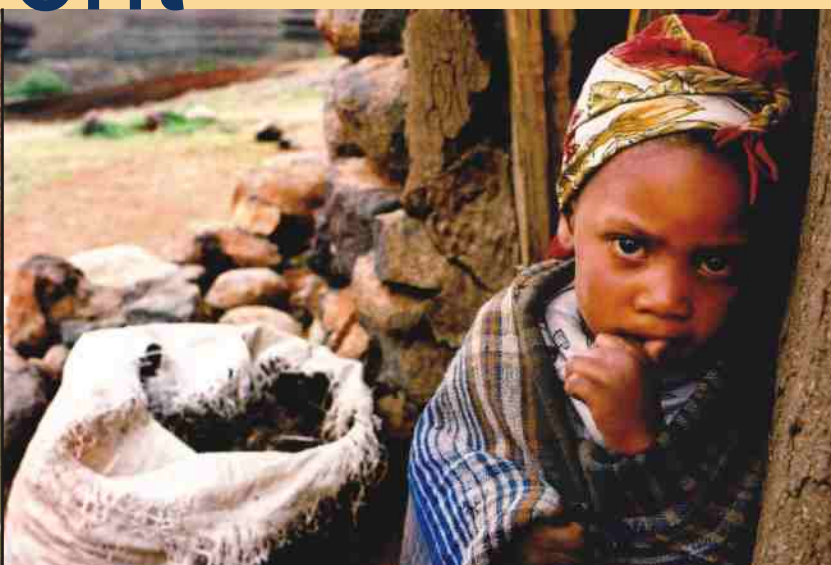


# Invest to prevent



# disaster

Microfinance is a tool that has successfully been utilized to improve livelihood options and reduce poverty. It has hardly been used yet as a tool for reducing risk vulnerability to natural hazards. Leading up to the International Day for Disaster reduction (12 October 2005), the ISDR secretariat will promote dialogue with the microfinance community on the possibility of using these tools to reduce disaster risk and increase community resilience to disasters.



United Nations



# Invest to prevent disaster

## An International Technical Cooperation Perspective

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In many parts of the world, natural disasters pose a serious problem that can enormously hamper human development. When a disaster strikes, its impact is usually more devastating for poor households as they have fewer options to cope with the impacts. The destruction of income-generating assets or of trading stock seriously affects poor households' ability to earn a living and leads to the quick depletion of financial savings. In such cases, microcredits represent a suitable instrument to assist poor people in coping with the impacts of a disaster. However, these needs have to be quickly met, otherwise the secondary negative impacts of disasters (such as deteriorating health conditions, lack of income, among others) start to weigh in. Microcredits can also represent a viable option for reducing the impact of disasters, as members of the population affected by a disaster and other poor people often lack the capital to introduce preventive measures, such as earthquake-resistant housing.

Although microcredits are receiving more and more attention in responding to disasters, many challenges still exist that have to be taken into account when deciding in their favour in the context of disaster risk management.

For example, there is the risk that the next disaster will strike before the loan borrowed can be reimbursed, especially in regions where natural disasters are a frequent threat. This would have negative impacts on both microfinance institutions (MFIs) and their clients. MFIs, especially in the case of geographically widespread disasters, such as floods or droughts, often undergo severe liquidity crises. On the one hand, this is due to the high number of clients affected at the same time. As an entirely sensible reaction, these clients are likely to withdraw their savings, stop depositing money and reduce their repayments to the minimum required. On the other hand, liquidity crises can be caused by MFIs not possessing abundant capital; moreover often they reduce their reserves to a bare minimum to allow the maximum possible lending outreach. This can lead to a serious situation: in times when demand for financial support is highest, MFIs often struggle to survive the crisis themselves.

To lower the risk of being bankrupted by a disaster, MFIs have to work together to spread their risks regionally as well as in terms of hazards. In addition, microcredits should be tightly bound to making households significantly less vulnerable, for instance by reinforcing houses to make them more resistant against earthquakes or floods. This will enhance the probability that the creditors will be able to repay their loans. However, the process needs some support from powerful institutions, which in the first few years can act as reinsurers, especially in poor regions.

Despite some progress on this issue, obstacles remain. The allocation of microcredits for investment in disaster risk management requires a certain awareness of the positive impacts of preventive measures among the population. Experiences from a Deutsche Gesellschaft für

Technische Zusammenarbeit (GTZ) GmbH project in Peru dealing with the contribution of a low-cost construction technique for earthquake-resistant houses show that many people still lack this awareness. Although the construction technique is only slightly more expensive than the ordinary one, many people refuse to spend any extra money on preventive measures, as this does not result in direct benefits and the money is moreover needed to repay the loan.

A solution to this problem might be to ensure loans combining both productive and preventive issues. Loans provided for productive investments should be connected to incentives that encourage clients to reduce their vulnerability related to natural disasters by making the loan contingent on the client moving to less disaster-prone location or rebuilding a dwelling in a more disaster-resistant way.

Microcredit programmes also require a certain degree of confidence in financing and insurance institutions. In the past, people in many countries trusted more the support of family and friends than finance institutions. In many parts of the world, existing informal microcredit and saving systems indicate that people are aware of the need to cover unforeseen events. One example of such an informal scheme is the so-called "Arisan" system, which is found in Indonesia and takes the form of neighbourly help or help among colleagues at work. Such well-established structures can be useful for MFIs in promoting their credit systems and in creating trust between the institution and the client.

In the near future, efforts have to be made to solve the above-mentioned problems by developing a broad range of microfinance schemes that meet the individual needs of poor people in disaster-prone regions. Together with other microfinance products, such as saving programmes or microinsurance projects, this can make a fruitful contribution to reducing poor people's disaster risk.