Financing Recovery: A Case of Kerala Floods 2018

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Abstract

Financial constraints are a reality when it comes to managing disasters. In absence of sufficient endogenous wealth to finance recovery the State has resorted to creating conditions to attract foreign investments in affected region. As global capital markets are closely intertwined, various States aspiring for aid are judged in terms of their 'comparative hospitality' to external capital and overall investment climate; this triggers a race to the bottom. Aspiring States, driven by the lowest common denominator, undertake massive deregulation, lowering of trade barriers, granting tax holidays and subsidies to international investor. The liberalisation of market and State led deregulation eliminates domestic rivals to the extent of having monopolistic control. Post disaster, states have little bargaining power viz. a viz. the foreign investor, whose aim is to profiteer. They exercise control over the destination, type and nature of use that foreign capital would be put to.

1. Introduction

Disaster Financing is important for all stages of disaster: preparedness, mitigation, response and recovery. Act provides special mitigation plans and funds at District, State and National level. Of late, with increasing frequency and magnitude of disasters, various channels have emerged to finance recovery. It is important to understand the sources of finance, their pros and cons to plan for a robust recovery in advance.

2. Methodology

The study uses Critical Realism paradigm of social science research. It is pertinent as it views reality as a 'multilayered and multicausal (Oliver, 2012:75. Critical realism provides a lens to understand the political construction of events and environment

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which goes on to uncover seemingly apolitical, benevolent exercises like disaster recovery. This paradigm contends that both extensive (statistical) and intensive (interpretive) data should be collected in a study in order to construct a complete picture of social reality (Fletcher, 2017:185). As a result, the study uses mixed method research. Apart from quantitative data analysis, qualitative method is suited to this study as the topic of research is relatively new, knowledge in the field is limited to begin with and secondary data is very scarcely available and often difficult to access. Using multiple sources of data and methods of analysis helps to triangulate the results. The study uses case study approach to look at issue of recovery financing. While case study research has its advantages the results cannot be generalized. The uniqueness of every disaster episode should be appreciated. Expert interviews have also been conducted to enrich understanding.

3. Results and Discussion

3.1 Constitutional and Statutory Provisions

Before the enactment of the Disaster Management Act, the Finance Commission played a central role in providing guidelines for fund allocation for disaster management. The Second Finance Commission brought about the concept of 'margin money' scheme to be kept aside for extreme events. It also laid down provisions for central assistance in case of disasters. Subsequently, the Ninth Finance Commission introduced the concept of the Calamity Fund Relief. The Tenth Finance Commission, additionally, laid down a National Fund for Calamity Relief which was later subsumed under the National Calamity Contingency Fund.

The Disaster Management Act claimed to make a categorical departure from response and relief centric focus to one which augments preparedness and mitigation activities. The Act provided for the setting up of two funds: National Disaster Management Fund and the National Disaster Mitigation Fund. Such funds are to be created at State and District level as well. District level funds have still not been created. The State governments cite the reason that districts are not equipped with the administrative and operational capacity to manage such funds.

The Disaster Management Act, 2005 lays down that the funds would be financed by the Parliament through appropriation. It is also authorized to receive contributions from individuals as well as institutions. Interestingly, no model mechanism for state/ district disaster financing has been outlined. The implicit assumption is that States will make their respective provisions for meeting the fund requirement.

The Disaster Management Act, 2005 mandates the creation of the National Disaster Response Fund (NDRF). Further, the Act envisaged public contributions to the NDRF, however, in response to an RTI the Home Ministry revealed that it is yet to open a bank account under the NDRF to solicit public contributions. It is to be noted that the National Disaster Response Fund, having been conceived by an Act of Parliament, is subject to audit by Comptroller and Auditor General of India and disclosure directives under the RTI Act 2005.

Prior to the NDRF, the Prime Minister's National Relief Fund (PMNRF) was created in 1948 and has been operational ever since. PMNRF had no budgetary contributions and only solicited funds from general public. The PMO therefore insists that the fund does not fall under RTI and is audited by an independent auditor. Notably, much like the recent PM CARES fund, there exist operational ambiguities about the PMNRF.

National Disaster Response Fund which has been mandated to receive funds from individuals and institutions alike is a better alternative as it is more transparent and has statutory sanction.

Section 46 (1) of the Disaster Management Act, 2005 provides for the setting up of the National Disaster Response Fund to meet any contingency like disaster. Accordingly, the Central government credits a given amount to the fund every year. Under the same section, the next sub clause 46 (1) (b) allows any individual or institution to donate funds for the purpose of disaster management. To reiterate, no mechanism has been put in place so far to enable the same.

Expert interviews revealed that the Home Ministry is increasingly eyeing public donations citing the "shortage of funds". In the pre-GST era, the expert opines, a lot of fund was received in form of cesses. Implementation of GST has necessitated budget spending for disasters. On the issue of disaster financing, there is a lot of tussle between Ministry of Home Affairs and the Ministry of Finance as both are seen passing the buck in response to RTI appeals made during the course of writing this thesis.

Under the Disaster Management Act, Centre has been entrusted with co-ordination during disasters but major responsibility of managing disasters rests with the State. The PRS analysed Ministry of Home Affair's budget expenditure highlighting that in the year

2017-18, 80 per cent of the Ministry's expenditure went to police and only 6 percent on Disaster Management. Finance Ministry's notice on Demands of Grants for the year 2018-19 showed INR 10,000 crore as budgeted expenditure for State Disaster Response Fund (SDRF) and INR 2,500 crore for National Disaster Response Fund (NDRF).

The SDRF is therefore the primary means available to states for financing disaster relief and losses. For general category states, Centre contributes 75 per cent to SDRF; in case of special category states, it contributes 90 per cent. The total budgeted expenditure for disaster management for the year 2018-19 was INR 12,500 crore. The inadequacy of the quantum set aside for disaster management becomes clear when we compare it to INR 20,000 crore worth damage in Kerala floods alone.

However, there exists a caveat in the operational guidelines of National Disaster Response Fund. The two statutorily conceived funds NDRF and SDRF are intended to be used for providing immediate relief. Long term rehabilitation needs have to be met with separate budgetary heads and external assistance. But in practice it is observed that states underestimate the probability of adverse events occurring

3.2 Kerala Floods 2018: Recovery Financing

The Kerala Floods opened a new debate about fiscal federalism. Katju and Roy highlight that the imposition of Goods and Services Tax has led to greater centralising tendency wherein the states are limited in their authority to raise their own revenue for meeting catastrophic expenditures. It is to be noted that public health, agriculture, land, roads and bridges are all state subjects. The Kerala State government decided to levy a cess to finance disaster recovery. Under Article 279 A, the GST council is entrusted with the responsibility for approving state tax in the wake of disasters. The GST reform had promised to increase the state revenue, however, Kerala at the time of floods reported significant reduction in revenue. The GST council initially raised reservations about Kerala raising its own revenue, as such a cess would potentially threaten the uniformity of tax rates throughout the country. While Kerala solicited putting cess at 10 per cent, the GST council allowed it to levy 1 per cent cess for two years. If states are not allowed to raise their own fiscal resources, the Centre should step in with additional funds to prevent excess state borrowings.

Besides cess, Kerala resorted to an unorthodox measure, i.e. issuance of rupee denominated masala bonds overseas. Consequently the Kerala Infrastructure

Investment Fund Board issued Masala Bonds worth INR 2150 crore in 2019. It was argued that the use of such instruments is in contravention to Article 293 (1) of the Constitution of India which prohibits the state governments to borrow from abroad. The constitution requires that only central government can be responsible for foreign country's foreign exposure. However, it is the Reserve Bank of India that monitors the country's foreign exchange exposure and has allowed the usage of such bonds subject to stipulations. The Union government argued with the legal maxim that 'what cannot be done directly, cannot be done indirectly'. The centre has raised concerns that in future other states may resort to such routes of disaster financing citing this precedent.

It is also to be noted that the Central government declined foreign aid offered from UAE and other middle-eastern countries which are popular destinations for migrants from the affected state. While opposing foreign aid, the government argued that there has been an informal consensus since the Indian Ocean Tsunami to not accept foreign aid in the wake of natural disasters. In 2004, the then Prime Minister of India had said, "We feel that we can cope with the situation on our own and we will take their help if needed." Jacob (2018) has interpreted this statement to mean that it does not necessarily mean that the country has closed its doors to foreign aid forever. The 2004 decision has to be contextualized on case by case basis. Interestingly, since 2004, various policy documents of the government have highlighted that it is not principally averse to accepting foreign aid. According to the National Disaster Management Plan, "if the national government of another country voluntarily offers assistance as a goodwill gesture in solidarity with disaster victims, the Central government may accept such an offer."

In a similar way both the National Policy on Disaster Management 2009 and the Disaster Management Act of 2005 are predisposed to forging positive external linkages for disaster recovery. Apart from policy precedent, Jacob (2018) lists National pride as the second most significant deterrent to accepting foreign aid. However by citing instances of India offering aid to USA (Hurricane Katrina 2005) and China (Sichuan earthquake 2008) he critically dismantles the theory of 'national pride' by showing that the so called better off countries have also routinely accepted emergency foreign aid from friendly nations.

The Disaster Management Act 2005 mandated the creation of National Disaster Response Fund and the National Disaster Mitigation Fund. Similarly, it also mandates the creation of State Disaster Response Fund and District Disaster Response Fund separately. The mitigation fund has still not been conceived. Funds at district level are created in very few districts.

3.3 Sources to Finance Recovery in Kerala

The State of Kerala estimated its recovery needs at INR 31000 crore over a period of five years. The State government states that 35 per cent of the estimated cost will be contributed by the beneficiaries. It envisages recovery to be a "collective exercise with shared responsibilities." It has solicited the contribution of private partners, NGOs, philanthropic organisations and common citizens. The government categorically states in its rehabilitation policy document that it is primarily the responsibility of the government (State and Local Self Government), to take the responsibility of rebuilding post-disaster.

Even so, the State government acknowledges that it is beyond its fiscal capacity to build back all damaged assets. As regards housing reconstruction and livelihood restoration the government concedes to providing the basic minimum stimulus to resume life. It explicitly states that it cannot provide for full replacement cost for damaged assets. The government having estimated the damage at 31,000 crore aims to raise finance through public and private means.

The channels of raising finance listed by the government are:

1. Central Assistance
2. Increase Tax Revenue
3. Private Contributions
4. Market Borrowings by State Government
5. Efficiency Savings
6. External Assistance (Overseas Development Assistance)

Of these, the primary significance is attributed to assistance provided by the central and state governments. Besides, unconventional and rather innovative channels of financing are also gaining relevance. The role of State, insurance companies, private contributions and crowd funding has been elaborated here.

3.4 Central Government Assistance

Under the Disaster Management Act, the National Disaster Response Fund has been created. Interestingly, the National Disaster Response Fund is only available for relief measures and not for recovery and reconstruction. Therefore the State government cannot lay claim to NDRF as a matter of right for reconstruction measures. However central relief allocations are tweaked to support rehabilitation efforts by the states.

The Kerala government solicited INR 4700 crore under NDRF by submitting a memorandum to the central government by claiming the 2018 floods to be the worst in a century. After receiving the memorandum, the Central government sent an Inter-Ministerial Central Team (IMCT) to assess the damage on ground. ICMT submitted its report to the National Executive Committee (NEC), headed by the Union Home Secretary. The Union Home Minister heads a High Level Committee where, in consultation with the NEC, final approval regarding quantum of assistance is made. In case of Kerala, the actual assistance given to the State government by the Union was INR 3048 crore.

Besides, the State also solicited additional funds under Centrally Sponsored Schemes, for example MGNREGA, PM Awas Yojana (PMAY).

Other sources of financing are Chief Minister's Relief Fund which accepts private contributions. The fund aimed at mobilizing INR 3000 crore. The state government also considered requesting grants from the central government (INR 6000 crore) under Article 275 (Grant from Union to certain States). Kerala government also launched a Nava Kerala Lottery to fund recovery needs (INR 80 crore): The Government of Kerala has floated a lottery for recovery needs and expects to mobilise about INR 80 crore through this source. Kerala also proposed to the Union government to grant the state 4% of total funds (i.e. 15000 crore) received under Corporate Social Responsibility (CSR). The government actively used crowd funding through social media and other digital platforms to rope in philanthropic contributions from the state diaspora. Besides, it also invited NGOs to support its effort in rebuilding housing and livelihood. The State government was pro-active in forming the Inter-Agency-Group (IAG) at the state and district level to coordinate their activities.

The government also considered augmenting the tax base to enhance revenue. It suggested doing so by expanding the tax base, introducing new taxes, improving overall tax efficiency and increasing the tax rate. Kerala's tax to GDP ratio is 9 per cent compared to the national average of 16.8 per cent. Augmentation of tax revenue would give the government a better fiscal space to finance recovery and reconstruction needs. The state government is considering various business units in the state which did not fall under the commercial tax net of the State. Further, the State government is also considering levying a new tax on vacant houses in the State with a higher tax slab for bigger houses. This step would also help in bringing 1.2 million houses into the rental market. The government envisages that this step would make Kerala and attractive destination for IT industry.

Moreover, the State also considered imposition of carbon tax on building material and motor vehicle.

Close to INR 12000 crore is pending in tax litigation in courts, the government is aiming at salvaging this amount. It also aims at improving efficiency in tax collection, introducing cess etc. For the purpose of introducing cess, the Kerala government cites Article 279 A (4)(f) which provides for increasing rates of taxes under Goods and Services Tax (GST) for a short period in wake of a natural calamity subject to the approval of GST council. The Kerala government also proposed imposition of a calamity cess on intra state trade (over and above GST rates) to the tune of 10 per cent. When the GST council took up the matter, it reduced the cess to 1 per cent for a period not exceeding 2 years.

Finally the government also considered market borrowings as an option. While the option to borrow via market instruments was available, both nationally and internationally, the government realised that this can, at best, be an option in the short term, as loan has to be returned with interest soon enough.

The government was also keen on issuing reconstruction bonds which can be purchased by the state's diaspora living abroad. Interestingly, this option has been used by various national governments in the aftermath of disasters.

Finally there is the option of borrowing from Banks.

In the domestic realm the State government has the option of borrowing from National Bank for Agriculture and Rural Development (NABARD), Housing and Urban Development Corporation (HUDCO). However, it is a common compliant from various states that domestic banks charge a higher interest rate. Disaster affected states are therefore driven to negotiate with the World Bank and Asian Development Bank to finance recovery and reconstruction needs.

The State governments, in order to raise funds through market borrowings, need the approval of Central government. This is also necessary as market borrowings would exacerbate the fiscal deficit to GSDP ratio beyond the mandate of Fiscal Responsibility and Budget Management Act, 2003.

Under Article 293 (3) of the Indian Constitution, the State government requested the Union to allow it to borrow to the tune of 4.5 per cent of GSDP. This would yield INR 10000 crore for recovery and reconstruction.

3.5 Economy in Government's Expenditure

The government aims to bring in economy and efficiency in its expenditure. The savings can be used to finance reconstruction needs. By re-prioritizing budget allocations, cutting down on funds for State schemes, the government hopes to achieve its target.

Kerala government is also eyeing Overseas Development Assistance (ODA) which would reduce the burden of market borrowings on the State.

3.6 Finance Commission Recommendations

The Disaster Management Act 2005, provided for the creation of National Disaster Response Fund and the State Disaster Response Fund. The 15th Finance Commission chaired by N.K. Singh submitted its report with recommendations for the financial year 2020-21.

Table 1: Grant for Disaster Risk Management (Rs. in Crore)

Sl. No.	Corpus	Mitigation	Percentage to Total	Response	Percentage toTotal	Total
1	State	2478	6	9912	24	12396
2	National	5797	14	23186	56	28997
3	Total	8275	20	33098	80	41393

Source: Report for the year 2020-21, 15th Finance Commission; PRS Legislative Research

Table 2: Sub Components of Response under 15th Finance Commission (Rs. in Crore)

Sl.No.	Category	Response and Relief	Recovery and Reconstruction	Capacity Building	Total Response
1	State	4956 (12%)	3717 (9%)	1239 (3%)	9933 (24%)
2	National	11593 (28%)	8695 (21%)	2998 (7%)	23186 (56%)
3	Total	16549 (40%)	12412 (30%)	4237 (10%)	33119 (80%)

Source: Report for the year 2020-21, 15th Finance Commission; PRS Legislative Research

Amongst its various recommendations, the Commission suggested the setting up of National and State level Mitigation Funds. The Commission held that the existing pattern of cost sharing: 75:25 for general category states, 90:10 for North Eastern and Himalayan States should be retained. For the term 2020-21, State Disaster Risk Management Funds have been allocated INR 28,983 crore, out of which union share is to the tune of INR 22,184 crore. The National Disaster Risk Management Fund has been allocated INR 12, 390 crore.

3.7 Other Innovative Channels for Financing Disaster Recovery

1. Role of Insurance Sector

While the total quantum of economic loss was in 2018 floods was more than 20000 crore, only about five percent could be covered under insurance claims. The lack of penetration of insurance sector, even in the relatively better off states, puts enormous burden on the State treasury.

It was reported that insurance companies in Kerala had eased their claim settlement process with teams dedicated for the purpose. Most claims were received for vehicles and property such as residences, shops. As far as vehicular damage is concerned, a comprehensive motor insurance policy covers all damage due to natural calamity. However, water entering the engines is covered only when an ‘engine protection’ add on is specified in the insurance policy. Post-disaster, vehicular insurance companies incorporated engine protection add on in their package.

2. Salary Challenge

Through Government order GO(P)144/2018/Finance dated 11/9/2018, the state government requested all the government employees to donate one months salary in ten installments to Chief Minister's Disaster Relief Fund (flood relief). The government aimed at raising a revenue income of INR 3800 crore .

3. Involvement of the Online Market in Financing Recovery

In the immediate aftermath of the deluge, the state government launched a crowdfunding initiative, with help from KPMG, for rebuilding. However, the initiative was unable to elicit a substantive response from the public at large. The lack lustre response compelled the government to introspect subsequently deliberate on an elaborate expert consultancy.

4. Conclusion

Disasters are the new normal. The challenge, however, is to live with it ,and no despite it. Once immediate relief has been provided for, the challenge is long term recovery.

The ideal goal is to 'build back better', naturally, this is a financially intensive exercise. While state support is imperative, it is far from substantive. United Nations Organisations and International Financial Institutions repeatedly emphasise on the need to increase penetration of insurance market. While broader insurance coverage can be a desirable goal, it is far from being an end in itself. There will always be a segment of survivors, however small, which will be left out of the insurance net. Market based borrowing is also a popular alternative. However, this instrument has to be used very carefully, in that it creates long term dependence, as the loan has to be repaid later. Thus we need a mix of institutions and channels to finance recovery.

The role of government is central to regulating and steering the recovery exercise. The Disaster Management Act, 2005 puts the responsibility of managing disasters with the states while the overall coordination is with the central government. However, given the scale of responsibility, states are overwhelmed in absence of adequate financial, administrative power and lack of trained human resource. For a successful recovery, governments, corporates, institutions, civil society actors, non- government organisations and individuals, all have to come together and put their best foot forward to 'build back better'.

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