International Workshop on

Disaster Risk Mitigation: Potential of Micro Finance for Tsunami Recovery

P.G. Dhar Chakrabarti

Daniel Kull

Mihir R. Bhatt

UNITED NATIONS INTERNATIONAL STRATEGY FOR DISASTER REDUCTION

NATIONAL INSTITUTE FOR DISASTER MANAGEMENT

ALL INDIA DISASTER MITIGATION INSTITUTE

For Personal and Educational Purpose only October 14, 2005 Special Issue: 7

southasiadisasters.net

An Effort to Turn Local Tsunami Recovery into Regional Disaster Risk Reduction for the Poor

In this issue

Invest to Prevent Disaster: A Local View

1. Can microfinance be a tool to reduce disasters?

Access to microfinance facilities is increasingly becoming relevant for both the vulnerable poor and humanitarian sector. Relief and compensation efforts are useful but not enough; they do not fully compensate or adequately help the poor recover all the incurred losses. Thus, in addition to relief or compensation, victims also need access to microfinance. Financial services enable the poor among victims to leverage their initiatives and accelerate the process of rebuilding lives and livelihoods, as we have learned from our Livelihood Relief Fund (LRF), which reached 15000 small businesses after a 2001 earthquake. Microfinance can help the poor in moving out of poverty and the vulnerable in moving out of risk. Similarly, promotion of microfinance as a risk reduction investment can significantly reduce the total cost of financing post-disaster relief and reconstruction. Microfinance has helped victims of disasters accelerate their recovery and diversify their livelihoods with more productive sources of income. Microfinance as an emergency loan has also promoted a culture of preparedness as victims use it mainly to recover after a disaster.

2. What are the main limits or constrains of this tool in this context? What are the best conditions for its optimal functioning?

Though microfinance is an effective tool for risk reduction and risk mitigation, it has limitations. Firstly, microfinance cannot provide complete protection against disaster risks resulting in a loss greater than what a household can save or repay. A majority of microfinance programmes do not combine risk transfer or risk mitigation strategies along with microfinance. Secondly, microfinance services cannot immediately translate into a stand-alone successful disaster recovery enterprise. Thus, providing a range of other services for accessing basic amenities, relief compensation and business development services, including marketing after a disaster are crucial for the swift recovery of the poor. Thirdly, microfinance programmes have emerged in response to the needs of the poor. However, when it comes to financing disaster losses of the poor, commercial banks and microfinance institutions are unwilling to finance such losses.

> ***Financial services enable the poor among victims to leverage their initiatives and accelerate the process of rebuilding lives and livelihoods, as we have learned from our Livelihood Relief Fund (LRF), which reached 15000 small businesses after a 2001 earthquake.***

Thus, the poor remain marginalized. It is a common myth that disaster victims are unable to save and that they are unreliable borrowers. However, random and unreasonable flows of relief discourage savings and repayments. Fourthly, the economic losses of disasters are relatively higher for the poor. Loss estimations mostly bypass their loss of income and livelihoods. They usually suffer the longest and the most compared to other social groups. However, a vast majority of disaster victims in India have limited access to microfinance services, especially after a disaster or during recovery. In addition, they do not have any say in deciding the level of interest rate or other terms of financial agreements. Market penetration in the lower income strata of India is low and even lower in disaster-prone areas. The spread of SHGs and vulnerable areas do not overlap. Thus, the role of microcredit demands a cautious approach. Fifthly, a majority of financial institutions prefers dealing with large loans in small numbers to minimize administrative costs. However, a large number of small loans are needed to serve the poor among victims.

Some of the best conditions for optimal functioning of microfinance for disaster risk reduction and risk mitigation at grass roots level include, a) convergence of microfinance with microinsurance and micromitigation, b) adaptation of demand driven and decentralized approach, c) microfinancing on a cost-recovery basis and d) increased investment in communitybased microfinance initiatives. Microfinance has worked when: a) institutions installed financial discipline through savings and demonstrated a matching value themselves before landing; b) disaster-affected communities governed the design and implementation of schemes (by deciding rates of interest, amount, and repayment period); relief or savings preceded credit; c) microfinance programmes worked more closely with women; d) programmes were conceptualised, localized, and monitored closely; e) programmes leveraged maximum funds from formal markets; and f) a facilitative environment and enabling regulatory regime contributed to its success.

3. Could work in India be used for deducting the impact of floods in other countries like Philippines? What would be required to achieve that? What are the future prospects for microcredit?

India has mainly two sets of institutions offering microfinance, which are formal and informal institutions. Traditionally, the formal-sector banking institutions in India, such as commercial banks, housing finance institutions (HFIs), NABARD, rural development banks (RDBs), land development banks and co-operative banks (CBs), have served the needs of the commercial sector only. It is difficult to assume that formal-sector banking institutions in India have shown enough application of microfinance in the disaster context. We do not have any data or studies to prove in what way and at what scale or level formal sector institutions have played their role in disasters risk reduction through microfinance.

The All India Disaster Mitigation Institute (AIDMI), a small and informal microfinance institution that provided microfinance to small businesses after the Gujarat Earthquake of 2001 and the 2002 riots itself and also with Kheda Association, has had a fascinating and satisfying experience with microcredit. Disaster victims of both riots and earthquake used the provided loans for multiple purposes, including business recovery, housing reconstruction, insurance protection, education, including mitigation and physical security. Similarly, Self Employed Women's Association (SEWA) gave a major proportion of its loans to its women members immediately after the Gujarat earthquake. The loans were again used for multiple proposes to recover from the earthquake and reduce future vulnerabilities. The loans that are made available immediately after a disaster are more valued, repaid on time, strengthen trust and contribute toward risk reduction at the household level.

4. What would the next steps be to expand the effectiveness of microfinance for disaster risk reduction? What is needed for microfinance to develop into a sustainable product for disaster risk reduction?

Firstly, microfinance services have not penetrated deeply enough into rural, isolated and vulnerable areas. There is an urgent need to replicate, develop and expand innovative products and set-up service networks that can function at breakeven.

Secondly, there is a need to recognize the fact that microfinance products can only become sustainable from a disaster risk reduction perspective when they are perceived as risk-transfer investments and converged with micromitigation and microinsurance in order to pull a greater variety of risk and recovery initiatives. Microfinance alone cannot remove poverty; it must include mitigation.

Thirdly, there is a strong need to develop a stabilization fund for microfinance institutions to help them respond to the overwhelming demands for loans and services immediately after a disaster. A majority of microfinance programmes to date in India take a supply-side and grant-based approach. There is a need to help them develop a demand-driven approach and to make them self-sustaining.

Fourthly, it is critical to link the poor and microfinance institutions with a formal financial system. We must strengthen links between microfinance institutions for the poor in the informal sector with formal sector institutions. In order to ensure the sustainability of investments in microfinance products, capital formation must take place at the community level with the active participation of the poor. Poverty removal and disaster risk reduction are not two separate issues. Development cannot be achieved unless both of them are simultaneously addressed.

Fifthly, microfinance programmes must combine the developmental and disaster recovery needs of the poor. Victims work hard, recover, save, repay and are willing to pay interest at market rates. Thus, lending should be grounded on market principles because large-scale lending cannot be accomplished through subsidies. ■

Mihir R. Bhatt
(from ISDR, Geneva, 2005, www.unisdr.org)

Disaster Risk Mitigation: Potential of Micro Finance for Tsunami Recovery

Introduction
On the occasion of the International Day for Disaster Reduction (October 12), and to mark the International Year of Micro Credit, the secretariat of the International Strategy for Disaster Reduction (ISDR) is launching a global debate on how microfinance can reduce the impact of natural disasters on vulnerable communities.

Realising the important role microfinance plays not only in the region's development, but also in recovering from disasters like the December 2004 tsunami, the Government of India, through the National Insitute of Disaster Management (NIDM), is graciously supporting this initiative by hosting this workshop.

As a partner to both UN/ISDR and the NIDM, the All India Disaster Mitigation Institute (AIDMI) has agreed to provide expert guidance and tsunami experiences in support of this initiative.

State of knowledge
Although the utility of microfinance for smoothing of socio-economic shocks has long been touted by the microfinance community, it is a relatively new topic for the disaster reduction community. Recognising the need to incorporate financial tools in disaster reduction strategies, the expertise and experience of microfinance practitioners is paramount to the disaster reduction mandate.

India and its neighbors are global leaders in terms of microfinance activity. At the same time, the region faces many natural hazards. This combination results in great capacity to compile and share successes, challenges and new ideas for microfinance for disaster reduction. The urgency for such cooperation has been enhanced by the 2004 tsunami and very recent Pakistan/India earthquake.

After the initial relief is provided, longterm strategy is needed for full economic recovery.

While there is already much knowledge and publications on this topic, new ideas and recent experiences in the south Asia region will serve to update and optimise practice in the field throughout the world.

India and its neighbors are global leaders in terms of microfinance activity. At the same time, the region faces many natural hazards. This combination results in great capacity to compile and share successes, challenges and new ideas for microfinance for disaster reduction.

Aspects of microfinance for disaster reduction
UN/ISDR asked experts and colleagues from various backgrounds to share their points of view on the issue. These are summarised in the following 10 conclusions, available in more detail in the document UN/ISDR (2005):

1. Through its long-term impacts of reducing poverty and supporting sustainable development, microfinance reduces the vulnerability of the poor to disasters.
2. Microfinance cannot, however, provide standalone protection against disasters. It must be part of a greater strategy of disaster risk reduction.
3. In the aftermath of a disaster, microfinance can quickly provide relief, and then support sustainable recovery and rehabilitation. Microfinance

institutions (MFIs) can additionally provide post-disaster communication and coordination through their established community networks.

4. Microfinance requires a degree of self-management by clients and is normally community based, thus fostering recovery ownership, dignity and community cohesion during traumatic and unstable times.
5. Microfinance can reduce the cost of post-disaster recovery financing, while reducing aid dependency. At the same time, however, post-disaster aid can distort markets, adversely affecting microfinance performance.
6. MFIs must be prepared for disasters by developing disaster management plans that ensure the survival of the MFI and sustainable delivery of its services. Post-disaster activities must be carefully considered to prevent negative long-term impacts on local markets and MFIs.
7. To best reduce disaster impacts on a community, MFIs should offer a suite of flexible products to adapt to specific needs and situations.
8. Links and/or partnerships with the formal financial sector are needed to enhance liquidity and support institutional and managerial capacity.
9. Microfinance must be linked to disaster mitigation, especially during rehabilitation when the links between recovery and preparedness are clearly evident.
10. Education on microfinance and disaster mitigation is needed for both successful poverty reduction and disaster impact reduction.

Tsunami is an opportunity for exploring potentional of micro finance services for poor among victims, especially in housing and livelihood sectors.

Microfinance can fill transition gaps

Microfinance can provide a link between relief and development, thereby filling a multitude of gaps and deficiencies at all levels that can occur in the wake of disasters. These gaps represent some of the major challenges facing developing countries, and are optimally spanned through socio-economic transition. Table 1 shows some of the delivered services, impacts and programme changes of microfinance at different levels, aiding the transition from relief to development.

Table 1: Microfinance aiding the transition from relief to development.[1]

Level of impact	Relief	→	Development
development	recovery	→	sustainable growth
	emergency response	→	mitigation and preparedness
socio-economic situation	market stabilisation	→	market sustainability and growth
	aid dependance	→	self-sustaining finance system
	social support	→	social cohesion
implementing institution	social enterprise	→	economic enterprise
	disperse grants (charity)	→	profitable financial services
	limited emergency products	→	robust suite of flexible products
individual	targeted beneficiairies	→	financial services available to all
	beneficiairies in need of relief	→	aware and empowered population
	limited options for survival	→	self-managed economic strategy

Summary of microfinance tools for disaster mitigation

As previously discussed, as a tool for poverty reduction, microfinance reduces vulnerability and increases coping capacity against socio-economic shocks, including natural disasters. At the same time, microfinance can provide relief in direct response to disasters. Thus, it is possible to make micro finance tools a part of diverse disaster relief programmes or response. Microfinance tools are designed to absorb economic losses or to promote economy itself. However, disaster mitigation practices needs to be tied up throughout the life cycle of such products in order to make them sustainable and minimise non-financial losses. Table 2 summarises how various microfinance tools can be used for these two purposes. More on this gap is on page 10.

Table 2: Microfinance tools for disaster mitigation

Reducing vulnerability	**Disaster response**
Client-responsive loans	Adaptation of current lending: • loan restructuring • switch from group-based to individual liability • adapt current credit products to temporary recovery products • provide emergency subsistance loans • lending moratorium for MFI protection • loan forgiveness and write-offs (not recommended)
Housing improvement loans[2] • ensure disaster-resistance and building code compliance	Emergency reconstruction loans[2] • ensure disaster-resistance and building code compliance
Forced/compulsory savings[3]: • used to collaterise loans • usually not accessible until end of loan cycle	Adaptation of forced savings: • allow access so clients can withdraw as needed
Voluntary savings[3]	Voluntary savings • clients will withdraw as needed
Leasing for assets[4] • with option to purchase at end of cycle for residual price	Leasing for assets • likely increase in demand
Insurance[5] • best established before disaster	Insurance • applicable pay-outs made
Money transfer services	Money transfer services • remittances likely to increase
Grants and donations • used for increasing purchasing power and building financial discipline.	Livelihood relief (no repayment) • provision of income-generating items (kiosks, carts, machines, seed, stocks, etc.) • cash grants
Non-financial services: • training	Non-financial services: • training • information dissemination • distribution of supplies

Table contents compiled from World Bank (2005), AIDMI (2005) and Nagarajan (1998)

Summary

Works Cited

AIDMI (All India Disaster Mitigation Institute) (2005). *Transferring Risk Through Micro-Insurance, Micro-Credit and Livelihood Relief (DRAFT)*. Experience Learning Series, No. 34, AIDMI, Ahmedabad, India.

Nagarajan, G. (1998). *Microfinance in the Wake of Natural Disasters: Challenges and Opportunities*. Microenterprise Best Practices, Development Alternatives Inc. (DAI), funded by USAID, Washington, D.C., USA.

UN/ISDR (2005). *Invest to Prevent Disaster*. Media kit, United Nations International Strategy for Disaster Reduction, Geneva, Switzerland.

World Bank, The (2005). *Surviving Disasters and Supporting Recovery: A Guidebook for Microfinance Institutions*. Disaster Risk Management Working Paper Series, No. 10, The World Bank Hazard Management Unit (HMU) and United Nations Capital Development Fund (UNCDF) Microfinance, Washington, D.C., USA. ■

Daniel Kull, UN/ISDR

[1] Based on personal communication with Mihir Bhatt, AIDMI.
[2] commonly called micro credit
[3] commonly called micro-savings
[4] commonly called micro-leasing
[5] commonly called micro-insurance

Humanitarian Policies: Disaster Mitigation at the Institutional Level

Whilst NGO's and humanitarian organizations work tirelessly on the ground in disaster mitigation and recovery, work behind the scenes is going at an international and institutional level. The importance of adequate funding for operations in the field is widely known and unquestionable, but what is also required and sometimes overlooked is the need for effective strategy formulation and implementation at the national and international policy levels.

Disasters destruction on an unprecedented level in recent years and a recognition of the value of investigating new ways of minimizing disaster impact have brought the issues of disaster management and mitigation to the table across the world. Public forums have taken place, consortia such as the World Bank's ProVention consortium have been established and policies have been drafted, bringing together experiences from all sectors across the globe.

The World Bank: Hazard Management Unit

As a result of global disaster response and recovery experience, attention has been turned to matters of mitigation. Rather than immediate disaster relief, the World Bank sees its primary focus to support "near and longer term recovery and reconstruction" in order to reduce the vulnerability of affected communities.

Since 1980 the Bank has financed 550 disaster-related projects worth $40 billion. They have committed more than US$835 million to help countries devastated by the December 2005 Tsunami, of which US$528.5 million has been committed to help India with the majority of the funding for housing reconstruction and restoration of people's livelihoods.

Financing repairs and hausing markets after tsunami is limited.

In addition to the assistance in disaster response coordinated by the affected country's World Bank unit, the Hazard Management Unit of the World Bank was established to implement and promote disaster risk reduction. The Hazard Management Unit provides technical assistance to developing countries to plan for potential natural hazards, instead of confronting them only as a humanitarian emergency when a crisis strikes. The unit is comprised of experts from various sectors who draw on the latest academic, scientific, and professional research and experience to advise and assist in disaster risk reduction.

The ProVention Consortium

The ProVention Consortium is a global coalition of governments, international organizations, academic institutions, the private sector and civil society organizations dedicated to increasing the safety of vulnerable communities and to reducing the impact of disasters in developing countries. Its establishment enables the sharing knowledge and resources on disaster risk management. It also acts as a broker to forge links between members of the Consortium so that efforts, and benefits, are shared.

ProVention activities are helping to advance policy and practice in disaster risk management and fall into the following three categories:

- Risk identification and analysis - assessing hazards, vulnerabilities and capacities.
- Risk reduction- avoiding hazards and reducing vulnerability.
- Risk sharing and transfer - protecting investments and sharing the costs.

Projects are designed to encourage innovation, improve practice, promote partnerships and influence decision makers. Activities include research studies, pilot projects, education and training activities, advocacy initiatives and policy development.

The Disaster Management Bill 2005 - India

The July 2005 Disaster Management Bill is a landmark step for disaster risk mitigation in India. The Bill will attempt to introduce a decentralized approach to disaster risk reduction and risk management from a grass-roots level. It is the first time in free India's history that disaster risk management and reduction has been institutionalized across the board, combining efforts from a broad base of participants comprising states, institutions, experts, and communities.

The Bill will create a National Disaster Management Authority (NDMA) under the Chairmanship of the Prime Minister. At state and district levels, Disaster Management Authorities will also be created. All of these authorities will be financed by individual capitalizations, however this raises questions about the efficiency of funding. In total, 525 separate funds will be created, and currently there are no conditions ensuring that the money is spent on preparedness, risk reduction and transfer, and mitigation, thus there is an inherent danger that relief and rehabilitation packages will absorb the funds. Therefore it is crucial that the Bill is properly implemented across all areas of mitigation and relief, ensuring that its aim to turn disaster into opportunity with the minimum amount of loss or damage is realized.

Whilst the Bill represents a milestone for India, it is not the only country to be working towards an institutional framework for disaster risk management, reduction, and mitigation. With south Asia is exceptionally prone to natural disasters, other countries too have established institutions and adopted holistic disaster management policies, reflecting the global trend towards hazard management and mitigation policy implementation. ■

AIDMI's Experience with the ProVention Consortium

On 25th September 2003, AIDMI launched its Regional Risk Transfer Initiative (RRTI). Borne from AIDMI's tradition of Livelihood Relief experience, with reference to the evolving guideline from the United Nations Development Fund, the RRTI aims demonstrate and accelerate the application of microcredit and microfinance for mitigating disaster risk.

The project builds on recent ProVention Consortium initiatives in developing innovative approaches to risk identification, risk reduction, and risk transfer and sharing. Current thinking reveals that the consolidation of microcredit and microinsurance can be an eefective way for poor communities to manage risk. Since traditional credit and insurance is uttainable for the majority of poor among disaster victims, the transfer of risk through the provision of microcredit and microinsurance services can reduce vulnerability to the crippling impacts of disasters which often lead the poor to become trapped in a permanent state of disaster. In this regard, risk transfer can play a valuable role in building safer communities

The innovations, experiences, and outcomes of the programme will be shared with a wider stakeholder group, including donors, NGOs, and the private sector, across the region and with other ProVention Consortium partners.■

A Second Incarnation of the Cash for Work Programme: Flood affected Kheda

When the July 2005 floods struck the slum community of Indiranagar in the Kheda region of Gujarat, AIDMI were able to respond quickly and using their 'Cash for Work' experience in southern India, were able to implement the programme almost as soon as the waters receded.

This time, 49 individuals benefited from being able to earn a daily wage again after the floods took away their earning capacity. Under the Cash for Shelter programme, 22 households benefited from both employment and habitat reconstruction. In this livelihood relief programme, youths under the age of 18 were able to be remunerated for their contributions to reconstruction.

In addition to the repair of flood damage to property, infrastructure and livelihoods, perhaps one of the most significant benefits of the programme is the opportunity it has given to construct a new drainage system. The first one of its kind in the region, it will make dramatic improvements to public health, sanitation, and disaster mitigation in the community, and would have been unattainable had it not been for the Cash for Work programme since it would cost around Rs. 60,000/-. There is a sense of enormous pride apparent as they proudly display the drainage canal system. It has given the community a renewed sense of optimism, and members have expressed that they feel a little more secure now that these measures are in place. ■

Identifying and Explaining Vulnerability in Disaster Prone Regions

It is generally believed that natural disasters indiscriminately affect all people without regard to caste, class, or gender. However, social reality reveals that certain groups of people are more vulnerable to natural and man-made disasters than others. Whilst many parts of the world are affected by natural disasters of devastating magnitude, history shows that vulnerability in the developing world exacerbates these effects. The governments in developing countries are often caught unaware at the time of disasters and their preparedness and response is often found wanting. The poor and marginalized groups in society suffer human and property loss unimaginable to the rest of the world, since it is poverty which renders them vulnerable and inhibits their capacity to recover. It has been estimated that 30% of disaster victims take between 5 and 20 years to recover. Victims become the poor of the development process, and 1 in 5 finds themselves trapped in a permanent state of crisis after a disaster.

The All India Disaster Mitigation Institute (AIDMI) recognizes that development and disaster are highly correlated, and it is their mission to reduce disaster risk in vulnerable communities through promotion of mitigation measures. Formed in response to the repeated 19897-9 Gujarati droughts, it has responded to 11 disasters across India, and gained considerable experience in the field of disaster relief, mitigation, and risk reduction, aim to enable disaster-affected communities to move beyond the relief phase and into the next phases of development.

Why are some individuals more vulnerable in the same disaster-prone area?

Credits for products is becoming common but what about services?

There are a number of socio-economic reasons for disparities in vulnerability. Vulnerabilities are differentially distributed and are intricately linked to certain processes of marginalisation, which in turn are linked to the nature and direction of economic development. Generally speaking, vulnerable groups are those who are deprived of social, economic and political rights and opportunities due to pre-existing ideologies and social and economic conditions.

In many societies in which gender, caste, religious, regional, and class differentials are extremely pronounced and social exclusion is strictly adhered to, vulnerabilities are more marked. These social and economic cleavages increase vulnerabilities and are amplified by poverty, and are more pronounced in a disaster situation, producing new vulnerabilities. Thus, women, scheduled castes, marginalized tribes, and the landless are particularly vulnerable because they have far fewer resources under their own control. They have little place in decision-making systems and they suffer numerous forms of oppression - gender, cultural, political, and economic.

What made individuals in the Indian coastal regions of Tamil Nadu and Pondicherry so vulnerable to serious loss in the wake of the Tsunami?

The vulnerability of the inhabitants primarily stems from the inherent nature of their economic activity. According to estimates, 92% of India's workforce is employed in the informal sector. In the coastal communities in Tamil Nadu and Pondicherry, this figure is even higher, close to 100%. Almost without exception, residents are dependent on the product of small-scale fishing, and related activities. This lack of labour and production diversification exacerbates the vulnerability which stems from the relative economic underdevelopment of the region. Single-sector employment prevents risk transfer and multiplies vulnerability. In addition, the remote coastal location in the economic periphery and the socio-economic marginalization of its community members further exacerbate their risk and vulnerability to disaster losses. Location is particularly significant given that the southern coastal regions of India are disaster-prone and at risk from substantial devastation from hurricanes, cyclones, and tsunamis. The losses induced by the 2004 Tsunami are testament to the consequences of vulnerability.

Why were livelihood losses in the Tsunami so great?

Natural or man-made disasters lead to the breakdown of established work, the disappearance of economic activities, the disruption of raw material procurement, the marketing and distribution of goods, potentially the enforced displacement and physical relocation of workers. This has a profound and devastating effect on the earning capacity of individuals, and on the local economy. In the case of Tamil Nadu and Pondicherry, the decimation of fishing activities caused by the Tsunami meant the destruction of the earning capabilities of the inhabitant communities in coastal regions. No income from fishing and related activities meant that people were unable to meet their daily needs for survival, resulting in a subsequent dependence on external relief. An absence of alternative livelihoods resulting from the communities' monopsony of labour in the fishing sector meant that people could not immediately seek other employment.

What can be done to reduce vulnerability for workers in the unorganized sector?

Livelihoods are particularly precarious in the unorganized sector, and this is accentuated in disaster-prone regions. Any measures that enhance the socio-economic position of these workers and their families will reduce their vulnerability to disaster risk and loss. In particular, the employment of mitigation measures such as microfinance strategies serves to transfer risk. This is especially true of microinsurance initiatives which pool risk amongst different communities across a wide geographic area. The application of microcredit and microsavings schemes improves individuals' economic conditions which reduces susceptibility and increases recovery capacity. ■

Understanding the Gap: Lessons for the Public and Private Sector

After the initial relief phase of the recovery process, the demand for credit within the affected communities increases. When a degree of livelihood recovery has been achieved through cash for work programmes and livelihood relief initiatives, entrepreneurs require credit provision in order to further develop their enterprises. However, due to inherent market failures in the credit market for low-income entrepreneurs in the unorganized sector, there is a shortfall in supply, creating a credit gap.

The Gap Explained

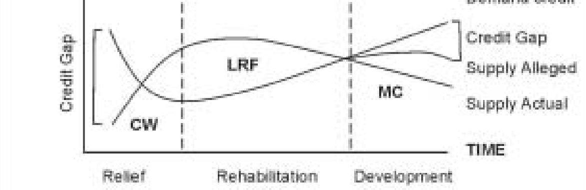
Prior to disaster, demand for credit in poor communities is high, but are denied access to conventional credit services because of their economic position and lack of capital or collateral. The diagram shows the initial credit gap in period I. During this period, disaster strikes, and a relief programme isinitiated. Firstly a Cash for Work programme is begun which increases the demand for capital as individuals return to earning. In period II of rehabilitation, demand for credit increases as enterprises recover and livelihood relief is provided, giving rise to the opportunity for expansion. In phases I and II, the financial industry, in both the public and private sectors increase the supply of credit available to aid economic recovery. However, as time progresses and enterprises grow, demand for credit is still increasing, although since relief programmes are no longer in operation, the supply of credit to poor consumers decreases. Once again a credit gap is visible in period III. A disparity also emerges between alleged industry supply and actual supply. Although insurance companies are required to provide services to a quota of low-income consumers, most would prefer to incur the financial penalty than make small, unsecured loans to entrepreneurs in the unorganized sector.

Bridging that Gap

The existence of this gap, itself an indicator of market failure, has implications for policy makers, and for the finance industries. Clearly there is a need for an increase in the supply of credit options for the poor, both pre, and post disaster.

The provision of credit prior to a disaster serves as risk transfer and will mitigate the losses sustained in future disasters. Policy makers should increase the penalties for failure meet low-income quotas, and support Microfinance Institutions (MFIs) who provide microfinance services to low income entrepreneurs.

Work is also needed to dispel the widely held misconception that low-income businesspeople in the unorganized sector are unreliable and uninsurable against risk. However, reality and experience show that repayment of loans is prompt and premiums are met. ■



Post Disaster Credit Gap

Cash for Work Initiative: Building Markets for Credit

When the 2004 Tsunami struck southern India, the AIDMI team found that something was needed to make the first step towards livelihood recovery, to enable individuals once again to be able to meet the daily needs of their dependents. Thus the 'Cash for Work' experiment was borne to build markets for credit.

How does livelihood relief work in the aftermath of a disaster? How does one set about re-establishing the means of recovering earning capacity? AIDMI have found that the first step is enabling individuals to earn a cash wage before their livelihoods can be reconstructed along with their homes and lives. However, this first step is often the most difficult to realize. The chaos of a disaster situation makes is difficult to discern the extent of damage; human, physical, and economic. However, frequently the damage to people's livelihoods is overlooked.

Cash for work revives purchasing power which builds markets.

The Cash for Work programme differs from other conventional relief programmes in a number of ways. Firstly, embodying AIDMI's emphasis on bottom-up activities, the programme is entirely community-based and at every stage, decision-making, organization, record-keeping, and supervision responsibility lies with the community. This increases the capacity of the community and its members, and allows for the acquisition of new abilities.

Secondly, unlike many conventional top-down programmes, the Cash for Work programme does not encourage dependency, rather the opposite. In a disaster situation, it is financially infeasible and unsustainable for the physical replacement of lost assets. Therefore, the Cash for Work programme affords individuals the opportunity to return to the earning of a daily wage so that new assets are created and sustainable recovery is facilitated. This makes the programme efficient and non-patronizing. It also serves to dispel the myth that disaster victims are merely recipients of aid and eke out their existence from donations, since the programme does not constitute a lump sum transfer, which leaves recipients dependent on further relief when the cash expires.

The objectives of the Cash for Work programme are threefold;

- Restoration of a degree of earning capacity to those whose livelihoods have been taken away
- Repair and reconstruction of the tsunami damage.
- Contribution towards achieving long-term sustainable development.

Individuals are paid a cash wage (up to a maximum of Rs. 120/day depending on work undertaken) in return for their labour provision. Work initially concentrated on the cleaning of the affected areas in order for reconstruction to begin. Roads linking villages, which had been washed away or damaged, were then cleared and repaired, and access to markets was re-established.

The Tsunami waters took life, livelihood, and shelter. The need for shelter security was manifest, AIDMI were able to combine livelihood relief with shelter relief under the 'Cash for Work' programme. Like 'Cash for Work', 'Cash for Shelter' enabled one member per household to earn a cash wage for constructing temporary shelters.

The work not only provided much needed income, but also allowed for the implementation of mitigation and preparedness measures such as solid waste, drainage measures, and monsoon protection measures, in addition to shelter and infrastructural reconstruction. Disaster became the opportunity to make valuable improvements to community infrastructure.

To date, there are 1100 beneficiaries in ten coastal communities. Of the beneficiaries, 90% are women, who have benefited not only from the provision of a cash wage, but also from AIDMI's Alternative Livelihoods programme. Since the sole employer was the fishing sector, there was no alternative when fishing was decimated. AIDMI encouraged women with other skills such as weaving, coir production, tailoring, and incense making to train other women and begin production. It was explained that they could create new resources, which could be built upon in the future. Community work sheds are being established in villages, which act as a centre for training and manufacturing. The women are now using the skills acquired whilst participating in the Cash for Work programme, to oversee and organize production of these goods.

Aside from the obvious physical effects of the Cash for Work and Shelter programmes - the reconstruction of shelter and infrastructure, there have been tangible positive economic and psychological outcomes. The capacity of household economies is augmented by the cash wage, which is in turn translated to increased demand and economic activity within the communities. This creates a local multiplier effect thereby stimulating regional economic growth. In psychological terms, the provision of temporary employment and wage earning gives rise to a sense of normality, and serves as a form of displacement therapy. From this point, recovery and sustainable development can become a reality. ■

Explaining Risk Transfer through Microinsurance

Ordinarily, conventionally high premiums renders insurance inaccessible for society's poor. However, the concepts of risk transfer and risk spreading allows for the creation of low premiums accessible to thousands of otherwise ineligible individuals.

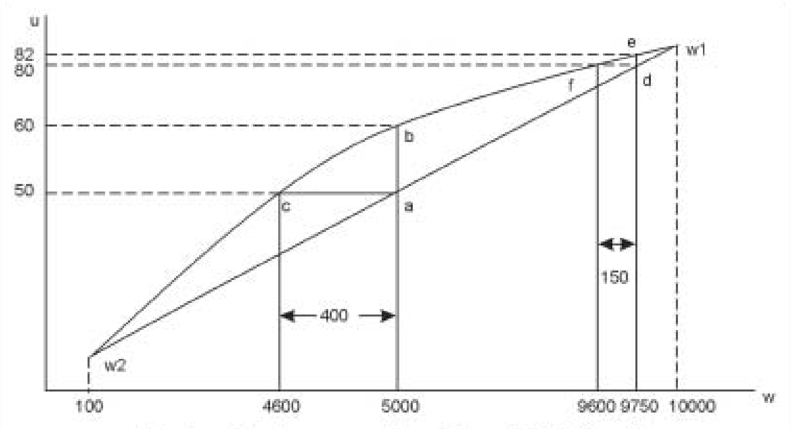
The benefits of insurance cannot be extolled highly enough by development professionals, researchers, and economists. Yet millions are denied access to this essential risk reduction tool, and these individuals are arguably most in need. They are typically poor and highly susceptible to disaster. Lacking the capital savings and capacity to recover from disaster unaided, when catastrophe strikes they are unprepared and are left to rebuild their lives with the aid of whatever assistance is provided.

There is a commonly held misconception that the poor of society are untrustworthy as beneficiaries of insurance, and are unable to meet payments. Reality has proved that this is not always the case through positive results in the fields of microcredit and livelihood relief. It is experts' firm belief that the poor should be able to reduce their vulnerability and mitigate risk in the future through disaster insurance.

However, the provision of low premium microinsurance policies makes insurance accessible to the majority of society's poorest victims. But how are insurance companies able to provide such low premiums?

The key to low premiums is the economic concept of risk transfer and spreading. When individuals in several communities in different geographic locations all take out microinsurance policies, the risk associated with administering each policy is spread across a large number of people and regions.

The likelihood of all of the regions being hit by disaster and everyone claiming simultaneously is remote which enables the policies to be underwritten by the insurance companies at such low premiums. Additionally, the low-income policyholders are insuring few assets at a low value, so even in a disaster situation, claims are not exorbitantly high. ■



How Low Premiums are achieved through Risk Transfer

What Key Organizations are Doing in the Field of Microcredit

2005 saw the launch of the United Nations' Year of Microcredit, designed to help achieve one of the UN's Millennium Development Goals; to halve extreme poverty by 2015. During the past 20 years it has been recognized by economists, policy makers and development strategists that if the income and equality gaps between the developed and developing worlds are to be closed, it needs to start at a microeconomic, grass roots level. Thus, using various tools such as MicroCredit, designed to cultivate economic self-sufficiency, sustainable and non-dependent development can be achieved.

Use of micro credit after disaster is spreading in South Asia rapidly.

"Sustainable access to microfinance helps alleviate poverty by generating income, creating jobs, allowing children to go to school, enabling families to obtain healthcare, and empowering people to make the choices that best serve their needs" (Kofi Annan, Secretary General, UN)

The recovery of South Asian countries and microeconomies following the decimation caused by the 2004 Tsunami has provided an opportunity for the application of microfinance initiatives to foster long-term sustainable recovery and growth in these underdeveloped regions.

The Philippines

The government policies in the last decade have shaped the reforms to promote private sector participation in microfinance and streamline its practice in the Philippines. The government has recognized and actively supported the role of microfinance as an effective tool for economic development and poverty alleviation. Through a National Strategy for Microfinance and the subsequent related laws and issuances, the following policy principles were set forward:

1) Greater role of the private microfinance institutions in the provision of financial services, 2) market oriented financial and credit policies
3) Non-participation of government line agencies in the implementation of credit programmes
4) The creation of an enabling policy environment that will facilitate the increased participation of the private sector in microfinance.

In addition to the government, over 3000 Thrift and rural banks, cooperative banks, credit unions, and NGOs provide microfinance programmes. The rural and thrift banks (2500) provide savings deposits and loans designed to make financial services available in the rural areas on reasonable terms, and to small and medium enterprises (SMEs). The cooperative banks and credit unions offer micro-loans to members from savings deposits created by membership. Several NGO-MFIs also supply microloans to individuals and community enterprises.

Bangladesh

NGOs are the most prevalent organizational form offering microfinance in Bangladesh, providing both credit and deposit services. Microfinance is also provided by government-sponsored microfinance projects. By June 2002, there were over 12 million active members benefiting from NGO-MFI (Non-Governmental Organisation - Micro Finance Institution) microfinance programmes, which represent a disbursal of US $3.257 billion in loan funds.

Cooperatives and Credit Unions are also active in the field of microfinance, with over 400 currently in operation. By 2001, they had combined assets of over $12 million and had reached well over 100,000 stakeholders. These figures have risen considerably since then. The Palli Karma-Shayek Foundation (PKSF) is principlerefinancing body for MFIs in Bangladesh, and has been instrumental in meeting the demand for finance in disaster response. It has formed partnerships with the three largest NGOs (Grameen, BRAC, and ASA) and 141 small and medium sized NGOs.

The role of microfinance in disaster response was first seen in Bangladesh in 1998 in response to the worst flooding the country's history; affecting 30 million people and businesses.

As a result, the Disaster Management Fund was established, and the PKSF was able to disburse over Tk. 650 million in 1998 in flood response. Since then, the contributions of PKSF organizations have increased to augment the capacity of the fund.

Grameen Bank

The Grameen Bank, established by Professor Muhammad Yunas in 1976, and was the first specialized microfinance bank. Since then it has grown to over two billion members, 95% of which are women. Members' control constitutes 93% of total ownership of the bank (7% government controlled), and it has over 1100 branches across Bangladesh, working in 42,127 villages, and has disbursed in excess of Tk.174 bn. to date.

The recovery of South Asian countries and microeconomies following the decimation caused by the 2004 Tsunami has provided an opportunity for the application of microfinance initiatives to foster long-term sustainable recovery and growth in these underdeveloped regions.

It has become a model for microcredit lending and microfinance services for the developed and developing world. The Bangladesh Rural Advancement Committee (BRAC) and Grameen constitute the largest microfinance lenders in Bangladesh.

Sri Lanka

Cooperatives remain the key microfinance service providers (over 8000) in Sri Lanka, serving over 800,000 people. Local NGOs (200) and commercial banks (39) also have a small coverage at national level. Historically microfinance activity was heavily subsidized, but now appears to be largely financed by savings deposits, which would indicate a shift towards private sector and market-based operation.

The majority of the work being carried out in Sri Lanka has been targeting poor and rural entrepreneurs to encourage self-sustaining growth and development through the provision of microcredit loans.

There is widespread reinvestment of deposits by cooperatives in community-based lending programmes, and NGOs have been working towards eradicating poverty by empowering the poor to develop individual and collective self-reliance through mass mobilization. ■

Ashoka: Encouraging Social Entrepreneurship

There might not be a panacea found yet for worldwide poverty reduction and development for the vulnerable, but it is recognised that socio-economic prosperity can only be achieved at the grass root level. The international community can facilitate opportunities, but the local communities must grasp these opportunities. For this reason, the development sector has intensified its focus on local, social entrepreneurs, since these local businessmen are most willing and capable to take advantage of these opportunities.

Since its founding in 1981 by Bill Drayton, a former McKinsey and Co. consultant and assistant administrator at the Environmental Protection Agency, Ashoka has recognized the fact that innovative entrepreneurs make a significant difference in their communities. Ashoka has supported both individuals and ideas from all over the world in their mission to shape a citizen sector that is entrepreneurial, productive and globally integrated, and to develop the profession of social entrepreneurship around the world.

Ashoka encourages and supports social entrepreneurship in many ways, of which online competitions is the latest format. With the introduction of www.changemakers.net, Ashoka has given every global citizen the opportunity to learn about projects that aim at changing communities for the better. Moreover, everybody can grade the different initiatives in order to surface the best solutions to pressing social problems such as improving the lives of the world's poor.

Recently, www.changemakers.net launched the Changemakers Innovation Award: Market-Based Strategies that Benefit Low-Income Communities. This competition gives NGO's, corporations and other organizations the chance to show the world their projects that can help the poor, while being financially sustainable. Already more than 110 projects, have been subscribed for the contest, and thousand of interested global citizens have voted. The four projects, which have received the highest grades, are awarded with the Changemakers Innovation Award. ■

Disaster Induced Market Failure: Using Livelihood Relief to Restore Local Markets

Although the government on a regional, and national level pledge compensation for disaster-induced losses, a loss of income is not compensated. Whilst physical assets are replaced, individuals are left without the means to earn an income, and are left dependent on relief. This relief may be slow to materialize, and in the cases of residents of illegally established communities, members of marginalized tribes and scheduled castes, the relief may not appear at all.

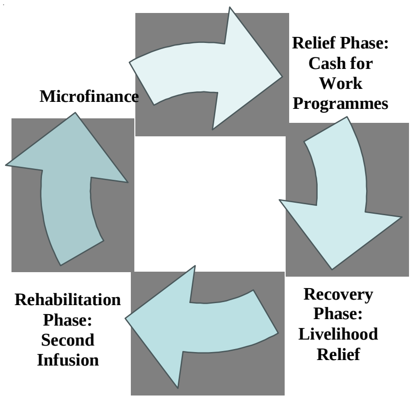
When relief programmes are implemented, many victims are often left wanting since these programmes do not provide for the reestablishment of livelihoods and earning capacity. The beneficiaries are not looked at as helpless victims who eke out an existence from relief packages, but capable people with hands to work, brains to think, and courage to pick up their lives and take charge of their recovery.

Following the 1998 Kandla cyclone, AIDMI established the Livelihood Relief Fund which is actively working on providing livelihood relief to disaster-affected victims across India. Since 1998, the LRF has grown steadily to reach out to victims of the Kandla Cyclone, January 2001 earthquake, the February 2002 riots, ongoing drought in the Gujarat region, the 2003 Squall, 2004 Tsunami, and 2005 Gujarati floods. There are now over 13,500 beneficiaries of the LRF.

Addressing disaster induced market failure

When disaster strikes, local markets cease to function properly. Supply is interrupted or curtailed, and demand for goods and services becomes almost non-existent. LRF seeks to restore the functioning of local markets with its market based and community driven approach to recovery. Once businesses are recovered and demand and supply are restored to a pre-disaster level, individuals have the opportunity to receive a second infusion into their business to promote further growth.

Since LRF is demand based and tailored to every stakeholder, it does not intervene in the market causing externalities. In the long run it



becomes self sustaining as microcredit loans can be used and repayment into the Livelihood Revolving Fund allows the recycling of credit.

Moving beyond recovery - Local market development

The proper functioning of local markets improves the allocation of resources in the locality, and promotes growth. Vulnerability and disaster reduce the effectiveness of the market mechanism, therefore measures should be taken to ensure that disaster risk is reduced in vulnerable communities.

Risk transfer through microfinance is recognized by policy makers, disaster experts, academics and professionals as being an important tool in risk reduction for disaster susceptible individuals. Through microcredit loans, businesses are expanded, investments are made and demand is increased resulting in multiplier-led growth. Any improvement in socio-economic conditions constitute a reduction in vulnerability.

Safeguarding Assets created under livelihood relief

But what steps should be taken to safeguard these new assets created in the recovery process and reduce future disaster loss vulnerability?

Microfinance Solutions

The provision of microcredit and other microfinance services are crucial in the protection of assets created. Microinsurance schemes allow for protection in the case of disaster or other income-limiting event, and microsavings allow the establishment of a capital base from which future investments or recovery can be drawn. Through microfinance, microeconomies of scale can be realized which increase business capacity and further reduce risk.

Business and Contingency Plans

As part of any planned business expansion, asset creation, or capital investment, a business plan is required. These are mandatory in the case of microcredit, since proposals must be approved prior to a loan. In addition to this, entrepreneurs should be encouraged to formulate contingency plans in case of emergency or disaster, and set aside capital to provide for these eventuality so that they are less dependent on relief.

Capacity Building

Increasing the stakeholders' capacity is essential for asset protection. Capacity is built in the recovery and expansion of businesses, but this must be complemented by education, training, and updating. ■

Glossary of Key Terms

Microeconomics is a branch of economics concerned with the smallest level of activity in the economy, usually at the individual supplier and producer level. The combined interaction of these small (micro) units in several regional **microeconomies** form the larger **macroeconomy** on a national and international level.

Microcredit is the use of small loans (usually less than US$200), and support from local organizations called **microfinance institutions (MFIs)** to start, establish, sustain, or expand very small, self-supporting businesses. These loans are known as **microloans.**

Microsavings programmes are small-scale savings schemes available to those who would not otherwise be eligible for a bank account. These savings programmes are encouraged in poor communities as a method of risk transfer and mitigation. In some cases they are mandatory for recipients of **microloans** to ensure and enable loan repayment. It is also crucial for small business development and **microeconomic** growth.

Repayment: Microloans from an **MFI** are repaid by the individual or community who have taken out the loan. The total amount borrowed is repaid with interest set at a rate determined by the **MFI**, and the repayment schedule is anywhere from six months to over one year. The money is recycled as another **microloan**, thus multiplying the value of each dollar in defeating global poverty, and changing lives and communities.

What is the difference between microcredit and microfinance? Microcredit covers loans and the credit needs of clients, while **microfinance** provides a broader range of financial services and creates a wider range of opportunities for success. Examples of these additional financial services include **microsaving**, **microinsurance**, housing loans and remittance transfers. The local **MFI** might also offer **microfinance** plus activities such as entrepreneurial and life skills training, and advice on topics such as health and nutrition, sanitation, improving living conditions, and the importance of educating children. ■

Do you wish to receive this publication regularly? Write to Vandana Patel at AIDMI (dmi@icenet.co.in). The publication will be sent to you by E-mail.

You may also send your comments to improve this publication so that it is more effective and informative.

Please contribute comments, features, reports, discussion points, and essays about your work. Today!

Livelihood Relief Fund

The Livelihood Relief Fund secures food, water and habitat of the disaster-affected poor victims by protecting and reviving their means to work and earn an income. Its main focus is to build livelihood security and reduce economic risks through sustainable long term recovery.

PRINTED MATTER
Book-Post

Mr. ______________________

ALL INDIA DISASTER MITIGATION INSTITUTE
411 Sakar Five, Near Natraj Cinema, Ashram Road, Ahmedabad-380 009 India
Tel: +91-79-2658 6234/2658 3607, Fax: +91-79-2658 2962
E-mail: dmi@icenet.co.in, Website: http://www.southasiadisasters.net