ANNEX 1.A1

Framing Risk in the Public Sector

Different conceptions of government and risk

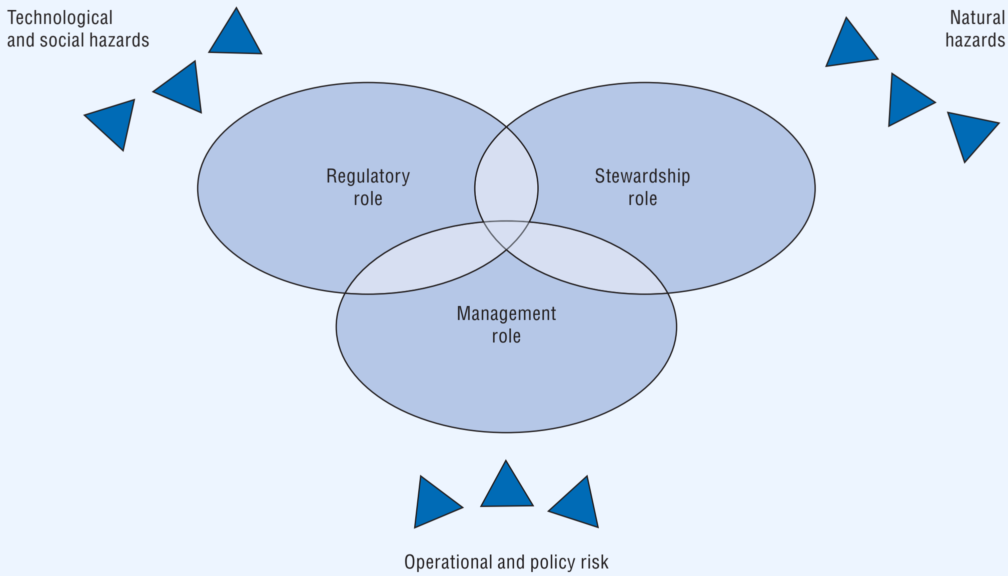
Because the reduction of risks is a pervasive part of government activity, the management of risks is a primary function embedded in the operations of capable governments. In practical terms, government action provides protection for citizens against myriad risks every day. However, this is clearly being done better for some risks (and in some countries) than for others. Meeting the challenges from new emerging risks is a constant source of pressure on government administrations that can result in reactive regulatory responses. The political consequences of failing to manage risks are significant. Elections can be won or lost on the public estimation of a government's capacity to manage particular risks, and the choices made at the administrative level about the treatment of risks are also under increasing scrutiny and pressure from interest groups, particularly when viewed retrospectively following a critical event. Governments can only benefit from a better understanding of how to assess, manage and communicate with the public about risks at both the political and the administrative level.

As the primary role of regulation is the reduction of risks an assessment of risk is a threshold issue for determining whether and how to regulate private activities. Risk is a key consideration in the selection among regulatory and non regulatory approaches, for guiding the assessment of costs and benefits of regulation to reduce the burden of regulation in its design and in developing models of enforcement and compliance. Risk assessment and risk management have an important place within regulatory quality management strategies and the better regulation policy agenda. The policy goal is to help integrate risk considerations in regulatory decision making to improve regulatory design and enforcement in order to reduce the economic and social costs of coping with risks.

Risk and public policy is obviously a broad topic with many dimensions; the objective of ameliorating risk underlies so much government activity, that inevitably there is overlap in any segmentation of the topic of risk in public policy. For clarity of the analysis some useful distinctions can be made. The UK Strategy Unit (2002)[1] identified that governments have three roles in handling risk and uncertainty: the regulatory role addressing potential technological and social hazards; a management role in relation to its own business operations and; a stewardship role to protect individuals, business and the environment from risks imposed from the outside.

Different conceptions of risk policy can be distinguished as follows: crisis management; the co-ordination and prioritisation by government of social risks, and; decisions on when and how to regulate.[2] Crisis management can be described as including

Box 1.A1.1. **Risk and the role of government**



Source: UK Strategy Unit, 2002.

the issues encountered by governments in preparing for and responding to large-scale incidents such as natural disasters. The second characterisation, the co-ordination of risk responses from the centre of government, covers multiple priorities and approaches, including internal risks and policy risks. The final issue concerns risk as a threshold issue for the consideration of whether and how to structure government intervention in private sector activities. For the purpose of identifying different implications for risk policy each of the above areas are briefly outlined as follows:

- Risk and crisis: Government has a stewardship role to reduce those risks to the public from natural disasters, threats to national security, disease and widespread systemic risks. Clearly there is some potential overlap with the regulatory role, although how governments organise their broad stewardship role cannot be allocated straightforwardly to any individual or agency. From a policy perspective governments must have strategies to identify risks, to respond to public perceptions about emerging risks and to make decisions about what level in society those risks may be best managed. Various strategies are employed, including pooling risks that individuals cannot address by themselves (for example third party motor insurance) and applying arrangements to protect critical networks.
- Risks to government: As a whole and within individual business units, governments have a role in identifying and addressing internal management risks. These risks relate to the potential failure to achieve policy and operational goals. They have impacts on the budget and the achievement of service delivery objectives. This is addressed by governance arrangements, accountability measures and other public management strategies. It can involve identifying and managing risk-risk tradeoffs, where the activities of one part of government increase the risks for another.
- Risk and regulation: As the primary role of regulation is the amelioration of risks, an assessment of risk is a threshold issue for determining whether and how to regulate

private activities. Risk is a key consideration in the selection among regulatory and non regulatory approaches, for guiding the assessment of costs and benefits of regulation to reduce the burden of regulation in its design and in developing models of enforcement and compliance. Risk assessment and risk management have an important place within regulatory quality management strategies and the better regulation policy agenda. The policy goal here is to help integrate risk considerations in regulatory decision making to reduce the economic and social costs of coping with risks.

These roles each present co-ordination and governance challenges. For example, regulatory practices have to be responsive to the nature of external risks, and government's management role has to deliver the capacity to enforce regulatory compliance. Government organisations need to be able to identify and communicate risks where they have wider effects than can be handled by a single agency and may impact on other agencies or the wider concerns of the country or state. This is particularly the case where there is a policy goal that requires co-ordination by more than one agency and may require a regime or system of responses rather than a single regulation or the actions of a single regulator.

Box 1.A1.2. **Categorising state sector risks**

In the Government of the state of Victoria, Australia, the Auditor General has identified a number of categories of state sector risk where risks may be joint or multiple, affect only one agency, a number of agencies, or impact at a whole-of-government level. Risks that have impacts that go beyond the interests of one agency require a systemic approach:

- Agency level risk: these can become risks to the state because of their size and significance, because of the wider impact of measures to manage them, or because of poor management by agencies.
- Inter agency risk: if unmitigated by one agency become risks for other agencies; and
- Statewide risks: are beyond the boundaries of any one agency and call for a response across agencies co-ordinated by a central agency.

Source: Auditor General's Office (AGO), Victoria Australia, *Managing Risk across the Public Sector: Good Practice Guide 2004*, p. 2.

In some cases there will be overlapping spheres of the regulatory, stewardship and management roles of government. Each of the above areas may also involve the same actors and processes (including Ministers, and risk management practices) in pursuit of different aims. Furthermore, the general techniques of risk assessment, management and communication have common elements that are influenced by the scientific knowledge and by the adaptation of the application of private sector risk management practices.

Risk policy in a broader context

Effective risk policy needs to go well beyond the generic elements of risk assessment and management. Equally important to the policy-making process are co-ordinating public and private responses to risk, the interdependent nature of risk, and strengthening and global responses to risk. As illustrated in the following box which draws on the work of the OECD, *Emerging Risks in the 21st Century* (2003), in many cases the role of the government in protecting society from risks is linked inextricably with the proper functioning of the private sector.

Box 1.A1.3. **Co-ordinating public and private responses to risk**

Over the last 20 years, the interface between the public sector and the market has shifted dramatically. For instance, in a majority of OECD countries, critical infrastructures – electricity grids and telecoms – have been privatised and are in private hands. Likewise, key public services – health care and pensions – have moved away from the exclusive domain of the public sector and are being provided by the market. Given this shift, a major challenge for public authorities is to define, apply and enforce appropriate regulations which shift a greater share of risk management to the private sector.

Such efforts would seem to stand a better chance of success when they benefit from high-level political backing, or indeed are initiated by political leadership.[1] This idea is clearly supported by the more widespread trend of the need for high-level support for regulatory reforms.

One way to structure such a partnership is to have government standards and regulations coupled with third party inspections and insurance to enforce these measures. Insurers can require – at least as a minimum condition for providing coverage – that safety rules and regulations are respected. By doing so, they benefit from the scale economies of a common system of norms and standards. In turn, regulatory authorities can rely on the insurance sector for enforcement. For example, insurance companies and other financial institutions could play a major role in the implementation and enforcement of norms such as building codes. Insurance coverage or mortgages could be made conditional on inspection, certification and, when necessary, the adoption of loss mitigation measures.

Another form of co-operation is to create funds financed jointly by the private sector and the government with the aim of promoting risk prevention in specific areas or industries.[2] Such funds could improve the handling of industrial risk in inhabited areas by assisting industries in their efforts to reduce risk and by furnishing the means to purchase threatened properties.

Another example is provided by the impact of certification on the implementation of safety measures in corporations. Such public/private co-operation can be an effective risk management tool, complemented when needed by liability law. For instance, an injurer can be held liable for damage even while complying with safety norms if the optimal level of care cannot be imposed through norms.

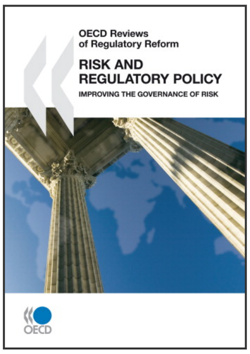
At the core of such public/private partnership is the need to get the incentives right, in particular by internalising to the extent possible the costs of risk-generating activities. Public/private co-operation can also aim at creating positive-sum solutions with regard to risk prevention.[3]

1. The United States is a case in point. In response to the findings of a presidential commission, a Presidential Decision Directive (PDD63) on "Protecting America's Critical Infrastructures" was issued in 1998, launching a major interagency initiative.
2. Such a scheme was suggested by the French Parliament after the Grande Paroisse chemical plant accident in 2001.
3. The Turkish Catastrophic Insurance Pool (TCIP), created after Turkey's 1999 earthquake disaster, illustrates how the combination of legislative measures (making insurance compulsory), public service (providing insurance up to a ceiling) and market forces (complementary insurance, reinsurance of the pool, possibly issuance of catastrophe bonds) can create the appropriate mix of regulation and incentive to better address risks. It is expected that the TCIP will help significantly improve enforcement of building codes and both prevention and coverage of earthquake risks in Turkey.

Source: OECD (2003), *Emerging Risks in the 21st Century*.

Notes

1. UK Government (2002), UK Strategy Unit, *Risk: Improving Governments Capability to Handle Risk and Uncertainty*, November, *www.strategy.gov.uk*.
2. This was also raised in a paper by the Secretariat to the working party on Regulatory Management and Reform GOV/PGC/REG(2007)12. A fourth dimension which has not been discussed here is the perception of political risk which in a more sophisticated assessment might be seen to overlay each of the three spheres.



From:

Risk and Regulatory Policy

Improving the Governance of Risk

Access the complete publication at:

https://doi.org/10.1787/9789264082939-en

Please cite this chapter as:

OECD (2010), “Annex 1.A1: Framing Risk in the Public Sector”, in *Risk and Regulatory Policy: Improving the Governance of Risk*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/9789264082939-4-en