A SOCIAL PROTECTION ‘RISK DEAL’
THE MISSING ELEMENT FOR CONNECTING MONEY-IN AND MONEY-OUT

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Abstract

This paper asks what is required for social protection systems to deliver timely, predictable, well-targeted and cost-effective shock response to disasters. Currently, international support for two key elements – namely, investments in shock-responsive social protection and securing pre-arranged funds for shock response – are growing. The paper, however, argues that a third, linked element is necessary: the need for governments to clarify a shift in the social contract through reliable disaster-contingent public policy and for international actors to align behind this objective.
About the Centre for Disaster Protection
The Centre for Disaster Protection works to find better ways to stop disasters devastating lives, by supporting countries and the international system to better manage risks. The Centre is funded with UK aid through the UK government.

About the authors
At the time they contributed to this paper, Zahrah Nesbitt-Ahmed was Lead Researcher, Daniel Clarke was Director, and Lydia Poole was Associate Director – Policy and Evidence.

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1. Introduction

Globally, the impact of disasters is on an upward trajectory, with the frequency and severity of climate-related disasters increasing (IPCC 2022). The UN’s General Assembly midterm review of the implementation of the Sendai Framework for Disaster Risk Reduction (2015–2030) notes that in the past 20 years the frequency of climate-related disasters has almost doubled, with the proportion of people affected by disasters having increased from 1.1% over the period 2005–2014 to 2.0% over 2012–2021.\(^1\) The average annual number of disaster-affected people during the period 2015–2021 was 150 million people per year (UNGA 2023). The compounding and protracted nature of disasters presents a critical development challenge, particularly for low- and middle-income countries, undermining efforts to reduce poverty, and further deepening existing inequalities and vulnerability (Hallegatte et al. 2020). In this context, where disasters are anticipated to increase, a growing number of governments and international agencies are finding new ways to respond more efficiently and effectively to shocks. This includes leveraging national social protection systems (Scott 2022) – and particularly social assistance in the form of cash transfers, which has expanded considerably in low- and middle-income countries in the past few decades.

Increasingly, it is theorised that social protection systems – when adapted – can be used to strengthen shock response in the wake of disasters, including climate shocks (Anderson 2021; Costella et al. 2021; Tenzing 2020; Ulrichs et al. 2019), and in addressing gender- and age-related risks and vulnerabilities to climate stresses and shocks (Jordan et al. 2021; Lowe et al. 2019; Nesbitt-Ahmed 2023; Pereznieto and Holmes 2020). Governments in low- and middle-income countries, such as Kenya and Malawi, are working with development partners to include shock-responsive elements in their social protection programmes (Lung 2022). UN agencies including the World Food Programme, Food and Agriculture Organization and United Nations Children’s Fund are also working with governments to deliver shock-responsive and or adaptive social protection programming in both their development and their humanitarian operations (FAO 2022; UNICEF 2019; WFP 2022).

It is important to place these positive shifts, in perspective, and to qualify that in many low- and middle-income countries affected by disasters overall levels of finance for shock-responsive social protection are low (Longhurst et al. 2021).\(^2\) Moreover, financing shock-responsive social protection in low- and middle-income countries is often a mosaic of funding from a mix of sectoral sources and actors, including domestic and donor funds, with low-income countries relying heavily on donor funds (McCord et al. 2021).

Crisis financing, in low and middle-income countries has historically been reactive. Governments often rely heavily on ex-post financing, including budget reallocations. This can have significant

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\(^1\) Part of this increase is due to improvements in government reporting on disasters.

\(^2\) In 2019, prior to the covid-19 pandemic, a little over 1 per cent (or US$2.4 billion) of total overseas development assistance (ODA) – estimated at US$180 billion – was for routine social protection provision. It is unclear how much of that was for shock-responsive social protection as it is currently not possible to estimate the proportion of development or humanitarian ODA allocated to shock-responsive social protection due to limitations in the granularity of the data collected by the Organisation for Economic Co-operation and Development (Longhurst et al. 2021).
opportunity costs, impacting economic growth and recovery (Allan and Bayley 2023). Crisis financing from international donors has also historically been highly reactive (Poole et al. 2020). This is starting to change, however, and the feasibility and acceptance of arranging financing in advance of shocks is building.

International development financing for pre-arranged financing (PAF) grew steadily over the five-year period 2017–2021, from US$177.2 million in 2017 to US$1.9 billion in 2021 (Plichta and Poole 2023). Overall, this represents a small proportion of international development financing for preventing, preparing for and responding to crises, at just 2.7% of total crisis financing flows in 2021 and 2.2% of crisis financing across the five-year period 2017–2021 (ibid.). However, while the baseline remains low, international policy dialogue is increasingly concerned with ensuring predictable financing for shocks. Most notably, at the United Nations Framework Convention on Climate Change Conference of the Parties meeting in Egypt in November 2022 (COP27), PAF was elevated to a key focus of international climate policy with the formal launch of the G7- and V20-backed Global Shield against Climate Risks, and the landmark agreement among the Parties to establish a fund to respond to Loss and Damage.

There is growing innovation, investment and interest, therefore, in both ‘money-in’ and ‘money-out’ elements of effective disaster response, yet neither is yet reliably effective in its own right and they typically do not work in concert. The missing link bringing these two elements together is a ‘risk deal’ that acts to both clarify and shift the social contract to better protect at-risk people and help strengthen their resilience, and provides incentives for risk reduction and preparedness (see Figure 1). Risk deals are born out of political commitments, but they become durable through the delivery of reliable public policy and action. The three elements are mutually reinforcing and depend on one another for their success.

**Figure 1: Getting disaster risk financing right**

![Risk Deal Diagram](image_url)

Source: Centre for Disaster Protection

1. **Money-out systems.** The systems and knowledge in place that allow governments to use money to deliver public services to anticipate, respond to and recover from the impacts of likely, imminent or current crises.

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3 Research commissioned by the Centre for Disaster Protection into the opportunity costs of budget reallocations to finance responses to covid-19 in Ethiopia, Pakistan, South Africa and Albania found that ‘the impact of budget reallocations, in terms of opportunity cost of returns forgone from diverted funds, was significant. For covid-19, in the countries studied and for the time periods analysed, this cost is estimated to have been of the order of 0.5–2 % of GDP[…] Moreover, the opportunity cost multiple for budget reallocations is estimated to be in the region of 1.2–1.6, meaning each dollar mobilised incurs an opportunity cost of between US$1.20 and US$1.60’ (Allan and Bayley 2023).
2. **Money-in instruments.** The pre-arranged finance instruments in place that trigger the timely, transparent and reliable release of money so that plans can be implemented.

3. **Risk deal.** Reliable public policy that provides clarity to people on what support they would actually receive from government in the event of a future disaster, that is communicated clearly and fairly so different communities and groups facing different and changing disaster protection gaps understand the implications of the policies for them, and which has sustainable political demand.

Approaches to realising effective shock-responsive social protection are described in detail elsewhere (e.g. World Bank 2021; O’Brien et al. 2018; Longhurst et al. 2021). Therefore, this paper focuses on the ‘risk deal’, the settlement between governments and their citizens clarifying what it is reasonable to expect when disasters happen, and the ‘money-in’ element, with a particular focus on the potential for arranging financing for disaster response in advance.

This paper argues that, done well, disaster risk financing (DRF) can contribute to political risk deals, providing clarity to people on what support they would receive from government in the event of a disaster – both in terms of maintained and expanded public services – and clarity across line ministries over what responses they need to prepare to deliver, enabling all stakeholders to better understand risk and plan their options for when it happens. DRF is therefore not only a technical mechanism for financing disaster response, but can be part of a systemic shift. Specifically, it can facilitate a move away from political leaders treating (and being rewarded for treating) disasters like surprises, towards public policy with clear communication that people facing risk can better rely on, that can be improved upon incrementally over time, creating power for people facing risk, and which is intentional in its links to broader public policy.
2. **Element 3: Forging a risk deal**

We use the term ‘disaster risk deal’ for a situation where disaster-contingent public policy is reliable – that is to say, it can be relied on and trusted by people – for a range of potential disasters.

Many governments around the world make significant investments to provide reliable, contingent public policy for other risks – take pensions policy and the risk faced by individuals that they might outlive their assets, for example. Many people around the world want to know what support their government will provide them in old age; responding to this, many governments aim to provide reliable pensions policy. Governments routinely communicate with individuals about what support they can expect to receive from government (and equally the limits of such support), introducing legal protections that make it challenging for future governments to renege on commitments made. Reliable pensions policy can bring significant benefits, allowing people to plan better for old age, allowing governments to plan better for their share of the costs, and facilitating better public scrutiny of policy (Barr 2020).
The situation for disaster risks is similar in many respects, though political demand is weaker in many countries. This is partly because scrutiny of disaster-contingent public policy is more challenging than scrutiny of pensions policy, as people are getting older all the time and the consequences of this are readily apparent, whereas disasters tend to occur infrequently, so the implications of disaster policy cannot be directly observed (Healy and Malhotra 2009). This unobservability means that public interest in reliable disaster policy often does not evolve into helpful political incentives, with political leaders rewarded for discretionary post-disaster policy and not rewarded for disaster preparedness (Clarke and Dercon 2016).

There are exceptions: agricultural producers are often successful in obtaining commitments from government for reliable support in the aftermath of disasters that affect agricultural production, often manifesting as highly subsidised, regulated agricultural insurance schemes (Mahul and Stutley 2010). Similarly, homeowners often obtain commitments from government for reliable support in the aftermath of disasters that damage homes, either through insurance-backed schemes such as Mexico’s Natural Disasters Fund (FONDEN) or Morocco’s Solidarity Fund for Catastrophic Events (FSEC), both of which provide insurance-backed support for low-income housing damaged by disasters. However, the most vulnerable groups, usually those most affected by disasters, often do not benefit from such risk deals.

Nevertheless, demand for reliable disaster policy (risk deals) is growing in many countries, particularly those experiencing more or greater disasters, and particularly for subsidised agricultural or homeowner insurance schemes. National risk deals are often developed through the rejection of ad hoc approaches to public policy in the aftermath of crises.

There is also a high level of demand from stakeholders in the international crisis financing system, both for the system to deliver more reliable support to the most at-risk people and for it to provide more help to support countries to forge risk deals. A recent spate of high-level international policy initiatives – the Bridgetown Agenda, the V20 Accra-Marrakech agenda, the World Bank Evolution Roadmap and the G7-V20 Global Shield against Climate Risks – all include predictable DRF as a core ambition.

This section reviews the potential economic benefits of risk deals, then outlines three dimensions of reliability that require particular attention from policymakers: transparent communications, time-consistent policy, and the conversion of implicit contingent liabilities to explicit contingent liabilities.

### 2.1 Benefits of reliable public policy

There are three main welfare benefits from governments providing reliable shock response. First, the best documented – and probably most significant – benefits from reliable shock response come from allowing people to plan and giving them the confidence to invest in their future. While we know of no studies that have directly looked at ex-ante benefits of reliable shock-responsive social protection, a large number of studies look at the ex-ante benefits of commercial insurance for rural households in extreme poverty or at risk of falling into extreme poverty. These studies find that
uninsured risk substantially reduces productivity, whether a shock occurs or not (Hill et al. 2021). If people do not know whether they will receive support, or what support they will receive, they will be less willing to make productive investments out of fear that a shock will affect them at a time when they have no liquidity. If people trust that insurance will help them cope in extreme years, they are willing to make more productive investments, increasing their ability to move out of poverty. The welfare benefits from this shift in precautionary behaviour can be large – larger than the welfare benefits from actual insurance payouts (Carter and Chiu, 2018). There is already strong evidence that social transfers can strengthen the social contract (Sabates-Wheeler et al. 2017). We theorise that having social protection that also provides reliable support against the impact of shocks is likely to strengthen the social contract further, while delivering economic and welfare gains beyond the direct benefits from the transfers themselves. Reliability itself is socially valuable, over and above the support actually provided after shocks.

Second, converting unreliable to reliable public policy can reduce the cost to line ministries of delivering shock response. Not knowing what government policy might be in the event of a disaster can lead to line ministries underinvesting in preparedness relative to the socially efficient level of investment, or investing in the wrong kind of preparedness for the wrong people for the wrong hazards. There are few published cost benefit analyses of investments to strengthen the shock-responsiveness of social protection systems; but there are a number of careful cost benefit analyses of the benefits of preparedness for humanitarian response, including cash response, which suggest that such investments made wisely can be valuable (BCG 2015; DEPP 2018). There are also more extreme examples of the benefits of reliable public policy for disaster reconstruction, such as the Government of Japan’s approach to post-disaster reconstruction for lifeline infrastructure. In advance of the Tōhoku earthquake and tsunami in 2011, the Japanese government had signed a contingent service contract with a construction company for post-disaster reconstruction, leading to key highways being rebuilt within two weeks of the disaster. Such rapid reconstruction would not have been possible at any cost without reliable policy and contingent contracting in advance.

Third, shifting from implicit to explicit contingent liabilities can be used to create (political) power for those at risk, as upfront planning allows for greater participation and co-creation of solutions with affected or at-risk communities. A paper specifically reviewing recent experiences in this area (Swithern 2023) highlights the potential for increasing accountability in disaster response when policy is supported by PAF for response. It provides recent examples of building accountability through increasing transparency, participation and answerability. The main conclusion is that this link between DRF and improved accountability is not automatic and that much more needs to be done to ensure accountability in DRF programmes.

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4 Hill et al. (2021) summarise the evidence as follows: ‘There are 10 studies across contexts and products showing that productive investments increase significantly when insurance is provided: Bulte et al. (2020) for multiperil crop insurance in Kenya; Stoeffler et al. (2020) for area yield in Burkina Faso; Hill et al. (2019) for rainfall and area yield insurance in Bangladesh; Jensen et al. (2017) for livestock insurance in Kenya; Cai (2016) for area-yield insurance in China; Fuchs and Wolff (2016) for rainfall index insurance in Mexico; Cai et al. (2015) for swine insurance in China; Mobarak and Rosenzweig (2015) for rainfall index insurance in India; Elabed and Carter (2014) for area yield insurance in Mali; and Karlan et al. (2014) for rainfall index insurance in Ghana. The range of impact is about a 15%—30% increase in farm investment (Carter and Chiu, 2020). Insurance does not encourage households to necessarily take inappropriate levels of risk but allows households to reduce costly risk-avoidance behaviour.’
2.2 Transparent communications

Reliable public policy on how social protection systems will be used to respond to a range of potential shocks must be transparently communicated to potential recipients. Public policy should not be secret or obfuscated, nor presented in a misleading way. A government must be able to explain how it would use social protection systems for response to shocks so recipients of social protection programmes can understand what support would be provided to them, for what shocks (both shock type and intensity), and what conditions would apply to the support (e.g. if the person must be pre-registered). This is a high bar, going far beyond access to information, to effective communication.

Achieving this will not be easy as there are often low levels of awareness among recipients about social protection programmes, the benefits they are eligible for and how to access them. Communicating about social protection programmes is challenging in its own right; that difficulty is compounded when it comes to communicating what would be offered in the aftermath of a range of potential disasters. For example, an assessment of the Indian government’s social protection response to covid-19 suggests that only 41% of programme recipients were fully aware of the benefits they were eligible to receive (Aadil et al. 2020), suggesting that even fewer would have been able to predict what benefits they would be eligible for before covid-19 hit India. Moreover, a qualitative evaluation of Kenya’s Hunger Safety Net Programme highlighted that although emergency (i.e. disaster-contingent) transfers to households were based on objective criteria, households did not understand the criteria and found the transfers to be unpredictable; this limited the impact of the transfers compared with regular programming (Farhat et al. 2018). In general, lack of information and ineffective communication can lead to exclusion of deserving recipients, lack of credibility, erosion of trust in governments and, most importantly, the poor impact of social protection programmes (Wright et al. 2020).

It is possible to provide clear and fair communications about disaster-contingent benefits. In well-regulated environments, insurance companies are required to provide transparent and not misleading information on disaster insurance contracts before the contracts come into force (see Insurance Core Principles 19.6–19.7). While not precisely the same as communicating disaster-contingent social protection support, there are sufficient similarities that those operating social protection schemes should be able to learn lessons from well-regulated insurance companies and their regulators, such as using plain language, focusing on the quality of communications rather than their quantity, and being intentional about who provides information.

Individual social protection programmes have already learnt many of these lessons. For an example of the importance of who provides information, in north-east Nigeria (Borno, Yobe and Adamawa states), 96% of respondents in a Cash Barometer perception survey said they preferred receiving information about access to assistance through their community leaders and responded positively to the information they received (CALP 2020). Without analysing the culture of participation and customary information flows, it is difficult to encourage equitable engagement across crisis-affected groups. At the same time, communicating what the shock response would be in the event of a shock must be context specific, drawing on and engaging with the knowledge and needs of communities.
Once social protection programme recipients know about and understand information about a programme – specifically, about the programme’s adaptation due to a shock or crisis, linked to the above – the recipients and their wider communities should be able to interact with the government and service providers to provide feedback, raise complaints or appeal over exclusion from a social protection programme when it is adapted following a shock (Pereznieto and Holmes 2023). They should also know that their complaints will be dealt with in an appropriate and timely manner. In other words, they should be able to hold government accountable for the information communicated to them.

2.3 Time-consistent public policy

Reliable public policy must be time consistent in the economic sense of the word; that is, future policymakers should not have incentives to renege on or change public policy in the face of an actual shock. Current policy may be time consistent if it accurately captures what policymakers would do in the event of a disaster or if the political costs of deviating from a stated policy are sufficiently high (e.g. if deviating from the stated policy could lead to costly lawsuits). Reliable public policy is typically built around some combination of political commitments, laws or other legal commitments, and financial commitments.

In the absence of commitment devices, governments may have incentives to provide ambiguous, and unrealistically high or unrealistically low promises to voters. They may prefer ambiguity to reduce pre-disaster scrutiny of public policy and to make it easier to direct any benefits to elites or other preferred groups in the event of a disaster. They may wish to present unrealistically high estimates for support they will provide in the hope of winning votes at no cost today (and hoping that a disaster does not actually occur). And they may have incentives to present unrealistically low estimates for how much support they will provide in the hope that households and communities will invest more in self-protection, thereby limiting the need for a government response. Moreover, these incentives can change rapidly from government to government.

These challenges notwithstanding, the willingness and ability of a government to provide clarity and certainty for its citizens both helps to build the social contract, and has economic and welfare payoffs. We now turn to the issue of financial commitment devices.
2.4 Converting implicit contingent liabilities to explicit contingent liabilities

A fundamental enabling condition of a risk deal is whether a government acknowledges the potential costs arising from shock response. In the language of fiscal risk management, a key question is whether the government considers the cost of shock response to be an implicit or an explicit contingent liability (see Box 2). Shifting from treating shock response as an implicit contingent liability to an explicit contingent liability is necessary (though not sufficient) for reliable public policy responses to shocks. It is also very challenging.

Box 2: What are contingent liabilities?

**Contingent liabilities** are obligations to pay costs associated with a possible, but uncertain, future event. Because there is no obligation to pay unless the event occurs, contingent liabilities might not be formally listed as liabilities on an organisation’s balance sheet. Contingent liabilities might be explicit or implicit.

**Explicit contingent liabilities** are contractual commitments to make certain payments if a particular event occurs; the basis of these commitments can be contracts, laws or clear policy statements.

**Implicit contingent liabilities** are political or moral obligations of the government to make payments; for example, in the event of a crisis or a disaster – governments do not recognise these liabilities until a particular event occurs. Implicit contingent liabilities are difficult to assess, let alone manage in a consistent manner, precisely because of their implicit nature.

Source: Centre for Disaster Protection (n.d.)

A large body of experience and work on fiscal risk management around the world strongly points to the benefits of governments converting implicit liabilities to explicit liabilities. This recommendation has come from decades of experience with fiscal risks ranging from pension liabilities to banking crises. All too often, if a government keeps such risks as implicit contingent liabilities the risks are often not properly assessed and managed in the interests of taxpayers, and end up resulting in very high costs to the government and wider society. HM Treasury (2020) reviews UK failures and subsequent action from this perspective; Beck and Sheppard (2023) makes the case that German government failures in response to covid-19 should be viewed in this light; and Poole et al. (2020) review failures in the international crisis financing system from this perspective.

A practical example outside the realm of natural hazards is bank failure in Australia (OECD 2013). Over a long period, successive Australian governments stated that bank deposits were not guaranteed. Yet repeatedly, when faced with bank failure the government bailed out depositors. The government could never credibly pre-commit that deposits would be forfeited; ultimately, the government introduced a constrained bank deposit insurance scheme. This converted what was an implicit contingent liability to an explicit contingent liability. It also allowed the government to place clear boundaries around what government support would be, making it easier for banks and consumers to understand their residual risks. The basic idea underlying this is very similar to the Samaritan’s dilemma in Buchanan (1977 [1999]), where a well-intentioned ‘Samaritan’ (in this case a government) cares about a recipient and provides them with implicit insurance against risk, but
cannot commit to provide explicit insurance, leading to poor incentives and economic inefficiency. Converting implicit contingent liabilities to explicit liabilities can lead to better risk management, and incentives for beneficiaries or the private sector to reduce risk.

OECD (2013) proposes that governments should always convert implicit liabilities to explicit liabilities, unless the government can reliably pre-commit that it will not take measures in response to the risks stemming from the implicit liability. It is rare that a government can credibly pre-commit that it will not use social protection mechanisms for shock response; it follows that most governments should convert these implicit contingent liabilities to explicit contingent liabilities.

The role of PAF for explicit contingent liabilities is explored next.

3. Element 2: Securing predictable finance in advance

Where countries use social protection schemes to respond to shocks, most of the finance for such responses is unplanned. For example, very little of the finance used to scale social protection systems in the wake of covid-19 was planned. Where finance was planned, mostly it was in the form of crisis response funds; the fund manager had discretion over whether to fund covid-19 response through social protection systems or not.

This is part of a broader pattern in low-income countries where crisis response is financed overwhelmingly with unplanned crisis financing, both from government and international humanitarian funding. Where funds are pre-arranged or set aside in advance, they are rarely earmarked for particular crisis response actions such as social protection responses. There is no guarantee that unplanned crisis financing, particularly from international sources, will ever arrive. When it does, it is likely to be programmed through parallel response systems and not through government-led shock-responsive social protection.

A ‘mature’ approach to preparing for shocks would include a far higher proportion of funding that was pre-arranged and set aside in advance; of this funding, far more would be clearly designated or earmarked for pre-agreed crisis response purposes, including shock-responsive social protection. Countries would, then, rely far less on unplanned financing responses.

Figure 2 provides a typology of five different types of financing for shock-responsive social protection. In a mature system, a much higher proportion of funds would fall within the category of PAF, and a higher proportion of both crisis response funds and PAF would be earmarked for pre-agreed purposes.
Figure 2: A typology of financing for shock-responsive social protection

Unearmarked | Earmarked
---|---

Unplanned crisis finance

Crisis response funds

Pre-arranged financing

Finance arranged after the shock

Finance set aside in advance; pays out at discretion of fund

Finance approved in advance; pays out on pre-determined triggers or at discretion of recipient

Source: Centre for Disaster Protection

Table 1 provides some examples of instruments that would fit into each of the categories presented.

Table 1: Examples of risk-financing instruments

<table>
<thead>
<tr>
<th>Instrument</th>
<th>Not earmarked for social protection before shock</th>
<th>Earmarked for social protection before shock</th>
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<tbody>
<tr>
<td>Pre-arranged finance (PAF)</td>
<td>• Sovereign contingent credit from international financial institutions (IFIs), such as the US$4 billion disbursed by World Bank Cat-DDOs (Plichta and Poole, 2023).</td>
<td>• A small number of internationally supported shock-responsive social protection systems with PAF.(^5)</td>
</tr>
<tr>
<td></td>
<td>• Most sovereign insurance, such as the US$270 million and £125 million of claims payments paid by the Caribbean Catastrophe Risk Insurance Facility and African Risk Capacity, respectively.</td>
<td>• Humanitarian anticipatory cash. In 2022, US$137.6 million was available within agreed anticipatory action frameworks, of which US$54 million was triggered or disbursed when activation thresholds were met (Anticipation Hub 2023). Much of this was earmarked for cash transfers.</td>
</tr>
<tr>
<td></td>
<td>• Sovereign catastrophe (cat) bonds, such as the $395 million of payouts provided by World Bank-issued cat bonds (Plichta and Poole, 2023).</td>
<td></td>
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<tr>
<td></td>
<td>• Debt pause clauses, such as the clauses integrated into debt issued by Grenada, Barbados and the Bahamas (Mustapha et al. 2023).</td>
<td></td>
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</table>

\(^5\) For example, the World Bank and Government of Malawi Social Support for Resilient Livelihoods Project includes both pre-arranged early response financing from the International Development Association (IDA)’s Crisis Response Window and financing for insurance from African Risk Capacity. Disbursements from both instruments are earmarked for the national Social Cash Transfer Programme. As another example, the World Bank and Government of Sierra Leone’s second additional financing for the Sierra Leone Social Safety Net Project included a US$4 million budget line earmarked for emergency transfers that could be triggered by the government.
Taking steps to pre-agree financing for shock response is a critical step. Without it, it is not possible to provide clarity to people about what to expect and assurance that they can rely on the response. However, PAF by itself is not sufficient. To be able to provide assurances, there also needs to be clarity over ‘money-out’; that is, what the funds will be used for.

Very few low- and middle-income countries have budgetary mechanisms that allow their finance ministries to provide line ministries with earmarked PAF. Moreover, few public financial management systems in low-income countries would realistically be able to implement such a mechanism in the near future, with many governments struggling to form credible budgets for current liabilities, let alone contingent ones (Allan and Paterson 2019). Many middle-income countries, and some low-income countries, have some form of disaster fund that can be triggered by the head of state or a relevant minister, a type of crisis response fund; but public financial management systems are often not strong enough to credibly pre-commit the funds allocated to them. Beyond this, the only budgetary mechanisms at their disposal are for unplanned crisis finance.

To be able to implement PAF — and, in particular, earmarked PAF — most countries would need to rely on off-balance sheet mechanisms, either by strengthening disaster funds or using financial instruments offered by development banks or development insurers.

Currently, most internationally supported sovereign PAF by volume is unearmarked. This includes aid-subsidised contingent credit or insurance instruments that disburse funding as general budget support. Far less is earmarked and therefore able to support countries to translate implicit contingent liabilities to explicit contingent liabilities, and shift the social contract (as discussed in Element 3: Forging a risk deal). The incentives are generally skewed towards unearmarked rather than earmarked PAF. For example, the World Bank’s unearmarked contingent credit instrument (the Cat-DDO) is available to the poorest countries on an ‘allocate US$1, get US$4’ basis, but their earmarked contingent credit instruments (‘contingent investment project financing’ and contingency emergency resource components) are only available on an ‘allocate US$1, get US$1’
offering (Clarke and Dercon 2023).

For the former, a social protection implementer will not know how much money would come their way in the event of a disaster until the disaster had started. This does not allow any shift in the social contract or any meaningful increase in reliability for programme recipients.

Unearmarked PAF may be helpful for finance ministries from a macro-fiscal perspective. After more than a decade of experimentation by international organisations, however, there is no evidence that it supports more reliable public policy, as defined in the previous section, or produces any of the benefits that might be achieved from more reliable public policy.

A large part of the value added of international financial institutions (IFIs) is for IFIs to offer low-income countries part of their balance sheet, in which those countries can do things they would not be able to do on their own balance sheets, such as to commit to multi-year projects. Development banks and development insurers should expand and incentivise their offer for earmarked PAF for shock-responsive social protection.

This argument differs from accepted guidance on PAF, which mostly focuses on financial planning for finance ministries, not reliable PAF for social protection risk deals. Our proposition is most similar to that of Scott (2022), albeit consolidating the number of financing categories, and adding the earmarked/unearmarked dimension. It also draws on Lung (2022), which challenges the applicability of received DRF wisdom for social protection in fragile states. Our presentation differs from current mainstream DRF doctrine in two ways.

First, most research on DRF reduces governments to a single financial entity – the finance ministry – whose objective is to avoid the risk of the finance ministry running out of money for what it wants to do in the aftermath of a disaster. When presented in this way, the question of how to arrange shock response financing is reduced to an exercise in actuarial ruin theory, similar to the question of how to run an insurance company without becoming insolvent.

The problem here is that very few low- and middle-income countries’ finance ministries have budgetary mechanisms that allow them to pre-commit to providing reliable finance to line ministries in the event of a disaster. Treating a government as a single unitary entity is misleading: even if the finance ministry knows it will have sufficient funding for disaster response, if it has no mechanism to be able to pre-commit this money to the social protection system, the finance is not predictable for the line ministry. If it is not predictable for the line ministry it cannot be used to clarify the social protection risk deal with potential recipients. Many countries have off-balance sheet mechanisms, whether they are disaster funds or financing agreements with IFIs; but disaster funds rarely commit to earmarked funding and IFI financing arrangements typically only include known expenditures, not disaster-contingent expenditures. Only high-income countries have contingent liability approval frameworks that allow line ministries to sign up to explicit contingent liabilities.

Treating governments as unitary agents whose objective is to avoid ruin is only really a helpful framework for some upper-middle- and high-income countries, where finance ministries can pre-

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6 Effective 1 July 2022. When a Cat-DDO is financed from the IDA Country Allocation, the Crisis Response Window will finance 25% of the Cat-DDO amount, with an additional 25% financed by the Country Allocation and the remaining 50% financed by IDA general resources.
commit to line ministries and this pre-commitment can form the basis for a risk deal. Despite this, however, it remains the dominant framing for DRF for low- and middle-income countries, possibly contributing to the dearth of IFI instruments that provide earmarked PAF, and a focus by international actors on national DRF strategies rather than social protection-specific DRF strategies (Lung 2022).

Second, most presentations of layered financial strategies include large numbers of financial instruments, typically ordered by their supposed appropriateness to shocks of different frequencies (Clarke et al. 2017; Ghesquière and Mahul 2010). This can encourage the idea that the best financial strategies involve countries buying a lot of instruments, with contingent credit at the bottom of the stack and insurance at the top. This is rarely the case for social protection financing in fragile states, where the fixed costs (both pecuniary and non-pecuniary) can be very large for each instrument, and therefore where getting one instrument working well is typically both cheaper and better than starting out trying to implement multiple instruments (Lung 2022). The idea that there are general economic principles that mean specific instruments are more cost-effective than others at different return periods is largely unfounded: whether a particular instrument is efficient for a particular return period is extremely sensitive to economic and commercial factors and to instrument design (Clarke et al. 2017) – there is no generic ordering of instruments appropriate to all countries, and most generic layered risk finance diagrams are not directly applicable to specific countries.

The finance ministries of most low- and middle-income countries themselves are unable to credibly commit to earmarked PAF for social protection, thereby prohibiting reliable public policy for social protection shock response. Strengthening off-balance sheet budgetary instruments such as disaster funds to provide PAF may be possible in some countries. But for many countries it does seem that international organisations could play a key role, offering their balance sheets to countries to allow them to put in place earmarked PAF for social protection that can form the basis for forging a stronger risk deal. To achieve this, international organisations should revisit the financial concessionality of earmarked PAF (the top right cell in Table 1) and, in particular, ensure that such instruments are at least as concessional as unplanned crisis finance.

4. Conclusion

There has been increasing demand for and commitment to financing and delivering disaster response systems by low- and middle-income country governments and international actors. Yet, when a disaster strikes, in many countries, social protection systems – while expanding – still need to be strengthened to adjust to shocks. Furthermore, too little finance is pre-arranged and earmarked for shock-responsive social protection. At the same time, the DRF discourse has focused on ensuring finance ministries avoid liquidity crunches during disasters. This chapter proposes that greater focus should be paid to providing PAF to specific public services to allow countries to clarify and intentionally shift risk deals, including social protection risk deals.

We agree with humanitarians and fiscal hawks alike that governments that cannot reliably commit not to use social protection systems as part of disaster response should at least commit to use them to some degree, including arranging predictable finance and strengthening their social protection
systems for shock-responsive delivery. For fiscal hawks, this helps to get potential disaster response costs on the government’s balance sheet, turning a potentially unlimited implicit contingent liability into a bounded explicit contingent liability with better scrutiny and risk controls. For humanitarians, committing to use social protection systems for disaster response allows line ministries and people to plan and manage risks better.

The same argument also holds for international actors. Following the experience of covid-19, and in the context of increasing pressure for loss and damage finance, few international actors can credibly commit that they will not fund social protection response in a time of crisis, and therefore they should commit in advance to finance it to at least some degree, providing predictable finance to countries and supporting system strengthening. They should support the development of national social protection risk deals rather than undermining such attempts by treating every disaster like a surprise. This is also true for global funds, including the Loss and Damage Fund itself as well as other parts of the emerging mosaic of solutions to address Loss and Damage, such as the Global Shield against Climate Risks, an initiative that explicitly aims to provide and facilitate more and better pre-arranged financial protection against climate- and disaster-related risks for vulnerable people and countries. Unless these funds can commit not to fund social protection systems, they should make clear commitments to provide reliable finance that strengthens national social protection risk deals.

With the rising frequency and impact of disaster, this paper offers a three-part solution at the intersection of social protection, disaster risk management and public financial management policy: namely, intentionally shifting the social contract through reliable public policy so potential recipients of social protection programmes receive information that can be trusted (Element 3); putting in place proper financial planning, including arranging finance in advance, so that shock response can be implemented fast when it is needed (Element 2); and strengthening social protection systems to be able to deliver shock response (Element 1).

These processes are challenging and often take a long time, particularly shaping the social contract. But this should not be a reason to be dissuaded from trying. Transparency, time consistency and accountability are all equally relevant factors for making social protection systems shock-responsive to disasters. International organisations have a special role to play both in channelling international climate and disaster finance through social protection systems, and in offering governments earmarked PAF instruments that many governments are unable to replicate on their own balance sheets, given the level of development of their public financial management systems.
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*[Image: UK Aid]*