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Fostering Good Practices in Disaster Risk Management for More Resilient Economies and Public Finance Frameworks

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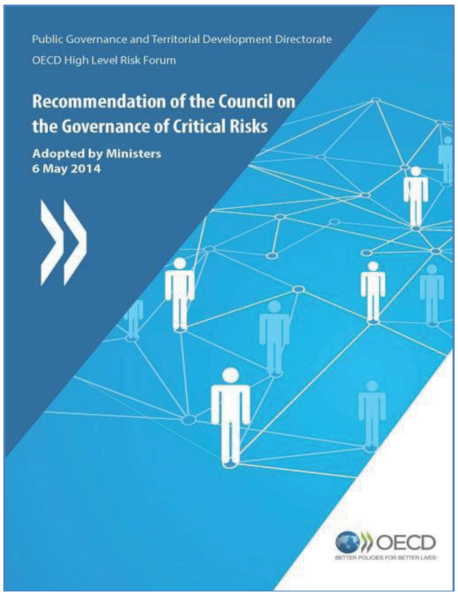
FOSTERING GOOD PRACTICES IN DISASTER RISK MANAGEMENT FOR MORE RESILIENT ECONOMIES AND PUBLIC FINANCE FRAMEWORKS



In order to establish efficient and forward looking Disaster Risk Management Systems, APEC Economies, may consider some of the following principles outlined in the OECD Recommendation on the Governance of Critical Risks that was adopted by OECD Ministers on 6 May 2014, including also the adherence of a number of OECD non-members, such as Colombia, Costa Rica, Latvia Morocco, and Tunisia.

In particular, APEC Economies may think further about raising awareness of critical risks to mobilise households, businesses and international stakeholders and foster investment in risk prevention and mitigation.

It is of vital importance to **preserve the functioning of major critical infrastructures**, and **in particular to mobilise households, businesses and international stakeholders and foster investment in risk prevention and mitigation** and to strengthen the mix of structural protection and non-structural measures to reduce critical risks through:

- ✓ *the reinforcement of investment in prevention and mitigation efforts that limit the exposure of persons and core services to known hazards and reduce their vulnerability;*
- ✓ *strategic planning to build safer and more sustainable communities, paying attention to the design of critical infrastructure networks (e.g. energy, transportation, telecommunications and information systems). This strategic planning should be coordinated with urban planning and territorial management policies to reduce the concentration of people and assets in areas where known exposures have increased over time;*
- ✓ *robust surveillance, monitoring and alert networks should be used to reduce critical risks associated with malicious attacks and threats to public health;*
- ✓ *the development of fiscal and regulatory options to promote reserve capacity, diversification or back- up systems to reduce the risk of breakdowns and prolonged periods of disruption in critical infrastructure systems;*
- ✓ *the incorporation of risk management decisions, safety and security standards in national and local regulations for land use, building codes and the design, development and operations of critical infrastructure;*
- ✓ *the use of cost/ benefit analyses conducted to maximise the cost- effectiveness of public and private investments that reduce the exposure of housing and commercial facilities.*

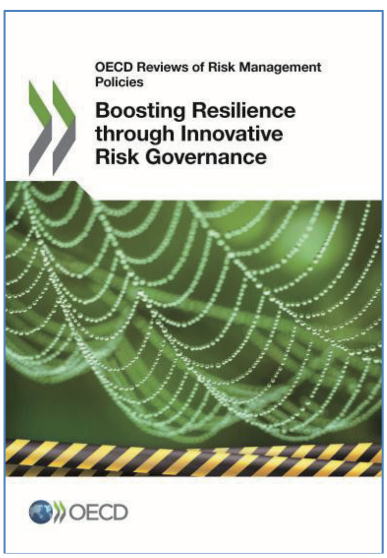
From a public finance perspective, it is also important to **build resilient public finances**, and in particular **to plan for contingent liabilities within clear public finance frameworks by enhancing efforts to minimise the impact that critical risks may have on public finances** and the fiscal position of an economy in order to support greater resilience. This could be done by:

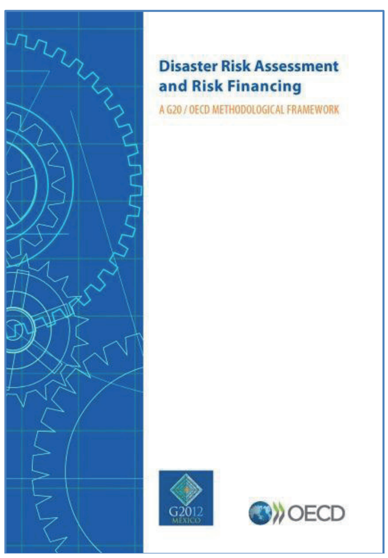
- ✓ *developing rules for compensating losses that are clearly spelled out at all levels in advance of emergencies to the extent that this is feasible to achieve cost effective compensation mechanisms;*
- ✓ *taking into account the distribution of potential losses among households, businesses and insurers, and encourage policies whereby all actors take responsibility within the context of their resources. In economies or areas that are known to be highly exposed or vulnerable to extreme events, cost-effective compensation should consider a mix of pre-funding mechanisms and clear and agreed public finance rules before a crisis occurs. The mix of mechanisms should include market-based mechanisms that enable households and businesses to transfer financial risks to insurance and capital markets;*
- ✓ *establishing mechanisms for estimating, accounting and disclosing contingent liabilities associated with losses to critical sectors in the context of national budgets;*
- ✓ *adopting broad frameworks for assessing risk-related expenditures. These frameworks should record, to the extent that this is feasible, the expenses at national and local level.*

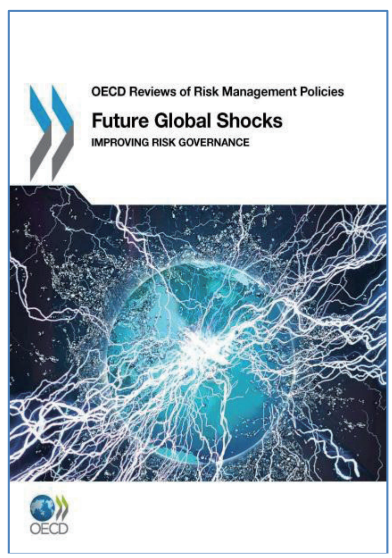
APEC Economies interested in these good practices are more than welcome to adhere to the OECD Recommendation which was developed through the OECD High Level Risk Forum. The OECD High Level Risk Forum will be working to develop a Policy Toolkit to facilitate the implementation of the recommendation through inclusive dialogue with a range of interested stakeholders and economies.

In particular, the OECD has also explored in more depth in this respect the policies that can help to manage risk related contingent liabilities in public finance frameworks through a **recent good practice report**.

Featured Publications







For more information, please visit: http://www.oecd.org/gov/risk/recommendation-on-governance-of-critical-risks.htm.

Good Practice Report:

The Case for Managing Risk Related Contingent Liabilities in Public Finance Frameworks

Fiscal risks and contingent budgetary liabilities may arise as a result of implicit or explicit commitments from governments to provide relief and or services (be they public

goods, private goods, mixed goods, or merit goods) in response to disasters. The goal is to discuss the ways in which policy framework can be adapted so that these contingent liabilities can be best managed, while also taking advantage of the possibilities offered by insurance. In the aftermath of disasters, governments and the most senior levels of governments are being held accountable for the public policy response and the ways in which relief is being brought. Strengthening governments' financial preparedness is therefore also a crucial point which has implications for public finances and public policy.

As often governments are seen as guarantors of last resort, and also as the guardian of the public interest, they are often called upon in the aftermath of a disaster, with responsibilities which in practice they most of the time are not in a position to shy away from. This report discusses some of the advantages and disadvantages of two broad types of financing arrangements that represent classes of instruments that governments can use to fund the costs associated with the financial costs of disasters:

- ✓ ***Ex-post*** financing arrangements include domestic and/or foreign borrowing as well as *ad-hoc* tax increases or spending reductions in other areas.
- ✓ ***Ex-ante*** financing arrangements include reserve funds (funded by tax increases and/or spending reductions), contingent spending arrangements, contingent debt facilities, and private and public insurance (including catastrophe bonds or other catastrophe linked securities and financial derivatives), as well as re-insurance with international firms.

Whilst ex-post arrangements have tended to dominate most government approaches to financing the costs of disasters, governments may find it increasingly useful to avoid disruption of longer term

economic growth and fiscal balance objectives through fiscal strategies that help smooth fiscal shocks. The existence of explicit or implicit borrowing limits - or of rapidly rising but finite borrowing costs – may introduce a form of risk aversion into government budgeting. In other words, there may be an inherent value to government in reducing fiscal volatility: for two paths of revenue and spending, both of which have the same expected outcome, a risk averse government may prefer the stream that is less volatile.

The challenges that government face to strengthen their financial resilience to such disasters that were identified by the report include the need to:

I. Clarify Objectives

II. Recognize All Disaster-Related Contingent Liabilities in National Budget Documents and Make them Fully Transparent

III. Determine the Government's Degree of Prudence and Risk Aversion

IV. Where Possible, Determine the Magnitude and Probability of Contingent Liabilities

V. Be Mindful of Correlation Structure of Risks

VI. Discount Risky Revenue Streams Appropriately

VII. Carefully Assess the Costs and Benefits of Appropriately Structured Reserve Funds

VIII. Carefully Assess the Interaction between Ex-Ante and Ex-post Funding Mechanisms and Moral Hazard

IX. Clarify rules ex ante for government funding mechanisms

X. Look for Alternative Ways Recouping Disaster-Related Costs

XI. Where Disaster-Related Risks are Quantifiable, Assess the Costs and Benefits of a Variety of More Formal Risk Assessment Approaches

XII. Where Disaster Related Risks are not Quantifiable, Assess the Costs and Benefits of a "Traffic Light" Approach

XIII. Engage in Stress Testing Exercises