Risk of What?

*Using ERM to Consider National Interests*

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Purpose: Introduce a New Model

1. Demonstrate need to reflect on National Interests (NI)
2. Develop a way to conceive of NI as Resources, broadly defined
3. Consider how “Effective Power” is related to NI, Resources and Risk
4. Encourage application of ERM in further analyses
What is Enterprise Risk Management (ERM)?

• **COSO on ERM:** “A process, effected by an entity’s board of directors, management and other personnel, applied in *strategy setting* and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the *achievement of entity objectives.*”

• **ISO 31000 on Risk Management:** “A key feature of this International Standard is the inclusion of *establishing the context*” as an activity at the start of this generic risk management process.” This involves external as well as internal contexts.
**ERK will be used in U.S. Government**

**Obama Administration:** Priority Performance Goals
- Three to Eight Goals Per Agency
- **Cross-cutting Goals**
  Such as: manage climate change, homelessness, national security

**Bush Administration:** Performance Improvement Officers
Performance Assessment Rating Tool (PART)

**Clinton Administration:** Government Performance and Results Act (GPRA)

“Lens of risk” will be applied – Jeffrey Zients, Chief Performance Officer

De facto National Interests?!
Past Attempts to Define Interests

  - Provided clear thinking
  - Recommended DHS
  - Predicted terror attacks
  - Identified education as national security issue

“Nothing of this magnitude can be accomplished without a president who doggedly stays with it for its implementation. Follow through, follow through, follow through!”

• Developing Countries: Lending institutions require development plans
• Some developed countries have explicit plans – mainly economic

Priorities = Anything for which the country “is willing to pay a price” to promote or maintain – Prof. Joseph S. Nye, Jr.
Benevolent Dictator’s Decision*

National Interest ~ Avoid being set back and attempt to gain more Resources

More Finite

Resources:
- **Land** = physical resources
- **Labor** = healthy, productive human resources
- **Capital** = intermediate goods of production, or rents
- **Technology** = To facilitate productivity gains = Allows better results
- **Management** = Entrepreneurship, Leadership, Organization, Governance = Actually gets better results
- **Other Intangibles** = Freedom, Prestige ~ Goodwill = Enables enjoyment of those results

Less Finite

EIU Quality of Life Measure ~ National Interests:

- Political stability and security, political freedom, gender equity material wellbeing
- Job security, Health
- Family and community life, climate and geography

* Need Benevolent Dictator for the model given Arrow’s Impossibility Theorem.
Benevolent Dictator’s Decision

National Interest ~ Maximize Resources but:

• Include time element
  – Some countries have longer horizons

• Include discount factor
  – To reflect time preference
  – To reflect uncertainty and volatility
  (i.e., poorer states value volatility more negatively)

These elements capture some National Interests:
  Security, Stability, Family (Value for Future Generations)
Benevolent Dictator’s Decision

National Interest ~ Avoid being set back and attempt to gain more Resources

More Finite

Resources with Time Horizon and Discount Factor:

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* Milieu applies from the local community to the international level.
Benevolent Dictator’s Decision

Maximize Interests = \( f \left( \sum_{t=0}^{n} \frac{\text{Resources}_t}{(1 + r)^t} \right) \)

Subject to: Expected Constraints on Resources
Where: \( t = \) time, \( n = \) periods of time, \( r = \) discount rate

Resources =
\[ g (\text{Land, Labor, Capital, Technology, Management, Other Intangibles}) \]

Thus interests are the resources and the conditions to ensure future resources.
What are the constraints?

- **Internal**
  - Limits of resources
  - Multi-attribute preferences, i.e., how interests and resources connect and their trade-offs

- **External**
  - Other states’ preferences
  - Competitive or complementary interests
Internal Context: National Interests’ Tradeoffs

<table>
<thead>
<tr>
<th>Tradeoff Example using “Other Intangible Resources”</th>
</tr>
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<tr>
<td>Land: Eminent domain? Productive use vs. Private rights</td>
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Country A’s Preference Curves’ Increasing Utility

Other Intangible Resources

... But need to take a multi-attribute portfolio approach.

Internal constraints: Total Land/Labor ...Intangibles Available
Enterprise Risk involves the possibility of being set back to a lower preference curve or not achieving an expected higher one.

External Context: Power Decides Range of Optimal Relations

Country A’s Preference Curves’ Increasing Utility

Country B’s Preference Curves’ Increasing Utility

Land, Labor, Capital, Technology, Management

Relative Power Along Contract Curve

Know Other’s National Interests: Status Quo vs. Revisionist States

Other Intangible Resources

Idealized illustration assumes A-B zero-sum relations.
ERM maximizing Interests, Resources and Power

Effective Power expends fewer Resources than it expects to increase or to prevent losing. More than traditional cost-benefit assessment, considers broader Resources, including ability to implement, time, uncertainty.
Identifying the risks: UK

National Risk Register: High Consequence Risks facing the United Kingdom

But not Enterprise Risk
Identifying the Risks: Microsoft

- Strategic
- Financial/Credit
- Reputational
- Technological
- Competitive
- Customer
- People
- Operations
- Distribution
- Business Partners
- Regulatory/legislative
- Political

Breaking outside the silos: Taking a portfolio approach to manage the risks and the risk management strategies for optimal risk/return across interests.
### Applying Enterprise Risk Management Frame: *Possible* Risks

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<tr>
<th>Risks</th>
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<td>Special interests’ domination</td>
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<td>Low int’l labor standards; drug policies</td>
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<td>Heavy reliance on foreign capital</td>
<td>Uneven int’l standards</td>
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<td><strong>Tech.</strong></td>
<td>Inability to fully leverage (e.g., access); cyber vulnerabilities</td>
<td>Poor acquisitions mgmt.</td>
<td>Diminishing ability to invest</td>
<td>Others catching up and moving ahead</td>
<td>Lack of pure science investment; security focus</td>
<td>Lack of int’l. Intellectual property rights</td>
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<td>Future generation tax; international inequities</td>
<td>Lack of civil society; domestic inequities</td>
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<td>Double standards</td>
<td>Allies’ expectations</td>
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## Applying Enterprise Risk Management

**Frame:** Possible Risks

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**Sample**

Many risks to national interests can be more deliberately assessed and managed.
One example: Broader first-step look at Mortality

National Interest = Health
Labor Risks = Annual Deaths U.S. (2.4 million)

- Own Doing, informed choice:
  - Tobacco-related = 435,000
  - Poor diet and inactivity = 365,000
  - Alcohol consumption = 85,000
  - Sexual behavior = 20,000

- Unintentional Doing:
  - Accidents: Total = 122,000, of which motor vehicle = 43,000 (no alcohol = 25,000)
  - Inefficient Healthcare = 22,000 deaths per year from lack of health insurance
  - Ineffective Healthcare = 100,000-200,000 deaths each year from preventable medical errors
  - Bad air quality = Lose five months from life

- Intentional Doing:
  - Suicide = 33,000; Homicide = 19,000

Although terror-related incidents are low, need to assess risks considering potential threats in a dynamic environment.

Consider not only direct loss of life but also QALYs (injuries, physical and mental health illness) and broader psycho-social impact - as well as effects on other classes of interests - over a given period of time.

Then pose the tradeoffs. Devise hurdle rate for likelihood of the threat?
4. ERM

Risk management principles can be applied to national interests

• Establish the goals: Within the national and international context
• Consider the risks: What can go wrong? How can it go wrong? How likely is it? What are the consequences? What are the uncertainties?
• Manage the risks: Are we understanding the full range of risks, solving the right problems and developing good alternatives?
  – Mitigate, transfer, accept, avoid, leverage parts of the risk
  – “Price” the alternatives more fully/accurately
  • Recognizing execution risks
  • Costing out actions for “effective power”

We speak now often only in in general terms and measure only simple costs:
  Afghanistan: “Vital Interests,” $30 Billion for surge alone
  Healthcare Bill: $848 B over 10 years
  What are the effects on Total Resources and National Interests?
Benefits of the Model

• Promotes articulation of tacit assumptions
• Encourages decision maker reflection on national interests, larger trade offs, and fuller risk identification
• Can be incorporated into Game Theory analysis of international relations
• Provides clear avenues for further research to support decision making

“The role of systematic theorizing…is to inject into the intellectual climate, in which hunches are made and have to be made, an element of considered thought, as advanced as the existing conditions of the discipline permit.”

- Political theorist Arnold Wolfers
Next Steps for Development

• Research and application by risk analysts
  – Interdisciplinary collaborations: with political scientists, political/welfare economists, etc.
  – Input from private sector

• Support from government/others?
  – U.S.: Project on National Security Reform, NSC & Gen. James Jones, CBO, GAO, OMB?
  – International: OECD, World Economic Forum?

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Appendix

A. Determining National Interests
B. Considering Risk, Power
C. Notes
Set the Context: What are the Entity’s Objectives?

Who we are:
• Individuals
• Families
• Organizations
• State
• Global Community

What we want:

“Even when one is inescapably seen – by oneself as well as by others – as French, or Jewish, or Brazilian, or African-American, or...as an Arab or as a Muslim, one still has to decide what exact importance to attach to that identity over the relevance of other categories to which one belongs.”


To avoid Arrow’s Paradox (impossible to convert individual preferences to a societal ranking), assume a Benevolent Dictator (e.g., BRAC system).
Indices of Well Being

Economist Intelligence Unit Quality of Life Index: Satisfaction-Related Factors

1. Ireland
2. Switzerland
3. Norway
4. Luxembourg
5. Sweden
6. Australia
7. Iceland
8. Italy
9. Denmark
10. Spain
11. Singapore
12. Finland
13. United States
14. Canada
15. New Zealand
16. Netherlands...
110. Haiti
111. Zimbabwe

Factors:
- Material wellbeing: GDP per person, at ppp in $
- Health: Life expectancy at birth, years
- Political stability and security: Ratings EIU
- Family life: Divorce rate
- Community life: Value 1 if country has either high rate of church attendance or trade-union membership; zero otherwise.
- Climate and geography: Latitude, to distinguish between warm/cold climes
- Job security: Unemployment rate
- Political freedom: Average of indices of political and civil liberties.
- Gender equality: Ratio of average male and female earnings


UN Human Development Index: Health, Knowledge, Standard of Living

1. Norway
2. Australia
3. Iceland
4. Canada
5. Ireland
6. Netherlands
7. Sweden
8. France
9. Switzerland
10. Japan
11. Luxembourg
12. Finland
13. United States
14. Austria
15. Spain
16. Denmark...
172. Mozambique
173. Guinea-Bissau
174. Burundi
175. Chad
176. Congo (DR)
177. Burkina Faso
178. Mali
179. Central African Republic
180. Sierra Leone
181. Afghanistan
182. Niger


A. Determining National Interests
Different States Perceive Different Roles

**US** = establish justice, insure domestic tranquility, provide for the common defense, promote the general welfare, and secure liberty to ourselves and our posterity

**France** = ensure the preservation of the natural and imprescriptible rights of man: liberty, property, security, and resistance to oppression

**Saudi Arabia** = protect the Islamic Creed, apply the Sharia, encourage good and discourage evil, and undertake duty regarding the Propagation of Islam
### Power Characteristics

<table>
<thead>
<tr>
<th>Types of Power</th>
<th>Power Levers</th>
<th>Sample Behaviors</th>
<th>Who Controls Resources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Harder</td>
<td>Extreme Force</td>
<td>Coerce: Deter/Compel</td>
<td>Government</td>
</tr>
<tr>
<td></td>
<td>Limited Force</td>
<td>Protect</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Economic Policies, Aid/Assistance, Trade, Bribes, Sanctions, Blockade</td>
<td>Act or Threaten/Promise an Action</td>
<td>Business, Groups, Government</td>
</tr>
<tr>
<td></td>
<td>Values, Culture, National Success, Institutions, Social Policies</td>
<td>Induce, Set the agenda for</td>
<td>Individuals, Business, Groups, Government</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Co-opt Attract</td>
<td></td>
</tr>
</tbody>
</table>

Note: Developed based on work of Joseph S. Nye, Jr., and Richard L. Armitage.
Notes to Slides

Slide 3
Committee of the Sponsoring Organizations of the Treadway Commission, Executive Summary, Enterprise Risk Management – Integrated Framework, September 2004,

Slide 4
Testimony of Statement of Jeffrey D. Zients Chief Performance Officer and Deputy Director for Management Office of Management and Budget Before the Budget Committee United States Senate October 29, 2009,

Slide 5

Slide 8
Political theorist Arnold Wolfers uses the terms possession goals and milieu goals. He limits milieu goals to “shaping conditions beyond…national boundaries” – and notes they often are “nothing but a means or a way station toward some possession goal.” This presentation considers milieu goals to be both internal and external state goals that can be goals in themselves. See: Arnold Wolfers, Discord and Collaboration: Essays on International Politics (Baltimore: Johns Hopkins Press, 1962), pp. 73-74.

Slide 14
U.K. Cabinet Office, National Risk Register, November 9, 2008,
Slide 15

Slide 18
Data are rounded to thousands.


Notes to Slides cont.

Slide 18 cont.
Extrapolating from a 2002 Institute of Medicine study that estimated 18,000 people died in the year 2000 because they lacked insurance, the Urban Institute estimated 22,000 died in 2006. See Stan Dorn, “Uninsured and Dying because of It: Updating the Institute of Medicine Analysis on the Impact of Uninsurance on Mortality” (Washington, D.C.: Urban Institute, January 8, 2008), http://www.urban.org/publications/411588.html. The underlying study included certain diseases and outcomes based on whether individuals were insured; although other factors such as poverty levels did not appear to be controlled, one could assume that lack of insurance was a correlation and not the only determinant of the negative outcomes. For the original study see Institute of Medicine, Care without Coverage: Too Little, Too Late (Washington, D.C.: National Academies Press, 2002), http://books.nap.edu/openbook.php?record_id=10367&page=165.

For soldier fatalities, see: http://icasualties.org/


Slide 20