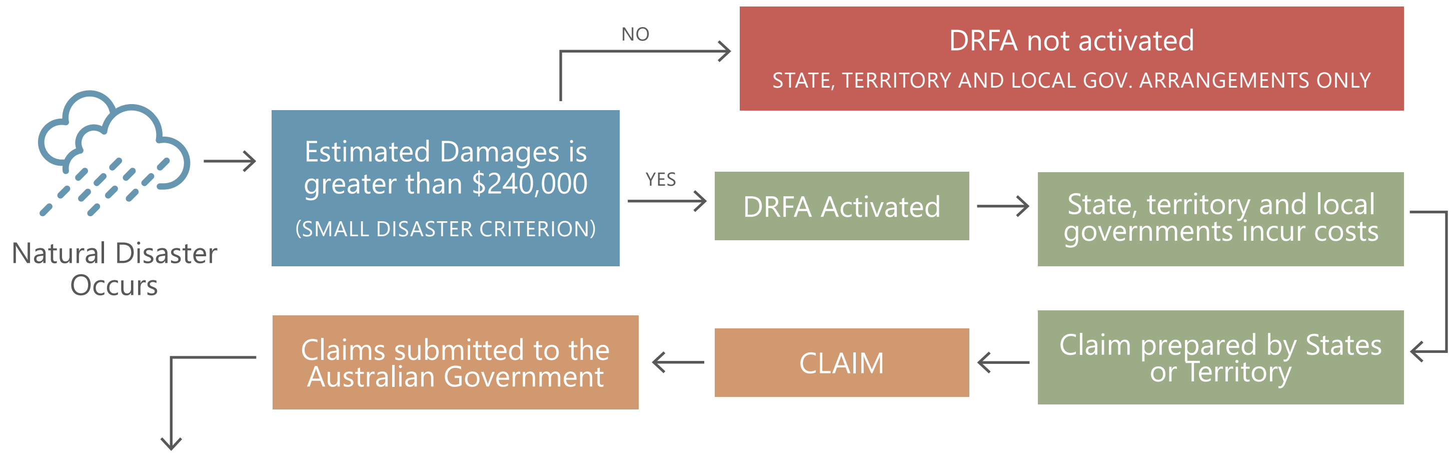
2. Providing evidence of the pre-disaster condition as well as a post-disaster damage assessment for claims relating to essential public assets

3. Launching independent technical reviews of essential public asset reconstruction projects

4. Providing record keeping and assurance requirements, including the states provision of quarterly reports of expenditures, and estimated reconstruction costs, as well as identifying likely future projects to be funded under the DRFA and independent national government audits.

11 - https://www.pc.gov.au/inquiries/completed/disaster-funding/report

FIGURE 2: AUSTRALIA'S DRFA PAYMENT MECHANISM




Australian Government Reimbursement

REIMBURSEMENT IS BASED ON WHETHER A CLAIM OR MULTIPLE CLAIMS EXCEED A THRESHOLD WITHIN A FINANCIAL YEAR. THE PERCENTAGE OF REIMBURSEMENT INCREASES WHEN THE TOTAL OF ALL CLAIMS EXCEED THE SECOND, HIGHER THRESHOLD

**2019-2020 FINANCIAL YEAR THRESHOLDS**

| | First Threshold | Second Threshold |
|---|---|---|
| NSW | $187,193,250 | $327,588,188 |
| VIC | $145,410,750 | $254,468,813 |
| QLD | $130,695,750 | $228,717,563 |
| WA | $65,673,000 | $114,927,750 |
| SA | $43,524,000 | $75,167,000 |
| TAS | $13,531,000 | $23,680,125 |
| ACT | $12,154,500 | $2111,270,375 |
| NT | $13,380,750 | $23,416,313 |

SECOND THRESHOLD
FIRST THRESHOLD

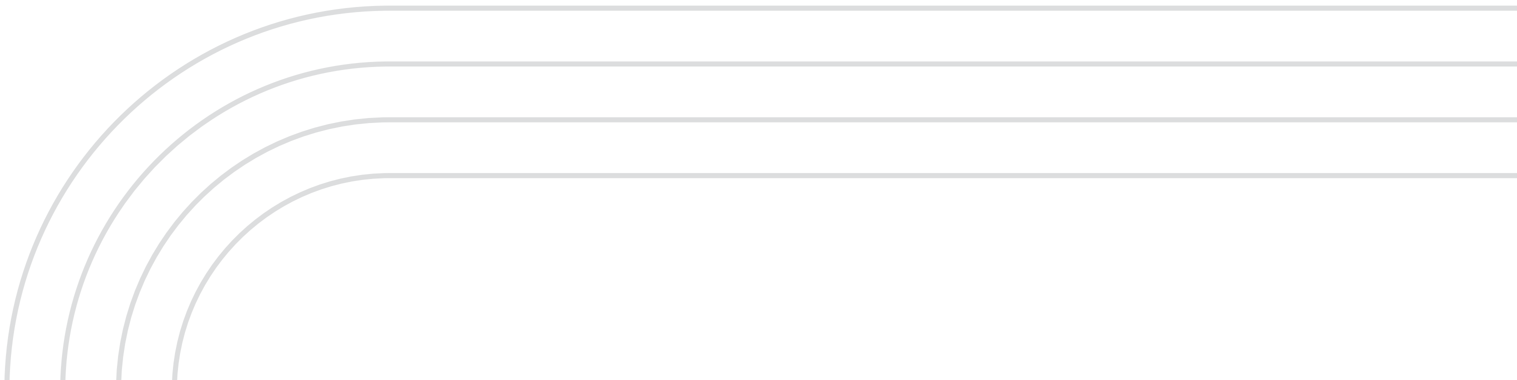
75% REIMBURSED | 50% REIMBURSED — **CATEGORY A** E.G. HARDSHIP ASSISTANCE

75% REIMBURSED | 50% REIMBURSED | 0% REIMBURSED — **CATEGORY B** E.G. RECONSTRUCTION OF ESSENTIAL PUBLIC ASSETS

NOTE: ACT= AUSTRALIAN CAPITAL TERRITORY; NSW= NEW SOUTH WALES; NT= NORTHERN TERRITORY; QLD= QUEENSLAND; SA= SOUTH AUSTRALIA; TAS= TASMANIA; VIC= VICTORIA; WA= WESTERN AUSTRALIA.

## Colombia

The Colombian regulation establishes the principle of subsidiarity that requires the national level authorities to support the lower tier or subnational authorities when they do not have the recourses to manage the risks and financial impacts from disaster events. For more than a decade the government has been increasing its financial response capacity to natural disasters and integrating disaster response into national public policies relating to fiscal risk and debt management. However, there is currently no explicit cost-sharing formula between the national and subnational governments for post-disaster funding.



## Indonesia

In Indonesia, the cost-sharing arrangements between national and subnational governments are embedded within the decentralisation framework that took effect in 2001. Funding of disaster management activities is shared by national, provincial, and district governments based on their specific authorities. The national government funds the cross-province, ex-ante activities, including early warning systems and tsunami walls, as well as emergency response activities of major disasters. Provincial governments usually fund cross-district activities, including flood prevention and emergency response activities of multi-district disasters. The districts are responsible for within-district measures, such as drainage systems and disaster readiness training.

A more specific sharing arrangement for disaster management was established for rehabilitation and recovery activities. Beginning in 2015, the national government enabled the district governments to request funding for rehabilitation and recovery (RR) activities. Following the verification processes, the approved funding requests are then channeled to the district budgets as additional fiscal grants. The districts will later manage the executions of these RR grants based on the subnational financial management framework.

More recently, as part of the DRFI Strategy, the Indonesian government is considering the establishment of a cost-sharing arrangement with subnational governments to allow for more efficient and transparent allocation of funds from the PFB to the subnational governments. Factors likely to be considered in the arrangement include the legal basis for payment, the decision-making process, sources of finance, and payment criteria.

## Vietnam

The current laws and regulations provide cost-sharing arrangements between the central and local governments for disaster risk financing, although no explicit and universal formula regarding cost-sharing across support programs was provided. The regulations empower the Prime Minister to decide on this issue, except for those cases provided under post-disaster agriculture and social assistance support programs. Priorities will be given to provinces that still have to rely on national fiscal transfer or transfer less than 50% of their collected revenues to the national government. Although primary responsibilities for disaster response and recovery lie with subnational governments (as stipulated in the Law on Natural Disaster Prevention and Control), financial assistance to subnational governments from the central contingent budget is allowed under the State Budget Law of 2015, as well as subsequent decisions by the Prime Minister concerning mechanisms and procedures for financing to subnational governments for disaster recovery. Eligible expenditures for this financial support include social assistance, agriculture support, and repair and recovery of critical lifeline infrastructure damaged by disasters.

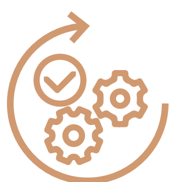
## NATIONAL FUNDING SHOULD ENTAIL MORE THAN ACTING AS A BANK

Disaster funding arrangements between national and subnational governments should involve a mix of pre - and post - disaster funding approaches, including incentivising pre-disaster initiatives by subnational governments (including risk transfer products) and communities to reduce/mitigate anticipated disaster events. The likely vertical fiscal imbalance between national and subnational governments means that national governments have strong financial levers to influence and reorient subnational governments toward risk management strategies that pre-empt disaster impacts and build community resilience.

### Colombia

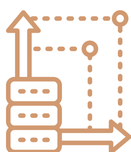
Since 2012, the Colombian government has made significant progress in designing a comprehensive strategy for the financial management of disasters, becoming a world pioneer in the development of disaster risk financing strategies at the subnational level.

Strategies have included:



1. Combining a portfolio of several financial instruments aimed at reducing the country's fiscal vulnerability to natural disasters, including public asset insurance, the establishment of a National Fund for Disaster Risk Management, budget reallocations, and a Catastrophe Bond for USD 400 million against seismic risk (issued within the framework of the Pacific Alliance).

2. A collective approach to purchasing insurance to pool risk and further lower insurance premiums. National insurance guidelines and objectives were developed to improve the level and quality of the insurance of public assets in the event of natural disasters. Since December 2016, public assets have been insured collectively under an umbrella framework agreement.



3. Improving information and data-gathering information to inform the quality of insurance.

4. Colombia's national disaster risk management authority is assisting many local governments in strengthening their disaster risk management capacity, which has led to over 600 municipalities adopting disaster risk management plans.

5. Providing support for the preparation of disaster risk financing strategies to the Metropolitan Area of Aburra Valley (Antioquia) and the provinces of Archipelago of San Andrés, Cundinamarca, Providencia, Putamayo, and Santa Catalina.

## Vietnam

The cost-sharing arrangement that allows central governments to channel financial support to local governments under the state budget law does not seem to explicitly provide any incentives for local governments to undertake risk mitigation measures or to make use of proactive risk transfer mechanisms, such as insurance instruments, before going to the central government for support. This is the case even though the cost-sharing arrangement is designed to ensure that local governments have exhausted all resources available before turning to the national government for assistance. It should be noted that the law on disaster risk management requires ministries and local provincial governments to integrate disaster risk mitigation and resilience into their investment planning, as well as their sectoral and local development planning.

## Australia

Three significant changes have been made to Australia's disaster response and resilience framework since 2018.

The first of these is the implementation of the DRFA in 2018, which represented a major change in Australia's disaster funding arrangements with the states. Specifically, it sought to identify and clarify a range of national/state claims and payment disputes that had been an ongoing feature of the NDRRA. In addition to clarifying payment issues, the DRFA also established principles against which the funding arrangements would be assessed, including the following:

1. States are best placed to identify the type and level of assistance to make available following a natural disaster, in accordance with their responsibility for disaster and emergency management.

2. National assistance is intended to support certain relief and recovery measures delivered by the states in relation to eligible disasters, which complement other state-based strategies, such as insurance and natural disaster mitigation planning and implementation.

3. Recovery is a shared responsibility of individuals, communities, and governments.

The second recent major national reform was the establishment of an Emergency Response Fund (ERF) in December 2019 (pursuant to the Emergency Response Fund Act of 2019). The ERF allows the national government to draw up to USD 150 million in any given year, in addition to existing funding for emergency response and natural disaster recovery, where the national government determines the existing funding is an insufficient response to natural disasters.

More recently, in May 2021, as part of the Australian Government's 2021-22 Budget, a new government agency, the National Recovery and Resilience Agency (NRRA), was established to provide oversight for USD 750 million in funding over four years for mitigation, resilience and recovery activities. This represents the most significant funding commitment ever made by an Australian Government for ex-ante mitigation and resilience expenditures.

# Building Subnational Financial Resilience

The majority of disaster funding is sourced from and controlled by national governments. However, subnational governments also have important roles independent of national funding or specific national direction. As noted, while national governments can require subnational governments to undertake a ranges of disaster resilience activities (implementing a disaster management plan, obtaining insurance, and expending state funds first on disasters until a threshold is reached), subnational governments with substantial autonomy and independence in the way they undertake ex-ante and ex-post disaster risk financing strategies and instruments.

## SUBNATIONAL FINANCIAL PROTECTION STRATEGIES AGAINST DISASTERS

### Colombia

Recognising the importance of building subnational financial resilience, under the leadership of the national Ministry of Finance, a number of local entities—the Aburra Valley Metropolitan Area, the Cundinamarca Department, Putumayo Department, the San Andres, Providencia, and Santa Catalina Archipelago Departments—have developed their own strategies for disaster risk finance and insurance management. Seeking to strengthen both national and subnational resilience against natural disasters, the strategies are underpinned by a robust regulatory and institutional framework. They also share three important policy objectives: (i) identification and understanding of disaster risk; (ii) disaster risk financial management for the public and private sectors, including the agricultural sector; and (iii) catastrophe risk insurance for public assets. The subnational strategies also consider the unique particularities of each territory. In addition, Bogota DC defined three strategic objectives within their disaster risk management plan and is currently in the process of developing their disaster risk financing management strategy.

### Vietnam

The City of Da Nang, Vietnam was one of the first cities in Asia to promulgate a strategy for financial management of natural disasters and pandemics in 2020. The strategy included financial resilience as part of a comprehensive resilience approach that comprises physical, social, and financial resilience. The strategy seeks to protect the lives, health, and assets of the city's people, firms and governments against natural disasters, as well as pandemic shocks. It also aims to integrate disaster risk financing instruments into the city's medium-term financial plan and five-year budget plan. This will increase the transparency and openness in implementation of policies for risk financing.

Key solutions under this strategy include: (i) policy, legal and institutional measures; (ii) financial solutions to improve fiscal resilience through the insurance of public assets, the strengthening of household resilience through improvements in access to finance for resilient housing; and (iii) enhancing firms' resilience through improvement in their access to finance following a disaster/pandemic event. These solutions will be underpinned by investments in data infrastructure and analytics. Knowledge exchange will be sought with peers from across the globe.

# SUBNATIONAL RISK FINANCE INSTRUMENTS

Subnational governments mostly rely on their own budgets or fiscal transfers to finance disaster response and recovery. However, many have come a long way in embracing innovative risk finance instruments to complement traditional budget resources. This section discusses some instruments that have been adopted by local governments in select countries.

## Australia

According to the DRFA framework, states are required to implement insurance arrangements, particularly in relation to state-owned assets. This is done to transfer as much of the disaster risk as is practicable. States have largely met this requirement in relation to state-owned assets through captive state insurance funds and reinsurance arrangements.

For example, the state of Queensland, which is usually hardest hit by natural disasters (cyclones and flooding), has its own insurance fund (the Queensland Government Insurance Fund [QGIF]) and resilience and recovery agency (the Queensland Reconstruction Authority [QRA]). The QGIF covers the physical assets and liabilities against natural disasters for all state government, budget–dependent agencies (except road infrastructure). Bridges and tunnels are covered under reinsurance policies with sub-limits. The QGIF also maintains a centralised geo-referenced database for all state government assets, which is updated every year. The QRA was established in 2011 after a major flooding event across much of Queensland. Its primary roles involve managing and coordinating the Queensland Government's program of recovery and reconstruction works within disaster-affected communities.

## New Zealand

The city of Wellington adopted an insurance management strategy that seeks financial protection for catastrophic losses, including those caused by natural disasters (including above and below ground assets), as well as sufficient cover for significant 1 in 1,000-year seismic events. The strategy is an integral part of a broader risk management framework to manage and mitigate risks. If the residual risk under this framework is at a level that is not acceptable and no further mitigation can be implemented to reduce the likelihood or consequence, risk transfer or insurance will be considered. The strategy also ensures that insurance proceeds can be used to support a return of the Council assets and services to its pre-event state. From 2010 to 2016, the city secured coverage with limits in the range of USD 700 to USD 1 billion[12].

12 - Wellington City Council Insurance Management Strategy, 2015

# Conclusion

Natural disasters place a heavy financial and social burden on all governments, which is largely met by national governments who act as the insurers of last resort. This is consistent with their national leadership roles and extensive financial reserves.

However, the different roles and responsibilities of national and state governments, particularly when responding to natural disasters, requires careful consideration concerning the funding flows between them. It is critical that funding to address the significant financial and social costs of natural disasters be spent as efficiently as possible to maximise the benefits to the community and build national resilience. This requires the right balance of national policy direction and leadership to encourage, support and incentivise subnational governments and their communities to be a part of building national resilience, while also providing a degree of independence to manage and deliver local priorities. A key element of this approach is the need for an overarching national policy and disaster risk finance strategy. The strategy should address a number of issues. First, it should ensure linkages across all government expenditure and risk management frameworks. Second, it should provide for the active engagement of all levels of government and the community. Third, it should provide subnational and local governments with some discretion and independence in undertaking local resilience and recovery expenditures. Fourth, it should include a range of disaster risk finance strategies, such as:

1. National/subnational natural disaster funding arrangements that capture all natural disaster funding flows, providing clear guidance and governance about how, when and where such funding will be provided and how it will be managed and recorded;
2. Natural disaster pooled funds to build financial capacity over time;
3. Incentives to encourage subnational governments to pro-actively manage their disaster risks and invest in mitigation and resilience measures, as well as to adopt post-event measures;
4. Risk financing options, including insurance of government and community assets.

# Knowledge Exchange Series on Building Sovereign Financial Resilience in Middle Income Countries

**Middle-income countries face fiscal challenges in effectively responding to disasters.** Relief, recovery, and reconstruction efforts are often constrained by limited fiscal capacity and capability, with many governments often relying on short-term international support as their primary source of post-disaster funding. Establishing the appropriate risk financing strategies can help address these challenges and build national resilience.

**Since 2012, Switzerland's State Secretariat for Economic Affairs (SECO) and the World Bank's Disaster Risk Financing and Insurance Program (DRFIP) have developed a joint program to support middle-income countries (MICs) in building their financial resilience to withstand natural disasters.** The Sovereign Disaster Risk Financing and Insurance Program for Middle-Income Countries (the Program) is one component of a broader World Bank-SECO partnership to address fiscal risk management in MICs. The Program provides tailored advisory services and institutional capacity building for public financial management of natural disasters. Program outcomes over the last eight years have been promising. Indeed, participating countries have improved their understanding of the financial and other impacts of natural disasters. As such, they have made significant regulatory, institutional, and operational changes to improve financial planning for disasters. In addition, they have successfully adopted innovative risk financing instruments.

As part of the Program, this webinar series aims to assist governments in developing and implementing more effective and cost-efficient financial protection strategies. Such strategies are key to better managing government disaster-related contingent liabilities and risks. In the process, they are also becoming more effective risk managers. This series also aims to bring countries together to share knowledge, experiences, and good practices concerning disaster risk financing.

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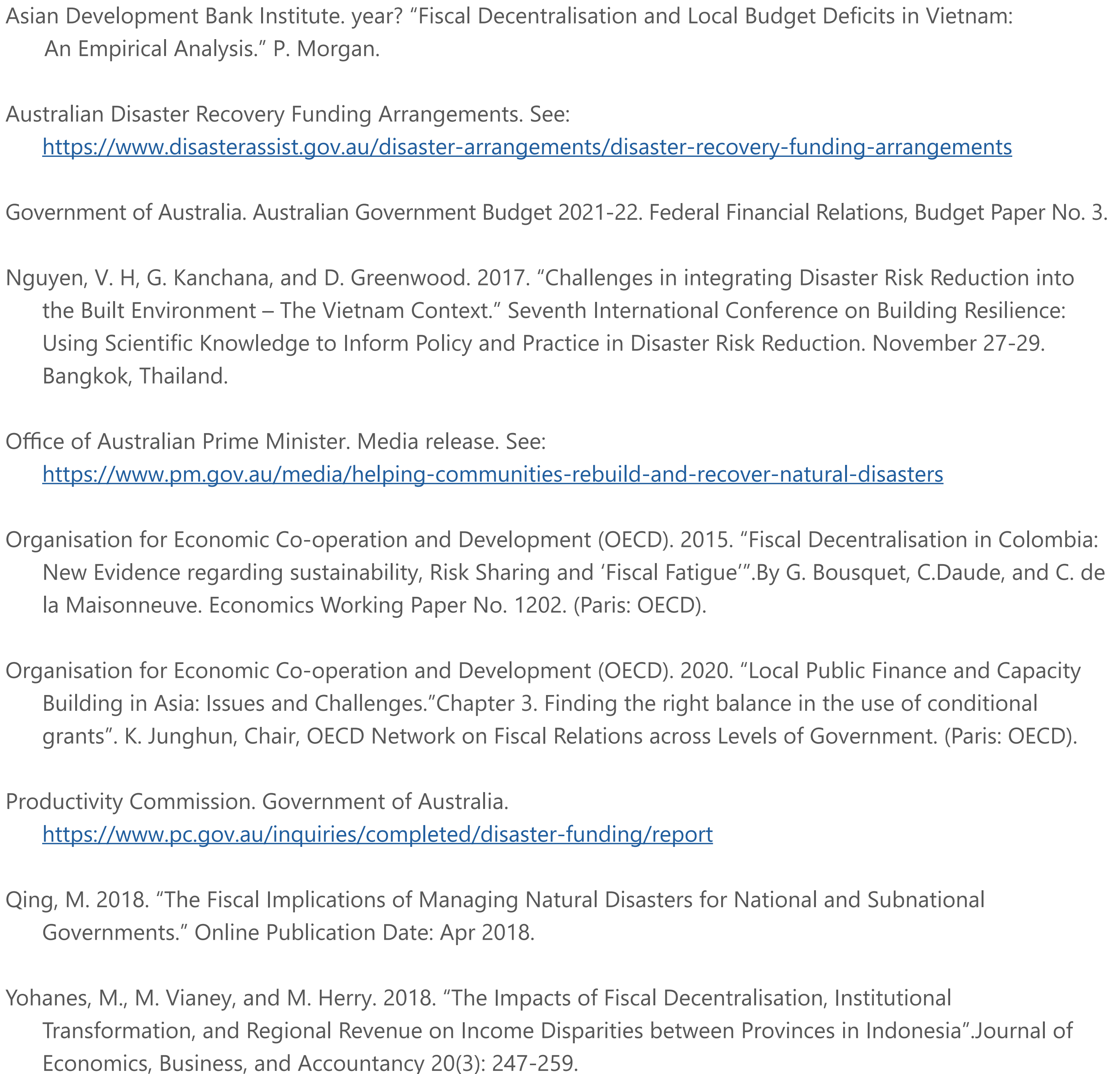

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# FACT SHEET 2: FISCAL AND FINANCIAL RESILIENCE FOR SUBNATIONAL GOVERNMENTS AGAINST NATURAL DISASTERS

**Test your understanding and record your insights through this easy, DIY worksheet!**

**Activity 1:** Given below are few statements about subnational governments in context of disaster risk financing. Identify if the following statements are true or false.

| Statements | True | False |
|---|---|---|
| 1. Subnational governments often act as first responders for disaster response and recovery. | | |
| 2. Subnational governments are often responsible for maintaining disaster impacted assets and delivering public services. | | |
| 3. Subnational governments have limited funds at their discretion for disaster response, recovery, and procurement of risk transfer instruments. | | |
| 4. Due to limited resources of subnational governments, national governments have to often bear the costs faced by subnational governments, as a result of disasters, usually as a contingent liability. | | |
| 5. Subnational governments mostly rely on own budget or fiscal transfer to finance disaster response and recovery. | | |
| 6. Subnational governments often rely on pre-arranged risk transfer instruments or other ex-ante risk finance mechanisms over fiscal transfer from national governments for funding disaster recoveries. | | |

**Activity 2:** While the majority of disaster funding is sourced from and controlled by national governments, subnational governments also have important roles independent of national funding or specific direction, with some level of autonomy and independence in the way they undertake ex-ante and ex-post disaster risk financing strategies and instruments.

Can you identify any Subnational Financial Protection Strategies against Disasters in your country and the primary objectives of the strategies.

| # | Subnational Financial Protection Strategy | Primary Objectives of the Strategy |
|---|---|---|
| 1. | | |
| 2. | | |

**Activity 3:** Now that you have seen various country examples, take a look at your country's national policy and DRF strategy in the context of national and subnational governments, and answer the following questions with "Yes" or "No".

| Do you think the strategy: | Yes | No |
|---|---|---|
| 1. Has linkages across all government expenditure and risk management frameworks? | | |
| 2. Actively engages with all levels of government and the community? | | |
| 3. Provides subnational and local governments with some discretion and independence to undertake local resilience and recovery expenditure? | | |

**Activity 4:** Reflections

[1] My Top 2 Takeaways from this Factsheet are:

[2] Two concepts/ideas I would like more information on are:

Disclaimer: The boundaries, colors, denominations, and other information shown on any map in this work do not imply any judgment on the part of The World Bank concerning the legal status of any territory or the endorsement or acceptance of such boundaries.