

# Payouts for Perils: How Insurance Can Radically Improve Emergency Aid

## We Must Radically Improve Emergency Aid

Natural hazards—earthquakes, storms, floods, extreme temperatures, and epidemics—affected more than 83 million people in middle- and low-income countries last year. This large and growing development challenge threatens our ability to deliver on the Sustainable Development Goals and strains already straitened resources. Between 2010 and 2015, OECD donors spent at least \$2 billion a year on average on the consequences of natural disasters. But there are crucial failures in how this assistance is deployed.

We may not know when or where disaster will next strike, but we know it will. Still, we treat natural disasters like surprises, planning and funding our response only after the fact. This approach makes advance planning difficult—budgets are uncertain, and some promised funding never arrives. The support that does materialise is often fragmented, gumming up delivery with red tape or bypassing national authorities.

Unpredictable funding undermines effective response to natural disasters. Two key innovations pre-agree funding for future disaster risks to save lives, money, and time:

- We should **pivot existing funding** to enable frontline governments and agencies to pre-enroll for quick-fire support against predictable future costs.
- Where no pool of money is available, we can **transfer risk to the insurance sector** by using concessional insurance to create certainty. Premiums are the price of making sure we have capital when we need it.

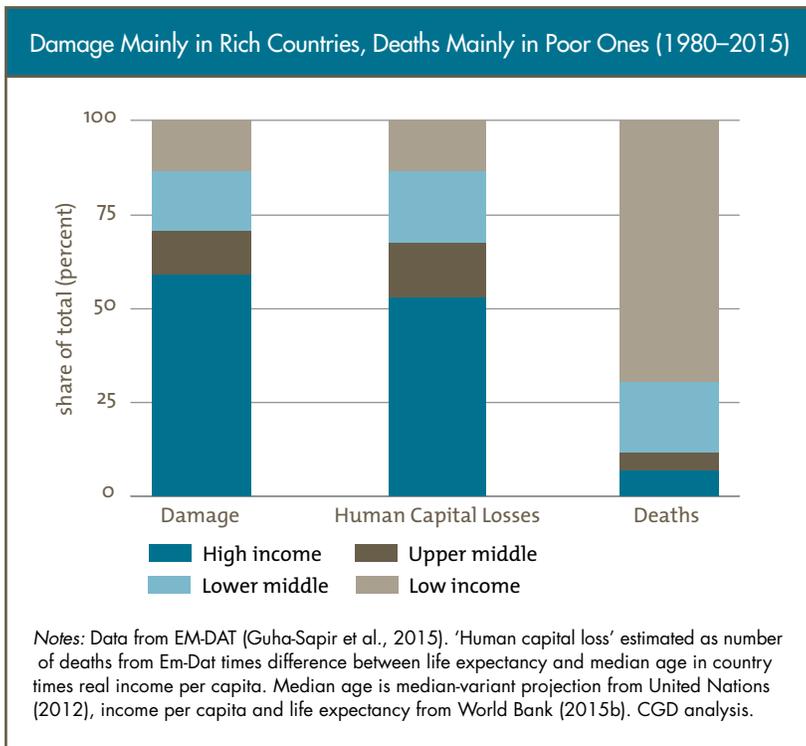
## Disasters: Expensive, Regressive, Dangerous, and Getting Worse

In 2015, international appeals after disasters ranged from more than \$500 million in response to a devastating earthquake in Nepal to \$1 million to help the Caribbean island of Dominica after tropical storm Erika. Donor funding covered only a tiny share of overall losses that year, estimated at more than \$37 billion in low- and middle-income countries.

Our focus on the immediate impact of disasters may distract us from their pernicious, longer-term costs. Disaster losses can make poor households permanently worse off by undermining their capacity to recover. We see this effect at the level

### What will change if we pre-agree more spending?

Frontline governments will have reliable, pooled funding attached to contracts that pay out when disasters hit, or in time for hazards to be tackled less expensively—for example, by responding to droughts rather than famines. Donors will be able to help cover more risk, more efficiently. Agencies will spend more time on planning, preparing, and implementing and less time on fundraising. Most importantly, we will provide better, more timely protection to families whose ability to cope has been stretched to breaking point by risks beyond their control.



of whole economies, too: the top 1 percent of the most extreme events lower economic growth rates by over 6 percent amongst low- and middle-income countries. Disasters can also drive mass displacement; more than 19 million people were displaced by disasters in over a hundred countries in 2014 alone.

Damage and loss estimates might lead us to believe poorer countries lose less. In fact, as the figure above shows, the human toll of disasters is borne disproportionately by the poor.

We face a future in which more hazards will evolve into disasters. The share of the global population living in urban areas will double in a century. These high population densities mean a hazard with the same footprint will affect many more people at once. At the same time, climate change is causing more extreme weather, more damage, and, potentially, greater death tolls.

### Aid Is Well-Intentioned But Often Late, Fragmented, and Distorting

Funding is not provided when it would do the most good. Soon after Ebola was detected in 2014, for instance, the World Health Organization estimated

it would cost \$5 million to contain; eight months later, the estimate was \$1 billion. Waiting to pay for response makes it more expensive by imposing additional damage.

A large amount of aid that does arrive is fragmented into many small programmes or projects. This multiplicity of programmes is expensive to coordinate, and it can deprive any one budget line of the resources necessary to make a difference.

Because financing arrives, however imperfectly, after disaster strikes, it blunts incentives to spend scarce funds on risk reduction. Among OECD donors, only a small sliver of disaster-related aid is spent on *disaster risk reduction*—on the order of less than half a dollar in every (inflation-adjusted) \$100 of aid over the last 20 years. Even if this estimate were off by a factor of 10 (because some investments, for example in new school buildings, increase resilience but are not recorded as disaster-related), spending on resilience would amount to just \$4.30 for every \$100 of aid in real terms—far lower than it should be, given the returns on investment from better resilience to natural disasters.

### Most Funding Treats Disasters Like Surprises

Taxpayers in rich countries provide generous support for emergency response. But this effort has been allocated mainly to facilities that are not agreed beforehand and so, *by design*, cannot match funding to predictable future risks. Just 10 percent of post-disaster support from donors between 2010 and 2015 was through facilities that could agree funding before disasters struck (see table opposite).

This is an **allocation problem**: we spend far too much through budget lines that do not enable planning ahead. We focus aid overwhelmingly on ex-post response, rather than pre-committing money that could enable better planning when predictable hazards arrive.

There are alternatives to the imperfect risk transfer of ex-post aid. But the vast majority of funding that is not provided through ex-post aid is not *pre-agreed*. This means we have not explicitly attached a payout to a predictable future risk, thereby undermining, rather than providing incentives for, planning. As a result, our current approaches to funding disaster risk are not an effective match for the hazards faced by vulnerable populations.

## Four Actions to Make Payouts Predictable

We should reform disaster aid's well-intentioned but underperforming business model by **moving from funding risk to risk finance**. Scaling up pre-agreed aid has been held back by uncertainty about whether payouts will be used well and worries about undermining incentives to manage disaster risk. And engaging with the insurance sector raises concerns about whether the public sector can be an informed buyer.

The working group recommends **four actions** to overcome these stumbling blocks:

- **Pivot funding.** The critical resource in disaster response is predictability, but we raise funds after hazards arrive because money is not generally available when they happen. In fact, donors have made substantial funding available through other windows, including faster access to concessional lending. The challenge is that most of these facilities respond to disasters that have happened but cannot be agreed in advance. **The cheapest source of predictability is enabling authorities to pre-enroll in existing funding windows against specific future risks.**
- **Reward planning, resilience, and equity.** We can realise a dividend from agreeing money in advance by tying more reliable funding to investments in risk management and smarter planning. Donors and national authorities might invest in flood defenses, for example, while agencies agree to pre-position emergency supplies and coordinate disaster plans with governments. In parallel, we must require that support be fairly and transparently distributed, leaving no group behind. Similar hazards affect people differently, depending on their political power and voice. **The offer of pre-agreement creates a novel incentive for more equitable, transparent response.**

### The Vast Majority of Aid Treats Disasters Like Surprises

	Agreed in advance <i>Ex Ante</i>	Not agreed in advance <i>Ex Post</i>
<i>Estimated average annual payouts, 2010–15</i>		
Transfers risk	\$12 million	\$2,276 million
Smooths costs	\$271 million	\$185 million

Notes: Authors' calculations. See section 5 of the full report.

- **Give technical advice.** Agencies and governments need technically accurate, genuinely independent, and strictly confidential advice to get a clear-eyed view of their potential losses, and the costs for insurance against them. That expertise lies with the insurance sector. **Donors should support a sophisticated advisory facility** to deliver this public good. The facility must have ironclad ethical walls separating it from insurers who might then underwrite risks.
- **Catalyse the market.** We can bring money on call **to deal with rare and expensive risks** by transferring them to insurers. Using brokers to secure the best deals, taking advantage of healthy competition among insurers, and relying on technically astute estimates of the underlying hazards and exposure will enable the public sector to buy cover for the right price. Each dollar of scarce development aid can go much farther because the premium we pay is less than the value of cover we get. And support from donors can be designed to have valuable knock-on effects by building requirements for resilience and planning into these contracts.

## **We can radically improve emergency aid**

**Matching financing to planning for smarter disaster response will save lives, money, and time.**

**It will leverage scarce donor funding during a time of pressure on aid budgets.**

**And it will enable donors to work closely and effectively with frontline governments and agencies.**

**Most importantly, it will deliver faster, better assistance to affected families.**



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*The Payouts for Perils working group brought together senior figures from donor agencies, frontline humanitarian agencies, academia, and the insurance sector to examine how we can improve financing for natural disasters to save lives, money, and time. The group was chaired by Owen Barder, Center for Global Development, and Professor Dr. Stefan Dercon of the Department for International Development and the University of Oxford. Theodore Talbot was the lead author of the report, which is at [cgdev.org/payouts-for-perils](http://cgdev.org/payouts-for-perils).*