SEPTEMBER 2022

Disaster Risk Financing: An Overview from Lesotho

A FEINSTEIN INTERNATIONAL CENTER BRIEF

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Introduction

Financial resilience to weather-related disasters is a growing area of importance for governments around the world, as they tend to shoulder most of the disaster-related costs (World Bank 2019). There is rising recognition that financial preparedness contributes to increasing a country's financial resilience to disasters and ensures a faster return to pre-disaster conditions. This brief considers the main components of disaster risk financing (DRF) through a case study of the Kingdom of Lesotho (hereafter "Lesotho").

DRF is a newer mode of assistance that enables governments to proactively put systems and financing required in place in advance of disasters or severe weather shocks (Radu 2021). It consists of fiscal buffers and pre-arranged financial instruments for actors such as governments to manage recovery costs in the wake of a disaster and in this way increase resilience (IMF 2019). Through DRF, the traditional "wait and see" approach to disasters is complemented or ultimately replaced with a preplanned national response system (World Bank n.d.). Risk financing is generally considered both more efficient and more effective than reactive approaches since it can increase resilience to disasters, help avoid losses, and promote a quicker recovery (UN 2018).

DRF has several key components:

Policy grounding: First, a country's DRF strategy must be grounded within a larger approach to disaster risk management (DRM) and frameworks to identify hazards, assess vulnerability, and respond to disasters. The strategy must include plans and policies for the management of the financial impacts of disasters on public finances (OECD 2015). This grounding must be premised on hazard analyses and contingency plans. The strategy should be developed with an awareness of existing capacity to put plans into action.

Financial mechanisms: Second, financial mechanisms must be in place to secure funding. These mechanisms commonly take the form of ex-ante expenditures for risk transfer, risk retention, and external risk finance in the form of disaster reserve funds, insurance, catastrophe bonds, or contingent credit arrangements (OECD 2015).

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Early warning systems and forecasting: Accurate forecasts and credible early warning systems are key to triggering disbursals and other assistance; concomitant with these systems must come timely communication regarding the timeline of weather events.

Disbursal mechanisms: Disbursal mechanisms (often discussed as delivery mechanisms or payment systems) must be in place to direct funding to both affected communities and the appropriate government bodies. While direct cash transfers have been the most common form of DRF payout, these mechanisms can take a variety of forms, including in-kind assistance.

Disaster Risk Financing in Lesotho

Lesotho is an example of a country highly vulnerable to climate change impacts that is working to better address climate risks. It is a small, landlocked country surrounded by the Republic of South Africa and situated in the Drakensberg escarpment of the eastern rim of the Southern African plateau. The country experiences drought and in some areas is at extreme risk of flooding and other weather-related hazards such heat waves, hailstorms, and frost (CIAT and World Bank 2018). In Lesotho and elsewhere, DRF offers an important opportunity to better prepare and offer advance assistance to affected communities in preparation for, as well as after, disasters.

DRF policies in Lesotho

DRF policies and frameworks in Lesotho exist but are in need of being broadened and strengthened. Disasters are currently addressed through a Ministry of Finance (MoF) contingency fund and a Disaster Management Fund (DMF). For 2019–2020, Lesotho spent an average of 1.6% of its budget on disaster response, which increased for more extreme, 1-in-10-year shocks to 2.6% of its budget (Lekomola-Danziger 2021). Despite this investment, funding gaps are estimated at United States dollars (USD) 12.5 million annually for disasters, increasing for 1-in-10-year events to an estimated USD 24.9 million (World Bank 2019).

Recent efforts to streamline managing and funding risks led to the drafting of a Disaster Risk Management Bill in 2020 as part of improving the management and operation of the DMF (GFDRR 2021). Interestingly, the COVID-19 pandemic has also contributed to the government strengthening responses to hazards and risk, with the MoF prioritizing three recommendations from a 2019 DRF diagnostic for the country: create a national DRF strategy; increase the amount of resources to address disasters and reduce the length of time needed to mobilize them; and strengthen the financial systems providing targeted support to affected households (Lekomola-Danziger et al. 2021).

The country has also recently formed partnerships to increase DRF and DRM. In 2020 the government of Lesotho and the African Risk Capacity (ARC) Group signed a Memorandum of Understanding (MoU), with the aim to better address the impact of extreme weather events in the country. Such partnerships build on other disaster response efforts, such as the 2016 additional financing by the World Bank Group to address the impacts of drought.

Financial mechanisms

Several financing mechanisms currently exist at the national level. However, it is important to note that funding from the finance mechanisms is not always available. This is mainly due to reliance on funding from international donors to carry out DRM. The government of Lesotho has two contingency funds in place that could potentially be used to respond to recurrent disasters. One fund is controlled by the MoF and is not specifically intended for disaster-related needs but is instead meant to meet a broad range of needs, such as additional expenses by line ministries. The DMF in the Disaster Management Authority (DMA) is designed to be responsive in meeting disaster-related needs.

The main challenge associated with the MoF contingency fund is that allocations to the fund must be spent within the fiscal year, the last months of which coincide with the rainy season in Lesotho. Given that resources are not dedicated to disasters, by the time droughts or floods strike there are generally very few resources remaining in the fund. The DMF, on the other hand, does not allow for direct disbursement of resources to other line ministries to finance their disaster response activities. The compounding effects of decreasing annual allocations to the fund, its nature of responding to instead of preparing for disasters, and the challenges associated with its disbursement affect Lesotho's financial preparedness for disasters. Both funds are reported to often deplete early in the budget cycle, leaving the government exposed when disasters occur later in the fiscal year (World Bank 2019). As anticipatory action is still in the early phases of implementation in Lesotho, there is a need to adapt these mechanisms to fit an anticipatory mindset and to be available prior to, rather than only after, climate hazards strike.

Disbursal mechanisms

Key considerations for DRF in Lesotho include the development and scaling up of effective delivery mechanisms to distribute assistance quickly and efficiently to disaster-affected populations. Payment systems are critical to this effort and are one area where the government of Lesotho is focusing its efforts.

Lesotho is currently taking measures to strengthen its social protection system to provide assistance in the face of climate shocks to vulnerable beneficiaries who are not part of the regular program. Lesotho has a variety of existing safety nets, notably a child grant program (a nonconditional social cash transfer program targeted to poor households with children), public assistance, which provides support in cash or in kind to destitute people annually, and an old age pension (a universal, noncontributory, unconditional cash transfer program, available to everyone over 70 years old not receiving a civil service pension). It is seeking to scale up these social safety nets in cases of disaster ("scalable social safety nets"), which was first piloted during the 2015–2016 El Niño event in the country. To be most useful, however, these social safety nets need to be comprehensive and backed by efficient financial systems and effective methods of reaching target populations. Recent evidence from Ethiopia and Kenya, where large-scale safety net programs were put in place but have faced significant challenges, also points towards the vulnerability of such programs to exogeneous events such as political change and conflict. Currently the Lesotho government disperses most of its cash for social protection manually, with the remaining amount paid through mobile transfers using Vodacom M-Pesa and Ecocash in several districts (Boko et al. 2021). Since 2015, in response to drought and more recently to COVID-19, various agencies, including the Lesotho Red Cross Society (LRCS), have also used e-transfers via network companies (Vodacom and Econet) and/or over-the-counter disbursement in partnership with the Lesotho Standard Bank (Auerbach and Sengupta 2022). Where packages of assistance are not feasible due to lack of mobile network coverage and/or protection issues for beneficiaries, assistance is provided using commodity vouchers through retailers.

However, the coverage of mobile and digital money systems is expanding rapidly in many low-income countries. Making use of these to transfer DRF payments enables the disbursement of cash faster, more efficiently, and with greater accountability than manual systems. This is true for both regular and emergency payments. In addition to speed, such systems offer security and flexibility, and minimize challenges such as theft. Cash transfers also break the cycle of aid being limited to the goods and services that humanitarian agencies can procure and deliver (Barder et al. 2015), and instead offer the chance for beneficiaries rather than aid agencies to determine what they need most. The need to take advantage of such systems before disasters cannot be overemphasized, particularly in countries like Lesotho, which is chronically affected by shocks and often still provides physical rather than digital cash transfers.

DRF good practices applicable to Lesotho

The following good practices are important for Lesotho to consider as it continues to develop DRF policies, frameworks, and implementation mechanisms.

- **Legislation and policy environment:** Mainstream DRF into disaster management policies to reduce drastic fiscal losses. Thus, the Government of Lesotho can develop comprehensive legislation and institutional arrangements governing DRM (REAP n.d.).
- **Types of finance:** Set up sovereign options such as contingent lines of credit so that governments have access to finance at competitive borrowing rates immediately after a disaster to meet emergency needs (REAP n.d.).
- **Mechanisms for disbursal:** Partner with telecommunications service providers, banks, and traders for successful cash delivery, with the understanding that a range of payout methods will enable the highest number of people to be reached. There are multiple options that the country and aid agencies can consider for delivering money, from bank accounts to mobile phones, prepaid cards, and delivery in envelopes, and multiple potential private and public sector providers (Save the Children 2010, Pople et al. 2021, Red Cross Red Crescent 2021).

Next steps for research

Qualitative primary and/or secondary research might seek to answer the following questions to further inform DRF in Lesotho and beyond:

- How can other populations not part of existing social safety net programs be assisted through DRF in Lesotho, such as through pre-identification, to aid scalability?
- How are choices about different cash delivery mechanisms made?
- Do outcomes, including the timing of receiving assistance, differ by DRF payment mechanism in Lesotho?

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The Academic Alliance for Anticipatory Action (4As) is a consortium of researchers from seven universities working to increase the knowledge base on anticipatory action. 4As is led by Feinstein International Center, Friedman School of Nutrition Science and Policy at Tufts University in the US, partnering with Bangladesh University of Engineering and Technology, Eduardo Mondlane University in Mozambique, Makerere University in Uganda, University of Namibia, National University of Lesotho, and University of the Philippines.

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This publication was made possible through support provided by the Office of Acquisition and Assistance, Bureau for Management, U.S. Agency for International Development, under the terms of Cooperative Agreement No. 720BHA21CA00044. The opinions expressed herein are those of the authors and do not necessarily reflect the views of the U.S. Agency for International Development.

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