

# Chapter 15

## Insuring Against Disasters: Commercial Business Engagement in Emergency Preparedness

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### Introduction

#### *Background and the Current State of Donor-Business Commercial Engagement*

The World Bank estimates that 94 percent of natural disasters and an even higher percentage of disaster-related deaths occur in developing rather than developed countries.<sup>1</sup> Not only human, but also economic costs of a natural disaster for a developing country prove exorbitant, with damages reaching levels 20 percent greater than in developed countries.<sup>2</sup> Such sudden, high losses place a significant burden on the governments of these particularly vulnerable countries, as the state becomes the ex-post insurer of last resort by providing recovery assistance to its population in the event of a disaster. However, doing so requires the government to shift funds unexpectedly from other areas of the budget to disaster response and inevitably means it reduces the ability of the government to provide other important services and even plan their budget appropriately. Furthermore, even after mobilizing funds from other areas of the budget, the amount is often inadequate in relation to need and in extreme cases, funding deficiencies turn a catastrophic event into a humanitarian disaster. With a rising incidence of natural disasters, this need continues to grow along with both donor and recipient nation funding gaps to meet this need. Falling short of funds and expertise, an increasing number of state donor organizations are expanding their cooperation profiles to include business.

Although most European and North American state donor agencies have public-private partnerships established or in the pipeline for development assistance, only a few engage on a for-profit rather than a corporate social responsibility<sup>3</sup> basis in the area of disaster assistance and fewer contract entire projects out to companies. Most engagements between donor organizations and business in the area of humanitarian assistance reflect a mere procurement nature and seek to acquire a specific product or service. The United States, United Kingdom and Canada present a few exceptions to this rule and examples from these countries will be outlined in the sections to come.

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<sup>1</sup> World Bank, *World Development Report 2000/2001: Attacking Poverty* (Oxford, Oxford University Press, 2001).

<sup>2</sup> P. K. Freeman, "Estimating Chronic Risk From Natural Disasters in Developing Countries: A Case Study in Honduras," *Annual Bank Conference of Development Economics—Europe Development Thinking at the Millennium*. Paris, France. June 26–28, 2000.

<sup>3</sup> While acknowledging the often fine line between non-profit and for-profit business engagement, this chapter considers those initiatives that bring direct profit.

**Topic Definition:*****Commercial Engagement for Disaster Preparedness and Risk Reduction***

It should be emphasized that the analysis at hand does not limit itself to true partnerships, but rather includes all forms of donor-business engagement in which the public partner concedes either the daily execution of a project or the responsibility for its end outcome to the private partner. The distinguishing characteristic of such a constellation is the outsourcing of responsibilities to the private sector. Therefore, the following analysis does not consider relationships that reflect a mere procurement nature or the hiring of a private company to provide specific services that do not make or break the entire project.

Proponents of increased donor-business engagement in humanitarian aid cite an array of advantages: more efficient and professionalized use of public funds; increase federal budget flexibility; knowledge and skills transfer from companies for utilization in humanitarian assistance; and a greater leveraging of funds, particularly at a time when financing of humanitarian disaster preparedness continues to fall short.<sup>4</sup>

While donor<sup>5</sup>-business collaboration may enable innovation and more efficient use of limited government resources with a more effective outcome,<sup>6</sup> this type of engagement has not been unproblematic. The list below outlines some prevalent critiques for contracting out to and partnering with business in humanitarian assistance:<sup>7</sup>

Because agencies most frequently award large contracts, they promote a small number of large contractors to lobby and sustain their influence on development or humanitarian assistance decisions in a sub-optimal way for the intended beneficiaries. In such a case, the assumed benefit of increased competition would be undermined;<sup>8</sup>

Large companies have the capacity to outbid many NGOs according to price,<sup>9</sup> but if these companies achieve a monopoly on certain technologies or services over time, a dependency could develop between the donor and business, rendering such an engagement for the public actor only profitable in the short-term;<sup>10</sup>

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<sup>4</sup> For more on the potential advantages to private sector engagement in humanitarian aid, see King, S., "Competitive Tendering and Contracting Out: An Introduction." *Australian Economic Review* 107 (July-September, 1994); Butler, S., "Privatization for Public Purposes." *Privatization and its Alternatives* (W. T. Gormley; Madison, University of Wisconsin Press, 1991); Osborn, D./ Gaebler, T., *Reinventing Government: The Entrepreneurial Spirit is Transforming the Public Sector* (Reading, Mass; Addison-Wesley Publishing Co., 1992).

<sup>5</sup> "Donor" in this paper refers to state development or humanitarian agencies only.

<sup>6</sup> Here, however, it must be noted that some studies do show that in some areas the public sector may be more efficient than the private sector.

<sup>7</sup> Many of the proceeding points also encompass the area of development aid.

<sup>8</sup> See Berríos, R., *Contracting for Development: The Role of For-Profit Contractors in U.S. Foreign Development Assistance* (Westport, CT; Praeger, 2000), pp. 44-50 for an analysis of USAID contractor concentration both geographically and by size. Results lend credence to this concern, as Washington D.C. and the surrounding area presented the largest regional concentration of contracts given and large companies dominate the list. While this analysis does not separate development and humanitarian aid contracts, it indicates certain trends of donor agency contract procedures.

<sup>9</sup> Berríos R., *Contracting for Development: The Role of For-Profit Contractors in U.S. Foreign Development Assistance* (Westport, CT; Praeger, 2000), p. 36.

<sup>10</sup> See for example Rimmer, S. J., "Competitive Tendering and Contracting: Theory and Research," *Australian Economic Review* 107 (July-September, 1994).

Contractors may concentrate on the input-output fulfillment of a contract and profit-making rather than on maximizing impact on the needs of the recipients;

Company workers may not be trained to properly function in and handle a humanitarian crisis and might not be as committed to humanitarian principles;<sup>11</sup>

Finally, a very pragmatic reason often prevents donor organizations from engaging with business; transition and transaction costs of working with commercial (or new partners altogether) may prove too high. Such costs include amending existing guidelines, using different types of contracts, changing ex-ante due diligence and bid evaluation and negotiating procedures, and monitoring.

Using case studies of catastrophe insurance and early warning systems, this paper will examine to what extent some rather innovative approaches to donor-business engagement in humanitarian aid actually bring with them the potential advantages or risks listed above.

## ***Methods***

The research for this paper consisted of a scoping exercise of the existing commercial donor engagements in disaster preparedness and reasons in favor of or opposed to them; an extensive literature review on the topic of index-based reinsurance schemes, early warning systems and outsourcing; and semi-structured interviews with several bilateral and multilateral donor organizations, as well as with representatives from the participating companies.

Initiatives profiled in this paper include two different projects involving reinsurance, one of the Famine Early Warning Systems (USAID), and finally a comparative case study of German and United States organizational and procedural structures that constrain or enable cooperation with the private sector in disaster preparedness and risk reduction. As the European Commission does not engage with businesses in this area, Germany was chosen for the comparative analysis since it is a policy leader within Europe in engaging with businesses. This discussion was then broadened to encompass reasons for and obstacles to engaging with business on a for-profit basis from the European perspective.

## **Case Study 1: Index-Based Weather Insurance**

Because government funds needed to cover response costs often do not suffice in developing countries hit by an unexpected natural disaster, both bilateral and multilateral donor organizations, as well as NGOs, often step in and offer their assistance. In such cases, donor organizations and national governments both fulfill the function of an insurer of last resort. Experts point to two main reasons why this arrangement presents a suboptimal option for recipient countries: 1) Disbursements of funds tend to occur much too slowly for an emergency situation, meaning that victims do not have the help they need when they need it the

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<sup>11</sup> Literature critical of contracting out practices from the early 1990s touch on several other points. However, since that time, USAID and other donor agencies have introduced selection, monitoring and evaluation mechanisms that render those critique points irrelevant. See for example Berríos R., *Contracting for Development: The Role of For-Profit Contractors in U.S. Foreign Development Assistance* (Westport, CT; Praeger, 2000), pp. 2–3 for some of these concerns.

most in order to avoid selling off important assets and; 2) International disaster aid is too unreliable.<sup>12</sup> From the perspective of donor organizations, the current ex-post form of disaster response likewise presents several problems: 1) Unable to plan ahead for disaster, donors may end up sitting on response funds and waiting for disaster seasons until the end of a budgetary period for the case that a prioritized recipient country suffers such an event. If this event does not occur, it may be too late to appropriate these funds to second or third priority recipients. Conversely, donors who do not hold on to funds for certain disasters may find their hands tied for catastrophes that occur late in the spending period;<sup>13</sup> 2) Current ex-post forms of disaster response cost donors much more than paying a fraction of this amount in the form of an insurance premium.

Increasingly during the 1980s and 1990s, innovative insurance models began to change the traditional property-liability insurance market in developed countries, most significantly by altering the securitization of catastrophe risk.<sup>14</sup> The United States, Canada and Spain developed agricultural yield risk reduction systems based on schemes with a public-private funding mix.<sup>15</sup> Such programs in developed countries, however, typically involve a significant level of government subsidies and guarantees. For developing countries, comparable expenditures lie beyond the fiscal capabilities of the federal government and are therefore not feasible. Furthermore, farms in developing countries are on average much smaller than those in developed countries, which makes the costs of administration, marketing, servicing and controlling much more expensive.

Despite the difficulty of applying risk management models of developed countries to developing countries in a fruitful manner, donor organizations and recipient countries of low and middle incomes have begun in recent years to explore how to do just that.

Weather insurance schemes differ from traditional forms of property insurance in several dimensions, all of which have rendered them unattractive for insurance companies in the past. Firstly, catastrophe insurance per definition responds to an event that inflicts damage on a large amount of people in a concentrated area rather than on the individual property of one family. These highly correlated and concentrated damages place a sudden, large burden on insurance companies. Moreover, the extent of loss may in fact reach catastrophic levels. Secondly, insurance companies tend to view the probability of loss as less predictable for catastro-

<sup>12</sup> See International Federation of the Red Cross and Red Crescent Societies, *World Disasters Report 2001: Focus on Recovery*.

<sup>13</sup> Devastating consequences of the lack of immediate donor money available for the earthquake in Pakistan in October 2005 exemplify this point. See Akbar, A./ Kirby, T. "Pakistan Earthquake: A Tragedy the World Forgot," *The Independent*. Rawalpindi, 2005 <http://www.independent.co.uk/news/world/asia/pakistan-earthquake-a-tragedy-the-world-forgot-516720.html>.

<sup>14</sup> For more on this, see Doherty, N. A. "Innovations in Managing Catastrophe Risk." *Journal of Risk and Insurance* Vol. 64, (No. 4, 1997).

<sup>15</sup> In Canada, the federal and provincial governments finance approximately 66 percent of agricultural production insurance, while producers themselves are obligated to deposit a certain amount money in a private financial institution depending on their level of production. In the United States, the Government cooperates with several insurance companies under the Federal Crop Insurance Program. The Federal Government regulates this process slightly by prohibiting companies to refuse insurance to eligible farmers on the basis of past history. In Spain the National Agricultural Insurance Agency works with the Insurance Compensation Agency and private reinsurance companies collectively provide Spanish agricultural producers with reinsurance in the event of disaster. For more on these insurance schemes, see World Bank. *Managing Agricultural Production Risk: Innovations in Developing Countries*. (Washington, DC, The International Bank for Reconstruction and Development/The World Bank, Agriculture & Rural Development Department, 2005), pp. 11–14.

the insurance than for other forms of insurance. Finally, particularly for the most vulnerable in developing countries, researchers have found a lack of either ability or willingness of the poor to pay to insure their risks,<sup>16</sup> which makes coming to a premium agreement for disaster insurance impossible.<sup>17</sup> All of these factors contribute to the unlikelihood that a market for individual catastrophe insurance would emerge on its own, without intervention from the state and/or donor organizations. Regional, index-based catastrophe insurance schemes such as the “LEAP” (Livelihoods–Early Assessment–Protection) Drought Risk Management and Caribbean

Catastrophe Risk Insurance Facility programs seek to counter some of these challenges by geographically bundling the insured and collecting premiums from donor organizations that would otherwise respond to a disaster after the fact. These models remain quite new, replication is yet to reach full proportions and the majority of donor organizations do not participate.

Although index-based weather insurance only recently caught media attention, ideas for this type of insurance trace back at least into the 1920s in India. Early attempts to design non-index-based crop insurance programs beginning in the 1950s and 1970s in Sweden and Canada and concentrated on insuring yields directly rather than through a correlated index mechanism.<sup>18</sup> Donor organizations such as the World Bank became involved in crop insurance in the 1970s and 1980s, but quickly realized that yield-based insurance would prove too costly in regards to assessing damages and also offered incentives for cheating rather than investing in the long-term sustainability of crops. Over the course of the 1990s, several experts, notably Jerry Skees, Peter Hazell, and Mario Miranda, diligently designed and researched the feasibility of new rainfall-based insurance schemes that would be able to counter some of the inherent problems recognized in earlier models. This work led to pilot projects from the World Bank in Nicaragua (1998), Morocco (2000), India (2003), Ukraine (2002) and Ethiopia (2003).<sup>19</sup> Of these projects, however, the pilot in Ethiopia presented the first index insurance endeavor that sought to mitigate disaster risk rather than improve economic growth or reduce poverty. A variety of researchers, donor organizations, (re-)insurance companies and potential recipient country governments have begun in recent years to build upon and replicate models introduced in some of these pilot countries. For this reason, the Ethiopian experience provides important insights and lessons fruitful for emerging models.

Governance structures of index-based weather insurance differ significantly from those of traditional property or crop<sup>20</sup> insurance, especially in regards to the monitoring process. On the one hand, the determination of whether or not to pay out lies in the hands of objective

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<sup>16</sup> Here it deserves mention that studies likewise show that citizens in developed countries also show an unwillingness to pay for disaster insurance such as flood insurance if they believe that the government will nevertheless step in and provide aid in the event of a disaster.

<sup>17</sup> Goes, A. / Skees, G., “Financing Natural Disaster Risk Using Charity Contributions and Ex Ante Index Insurance.” American Agricultural Economics Association Annual Meeting. Montreal, Canada; 2003, p. 4. See Rejda 1995:23 for standard conditions of traditional insurability.

<sup>18</sup> Skees, J / Black, J.R. /Barnett, B.J. “Designing and Rating an Area Yield Crop Insurance Contract.” *American Journal of Agricultural Economics* Vol. 79 (No. 2), 1997.

<sup>19</sup> World Bank, *Managing Agricultural Production Risk: Innovations in Developing Countries*. (Washington, DC, The International Bank for Reconstruction and Development / The World Bank, Agriculture & Rural Development Department, 2005), p. 36.

<sup>20</sup> Traditional crop insurance refers here to yield-based rather than index-based measurements.

measurement tools for rainfall or temperature, most often controlled by a company or organization independent of the insurance company. As a result, the insured can be sure of a fair payout decision. On the other hand, this model discourages moral hazard and cheating from the side of policy-holders because the factors determining a payout depend on variables beyond the control of the policy-holder, which is not the case in yield-based models. Nevertheless, weather-based models still highly correlate to yield outcome. In fact, designing an index-based model to correctly reflect actual damages or yield outcome presents the largest challenge for this type of insurance.

### *Drought Risk Management in Ethiopia*

The Drought Risk Management project in Ethiopia presents an interesting model through which the World Food Program invests on behalf of USAID and the Ethiopian government a portion of the money they would have spent on disaster response food aid in the event of drought in Ethiopia in an insurance premium. This policy is then sold to a reinsurance company, Paris Re (formerly AXA Re),<sup>21</sup> which shifts the risk of disaster to financial markets and allows for a more timely payout in the event of catastrophe. Although no event has triggered a payout to date, according to the contract, Paris Re agreed to transfer the insured amount within three days after drought levels reach the trigger level. Independent rainfall information from 26 different weather stations around Ethiopia channel into the data used to determine drought risk. The World Food Program then forwards the money to the Ethiopian Government, which disperses cash to the 67,000 most vulnerable households as identified by their own communities through the existing Productive Safety Net program.

After a first year in pilot stages, the World Food Program announced the LEAP project a success and is currently working with the government of Ethiopia to extend the project for 3 years beginning in 2009. Improved early warning systems through the design of more reliable trigger points, budgeted contingency planning, capacity-building and contingency financing all comprise areas under construction for the LEAP project before 2009.

### *Initiating the Partnership: Donor Perspectives*

In 2004, the World Food Program met with the Commodity Risk Management Group of the World Bank and initiated an informal joint effort to create new solutions for better responding specifically to drought in Ethiopia.<sup>22</sup> Ethiopia was chosen for the location of their feasibility study on index-insurance for many reasons, among them need. Ethiopia regularly required ex-post food aid and in 2003 reached a record high of 13 million in need of such assistance. Because aid recipients often found themselves forced to sell assets in order to pay for immediate post-catastrophe needs, a need to develop a model that could respond quicker and more effectively was identified. While the Productive Safety Net Program from 2003 proved effective in saving lives, it fell short of sustaining livelihoods. In the event of a drought,

<sup>21</sup> Despite a change in name and ownership, the deal between AXA Re and LEAP and now Paris Re and LEAP has remained unchanged.

<sup>22</sup> Hess, U./ Wiseman, W./Robertson, T., "Ethiopia: Integrated Risk Financing to Protect Livelihoods and Foster Development." *World Food Programme*; October 2006, p. 2.

millions of vulnerable Ethiopians plummeted into poverty. The World Bank and World Food Program team estimated that index insurance would allow for a response 4–6 months earlier than the country's former disaster assistance strategy and therefore protect livelihoods as well as lives.

Ethiopia proved a pragmatic choice for a feasibility study. After their first trip to Ethiopia, the team realized that the Ethiopian National Meteorological Agency, in contrast to many weather agencies in other developing countries, produced data reliable enough to use for index insurance. Moreover, Ethiopia already had in place a complementary food security system, which could be used for payout distribution and additional risk mitigation in the event of a catastrophe.

After creating the weather index tool, the team approached the government of Ethiopia, which welcomed the initiative. It was more difficult to convince the World Food Program's Board of the appropriateness of the project. The Board initially reacted skeptically to the proposal for a commercial pilot project in such a controversial area of food security. Many did not see the necessity of this project nor the reason why the World Food Program should take responsibility for such a risky new initiative instead of business as usual.

The World Food Program submitted a tender in October 2005 for the LEAP weather insurance contract to nine companies that held an AAA rating with experience in the weather market. Six of the nine accepted the invitation to apply and five of them completed the entire application process.<sup>23</sup> By November, bids from all companies had been received. They selected AXA Re on the basis of both cost and technical competence. The actual acceptance and signing of the contract occurred quite quickly by December 23, 2005.

Before the drafters of the LEAP project approached the World Food Program Board for final approval of the quite controversial initiative, they completed the invitation and subsequent preliminary selection process of a reinsurance company in order to reduce the number of unknown risk factors.<sup>24</sup> By investing time in a diligent, informal period of building the initiative and then in including the necessary contract details, a very high likelihood of success was ensured before the World Food Program made an official commitment or applied for approval from their Board.

From the World Food Program's perspective, the main risk involved in the LEAP program stemmed from the possibility that the index payout levels might not correspond with actual need.<sup>25</sup> In other words, a catastrophe could strike without an actual payout and money would still be needed despite donors already having paid the premium for such an event. In order to mitigate this risk, LEAP employs an index based on historical figures for Ethiopia's rainfall and agricultural output and sent data to an independent geospatial service company (MDA Federal) that helped to examine and revise it. This index correlates to actual food aid beneficiaries received by 80 percent. Moreover, an update of the index occurs every 10 days, which enables

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<sup>23</sup> The five companies consisted of one hedge fund and four reinsurance companies. One company did not accept UN privileges and immunities and therefore withdrew their application.

<sup>24</sup> Samii, R. / Wassenhove, L.N.V., "Capital Markets or Alms? An Emerging Paradigm Shift in Disaster Funding." INSEAD, 2006, p. 5.

<sup>25</sup> From the farmers' perspective, this gap constitutes their "basic risk."

the timely receipt of information. In a further step, field staff were sent to Ethiopia to confirm the accuracy of the index and ensure that measurements be taken from various geographical areas within the country in order to establish an accurate representation of the aggregate risk level.

Yet another risk that exists can be found in the operationalization of the payout. Some voiced concern about whether a monetary payout would actually reach the beneficiaries. However, in selecting Ethiopia for their pilot, the World Food Program chose to use a country that has demonstrated already through their Productive Safety Net Program that “cash-based responses can work at scale in Ethiopia.”<sup>26</sup> While both cash-based and food-based aid still can improve the speed with which it reaches beneficiaries, evidence suggests a timely delivery of cash aid to households in time to protect their livelihoods. Asset depletion levels proved lower for participants in the cash-based Safety Net than for non-participants in this program.

Because at this early phase, the Ethiopian government does not pay its own premium and because local capacity is not yet strong enough to take over control of the initiative, the World Bank and the World Food Program, in cooperation with the Food and Agriculture Organization maintain ownership of the initiative. Bilateral donors work through the Bank to pay for start-up costs or premiums, but remain uninvolved in the details of the project. While donors rely a great deal on their agreement with Paris Re, Paris Re has neither a presence in the field nor operational responsibilities for the project and fulfills nothing more than a tendered function.

#### *Interaction between Donor and Business*

The business actor in the LEAP project, Paris Re, maintains little contact with donors on a regular basis. Aside from formulating the contract and reviewing the data that feeds into the index, the company only becomes active in the case that there is a payout. For a payout, they would not even have to assess claims, as the insurance is rainfall-triggered rather than loss-based. Because internationally accepted rating systems are available to check the due diligence and risk of engaging with reinsurance partners, donors need not spend extra effort, time and money on monitoring their activities. An evaluation of whether a payout occurred in the time specified likewise requires minimal effort.

#### *Business Perspectives*

Weather and agricultural covers become more and more important in Paris Re's profile. Financially, the amount it earns from the drought reinsurance in Ethiopia is insignificant in relation to its weather and agriculture reinsurance portfolio. However, this experience gives Paris Re the opportunity to further develop their profile and image in countries where they currently have no presence. For example, after their involvement in Ethiopia, inquiries came from Malawi, Vietnam, and India where similar initiatives are being designed. Recently, Paris Re has begun to work with governments to define seismic-based index insurance. Such initia-

<sup>26</sup> Hess, U./ Wiseman, W./Robertson , T., “Ethiopia: Integrated Risk Financing to Protect Livelihoods and Foster Development.” World Food Programme, October 2006, p. 4.

tives give the company an edge on the competition, as most reinsurance companies are not developing these new products.

Paris Re associates the LEAP project with low risk, as it helps them to diversify the types of risk they own. Particularly in light of the recent global financial crisis, the company found weather insurance projects attractive because they are not really correlated. For these reasons, Paris Re remains proactive in seeking further initiatives in the weather and agricultural insurance markets.

### *Results and Lessons Learned*

Because the LEAP initiative did not pay out during its initial pilot period, it cannot yet be determined whether it will have the intended effect in terms of a payout to increase liquidity after a drought. Nevertheless, some positive results are apparent. Firstly, it enabled a degree of budget certainty for the Ethiopian Government. Secondly, the first pilot year demonstrated areas in need of improvement and led to a more comprehensive drought risk management strategy as well as the recognition that reinsurance should only serve as part of a more comprehensive strategy for mitigating livelihood risk in Ethiopia. The project, deemed the first “humanitarian reinsurance project,” caused a further externality, namely much press attention for its innovative approach.

### *Caribbean Catastrophe Risk Insurance Facility*

In contrast to the LEAP project, the Caribbean Catastrophe Risk Insurance Facility (henceforth the facility) is a regional rather than country-based model initiated, operated and owned by the beneficiary governments of the Caribbean Community and Common Market countries.<sup>27</sup> Also, rather than drought insurance, the facility covers earthquake and hurricane catastrophes.

Similar to LEAP, facility payouts are based on an index that scientifically and historically estimates the correlation between natural, measurable phenomena such as wind speed on the ground in relation to the eye for hurricanes or ground acceleration for earthquakes and the parameter of damage that these factors cause in each of the participating countries.

In a first step, donors such as the World Bank, Bermuda, Canada, France, the United Kingdom, and the Caribbean Development Bank gave money into a start-up trust fund. Beneficiary countries add to this fund through a one-time membership fee and their annual premium. Only five countries, which were deemed by their World Bank status unable to pay the premium themselves, received loans for their first three years, after which countries are expected to come up with the money themselves.<sup>28</sup> The trust fund pays for operational costs as well as any payout up to 12.5 million U.S. dollars. Facility directors anticipate that by the time the

<sup>27</sup> These countries include: Anguilla, Antigua and Barbuda, Bahamas, Barbados, Belize, Bermuda, Cayman Islands, Dominica, Grenada, Haiti, Jamaica, St Kitts & Nevis, St Lucia, St Vincent & the Grenadines, Trinidad & Tobago, Turks and Caicos Islands.

<sup>28</sup> These countries include St. Lucia, Dominica, St. Vincent, Grenada and Haiti. Haiti has an agreement to have the premium provided and an expectation exists that the World Bank will extend this agreement beyond the first 3 years.

start-up donations in the trust fund become depleted, premium payments for the countries' pooled resources will have amassed enough to make the facility sustainable.<sup>29</sup> Each country pays directly relative to its risk. If an event triggers a payout, beneficiary countries are notified within days and the affected country's treasury receives most of the funds within a month and all by the lapse of two months.

A second layer of protection for the facility includes the possibility of taking out reinsurance for the event that a payout or series of payouts surpasses \$12.5 million. A variety of reinsurance firms take on risk surpassing the retention level of the facility. Munich Re took the largest share for the 2007–08 period, followed by Paris Re and Hiscox, who also participate.

### *Initiating the Partnership: Donor Perspectives*

After Hurricane Ivan hit Jamaica in September 2004 and caused catastrophic damage there, the Jamaican Government asked the World Bank if it could devise a collective insurance scheme that would offer a degree of compensation in the event of a similar catastrophe in the future. With a generous financial contribution from the Government of Japan, the World Bank then financed the necessary front-end studies that led to the plan for the facility and presented it to the 15 member states of Caribbean Community in the region. Country officials accepted the arrangements and the Bank put the facility into operations, agreeing to fund the entry fee and premiums for the first three years for countries that could not pay. As a following step, the World Bank contacted the Canadian International Development Agency and presented together with recipient countries the design for the program. Canada agreed to help capitalize and on June 1, 2007, the facility was declared operational.

Because the World Bank found it paramount to keep the costs of insurance as low as possible for recipient countries, it decided on a minimalist, virtual entity to operate the facility. They organized the facility into a captive insurance company with a home in the Cayman Islands. They then created the Trust, which would own 100 percent of the company's shares, making it non-profit, which affords the facility certain tax advantages. The facility encompasses 5 board members: a representative from the Caribbean Community countries, a donor representative, finance expert, (re-)insurance expert and an Executive Chairperson. Furthermore, a Facility Supervisor handles all front-office operations (modeling, risk transfer, pricing, dynamic financial analysis, claims and marketing), a Captive Manager is responsible for back-office operations (corporate secretary, accounting, audit management and regulatory liaison) and an Asset Manager invests facility capital according to the company guidelines.<sup>30</sup> All operative personnel belong to for-profit consultancy firms and received their positions through World Bank tendering. In this way, two levels of commercial engagement exist in this partnership: operations and reinsurance.

<sup>29</sup> Careful financial modeling has shown that this assumption is very highly likely. For more on modeling methodology employed, see Young, S. / Pearson, M., "The CCRIF as a Technical Model." Natural Catastrophe Risk Insurance Mechanisms for Asia and the Pacific Special Session on CCRIF 4-5 November 2008. Tokyo, Japan; 2008, p. 5.

<sup>30</sup> Ibid, p. 8.

From the bilateral donor perspectives, the main risk concerned the uncertain sustainability of the facility, particularly in the beginning stages. The risk consisted of the possibility that a hurricane or catastrophic storm could require payouts that could deplete the fund by paying out, but the fund has survived the initial stage and the facility is strengthening. While not all donors could be interviewed, those who responded reported no perception of additional risk attributed specifically to private sector participation for two reasons: 1) bilateral donors made agreements with the World Bank and did not further involve themselves with how the Bank chose to fill positions. They felt confident that the Bank would make a responsible decision and; 2) they expressed a sense that commercial expertise was particularly appropriate for managing such a fund.

### *Interaction between Donor and Business*

The monitoring and evaluation process for weather insurance distinguishes itself from that of other commercial engagements. During the periods where no event has triggered a payout, monitoring of the initiative's activities remain placid and public sector participants look to see if funds are managed appropriately. In this particular case, the World Bank is entrusted with this task and has set up mechanisms to ensure that the private sector actor properly looks after these funds.

World Bank staff on the project communicate almost daily with Facility management, but decisions are left to management discretion. Bilateral donors have no regular communication with management or reinsurers with the exception of the donor representative who sits on the Board.<sup>31</sup> He and the Caribbean Community representative have formal functions of monitoring the facility's activities, but other community members frequently participate in meetings where the facility presents and discusses developments. The management further emphasized their operational inclusiveness, which allows for additional oversight and monitoring. Additionally, quarterly financial statements and an annual report reviews outputs of the facility, finances and operational governance. The operations company only enjoys a contract of 3 years and must afterward apply with the World Bank for an extension. Monitoring and evaluation for parametric insurance schemes focus largely on these above-mentioned management aspects, because the decision to payout or not in the case of the reinsurance is based on openly observable objective factors.<sup>32</sup>

### *Business Perspectives*

For the operational managers, the facility comprises a large portion of their business and the World Bank an important client. Many commented that receiving a contract from such a large and well-known client and for a well-publicized project within insurance magazines, regular

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<sup>31</sup> Interestingly, some donors, such as CIDA, have rules that prohibit its staff from sitting on the Board of a private entity. This rule actually forces CIDA to entrust others with monitoring responsibilities.

<sup>32</sup> For example, the Facility relies on the U.S. National Hurricane Center to measure wind speed for hurricanes and it uses the U.S. Geological Survey to determine the level of shaking an earthquake causes, which serve as measurements for the insurance index. In this way, independent scientific organizations are responsible for deciding when the company pays out and with a Caribbean community representative on the Board, the speed of the payout can be independently confirmed.

press, and so forth, presented an attractive opportunity to build a reputation with the Bank and other donors.

For Munich Re and other reinsurers involved in the facility, catastrophe insurance makes up less than one percent of their business, including both developed and developing countries. Out of this one percent, disaster insurance in developed countries dominates their business. Only a couple of engagements exist in developing countries, some of which still remain in the rather long gestation stage.

The largest risk associated with the facility for the companies interviewed is reputational. Even in the case of reinsurance, where the facility makes up only a small percentage of their business, if they get it wrong, repercussions could prove devastating and also ripple to the rest of the reinsurance community. They mitigate these risks by simply doing their job well: ensuring that contracts are made water-tight, that no fall-outs occur, and that claims are paid quickly. The recent 2008 facility payout arrived within 14 days without any unexpected hick-ups.

### *Results and Lessons Learned*

A natural disaster inevitably strains the economic livelihood of the countries it hits, but the extent to which this strain becomes catastrophic depends on preparation and risk reduction mechanisms. Weather insurances such as the facility allow for the necessary budget certainty through a quick pay out. Over time, experts also expect tourism to suffer less after a catastrophe because a successfully run insurance facility will give the industry more confidence that recovery will occur quickly and business will return to normal.<sup>33</sup> The facility indeed quickly paid out \$418,976 to St. Lucia and \$528,021 to Dominica in 2007 following the 7.4 earthquake in the eastern Caribbean in November of that year. A second payout occurred in September 2008 to the government of the Turks and Caicos Islands in the amount of \$6.3 million. In doing so, repetition of the situation in Granada in 2004 was successfully avoided. As planned, the facility notified recipient countries within 24 hours about the amount of their upcoming payout and made the transaction for the first payout within four weeks and for the second within 14 days.<sup>34</sup>

In addition to the direct benefit of a payout, many point to the positive, indirect effect that accompanies a shift from response payments to preparedness investments. Including a whole range of initiatives, a focus on preparedness is expected to lead to improving also the infrastructure of the country, making it more robust so that it can better withstand future storms. Also, ownership of the facility sends a clear message to the donor community that Caribbean Community nations are serious about addressing their disaster risk rather than relying on donors for relief.

Thirdly, the facility created a need to work with local experts on finding and developing historical exposure data for the calculation of each country's risk level. The Bank began building capacity at a local level for this information. Nevertheless, exposure data for the region proved very scarce. Therefore, facility directors recommend that similar pilot projects begin immedi-

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<sup>33</sup> Young/Pearson, op. cit., p. 7.

<sup>34</sup> World Bank.

ately compiling data with the help of local officials. This data, once accumulated can be used to update exposure models. They furthermore suggest that new initiatives create at least one model from a well-known modeling firm and one from a regional firm (or at least with the input of regional engineers and scientists) in order to maintain their flexibility.<sup>35</sup>

While St. Lucia and Dominica stakeholders positively reacted to the payout of over \$500,000 after the November 29 earthquake, stakeholders in other countries like Jamaica responded with disappointment after hurricane Dean caused major damage in August 2007, but did not trigger a payout from the instrument due to its failure to reach the agreed-upon attachment level of the countries' insurance policies. Jamaica for example suffers from enormous debt problems and the government already lacked sufficient funds to adequately react to a natural disaster. Once they paid the premium and nevertheless received no benefit from having done so, meeting these needs became even more difficult.

Jamaica's experience reiterated a very important lesson, namely that catastrophe insurance can only address a portion of a country's risk exposure. In fact, Facility Supervisor Simon Young stressed that the goal of the facility is to get countries covered for 10 percent of their exposure. Many countries have reached this level and some have not. Countries do not take out as much insurance as they need; they choose attachment points which they can afford and have a high deductible before coverage kicks in. For this reason, donors should not expect to be able to substitute disaster relief with catastrophe insurance, but should rather see it as a complement to disaster relief. Its added value lies in its filling of immediate liquidity gaps that exist after a catastrophic event. Between immediate payouts and release of development aid<sup>36</sup> however, a gap still exists.

Facility officials realized after the negative publicity following Hurricane Dean the need for an extensive communications strategy created parallel to such a facility. The facility therefore established an external relations strategy in 2007, emphasized the payout to St. Lucia and Dominica and made an effort to portray the facility not as a profit-seeking insurance company, but as joint reserve fund for the region.<sup>37</sup> Also in terms of communication, the facility learned the hard way that in addition to wind damage parameters, storm surge should be included in the hurricane insurance model because it causes a large portion of the damage. If not, beneficiary countries should be carefully informed that excess rainfall damage will not trigger a payout. Experts are now attempting to develop technologies for additional index measurements as a result of these experiences.

Since their brokering of the Caribbean Catastrophe Risk Insurance Facility, the World Bank has received replication inquiries from an additional 18 countries.<sup>38</sup>

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<sup>35</sup> Because the facility model is based on proprietary research, adding new hazards or member countries becomes quite expensive, as it requires the facility to pay for extensive and in part unnecessary remodeling.

<sup>36</sup> Paperwork generally takes 3-6 months.

<sup>37</sup> World Bank.

<sup>38</sup> World Bank.

## Case Study 2: Commercial Early Warning Systems

Following the devastating Indian Ocean tsunami in 2004, many efforts have emerged to create improved early warning systems. While risk assessments particularly in developed countries abound for several natural hazards such as floods, earthquakes, and volcanoes, a gap still exists for complex early warning systems that factor in crucial social, economic and environmental components that affect vulnerability. Food security early warning systems continue as an area of critical importance that simultaneously presents what Kofi Annan called a “risk knowledge gap.”<sup>39</sup>

### *USAID Famine Early Warning Systems*

The Famine Early Warning Systems Network presents a global food security early warning system funded by USAID and operated through a 5-year contract agreement by a commercial development consultancy, Chemonics International. Following the devastating famines in Ethiopia and Sudan between 1984 and 1985, high-level officers of USAID designed the initiative and previously several universities as well as for- and non-profit organizations won the tendering contract to manage field operations. The Network connects local, regional and international levels in Africa, Central America, Haiti, Afghanistan and the United States in order to monitor and analyze information<sup>40</sup> about factors that could threaten livelihoods and food security. Activities include information dissemination over the FEWS NET site, vulnerability assessments on various populations groups, alerts, updates and briefings of decision-makers according to the data received through livelihood framework monitoring, local capacity development for national and regional early warning systems.

#### *Initiating the Partnership: USAID Perspective*

Beginning in the 1980s, USAID began to intensify its prioritization of cooperating with (especially American) businesses in foreign aid, while the agency also collaborated with a variety of other players.<sup>41</sup> The Network, established in 1985, placed a five-year tender for the operation of the network’s daily activities and was no exception to this rule. Since its very beginning, a plethora of for- and non-profit actors received the contract for five years. Each time, regardless of whether for- or non-profit, USAID replaced the operating agency after this time period and hired a new partner. Chemonics recently broke this cycle by receiving the first renewal contract.

Because by the time of hiring Chemonics, USAID had often cooperated with the private sector for other operations contracts, decision-makers created no extra work for themselves by

<sup>39</sup> United Nations, *Global Survey of Early Warning Systems*, 2006, p. 8. <http://www.unisdr.org/ppew/info-resources/ewc3/Global-Survey-of-Early-Warning-Systems.pdf>.

<sup>40</sup> Relevant data include factors such as food prices, precipitation and crop failures.

<sup>41</sup> U.S. Congressional Research Service. The 1981 Private Enterprise Initiative announced a shift in strategy from “predominantly public sector, or government-to-government, focus to one that emphasizes market forces and active private indigenous productive sectors”. A second notable initiative, the 1990 Partnership for Business Development Initiative publicized USAID’s desire for a greater involvement from US businesses in their aid strategy. These policies continued largely out of budget constraints and domestic pressure to give all forms of foreign aid for the benefit of the American people.

accepting the application from Chemonics. They simply pooled their applications with others from non-profits and for-profits alike and chose the applicant that offered the most competence and best price.

The Network necessitates the hiring of a large number of field staff with rare expertise. For this reason, many local staff may become hired by Chemonics and then retained even in the event that Chemonics not receive the renewal contract. Such a constellation might make future contracting awkward to the extent that a new commercial actor might not be able to hire and fire personnel in a true commercial sense. Moreover, employees could always choose (if offered) to stay with Chemonics and work on a new project, leaving the donor at loss for rare local knowledge and skills. A further but related risk perception exists that in such a large, global and logistically intense contract, the private-sector firm amasses so much expertise by managing the project that it develops a monopoly over these rare skills and the contracting organization would then become dependent on the business.

### *Interaction between Donor and Business*

USAID gives contracts to businesses and grants Memorandums of Understanding to NGOs or International Organizations. While the agency leaves much to the discretion of non-profit partners, they keep commercial entities in general on a much shorter leash.<sup>42</sup> In the case of the Network or other contracts for commercial operating agencies, the USAID officer in charge of the initiative maintains daily contact with the business partner and often makes ongoing requests and inquiries, which, for the purpose of renewal of a contract become answered by the operating agency. For business contracts, USAID requires quarterly reports and very clearly defined deliverables. In this sense, USAID allows their non-profit partners much more freedom than it does its commercial partners on an operational level and the agency monitors and evaluates the work of their contracted businesses most frequently.

### *Business Perspectives*

A for-profit development consultancy firm, Chemonics has been involved (almost exclusively) with USAID in the development field for over 30 years. Because this long track record has enabled the company to establish local knowledge and connections in several regions around the world, as well as a relationship with USAID, their entrance into the field of famine prevention and early warning systems 8 years ago presents a rather natural development.

Incentives and benefits of engaging in the Network for Chemonics include both profit and impact on lives around the world. Chemonics is a business with a bottom line that expresses its mission as “by promoting meaningful change around the world we help people live healthier, more productive, and more independent lives.” Chemonics emphasizes their ability to create value for their clients, which far exceeds the amount the company earns on their humanitarian or development aid projects. Moreover, a representative asserted that as a business committed to value and excellence, Chemonics is able to offer benefits that attract the most skilled staff.

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<sup>42</sup> USAID tends to agree on work outputs with the NGOs, but leaves the process of their work to the NGO and require the NGO to report what it does, spending, and so forth.

Many employees actually come from the non-profit sector, having gained experience with an NGO, the Peace Corps or academic institutions before joining. Chemonics representative for the Network, Nancy Jaffie, refuted existing fears that a company might not be trained to operate in a humanitarian setting or that a company would be less committed to humanitarian principles. Firstly, the company only hires staff for field positions who have relevant experience in each respective setting. Secondly, she emphasized that a person who chose to work specifically in the disaster assistance or development field—whether for a company or an NGO—will care about his/her work all the same.

Chemonics can offer USAID or other donors two key advantages in comparison to non-profit actors conducting similar work. For one, technical assistance in development or humanitarian projects comprise all of what they do. It is their core business and they can offer specialized expertise. In many cases for early warning systems, as was previously true for the Network years back, universities fulfill this function. However, they only dedicate a department to this type of work and most universities are not set up to run a business that operates in 23 different offices around the world. Moreover, expenditure procedures for commercial purchases, contracts and logistic support at many of the universities that previously won the contract proved inappropriate for the various conditions under which these offices operate. Private enterprises on the other hand specialize in exactly this type of work and have appropriate procedures long in place. A second advantage concerns the large size and financial capacity of Chemonics. For many contracts, applicants know from the very beginning that they will have to put forth large amounts of money into the beginning stages of the project, for which they usually receive reimbursement 60-90 days later through a voucher system. This process places many humanitarian and development contracts out of reach for smaller companies or NGOs.<sup>43</sup>

For the company itself, Chemonics does not see any exceptional risks attached to the Network or any other project with USAID. Likewise for its client, USAID, and beneficiaries in developing countries, they see no additional risk associated with private sector engagement. In fact, because these types of projects reflect the exclusive, core business of Chemonics, the company feels it is better poised to address the main risk, which is a job poorly done and a queue misread.

A central facilitating factor for the success of the Network is effective collaboration and coordination with other actors in the field. Despite that, in theory, development or humanitarian projects by various actors could be seen as competition, Chemonics retains its ability to operate effectively in the same way that non-profits do, namely by working with all resources available in the field, including researchers, academic institutions, donor organizations and locals with which Chemonics reports to have a collaborative relationship for common goals. In the same way that many large NGOs or International Organizations have accumulated expertise and established a relationship with other donors, Chemonics maintains an active relationship with USAID.

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<sup>43</sup> A recently begun project in Sudan exemplifies this advantage. Costs for sending staff to Sudan in order to find office space and hire local staff proved quite expensive and the financial capacity of Chemonics allowed the company to be nimble and put forth this amount of money.

### *Results and Lessons Learned*

This donor-business engagement has demonstrated several positive results and effects. Firstly, it fills an essential need in famine early warning and successfully disseminates information to embassies, missions, stakeholders and others through their open website postings. As evidenced through the competitive open tendering process and contract renewal, openness to cooperation with a for-profit partner enabled increased success and satisfaction of these deliverables.

Negative consequences of this engagement could not be attributed to the fact that USAID chose to work with a commercial enterprise rather than a non-profit partner, but did exist as a result of contracting the project out to an independent entity. While Chemonics and not USAID carries legal responsibility for any comments made or outputs of the Network, legal restrictions cannot change perceptions. Therefore, any statements Chemonics may make locally in regards to food security could cause diplomatic difficulties when one of the governments does not agree with their findings. Occasionally, a mismatch occurs between local government and the project if the results did not show that government in a positive light. For famine early warning systems, this risk remains constant because of the complex nature of measuring famine vulnerability, including influences of government policies. Again however, this mismatch does not depend on the commercial nature of the operating entity, but is rather inevitable if such a project intends to disseminate factual and unbiased information.

This survey did not find any criticisms specifically of business, but simply of the fact that USAID did not follow through on its intention to build institutions locally and be involved only temporarily in the initiative. However, not until beginning their work did the leaders of the Network realize how much more complex institution building would be in comparison to individual capacity building, an area in which the Network enjoys extraordinary success. The Network builds local individual capacities for assessment and monitoring needed for the project. However, they, like the other agencies involved in similar programs, have not succeeded in building and sustaining national institutions which would engage and retain these individuals once they become exceptionally trained.

### *EC-FAO Non-Commercial GIEWS Program*

The Food Information Early Warning System Net and the Global Information and Early Warning System on Food and Agriculture Network share many similarities and have even shared staff over the years. Much like how the creation of the previous program grew out of the late and expensive drought response in the horn of Africa, the Food and Agriculture Organization established global warning system in 1975 in response to the world food crisis of the early 1970s. In principle, the goals of the two systems are also quite similar; the global warning system states its purpose as allowing for timely interventions in imminent food crises by “provid[ing] policy-makers and policy-analysts with the most up-to-date and accurate information available on all aspects of food supply and demand.”<sup>44</sup> Achieving this goal requires that the system monitor and post information on crop production and markets globally and on a

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<sup>44</sup> FAO, *GIEWS: The Global Information Early Warning System on Food and Agriculture*. Food and Agriculture Organization, Rome; 2008, p. 3.

regional, national and sub-national basis to produce situation reports. Both programs rely on a wide range of NGOs, research institutions, and other individuals in order to receive accurate and up-to-date information.

The global system's Chief Henri Josserand, who managed also the food information program from 1995-2000, summed up the differences between the two networks by highlighting two aspects: mandate and reach. The food information net has a mandate from the U.S. government and seeks first and foremost to provide those officials with the relevant information. While it also disseminates its information to a wider audience, such as government officials in the affected countries, the project is often viewed as a project of the U.S. government.<sup>45</sup> Accordingly, the geographic orientation and reach of the network focuses on areas of U.S. interests, such as Afghanistan, Haiti, the Horn of Africa and Central America. In contrast, the Global System has a UN mandate and is seen as a global project with a wider geographic orientation.

A large degree of collaboration exists between these networks, particularly through technical meetings which take a close look at the methodologies used for the work of both systems. Also, staff frequently meet to discuss some countries of common interests whose situations are more difficult in nature, such as Zimbabwe and Afghanistan. The Food and Agriculture Organization and the World Food Program, which operate the global warning system's network, are partners with the food information network in West Africa and teams occasionally conduct joint missions there. Despite stark similarities between the two networks, representatives of the systems voiced no real concern about work duplication because the networks largely complement each other geographically and even in cases where overlap exists, it often makes sense to have two analyses due to the complexity of the work.

Because both systems, like most early warning systems, are network-oriented, they cooperate with so many government and non-state actors and pull data from various independent sources that no fundamental difference is noticeable simply dependent on whether an international organization such as the World Food Program or a private business such as Chemonics operates the systems. Likewise, because of wide collaboration, no particular need can be identified for specific private-sector skills when it comes to carrying out the project. Most technical skills can be hired on locally, whether by the World Food Program or a private company. In the case of the food information system, Chemonics simply showed a comparative advantage through their international presence and ability to effectively manage the network. The global information early warning system Chief Josserand commented that throughout his extensive experience in the field and with managing both systems, no difference existed in stakeholder perceptions locally whether the project was run "commercially" or "non-commercially", but that it did on occasion matter that one project was US-mandated and the other UN-mandated.

### *The Lack of Commercial Engagement in Disaster Preparedness*

The majority of European donor organizations and ECHO have yet to delve into commercial engagements in the area of disaster preparedness. Inquiries into several state donor agencies investigated three possibilities:

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<sup>45</sup> Interview with Josserand, October 28, 2008.

- Agency decision-makers have ethical or moral concerns in regards to cooperating with the private sector in the humanitarian assistance field;
- Organizational constraints within the agencies render private sector cooperation too costly or a hassle; and
- The market for preparedness from the side of business remains underdeveloped.

Inquiries resulted in a confirmation of the latter two reasons, but a refutation of the first assumption. While a few interviewees acknowledged individual dispositions among some colleagues in their respective organizations of mistrust toward the private sector, moral concerns appear to at the most be a secondary concern. A vast majority welcomed in principle an openness toward cooperation with business in disaster preparedness. The second factor, organizational constraints seemed to dominate along with the lack of a market, although growing, in the area of disaster preparedness best explained the reason for the very few commercial donor engagements in the field.

The fact that few commercial engagements exist in disaster preparedness has led some to speculate that most donors are in agreement that such cooperation should be avoided. Had this investigation led to that result, transatlantic policy differences in this area would prove insurmountable or at least less likely to be mended, as they would have their roots in socio-cultural perceptions. However, the fact that organizational constraints form the most significant obstacle to private sector engagement in disaster preparedness suggests that a common transatlantic agreement is possible. The following comparison of United States (OFDA, Global Development Alliance) and German (the Foreign Office and the Federal Ministry for Economic Cooperation and Development) organizational structures seeks to illuminate some of these organizational constraints. The comparison should not imply that one organizational and procedural structure is superior, but rather aims to identify these constraints and enable dialogue as to whether it would prove desirable to change them. Also, it should be noted that aspects of the following structures find reflection in several other countries' systems, but certainly do not stand to represent in their entirety organizations that engage with business and those that do not in disaster preparedness.

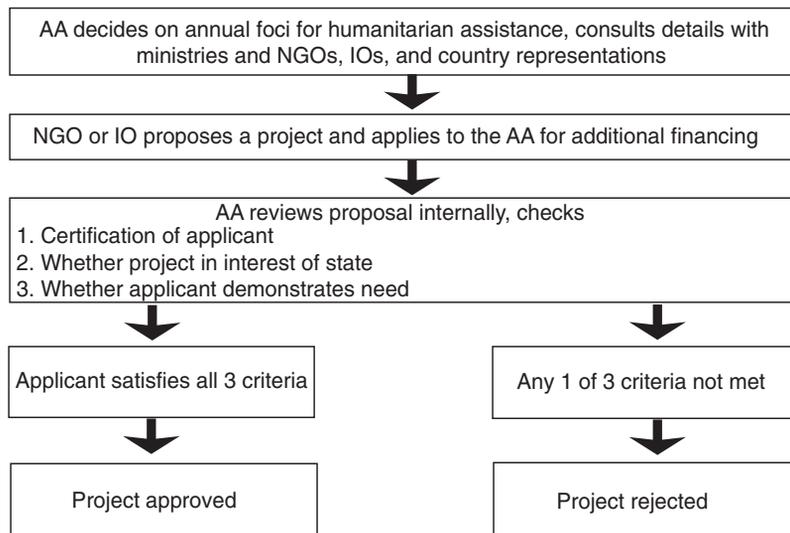
### ***Structural Constraints in German Disaster Assistance Organizations***

Although four German ministries have budget allotments for activities defined as humanitarian aid, the German Foreign Office (AA in the charts below) and the Federal Ministry for Economic Cooperation and Development (BMZ in the charts below) present the two main actors. The diagrams below depict their grant and contract approval processes.

The Foreign Office's decision-making process is such that all humanitarian aid funding is earmarked<sup>46</sup> and the decision process for financing a program or project is entirely contingent upon needs assessments made available to them through the UN Office for the Co-ordination of Humanitarian Affairs (OCHA) in addition to internal assessments. Because businesses usu-

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<sup>46</sup> OECD-DAC, *DAC Peer Review: Germany*. 2005, p. 86.

**Figure 1. Decision Process for AA Grant Approval**

Source: Author (based on interviews).

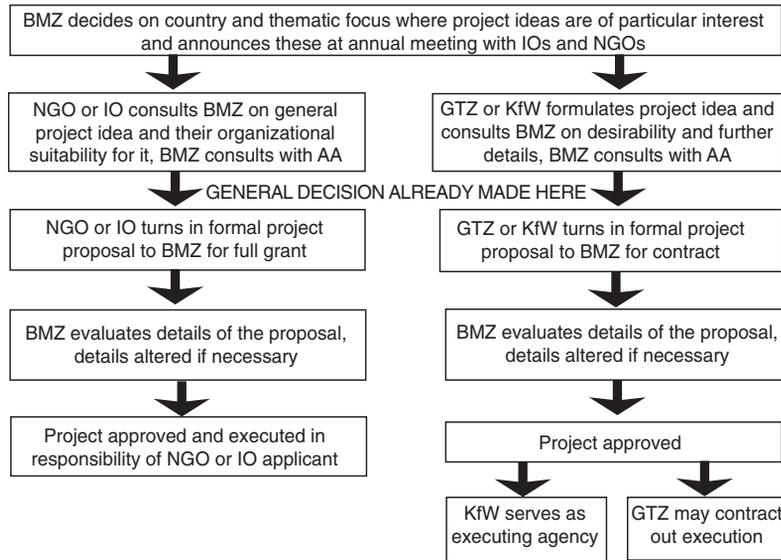
ally cannot demonstrate need<sup>47</sup> and because the UN database does not include them for pre-certification, companies have little chance of success in proposing a commercial project and receiving money for feasibility studies or start-up capital like those needed for the Caribbean Catastrophe Risk Insurance Facility if not designed by and brokered through an international organization. In their “Concept for Financing of Humanitarian Assistance Initiatives,” the German Foreign office discourages international organizations or NGOs applying for funding from conceding responsibilities to a business partner. Logically, the applicant itself should also not be a profit-oriented entity.<sup>48</sup> Therefore, early warning systems or minimally structured, consultant-operated projects like the Caribbean insurance facility would not qualify. Decision-making processes within the Foreign Office are at the moment structured in a way that inhibits a change in funding policies that would consider applications from private actors on a commercial basis by exerting tremendous transaction costs upon the Foreign Office in order to change their entire funding process.

In order to counteract these constraints, the German Foreign Office would need to formulate a much more complex, comprehensive system of need definition and evaluation. Furthermore, a needs assessment of a business model would prove more complicated and time-consuming than that of an NGO, as it would be necessary to calculate the costs of product and process develop-

<sup>47</sup> Companies with a new technology concept may demonstrate financial need to the extent that they would otherwise not make the investment in the further research and development due to lack of funds in combination with the high risk level of operating in a developing or transition country. Also, other non-quantifiable types of needs exist, such as access to certain markets or legitimacy that cooperation with public actors might offer.

<sup>48</sup> See Auswärtiges Amt. *Konzept zur Förderung von Vorhaben der Humanitären Hilfe aus Kapitel 0502 Titel 68712*. R. VN05. Berlin, 2007, p. 8. The exact phrase reads: “To the extent possible, the applicant [for funding] should, under its own responsible direction, cooperate with experienced and capable, non-profit-oriented executing partners in the partner country.”

**Figure 2. Decision Process for BMZ Grants/Contracts**



Source: Author (based on BMZ interviews).

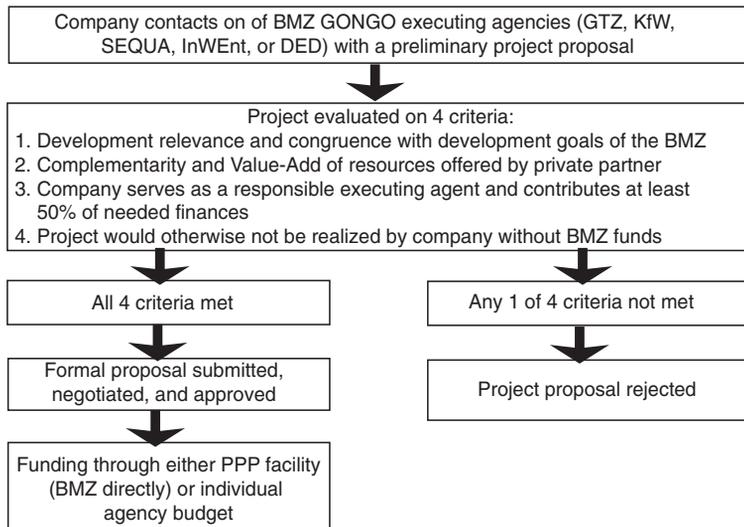
ment, market research and product testing of a business plan rather than the expected operation costs of output as would be the case for NGOs or international organizations.<sup>49</sup>

An added structural constraint relevant for transition costs lies in the emergency nature of the disaster response aid, which makes the ability to decide on fund allocation quickly very important. Establishing a new relationship with business takes time. Long-established relationships between the German Foreign Office and NGOs and international organizations in this respect build a further barrier to new cooperation with the private sector also for preparedness projects that are not subject to the same emergency nature. Because the same team handles emergency response and disaster preparedness, it is easier for them to work with the same partners for both.<sup>50</sup>

The left-hand column of the diagram above depicts the path for applicants other than the German Development Bank (KfW in the charts) and the German Technical Cooperation Agency (GTZ). This general application process, relevant for the contracting out of early warning systems for example, is open exclusively to international organizations and NGOs. The right-hand column shows the process through which the Agency and the Development

<sup>49</sup> This policy thus could possibly be causing the organizations to miss out on important technological innovations that could in the long run enable them to carry out their work in a more efficient and effective manner.

<sup>50</sup> In the Coordinating Committee for Humanitarian Aid, Tyderle of CARE commented that mostly short-term projects are discussed, so that it “would make no sense to form a PPP,” which remains predominantly a constellation of development assistance, but not humanitarian aid. While Tyderle attributed this divergence to the emergency nature of disaster response and the longer timeframe needed to work out a cooperation constellation with business where the private sector would also take on project responsibility (as opposed to simply fulfilling a specific contract for a product or service), the emergency nature does not explain why no commercial projects exist in the area of disaster preparedness and risk reduction, as this area involves longer-term planning.

**Figure 3. PPP Opportunities with the BMZ**

Source: Diagram based on BMZ 2004a: 81–95.

Bank realize the general contract in the form of a specific project application. As seen above, the bank must serve as the main executing agency but the agency may contract out the execution of a project to a private company if it lacks the needed competencies or capacity to carry it out itself. However, no such instances yet exist in the area of humanitarian assistance largely due to the fact that it is not the main focus of the German Technical Cooperation Agency.

A completely separate process exists for companies that wish to engage with the German Federal Ministry for Economic Cooperation and Development (BMZ in the charts below) through their executing agencies in the form of a partnership for development aid, although no such projects exist in the humanitarian field.

As seen above, no one entry point exists for partnerships. However, the Public Private Partnership desk maintains an overview of partnerships funded through its ministry. The fact that the desk reports that they would be perfectly open to partnerships also in the area of emergency and transition aid even though the desk for emergency and transition aid itself has a policy of not collaborating with business suggests that organizational rather than ethical constraints drive this decision.

Rather than having an open application procedure and evaluating the need of the organization, the German Ministry—like many donor organizations—formulates a project idea and invites a select few organizations<sup>51</sup> with which they have had a positive experience in the past to apply. Additionally, they may invite new partners, but in such a case, these few organizations are taken from the database of certified NGOs or international organizations with an exceptionally good rating and a documented specialization profile that would fit the needs of the Ministry for the particular project. Although the basis for funding decisions is a different one

<sup>51</sup> Interview with ministry officials.

than for the Federal Foreign Office, the Ministry nevertheless utilizes a similar database, in which only NGOs and international organizations can be found. This database acts as an expedited certification tool, as all organizations listed have been investigated and had their activities quite extensively monitored independently.<sup>52</sup>

The lack of a pre-certification for potential business partners presents a structural barrier so strong that it would be unimaginable for the Ministry to engage with new partners unless an external actor created such a database. Time and staff costs necessary to create a new database are also high enough to warrant the switching costs to business too high to bother. In this sense, after the policy and practice of cooperating with NGOs and international organizations came to be and these traditional partners became captured in a database upon which the Ministry learned to rely, entrance barriers became high for new types of partners.

Yet another factor giving non-profit actors an advantage over for-profit entities stems from their status as tax exempt. Because the Ministry prefers cooperating with German NGOs, working with these partners instead of for-profits amounts to a cost savings of 19 percent (level of taxation for such contracts in Germany). An automatic cost increase of 19 percent for switching to a for-profit actor presents a significant barrier to change in current policy on the basis of a very pragmatic cost-benefit analysis.

### ***Structural Constraints in U.S. Disaster Assistance Organizations***

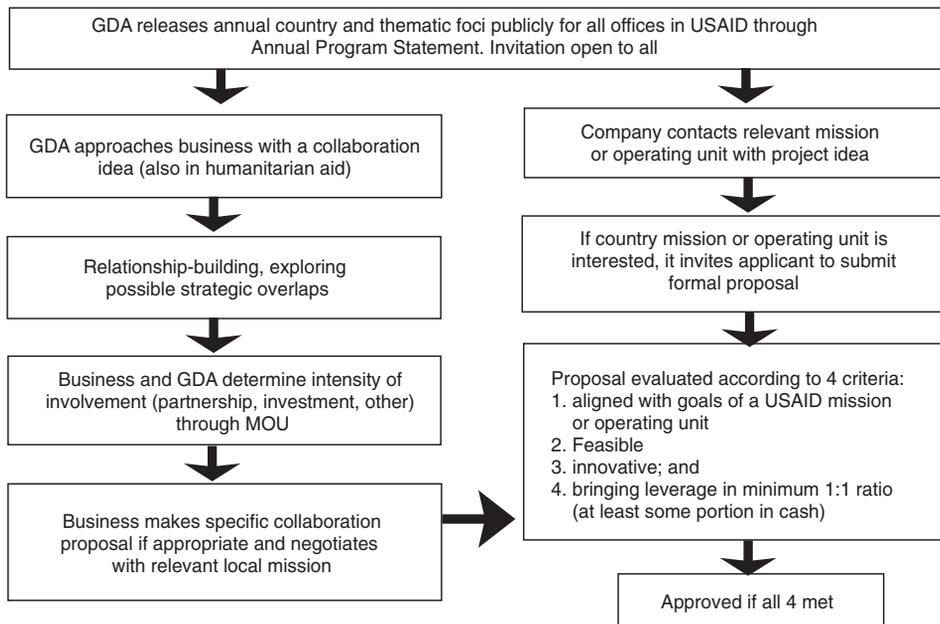
As in Germany, more than one office of the U.S. Government carries responsibilities for humanitarian disaster assistance. Within the Bureau for Democracy, Conflict and Humanitarian Assistance (DCHA) of USAID, the Office of U.S. Foreign Disaster Assistance (OFDA) plays a dominant role in coordinating disaster assistance from the United States government.

Before the founding of the Global Development Alliance in 2001, OFDA used local missions or headquarters as a point of contact for business proposals and published tenders openly so that business could also apply. Because the Foreign Assistance Act of 1961 allowed for private sector engagement from the very beginning of U.S. humanitarian aid policy, intensifying private sector engagement over the years did not cause much extra cost to any of the aid organizations. Most already engaged on some level with the private sector through announcing tenders for aid projects. A new level of USAID-private sector engagement emerged with the founding of the Global Development Alliance in 2001. OFDA as well as other USAID agencies began to rely on the GDA for their collaboration with the private sector. The Alliance became a single entry point for businesses interested in cooperation with USAID.

The Global Development Alliance office announces annual geographic and thematic foci through its Annual Program Statement and posts them on an open portal, allowing free and equal access for all non-profit and for-profit actors to react to the invitation for relevant project proposals in addition to contracts for USAID projects, which are also announced. While in

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<sup>52</sup> A Ministry representative emphasized the importance of a certification database that allows them to complete their work quickly while at the same time carefully assessing the risk involved in collaborating with each organization. Likewise, she acknowledged that the lack of such a system for the private sector makes engaging with business in an emergency setting much riskier for the Ministry. Were the Ministry to ever reconsider its policy, the creation of such a pre-certification system for business would be an absolute must.

**Figure 4. USAID Private Sector Collaboration through Global Development Alliance**

Source: Author based on USAID 2008b: 15–18 and interviews.

Germany it would cost the Ministry and the Federal Foreign Office more time (and thus staff expenses) to open up their announcement process for project execution to new partners, including for-profits, such an open process is most cost-efficient for USAID agencies, including OFDA and the Alliance.

One important structural difference in comparison to Germany relates to the use of a separate Controller's office for due diligence evaluations of companies that apply for a contract. Because all USAID offices moreover have a policy of reinvestigating due diligence for old as well as new partners, no real advantage exists for long-standing partners.<sup>53</sup> Their evaluation costs are if at all insignificantly less than that of a new partner for USAID. Also, in order to evaluate the feasibility of a new project proposal, the regional project officer assesses it together with a controller with a business background. In this way, OFDA is not constrained by the backgrounds of their immediate staff, most of which come from NGO, international organizations or government backgrounds rather than the private sector. Although OFDA still awards the majority of their contracts and grants to NGOs or international organizations, a flexible evaluation structure allows the application process to remain open to all.

<sup>53</sup> This was confirmed through interviews with the Office of Acquisition and Assistance of the Global Development Alliance. The reason for this is that any old and trusted partner could have received bad audit reports or had legal action taken against them since the time of the last collaboration with USAID. Re-evaluation serves as an added tool of risk-management that simultaneously almost equalizes the cost of evaluation for long-standing and new partners.

## Conclusions and Recommendations

Keeping in mind the commonly cited concerns of cooperating with the private sector mentioned at the beginning of this paper, this study found very little cause for concern in engaging in the types of commercial collaborations it profiled. Of the operational contractors, many were rather small and dynamic rather than large. Even the large contractor for the Famine Early Warning Systems Net, Chemonics, was not the only entity to win this contract and the specific skills, which could create a certain degree of dependence, proved connected to local experts rather than the contractor. Certainly in the case of the re-insurance companies, dependency is not an issue. The only company that had direct contact with the humanitarian setting is Chemonics and because their activities always involved local and sometimes additionally international participation, this study found that its commercial nature had no substantial impact on the results of the work, which even Food and Agriculture Organization's Global Information Early Warning System Chief labeled "fundamentally similar" to that of a non-profit initiative.

*Recommendation 1 for Donors: Increase commercial engagement particularly in initiatives that require no added cost or risk due to built-in structures of checks and balances.*

While it would extend beyond the bounds of this study to look into every type of donor-commercial engagement, collaborations similar to those profiled here present little added risk or cost and offer broad benefits for beneficiaries in a disaster context. For example, both index-based weather insurance schemes rely on independent weather agencies to measure whether a natural event hit the necessary trigger levels for a payout. Additionally, the Caribbean Catastrophe Risk Insurance Facility even includes a beneficiary in their Board of Directors. In this way, monitoring and evaluation of both the governance of funds and the appropriate payouts to beneficiaries occur without extra effort. Rather, the structures of the initiatives guarantee accountability of commercial actors vis-à-vis beneficiaries. Also, because the Famine Early Warning System Network relies heavily on local NGOs, weather agencies and research institutes for their information, the commercial nature of the operating company, Chemonics, loses importance. Inclusive participation by the non-profit and public sectors provides accountability controls in favor of beneficiaries. Because accountability remains the main source of risk for donor-business engagement, increasing engagement within these types of controlled constellations would prove a reasonable starting point.

*Recommendation 2 for Donors: Where they exist, dispose of limiting regulations that prohibit for-profit cooperation across the board in humanitarian assistance and conduct a cost-benefit analysis of increasing cooperation with the private sector in certain areas.*

The structural comparison between the United States and Germany illustrated the need for caution when assuming that the reasons for non-engagement with commercial actors beyond small procurement projects reflect moral preferences for non-profit actors. Structures and their practical consequences within donor organizations often play a decisive role in determining whether the organization chooses to participate with business in disaster preparedness. Each organization should assess what constraints exist for them and whether the costs of amending them are worth the benefits they bring in the long term. Changing structural constraints does not automatically mean that a donor will significantly intensify commercial

engagement at the expense of other partners, but would leave the option open for participating in new and innovative solutions with commercial partners as it sees fit.

*Recommendation 3 for Donors: Reach out to international organizations and other partners to enable joint efforts in reducing structural barriers to increased cooperation with the private sector and other partners.*

International organizations such as the World Bank or even consultancy firms can help ECHO or bilateral donor organizations reduce limitations by 1) conducting feasibility research for and facilitating (re)insurance schemes in cooperation with other actors and 2) by working to create a pre-certification tool which would reduce the transition-cost-disadvantage that exists for new players in the humanitarian field. A conglomerate of donor organizations could also pool together to fund such a tool, which would reduce costs for all donors seeking to expand their portfolio of cooperation partners in humanitarian aid.

*Recommendation 4 for Donors: Continue the shift from response funding to investment in preparedness while understanding that preparedness and risk reduction will never entirely eliminate the need for response.*

In addition to long-term cost advantages, disaster preparedness rather than response initiatives are more likely to contribute to building local capacity, as demonstrated particularly by the Caribbean Catastrophe Risk Insurance Facility and LEAP initiatives. Despite its advantages, this study found a general lack of preparedness projects (both for- and non-profit in comparison to response) and it would serve donors to continue increasing their funding for innovations in this area. Nevertheless, as the Caribbean insurance facility directors emphasized, donors should perceive preparedness initiatives as complementary to response. Catastrophe insurance with the Caribbean facility, for example, aims to cover 10 percent of a country's exposure and provide immediate liquidity rather than replace the need for response altogether. Donors should consider these factors in planning their budgets in humanitarian assistance.