Executive Summary

Natural disasters cause widespread damage and losses and fast growing economies are particularly exposed. Rapid and unplanned economic development increase vulnerability and exposure to natural disasters, while climate change could exacerbate the intensity and frequency of major meteorological disasters.

Governments shoulder a significant share of the costs of disasters. This is true in OECD economies and even more so in developing economies, where private insurance markets are not as well developed.

The fiscal impact of disasters on a government's budget can be sizeable. Major disasters, or a number of smaller events in a short timeframe, can result in significant government expenditure with potentially negative impacts on revenues. This can cause deviations from previously forecast fiscal outcomes leading (for example) to an increase in public debt. Depending on the level of these impacts, this can create a fiscal risk to government finances.

Expenditures for governments arise from both explicit and implicit commitments to compensate for disaster losses. Explicit commitments (or explicit contingent liabilities) are payment obligations based on contracts, laws, or clear policyies. Implicit contingent liabilities, by contrast, are expenditures governments make in response to a disaster due to moral expectations, political pressure or in an attempt to speed up recovery. Implicit contingent liabilities are harder to identify and quantify, and hence harder to manage.

This report presents the results of a study that compares governments' practices in the management of the financial implications of disasters for a set of OECD member and partner economies.

Key findings

Explicit commitments by governments to provide post disaster financial assistance vary widely. In some economies legal frameworks and policies clearly stipulate what central governments finance in terms of post disaster costs, while in others governments make a more general commitment to provide financial assistance, but without being specific.

Damage to public assets, such as public buildings and infrastructure is the largest disaster-related liability for central governments. Publicly owned buildings and infrastructure make up the majority of disaster costs incurred by central governments. To better control the level of these costs several governments have implemented measures such as asset registries, which allow for better monitoring of asset exposure, and public asset insurance, which reduces their liabilities in the event of a disaster.

The liabilities most difficult to control for central governments are those that stem from damages to assets and infrastructure owned by subnational governments. These damages become a central government liability where rules about the responsibility for associated costs are unclear or where financial capacity constraints at subnational level lead central governments to assume responsibility for these costs. To limit these liabilities, a number of

governments have implemented clear rules for sharing costs between levels of government for disaster damages. To further minimise such costs some central governments have strengthened incentive mechanisms, for example through co-financing agreements, to encourage subnational governments to invest in reducing their assets' vulnerabilities.

Governments have actively implemented rules limiting financial support for disaster damages incurred by state-owned enterprises. Most, but not all, governments have established rules obliging state-owned enterprises to manage exposure to disasters on their own, by purchasing insurance or creating the necessary emergency reserves.

Various measures are financed by central governments to provide post-disaster assistance for individual households. All studied governments provide immediate relief assistance to households, such as temporary shelter or food, without reference to household income. Additional support for the rehabilitation or reconstruction of houses is provided by some governments, while many make such aid dependent on the household's income.

Governments have supported post disaster assistance for businesses to limit the prolonged negative economic impact of disasters. This includes safety-net programs, such as interest-free loans, to help balance temporary cash-flow problems and avoid potential business closures.

The share of implicit disaster-related contingent liabilities rises when extreme events occur. Implicit liabilities tend to be higher still for governments that have made limited or vague commitments about what they are going to pay for prior to a disaster. Such liabilities arise in the form of an ad-hoc expansion of rules for financial assistance defined prior to a disaster. They tend to increase when political pressure to assist is high or when there is a risk for prolonged economic suffering.

Systematic quantification of disaster-related contingent liabilities remains limited despite significant information available to estimate their overall size. The case studies show that governments have significant information on the sources and potential level of disaster-related contingent liabilities. This information, however, is often stored in a scattered way and rarely collated to support financial planning.

Governments acknowledge the value of incorporating disaster-related contingent liabilities in fiscal risk assessments, however, in practice governments do not often take this step. Most governments do not count disaster-related contingent liabilities as part of fiscal risks or government liabilities. Some governments report such liabilities in a qualitative reference in their budget statements, while others point to a specific number, such as is the case for government-backed disaster insurances.

Policy recommendations

- ***Design clear framework rules for a government's post-disaster financial assistance***. Rules that are too general or too ambiguous make it difficult to control, and will fail to limit, government expenditures in the event of a disaster. Compensation rules could be regularly assessed and revised especially when financial outlays for the government continuously rise.
- ***Establish clear cost sharing mechanisms across levels of government***. Make explicit the central government commitments for providing financial assistance to subnational levels. A ceiling for such assistance along with clear cost sharing formulas between the central and subnational governments could help to control and limit overall central government costs.

- ***Include the assessment of disaster-related contingent liabilities in fiscal risk management frameworks***. Even where the impact of disaster-related contingent liabilities on a government's fiscal risk position can be reasonably expected to be limited, including them in the assessment process raises visibility and thereby increases effectiveness in public financial planning. It also often spurs a more whole of government focus on building resilience to climate and disaster shocks, including to reduce risks in the first place.
- ***Make risk reduction part of the framework conditions for co-financing disaster risk management measures***. Governments can boost the resilience of businesses and households cost-effectively by raising awareness about the risks and the role they have in ensuring their own resilience. Governments can also help improve framework conditions to increase access to and take-up of risk transfer instruments, such as business continuity or household insurance. To avoid paying for preventable damage repeatedly over time, governments may consider incentive mechanisms to sectoral government agencies, subnational governments and private stakeholders that provide higher damage reimbursement rates where measures are included to reduce future risks.
- ***Manage remaining fiscal risk through multi-pronged financial protection strategies***. Financial protection strategies secure optimal access to post disaster financing. Such strategies ideally take a risk-layering approach combining different financial instruments from budgetary measures, contingent credit facilities to risk transfer instruments, making sure each instrument matches the funding needs during different phases of disaster response. Effective strategies lay out processes to mobilise resources effectively in the event of a disaster and ensure they reach beneficiaries rapidly and appropriately.

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