ALIGNING WITH THE BIGGER PICTURE: THINKING STRATEGICALLY IN DISASTER RISK FINANCING

CENTRE FOR DISASTER PROTECTION

GUIDANCE NOTE

Author: Felix Lung
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About the Centre for Disaster Protection

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Cabo Delgado Province. The ICRC helps with the repair of the roof of a health centre. The roof was destroyed when Cyclone Kenneth struck in April 2019, Mozambique. Image: Nxedlana, Khatija/International Committee of the Red Cross

WHY IS THINKING STRATEGICALLY SO IMPORTANT?

A disaster risk financing (DRF) programme can be sound from a technical angle—but when it fails to consider the broader environment, its impact is diminished.

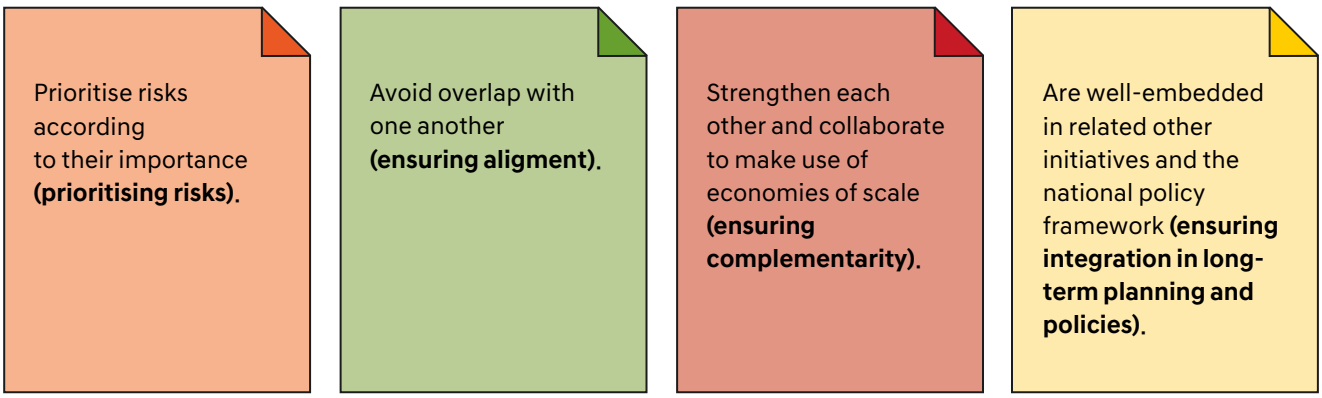
For example, a DRF instrument can only focus on a few risks. These need to be selected carefully. If not, a programme may end up focusing on the wrong risks for the wrong people. Covid-19 is a stark reminder that in disaster planning some risks may be missed altogether. Another example is when other DRF arrangements are already in place. Any new financing programme must take them into account and plan with and around them. If it doesn't beneficiaries could be double-targeted or delivery systems, such as cash transfer infrastructure, could be duplicated unnecessarily.

It is important that DRF instruments are not developed in a vacuum. They should be planned as the result of a systematic risk prioritisation process and build on and integrate with existing systems, ensuring that broader resilience is built.

There are four main aspects to taking 'a strategic approach' (see Figure 1).

- **Prioritising risks.** DRF initiatives should tackle priority risks—that is, risks that policy-makers have identified as particularly important for a given context. While the prioritisation process will look different in every country, typical factors that are considered include, for example, the associated financial loss and suffering of different risks. To start the prioritisation process, a disaster risk assessment is typically a suitable first step.
- **Ensuring alignment.** Well-aligned DRF initiatives are designed so that they do not duplicate impact unintentionally. For example, the targeting of two initiatives may not be well aligned so that they end up duplicating funding to some people, whilst missing out others entirely. This can be caused by a lack of planning leading to inefficiencies.
- **Ensuring complementarity.** DRF instruments should also be designed to support each other. For example, response financing instruments should not discourage investments in risk reduction—they should incentivise them. Likewise, public investments in risk reduction should not provide a false sense of security—they should incentivise people, firms, and communities to properly prepare themselves too. And given that many initiatives will use similar systems—for targeting or delivery for example—they should explore pooling resources to exploit economies of scale.
- **Ensuring integration with long-term planning and policies.** It typically takes a long time for DRF initiatives to develop their full potential. Including them in long-term planning and policies can support their durability and enable them to mature to a point where they are fully effective. Besides, DRF can touch on many policy areas beyond disaster risk management, such as climate change, agricultural development, economic development, and poverty alleviation. Policy plans for these areas should explicitly consider DRF instruments where they are relevant, to ensure full utilisation of their benefits.

Figure 1: Framework for strategic DRF



Source: Author

HOW IS THIS USUALLY TACKLED?

In most countries, DRF instruments are not designed with these principles in mind. Instead, they are often developed in isolation, resulting in poor alignment (Box 1).

Box 1: Overlapping drought response financing instruments in Kenya's arid and semi-arid lands

Kenya's arid and semi-arid lands (ASALs) are home to nomadic pastoralist communities, which are among the poorest in the country. The ASALs are affected by recurrent severe droughts, which cause pasture lands to dry out and animals to die—a catastrophe for pastoralists whose livelihoods are intricately linked with the wellbeing of their animals.

Various index-based shock-responsive initiatives have sprung up to provide financial drought protection to pastoralists. The **Hunger Safety Net Programme** (HSNP) is an unconditional cash transfer programme for the poorest. Since 2014, the HSNP has also provided payouts to drought-affected additional households through its existing delivery infrastructure. Payouts are triggered when a pre-defined threshold of the satellite-recorded Vegetation Condition Index (VCI) is reached. The **Kenya Livestock Insurance Programme** (KLIP, since 2015) and the **Index-Based Livestock Insurance** (IBLI, since 2010) likewise provide payouts to drought-affected households using an insurance-based approach. Their payouts are triggered by the Normalized Difference Vegetation Index (NDVI). Finally, the Government of Kenya purchased drought insurance cover from the **African Risk Capacity** (ARC) from 2014 to 2016 to provide emergency assistance to drought-affected households. There were no payouts but the trigger was an index comprising various data sources, including the Water Requirement Satisfaction Index (WRSI) and vulnerability data.

The initiatives seem to not operate 'strategically' in three important ways.

- There seems to be a possibility that beneficiaries could be double-targeted in the event of a drought. HSNP targets the poorest drought-affected households (Government of Kenya (GoK), 2016) and KLIP those owning at least five cattle (GoK, 2018a)—these criteria can overlap.
- There seems to be limited integration of operating systems—for example, KLIP and HSNP use different beneficiary registries and different payout delivery systems. Pooling them could unlock economies of scale. This is one key reason that the World Bank recommends that KLIP introduces an electronic beneficiary database as per the HSNP example (GoK, 2018a).
- The initiatives all use slightly different triggers, raising further questions around alignment and timing. All triggers aim to capture the occurrence of extreme drought but given the technical intricacies of their designs, some may activate in a given year while others might not. The reasons for these differences have not been articulated clearly.

Today, some lessons have been learned and improvements are underway. In 2018, the Kenyan National Treasury and Ministry of Planning adopted a national DRF strategy, providing an overarching framework for disaster response financing instruments (GoK, 2018b; GoK, 2019). Recognising the need to integrate better and to use a more area-specific index than the WRSI, ARC is considering piloting the use of VCI and NDVI triggers for the Northern Kenyan regions (ARC, 2018; GoK, 2020a). The national government, with support from donors, is advancing the development of a nationwide single registry of beneficiaries of social assistance programmes that integrates the targeting process of each of the drought-response initiatives (World Bank Group (WBG), 2019a)[1].

1 The single registry can be accessed at https://www.socialprotection.or.ke/single-registry.

It is lunch time in Farhiyo Mohamed's household. She came from Hiran region due to the prolonged drought and clan clashes over grazing land, Galgaduud region, Somalia.
Image: Hussein Dahir, Anisa/International Committee of the Red Cross

There are plenty of reasons why DRF instruments are not designed with a comprehensive outlook. Many are **practical**. For example, quantitative risk assessments—the natural starting point for designing any risk financing instrument—are often hampered by knowledge gaps. Decision makers may not know about such assessments or undervalue their benefits. Data needed for risk analytics may also not be available or of inferior quality. Besides, designing a financing plan for disaster risks is complex: many different stakeholders are required to provide input, support, and approval for it to be successful. The transactional cost to achieve this can be high, and policymakers and donors alike may opt to steer clear of a cumbersome planning process.

Some reasons are **political**. National policymakers or donors may have different objectives, so what is strategic for one, may not be strategic for another. For example, some donors may wish to advance financial protection against climate-related disasters rather than for health- or conflict-related disasters. Similarly, given the nature of election cycles, national policymakers may have an incentive to focus on frequently rather than rarely recurring events, although the impact of the latter may be much bigger. Meanwhile, donors may have an incentive to focus on the bigger, less frequent disasters that, if not well managed, may end up leading to large humanitarian appeals. These different objectives can lead to some risks being covered too little through risk financing instruments. Another political dimension relates to the role of international financial institutions. They often provide both the technical assistance on selecting the right financing instrument and subsequently offer the respective financing instrument itself, for example, a contingent line of credit or a sovereign insurance contract. Naturally, conflicts of interest may arise.

Finally, some reasons are also rooted in existing institutional **structures**. DRF is a multi-disciplinary field requiring inputs from specialists in the fields of finance, disaster risk management, climate, and social protection for example. However, country governments and donors alike tend to separate these fields into different line ministries or departments, hindering coordination across them. In addition, some donors continue to strictly separate their humanitarian and their development funding, which can lead to disagreements and funding shortfalls in the area of DRF, which touches on both sectors.

PRACTICAL GUIDANCE

This section offers some guidance for practitioners on each of the four strategic principles.

1. Prioritising risks

The question of which disaster risks should be addressed should be based on a clear prioritisation of risks. Key questions that policymakers should ask themselves include (WBG, 2014):

- Who do you want to protect?
- What do you want to protect them against?
- Who will pay and how?

Answers to these questions will vary in every context and depend on a range of factors, such as the impact of certain risks on certain population groups, the fiscal cost associated with them, or overarching political objectives. They should be tackled in a comprehensive process where all relevant stakeholders are consulted. The point is for policymakers to select the risks they would like to manage intentionally and strategically—and not choose them in a rush, subject to factors such as lack of information or recency bias.

As a baseline for decision-making, the first step is typically to prepare a quantitative disaster risk assessment. This uses probabilistic statistical techniques to analyse the likelihood of specific disasters occurring and the size of associated expected losses and costs. It also analyses the impact of disasters on vulnerable populations. Given the complexity of disaster risks, as well as frequent data gaps in many countries, technical specialists, including local experts, will be required to conduct such an assessment.[2] Methodological approaches are, for example, proposed by the UN Office for Disaster Risk Reduction (UNDRR) (2017) and by the Global Facility for Disaster Reduction and Recovery (GFDRR) (2014).

2. Ensuring alignment

DRF instruments should avoid unintended overlap with each other. Every instrument should pursue a specific purpose with its scope tailored according to the targeted risk, beneficiaries, and payout timing. Conceptually, if there is an instrument providing response funding to protect beneficiaries from a certain risk, there should not be other instruments providing protection to the same beneficiaries from the same risk, unless planners have concerns about reliability or needs are likely to exceed the level of support being provided by the instrument. However, overlap is common, as can be seen from the Kenya example in Box 1.

Avoiding overlap is hard. In-country authorities in many low-income and lower middle-income countries (LICs and LMICs) may struggle to lead the technical process of designing and aligning DRF instruments effectively. They may not have a full overview of existing initiatives, a strategic vision for a national DRF system, or the required analytical and operational capacity. They will often benefit from support and lessons from other countries that have tackled similar challenges. Meanwhile, donors, often providing the first push and start-up financing for new DRF initiatives, often rely on exactly that—leadership by in-country authorities. This can create a vacuum and ultimately lead to the adoption of poorly aligned financing instruments. The situation can be made worse by donor competition for thought leadership, logistical challenges, and pressure exerted by donors on governments to adopt certain instruments—all rendering an effective collaboration among stakeholders more difficult.

To remedy challenges of overlap, countries should ideally adopt national DRF strategies that indicate which disaster risks exist in a given country and how these risks are intended to be counteracted financially (see Box 2). As a minimum solution, policymakers and partners working on new DRF initiatives should be diligent in reaching out to all other initiatives working in the same risk context in a given country. New initiatives should be planned from the start in unison with other stakeholders active in the space.

2 For example, the World Bank prepared disaster risk country profiles for a series of low-income and lower middle-income countries (LICs and LMICs), available here: https://www.gfdrr.org/en/disaster-risk-country-profiles

Box 2: Steps to developing a DRF strategy

A national DRF strategy aims to define how disaster risks are paid for from a national perspective. Different approaches have been proposed to develop such strategies, including by the World Bank, the Organisation for Economic Co-operation and Development (OECD), Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), and the Asian Development Bank (ADB) (WBG, 2014; OECD, 2017; Meenan *et al.*, 2019; ADB, 2020).

Building on these, the following steps emerge for developing a DRF strategy:

- **Quantify risk.** Risk should be quantified by conducting a disaster risk assessment that assesses the probability of different disaster risks occurring, the size of associated losses and costs, and the impact on vulnerable populations.
- **Understand the status quo of disaster risk finance.** To enable financial coverage of all targeted disaster risks, it is equally key to understand both the contingent liabilities of the government or donors in case of a disaster, and the already existing landscape of instruments. To determine these for response financing, WBG and ADB have developed a useful methodology to conduct a 'disaster risk financing diagnostic' (WBG and ADB, 2017). A comprehensive approach should also include the status quo of financing for disaster risk prevention and preparedness building. Only by mapping out clearly what risks are covered and what are not, financial planners can implement initiatives that will close the gaps.
- **Prioritise disaster risks and political objectives.** Fiscal resources are limited, requiring financial planners to prioritise. The disaster risk assessment provides a baseline for understanding the most important risks in terms of cost and type of people affected. In addition, policymakers need to prioritise their political objectives. There are likely to be different views about who to protect, what to protect them against, and how protection will be delivered. In addition, beyond the protection from disaster impacts, different DRF instruments can also support efforts in other policy areas such as combating climate change or supporting agricultural development. A successful prioritisation process of political objectives requires the involvement of a great deal of stakeholders, ranging from the finance ministry, other national and possibly regional line ministries, government agencies, and poor and vulnerable people. Civil society as well as humanitarian and development partners should be included as well, as they will often have a role to play in the resulting financing framework and may serve as a voice for others not represented in the discussions (Start Network, 2019).
- **Determine which disaster risks to reduce, retain, and transfer.** Financial planners need to decide which risks are best tackled via which disaster risk management measures. In other words, they need to decide which risks to tackle via risk reduction activities (i.e. prevention, preparedness building) and which ones via risk retention or transfer activities (i.e. response financing). These are tricky decisions that will depend on many different factors, including the feasibility of risk reduction activities, expected benefits and opportunity costs, and inter-dependencies between the different risk management activities.
- **Select appropriate instruments.** A comprehensive approach to DRF will ensure that appropriate financing instruments are used for all targeted risks. At the most basic level, this means that any financing is pre-arranged for the selected disaster prevention, preparedness building, and response efforts. Beyond that, selected instruments need to account for the institutional context. DRF instruments supported by donors in LICs and LMICs are not always suited to the country context. For example, insurance-based instruments and other derivatives, such as catastrophe bonds, are complex programmes requiring a high level of political commitment, technical capacity, and financial infrastructure—these may not always be present in partner countries. Finally, financial planners should also place great emphasis on ensuring the adoption of high instrument quality standards.[3]

3 As per previous guidance notes produced by the Centre for Disaster Protection. For the slightly broader crisis financing context, also consider the 'gold standard' proposed by Poole *et al.* (2020).

3. Ensuring complementarity

DRF instruments should strengthen one another. This is often not the case as they are designed in isolation. One key concern is the relationship between financing for disaster response and financing for disaster prevention/preparedness building. There are many interdependencies. On the one hand, they can strengthen each other: for example, the more that disaster risks can be prevented or prepared for, the less response financing will be needed. Lowering disaster risks also makes risk transfer instruments such as insurance more affordable—thus, in theory, both clients and providers of risk transfer products should have an interest in activities for risk reduction and preparedness building.

On the other hand, if not structured appropriately, financing for response can also discourage prevention and preparedness activities (Hillier, 2018). Many publicly subsidised response financing schemes provide funding without strings attached. As a result, beneficiaries are not incentivised to invest in prevention and preparedness as they are covered anyway when a disaster strikes. Even worse, recipients may actively engage in risky behaviour in order to become or remain eligible for subsidies. For example, in Mexico, a subsidised crop insurance programme for poor farmers in non-irrigated areas in fact lowered investments in irrigation because farmers strove to remain eligible (Fuchs and Wolff, 2011). Similarly, houses in the United States continue to be constructed in flood-prone areas in part because the publicly subsidised US National Flood Insurance Programme (NFIP) provides protection (Hill and Martinez-Diaz, 2020).

There are ways in which financial planners can ensure that disaster response financing instruments encourage prevention and preparedness rather than vice versa. Four can be identified (Poole *et al.*, 2020):

1. **Include conditions.** Publicly-financed response financing instruments can be structured so that they require prevention or preparedness measures to be implemented. For example, when uninsured public assets are hit by a disaster in Mexico, the national disaster fund FONDEN funds 100% of reconstruction costs the first time, but only 50% when they are hit the second time, and nothing thereafter. Thereby, the fund encourages the adoption of more disaster-resilient building standards (WBG, 2012). Another example is the African Risk Capacity (ARC), which requires any insured country to draft a peer-reviewed emergency contingency plan according to which insurance payouts must be spent. The plan must be approved before the insurance contract can be concluded (ARC, 2020a).
2. **Calibrate payment terms to promote prevention and preparedness.** Funders of contingent disaster responses have an interest in lowering the risk of disasters. This is the same as in any risk setting, not only for disasters: for example, health insurance companies, expecting lower overall expenditures, may offer rebates for policyholders signing up to a sports club or having regular health checkups. Similar schemes should be developed for disaster settings with insurers or public funders supporting schemes that incentivise beneficiaries to take proactive disaster prevention and reduction measures.
3. **Provide financing early.** Disaster financing schemes can also be structured to provide funding during the early stages of a disaster or even before it occurs using forecasts. In this way, preparedness building measures can still be supported to enable responders to act effectively. This is, for example, the idea behind Forecast-based Action (FbA)—an initiative of the International Federation of the Red Cross Red Crescent Societies (IFRC) Disaster Relief Emergency Fund (DREF). In essence a centrally-held reserve fund disbursing disaster aid to national Red Cross Red Crescent societies based on disaster forecasts, the scheme provides early funding to national societies to prepare disaster relief measures (IFRC, 2020).
4. **Combine contingent financing for response with complementary prevention and preparedness measures.** This is what many national disaster funds around the world do already—providing both disaster response funding and supporting DRR and preparedness building. However, this can often be done in a more targeted fashion, specifically supporting activities that reinforce each other. For example, the World Bank-supported Pacific Catastrophe Risk Assessment and Financing Initiative (PCRAFI)—a regional risk pool that provides sovereign insurance against natural disasters to Pacific Island states—is closely integrated with the Pacific Resilience Program, strengthening related risk reduction measures including early warning and resilient construction (WBG, 2017c). Another example is the UN World Food Programme's (WFP) R4 Rural Resilience Initiative, which combines crop insurance for poor farmers with agricultural risk reduction measures and support to building improved risk management practices (WFP, 2019).

Besides strengthening each other, DRF instruments should make use of opportunities for collaboration. Different instruments will often face the same resource needs, for example, in terms of data or delivery channels to beneficiaries. Ensuring that instruments in such cases use the same systems can create economies of scale and mainstream technical methods. In some cases, disaster data is used for various purposes – for example, in Uganda, data from humanitarian needs assessments typically used for traditional humanitarian responses serve as a backup trigger for early payouts to drought-affected pastoralists (Maher and Poulter, 2018). Another example concerns the identification of beneficiaries in Kenya, which is now increasingly being pooled and streamlined across instruments (see Box 2). However, there is much unused potential for synergies across instruments that governments and donors should explore.

4. Ensuring integration in long-term planning and policies

It often takes time for DRF instruments to develop their full potential. For example, if a government purchases an insurance policy for an extreme disaster risk, by the very nature of that risk it may take some time for the risk to occur and therefore for the insurance pay out. Meanwhile, premium payments are due regardless. Given factors such as recency bias, fiscal pressures, and elections cycles, governments may, however, not always commit to DRF solutions for the longer term if no immediate returns are received (Clarke and Dercon, 2016).

To maximise the potential impact of DRF initiatives, it is useful to integrate them in longer-term planning and policy frameworks. One way is for the legal and budget framework to provide for regularly needed financial allocations. For example, by law, the Government of Mexico must allocate no less than 0.4% of its annual budget to its disaster fund FONDEN and the related funds FOPREDEN and CADENA (WBG, 2012). Similarly, the Government of Mozambique recently established a national disaster management fund which is expected to receive no less than 0.1% of the national budget every year (WBG, 2019d). Other ways to provide for more long-term planning on DRF can include the adoption of a DRF strategy, the inclusion of DRF in the national disaster risk management framework, or sensitisation and capacity building measures on the benefits of the DRF instrument among decision makers.

DRF instruments can serve many policy objectives beyond just enabling protection from disaster impacts: by reducing the severity or the length of the financial impact of disasters, they can contribute significantly to countries' growth and poverty goals. For example, using pre-committed financing in order to scale up unconditional cash transfer programmes to disaster-affected households can support the poorest to emerge from poverty (see Box 3). By reducing agricultural production risk, risk financing solutions such as agricultural insurance can help to attract lending to the sector, thereby helping agricultural and economic development plans. This was, for example, one of the key motivations for launching the Kenya comprehensive Crop Insurance Program in 2015, which today insures more than 400,000 crop farmers (GoK, 2020b; WBG, 2016). By lowering the fiscal burden on the government in the face of natural disasters, DRF instruments can also help achieve public financial management goals—again, another key motivation behind the Kenya comprehensive Crop Insurance Program.

Adamawa State, near the capital city of Yola, Wuro Dadi village. Fishing and farming are the main occupations in Wuro Dadi, Nigeria.
Image: Baiye, Adavize/ International Committee of the Red Cross

Box 3: Using DRF to support poverty reduction in Niger

Niger, one of the poorest countries in the world, is severely affected by drought. Major drought shocks occur once every three years. With approximately 80% of the population engaged in agriculture, most of whom depend on rainfall as subsistence farmers, this leads to frequent shocks to the economy and food security. In non-drought years, about 20% of the population already fail to meet their food needs; in drought years, this figure rises to 30%. Between 1984 and 2010, Niger experienced eight years of negative economic growth—drought was largely responsible for six of them (WBG, 2013).

Since 2011, the Government of Niger has implemented an unconditional cash transfer programme with support from the World Bank. Today, it provides regular cash transfers to 50,000 of the poorest households in the country. In 2019, the government started to pilot a drought-response pilot programme based on the cash transfer programme. The rainfall-based WRSI estimates millet yield at the end of the agricultural season—when it falls below a pre-defined threshold, poor farmers in the affected area receive a rapid emergency pay-out via the cash transfer infrastructure. In this way, the objective is to lower the often devastating impacts of drought on the poorest and help them emerge from poverty (WBG, 2018; WBG, 2019c).

DRF instruments should be designed with initiatives in the other policy spaces they are meant to support in mind. They could complement existing initiatives. For example, agricultural insurance might supplement credit guarantee schemes for emerging farmers, or directly build on them, as in the Niger example (Box 3). Or they might be able to share resources such as data across responsible entities and initiatives, for example in the form of shared beneficiary registries as in the Kenya example (Box 1). In some cases, tools from DRF initiatives can be put to direct use in other areas. For example, the African Risk Capacity (ARC) encourages its member states to use Africa RiskView, the model software underlying its sovereign insurance programme, also for disaster early warning purposes (ARC, 2020b).

The multitude of potential uses of DRF should also be recognised in the relevant policy frameworks of the country. Many countries do not include existing DRF instruments in national policies at all, or only in a dedicated strategy document or a disaster risk management plan. Integrating DRF instruments in the broader spectrum of national policies will help facilitate better alignment, bring about greater national ownership and sustainability, and ensure that the instruments benefit from the inputs of all concerned stakeholders.

Sool region, Godqaboobe village, camp of displaced people. A displaced family outside their home in the drought-hit region, Somalia. Image: Yazdi, Pedram/International Committee of the Red Cross

TOOLS AND RESOURCES

When designing DRF instruments, the following questions may help governments and partners to ensure they contribute to a comprehensive DRF approach:

Instrument design: Prioritising risks

✔ Has there been a systematic decision-making process for prioritising the selected risk, supported by a disaster risk assessment? Have all relevant stakeholders been involved in the prioritisation process?

✔ Does the instrument provide financing for a disaster risk that was previously uncovered, i.e. does it cover a gap?

Instrument design: Ensuring alignment

✔ Have potential areas of overlap with other instruments been identified, for example, with respect to the targeted disaster risks or beneficiaries? Has a framework been adopted to ensure that instruments are aligned? How else is this overlap being mitigated?

Instrument design: Ensuring complementarity

✔ What are the potential effects of the envisaged instrument on other DRF instruments? If any potential negative effects were identified, how are they being mitigated? How might a response financing instrument be designed to actively encourage disaster prevention and preparedness building?

✔ Does the instrument share design elements with other DRF or other initiatives? Have duplications of effort been avoided and economies of scale been exploited?

Instrument design: Ensuring integration in long-term planning and policies

✔ Has the DRF instrument been included in a longer-term planning framework, for example, budget plans or a DRF strategy? How else is its longer-term inclusion in government policy being ensured?

✔ Have other policy agendas been identified that might benefit from or be affected by the DRF instrument? Have all relevant government stakeholders been consulted? Has the instrument been integrated in respective planning processes and policy frameworks?

Further resources on strategic DRF

- Existing frameworks for designing overarching national DRF strategies include WBG (2014), OECD (2017), Meenan *et al.* (2019), and ADB (2020).
- Further reflections on adopting frameworks to humanitarian settings are provided by Harris and Jaime (2019).
- Methodological approaches to conducting disaster risk assessments include UNISDR (2017) and GFDRR (2014).
- A methodology for conducting a DRF diagnostic is provided by WBG and ADB (2017).

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Contact information

Centre for Disaster Protection
60 Cheapside
London
EC2V 6AX
United Kingdom

info@disasterprotection.org
CentreForDP
disasterprotection.org

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