

INTERNATIONAL LABOUR ORGANIZATION

**IDNDR Hemispheric Meeting for the Americas:
Towards Effective Disaster Reduction in the 21st Century**
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*Parallel Forum on Economic Aspects, Development Banks, Foreign
Assistance and National Institutions*

***“Thank Heavens We’re Insured”:
Economic Risk Reduction with a Social Purpose***

A proposal of the International Labour Organization

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Introduction

1. Disasters come in all shapes and sizes (although they seem to be getting bigger all the time) and produce a myriad of effects. The broad purpose of the present panel is to examine the “economic aspects” of disaster, a vast and far-reaching topic, in the treatment of which we might do well to make a first division of focus, inspired by the medical confraternity, between the **economics of prevention** and the **economics of recovery**.
2. The economics of prevention has both a positive and a negative aspect. Viewed positively, it should concern itself with how economic policy and economic measures can be used to support and promote a “culture of prevention”, as well as making clear to policy makers and the general public the economic advantages in the long term of preventive measures. The negative corollary concerns itself with demonstrating how short-term economic thinking, which places cost-cutting and profit-maximizing measures at its centre, can have, literally, disastrous consequences.
3. The economics of recovery is really just a specialized sub-set of development economics, at least in the context of developing countries. While natural (and, indeed, other) disasters serve to highlight, in a particularly harsh fashion, developmental problems in the countries affected, they clearly confirm the need, also, for a *continuum* approach, integrating recovery with broader development efforts. The present paper will therefore limit itself to those economic aspects of recovery and reconstruction which can play a positive role in reducing and mitigating the effects of subsequent disasters.
4. Appended to the present paper is a copy of a document recently presented at the Second Meeting of the Consultative Group on the Reconstruction of Central America (Stockholm, 25-29 May 1999) entitled, *Decentralization and Strengthening of Local Government*. It was considered that paragraphs 34 – 37 of this document might offer an interesting framework for the present panel, because they concern themselves with the relationship between economic development, natural disaster risk reduction and social improvement at the community level. To give our discussions a concrete focus, much of the present paper will be devoted to the development of the ideas contained in paragraph 36 of the Stockholm document, on the establishment of a Central American Programme for Disaster Insurance which, it is proposed, might go some way to using economic means both to promote a culture of prevention, to mitigate the economic effects of natural disasters and to facilitate recovery in their aftermath.

The Problem

- 5 By definition, all construction, agriculture, industrialization and every other kind of interaction between human beings and their environment, take place at the local level. There may be significant inputs, technical, design and financial, from other levels (regional, national and international) but, ultimately, things are actually done, if they are done at all, in a community. This means that the most important context for natural disaster reduction is the municipality.
- 6 Yet, in Central America, at least, the municipality is, by far, the worst equipped level of public administration to assume this responsibility. Its technical resources are extremely limited, in part because of low levels of education, in part because those who do acquire high levels of technical expertise tend to congregate in a few urban centres or emigrate and in part because local government does not have the financial means to attract and pay specialists. Systems of taxation are notoriously weak and consistently fail to provide government at all levels with a sufficient financial base to carry out its responsibilities to the citizenry. Unlike national governments, local governments have little access to loans and credit. Even where national law provides for minimum levels of financial transfers from central to local authorities, this is seldom respected, making local financial planning all but impossible. Corruption is rampant.
7. Against such a background, it is evident that the fundamental dynamic of local public spending is to do whatever it can as at the lowest possible cost. Building materials will typically be of the cheapest kind. Building codes and requirements which involve additional costs will be quietly ignored. Building inspectors, where they even exist, will be poorly qualified, poorly paid and constantly tempted by bribes from unscrupulous contractors. There is very little capacity, if any, on the part of the local authorities to evaluate technically architectural and engineering proposals. Trained urban and community planners are rare. Systematic maintenance of public buildings and infrastructure is seldom followed through and repair work is usually very much *ad hoc*. Land for public building projects is usually acquired because it is cheap, not necessarily because it is in a safe or socially convenient location.
- 8 All of this means that when disaster strikes, its consequences are even more devastating and there is a clearly observable correlation between economic development and the extent of damage. As was evident in the wake of Hurricane "Mitch" in Central America and Hurricane "Georges" in the Caribbean, their effects were much worse in the poorer countries (Honduras, Nicaragua, Haiti and the Dominican Republic) than in the relatively richer ones (Belize, Costa Rica, and Puerto Rico). While the erratic paths of the storms were partially responsible for this (Hurricane "Mitch" stayed much longer over Honduras than over Costa Rica, for example), it cannot be denied that the economically more advanced countries were much better able to mitigate their destructive impact.

Some possible solutions

9. Clearly sustainable and widespread solutions to these problems can only be achieved through long-term programmes to improve the capacity of local authorities, with significant increases in the human and financial resources at their disposal. In this connection, development banks, international official development assistance and national programmes all have an important role to play by insisting that all construction and reconstruction programmes which they support include criteria for risk reduction and disaster prevention and local capacity building for appropriate maintenance and inspection.
10. Classical economic incentives can (and should) also be applied to favour risk reduction, *e.g.*, tax incentives and access to credit on more favourable terms. More broadly, any measures which promote local economic development will amplify the resource base of the municipality, thus giving it greater capacity to implement disaster preventive measures.
11. A programme proposal which seeks to attend to many of the problems described above in a comprehensive and coherent manner is based on the concept of disaster insurance and while its ultimate purpose is social development, it involves many economic and financial aspects which, it is proposed, might usefully be explored and refined in the context of the present panel.
12. The basic scheme is that put forward in paragraph 36 of the annexed document of the Stockholm Meeting. It is directly related to the situation in Central America but might be equally relevant, with suitable modifications, to the Caribbean and even some South American countries and regional integration organizations.
13. The fundamental aims of **CAPDI**, (the Central American Programme of Disaster Insurance) are to mitigate the economic consequences of natural disasters in the region and to provide economic incentives for preventive and risk-reducing measures, especially at the level of local communities. The scheme would enable Central American municipalities to insure their public assets and infrastructure against loss, damage or destruction as a result of natural disasters. A first step would have to be a study to determine the degree of the contingent risks in actuarial terms and therefore the necessary level of capitalization.
14. Donors would be encouraged to contribute to the capitalization of the programme. This should constitute an attractive option both for development banks, official foreign assistance and even private direct investment for a number of reasons. First, the "identity" of the sources of funding and a

significant degree of supervision of their application could be assured through a system of “share-holding”, entitling the donor or investor to participate in the management of the programme. A significant part of the capitalization could be in the form of guarantees rather than grants or loans. Furthermore, the existence of the programme would significantly reduce the need for more capital transfers in the case of future disasters, making fewer demands on international funds. As capitalization gradually increased from the premiums of the participating municipalities, foreign donors could reduce their participation, if they wished, and recuperate at least part of their investment.

15. Like any insurance scheme, the programme would have a vested interest in reducing its exposure (risks). It would therefore offer incentives to influence positively practices at the municipal level which would be disaster-preventive and damage-mitigating. Premiums would thus be lower in the case of municipal assets which had been constructed according to risk-reducing criteria. Mindful of the correlation between economic development and disaster impact mentioned above, the programme would also provide economic incentives for measures that maximize the economic advantage of construction within the community (*e.g.*, labour intensive techniques and use of local services and materials). Regular maintenance, using local manpower, would also be a requirement.
16. In order to be able to assess risk and adjust claims, the programme would have to acquire the relevant expertise, thus creating in the region a body of experts who could advise municipalities on the safest building methods. This could be a cost-effective way of at least partially meeting the lack of human resources and technical capacity from which municipalities are suffering at present.
17. Most importantly, perhaps, the programme would provide an important financial incentive for municipalities to include and observe risk-reducing criteria in their planning and construction projects. Since short-term savings achieved through inappropriate building methods and inadequate materials would be immediately off-set by higher insurance premiums, there would be less temptation to continue in this fashion.
18. Since inspections and assessments would be carried out by employees or contractors of the programme and not poorly paid civil servants, the risks of corruption would also be significantly reduced.
19. If the programme is properly managed, it should within a reasonable period of time become self-sustaining. Indeed, it will necessarily have to examine the question of investment of its capital. Part of the latter, at least, (and applying appropriate criteria for security of investment and return on capital) could be made available in the form of loans to municipalities for both further construction and economic development. Criteria similar to those applied in the

calculation of premiums would be applied to the calculation of interest rates, thus doubling the incentives for safe construction and maintenance.

20. Once the programme was consolidated with widespread participation of local authorities, it could be extended to the private sector and even individuals. It might even be considered a better financial strategy to open participation to the private sector at the initial stage, thus greatly increasing the potential financial base. This possible advantage might, however, be offset by the need for a much larger administrative, managerial and technical staff than the scheme could reasonably provide in its early phase. Another option might be to design autonomous but inter-related public and private insurance schemes.
21. It is not obvious for the time being which of the Central American Regional Integration bodies would have the capacity to manage the CAPDI. Certainly both national and regional associations of municipalities should have an important role in its administration, The Central American Bank might be the best option, at least initially.
22. Such institutional and regional considerations are, however, not of central importance for present purposes. The objective, as mentioned above, is to stimulate debate and reflection on how economic and financial measures can contribute to disaster prevention and reduction. It is hoped that the present paper will have served, however modestly, that purpose.