MKI POLICY BRIEF

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THE RISE OF ECONOMIC SECURITY: DERISKING STRATEGIES AROUND THE WORLD

A GAZDASÁGI BIZTONSÁG NÖVELÉSE: KOCKÁZATMENTESÍTŐ STRATÉGIÁK A VILÁGBAN

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Summary: The term 'derisking' has become a geopolitical buzzword since Ursula von der Leyen first used it to distinguish the EU's future China-strategy from Washington's approach. The aim of this policy brief is to review the derisking strategies of major economic powerhouses being most affected by geopolitics-driven fragmentation and to draw conclusions that are relevant for the Hungarian foreign policy. China has a substantial track record of derisking policy and has used the means of limiting relations with the West before the other way around. Being the most comprehensive of all, the U.S. derisking strategy can only partly be seen as natural country-level risk management, as the policy obviously targets China. Recently the EU has become more sensitive to external dependencies, and this had an impact on the perception of any exposure to China as well. Due to corporate business interests, Japan and South Korea prefer a limited disengagement from China. India in the meantime sees Western de-risking strategies as an opportunity to attract investments and boost its own manufacturing sector. The pro-connectivity Hungarian foreign policy has to consider that managing risks arising from foreign economic relations is a legitimate and well-established activity at both corporate and country level, therefore it should advocate to keep derisking within reasonable limits and to avoid extensive decoupling of the Western and the Chinese economy.

Keywords: derisking, China, USA, EU, economic security

Összefoglalás: *A „derisking" kifejezés azóta vált geopolitikai varázsigévé, hogy Ursula von der Leyen először használta arra, hogy az EU Kína-stratégiáját megkülönböztesse Washingtonétól. Jelen elemzés célja, hogy áttekintse a geopolitikai ellentétek által leginkább érintett gazdasági hatalmak derisking stratégiáit, és hogy a magyar külpolitika számára releváns következtetéseket vonjon le. Kínában komoly múltja van a derisking politikának, Peking már jóval korábban alkalmazta a kapcsolatok korlátozásának eszközét a Nyugattal szemben, mint fordítva. Az amerikai derisking stratégia a legátfogóbb, és csak részben tekinthető természetes országszintű kockázatmenedzsmentnek, mivel az intézkedések jelentős része egyértelműen Kína ellen irányul. Az elmúlt időszakban az EU érzékenyebbé vált a külső függőségek iránt, ami a Kínával szembeni kitettségek megítélésére is hatással van. A vállalati érdekek miatt Japán és Dél-Korea csak korlátozottan határolná le gazdasági kapcsolatait Kínával. India mindeközben lehetőségként tekint a nyugati „derisking" stratégiákra, melyek révén külföldi befektetéseket vonzhat saját gyártóipari szektorába. A konnektivitást szorgalmazó magyar külpolitikának figyelembe kell vennie, hogy a külgazdasági kapcsolatokból eredő kockázatok kezelése megalapozott és legitim tevékenység állami és vállalati szinten egyaránt, ezért hazánknak célszerű azt képviselnie, hogy a derisking ésszerű keretek között maradjon, és ne eredményezze a nyugati és kínai gazdaság átfogó szétválását.*

Kulcsszavak: *derisking, Kína, USA, EU, gazdaságbiztonság*

Introduction

'Derisking' is a long-standing term in the world of finance. Its original meaning refers to the case when financial institutions terminate or limit their business relationships with certain customers deemed to be risky. Derisking is therefore a legitimate tool of corporate risk management, but risks characterize not only the operations of financial institutions and companies, but also the existence of countries. Therefore governments, like business leaders, are rightly taking steps to mitigate or eliminate them. The term has taken on a geopolitical content in recent times, specifically when Ursula von der Leyen first used the term in a speech on 30 March 2023 to distinguish the EU's future strategy towards China from Washington's approach, which was defined by experts as decoupling at that time. Since then, US leaders have also adopted the milder term 'derisking', for two main reasons. On the one hand, there is a growing view in Washington that a large-scale separation of the US and Chinese economies is neither desirable nor very possible, and on the other hand, derisking is a more digestible vision for businesses because it stems from corporate risk management strategy. However, Beijing sees no difference between derisking and decoupling, which Chinese leaders interpret as a play on words as both approaches are ultimately aimed at slowing China's development and preserving US global dominance.

To better understand the phenomenon, it is worth briefly reviewing what the derisking strategy means for the major economic powerhouses being most affected by geopolitics-driven fragmentation. On this basis, the analysis tries to draw conclusions that are relevant for the Hungarian foreign policy.

China: the 'master of derisking'

Based on the financial definition mentioned in the introduction, decoupling can be seen as a complete terminating of the business relationship and can be considered an extreme form of derisking. Indeed, there is no difference between the two approaches as regards the ultimate objective, and in this sense the Chinese argument quoted above is correct. However, it is not inevitable that derisking should go beyond a certain degree of limitation of the relationship and lead to a separation, and this is also true for the relations of the West and China.

The analysis should start with China itself, because while Beijing likes to portray itself as a victim, the facts show that China has a long history of derisking and has used the means of limiting or demarcating relations with the West before the other way around. As Jörg Wuttke, former president of the European Union Chamber of Commerce in China put it in an interview, "China is the master of derisking, and they have been teaching us for 15 years through their attempts to reduce their exposure to Europe and the US." One of the earliest examples of this was the keeping of US tech giants like Google, Facebook and Yahoo off the Chinese internet. The system, known as the "Great Firewall", has been in place since 1998 to isolate Chinese users from information and foreign technology platforms that do not serve the interests of the Chinese leadership or that they perceive as a risk to their own position of power. As a result, a relatively closed Chinese internet and its associated tech

ecosystem has emerged, which many refer to as the 'splinternet', or fragmented web. This relatively closed ecosystem can be equated with complete decoupling, or since it is not a matter of disconnecting an existing link, '*a priori* demarcation' is the most appropriate term. However, the point is the same: to limit or make impossible a relationship that is considered risky. The Made in China 2025 economic development strategy, published in 2015, also reflects a derisking approach. The document highlights in several places China's high dependence on foreign countries for advanced technologies, which is seen in the strategy as a problem (a risk, if you like) to be solved, and its priority is to significantly reduce this exposure by 2025. This objective is reflected in the latest Five-Year Plan 2021-2025, and although the document does not call for decoupling, it aims to eliminate dependence on foreign technologies and imports of raw materials as quickly as possible. The so-called negative lists, i.e. the restriction or outright ban on foreign FDI inflows in certain sectors, are another example of Beijing's longstanding use of the instrument of restricting economic ties when it sees risks in foreign linkages. And although the latest news is that the Chinese leadership will further relax regulations in this area, this is more a sign that Beijing now sees a complete drying up of Western FDI as a greater risk to economic development than a complete opening up of the manufacturing sector to foreign investors.

The USA and the EU: with eye on China, but with different meanings

As mentioned earlier, politicians in Washington had adopted the term 'derisking' and have stressed in several statements that the goal is not to separate the Chinese and US economies completely. That said, the US derisking strategy can only partly be seen as natural country-level risk management, as the policy obviously targets China. Of all the countries seeking to manage the China risk, the USA's derisking strategy is the most comprehensive, and Washington has the widest spectrum of tools at its disposal. Washington's derisking strategy has a threefold objective: first, to maintain US global leadership in technological development; second, to reduce dependence on China for critical raw materials; and third, to slow the development of Chinese military capabilities. Strengthening the position in the global tech race and reducing external dependence on critical technologies is fundamentally no different from the logic of derisking that China has been pursuing for many years. Weakening a potential military rival is the objective where the global great power perspective comes into play, and this is where the US derisking strategy differs most from that of other countries, and in this respect is most directed against China. In line with the complexity of its motivations, the tools used by the US are also manifold. The transformation of domestic industrial development policy and support systems, the restructuring of critical raw materials supply chains and reshoring efforts all play a role, and today these tools have a relevance independently of China, and it is no coincidence that they are also popular among other governments. The friend-shoring that US politicians are throwing into the public discourse is more directed against China, while controls on technology exports, sanctions on Chinese companies and the world's first regulations restricting outward FDI are admittedly targeting the Asian rival.

Due to their divergent global power status, the China threat is perceived differently in Brussels than in Washington, and therefore the EU's risk management goals and preferred instruments are not targeting China that directly. The restriction on the export of semiconductor technology by the Dutch company ASML was clearly a result of pressure from Washington and can be seen as an exception rather than the rule. The Joint Communication on a European Economic Security Strategy, published by the European Commission and the High Representative in June 2023, sought to lay the foundations for how Brussels envisages managing the risks inherent in its external economic relations (including with China). The document identifies the main risks for the EU as supply chain inflexibility, energy supply, physical and cyber security of critical infrastructure, technology leakage and the weaponisation of economic dependence. Although China is not mentioned once in the document, undoubtedly in some categories, such as technological security, supply chains and economic exposure, China is the main risk factor. It is also worth adding that the painful experience of dependence on Russian gas imports since the outbreak of the war in Ukraine has clearly made the EU more sensitive to external dependencies, and this will have an impact on the perception of any exposure to China in the future. The document is not a China strategy, and therefore the term derisking is used only once, but the listed tools for strengthening economic security are likely to be the ones the EU envisages to reduce the exposure to China. In this sense, the EU's derisking toolbox includes monitoring of FDI inflows, instruments to counter economic and trade pressures, various recommendations and toolkits for Member States, industrial development policy and subsidies, and technology export controls. The latter could receive greater emphasis in the future, given that Brussels has proposed a common risk assessment for Member States in 2023 in the fields of advanced microchip, quantum and biotechnology, and artificial intelligence. In economic risk management, the EU is looking for partnerships with like-minded countries. It is also worth noting that Germany, which has the closest economic relationship with China in the EU, published its first China strategy in July 2023, essentially aligns itself with the EU's derisking approach and lists mostly the same tools as those contained in the above-mentioned Brussels Communication on economic security.

Japan: a frontrunner in pursuing economic security

Japan was the first country to experience first-hand the consequences of exposure to China when, in 2010, China halted exports of rare earth minerals to Japan for two months over territorial disputes. On the other hand, China has rapidly become a technological superpower, creating economic competition between the two countries. This competitive situation, combined with overexposure and security risks, has led Tokyo to treat economic security as a strategic issue. Interestingly, this Japanese experience encouraged the USA to pay more attention to economic security. Washington first applied the approach to 5G networks, but Tokyo has extended it to undersea data cables and traffic and has also drawn attention to the risks associated with critical

mineral resources. The expanded understanding of economic security is therefore in large part a 'Japanese invention'. Tokyo believes that cooperation and alliance-building, whereby other states would help a country suffering from Beijing's economic coercion, is of utmost importance. Building on this basis, better relations with China can be developed, which is also in the interest of the Japanese industry. It is important to have a stable trade relationship and to keep channels of communication with Beijing open, but Japan needs to protect itself and reduce the exposure of its supply chains to China. Under this approach, only a narrow area of real disengagement from China is needed, with the bulk of business continuing to operate in an integrated market. In defining the area for divestment, it is important to be very careful and selective, but once this is done, it should be protected in a truly effective way (known as the 'small yard, high fences' concept).

South Korea: diversifying trade links and strengthening supply chains

It is also worth briefly touching on what derisking means for South Korea. Although the country has become increasingly negative towards Beijing in recent years, most South Koreans still support a friendly relationship with China. At the same time, high-tech Korean companies are facing increasing competition from Chinese companies. In this sense, Seoul could even see Washington's efforts to block China's technological ambitions as a positive development. At the same time, the Chinese market is a major source of revenue for Korean chipmakers such as Samsung and SK Hynix, which cannot afford to ignore business opportunities in China. This is in part why Seoul has never contemplated a separation of economies but, like Brussels, sees the possibility of reducing the risk to an acceptable level by regulating the relationship. The South Korean approach is more about diversifying economic and trade links and strengthening supply chains. US exports restricting measures of semiconductor technology to China are against the business interests of several Korean giants, so unlike Japan, Seoul has not clearly aligned itself with Washington on this issue. Like the European Union and Japan, South Korea envisages working with partner countries to strengthen economic security and manage the China risk.

India: self-reliance through others' derisking strategies

In India, the current discourse on derisking is seen through multiple lenses. On the one hand, the general notion of reducing dependence on foreign investments, technologies, and supply chains is a relatable policy goal for India's policy making elites. And on the other hand, U.S., European, and Japanese de-risking strategies are seen as an opportunity

at attracting a necessary amount of foreign direct investment and technology transfer that would contribute to India's own goals of eventual technological and economic self-reliance and a greater global economic footprint.

While India's post-reform economic model and global role were mostly based on the rise of the high-end service sector, turning the country into a global manufacturing and export hub has been an important policy goal since at least the mid-2010s. Now, amidst the 2020s' geopolitical fragmentation, India – alongside other countries such as Vietnam, Mexico, or Indonesia – is often seen as a prime investment target for U.S., European, and Japanese companies de-risking, near-shoring, and friend-shoring away from a politically more and more unfriendly and economically less and less dynamic China. Capitalising on the Western falling out with China is a major strategic goal for New Delhi, also supported by U.S. and Japanese diplomacy.

Despite these advantages, however, India may have a hard time attracting foreign investors on their way out of China. A decade's worth of policy incentives and regulatory reforms aside, investors in India still face considerable bureaucratic hurdles, major infrastructure deficiencies, and difficulties around enforcing contracts, protecting intellectual property, and acquiring mid-level local talent.

India, however, is not merely a passive beneficiary of other countries de-risking strategies. Getting hold of Western and Japanese investment and technology also serves the longer-term purpose of making the Indian economy more self-reliant and less dependent on foreign actors – a goal that has emerged independently of the current 'de-risking discourse', but nevertheless fits into it well. Such self-reliance has been a cornerstone of Indian political economy throughout the Cold War Era (albeit with little to show for) and gave way to more openness to foreign investment only in the wake of the 1991 balance of payment crisis and liberalisation reforms. In 2020 the slogan 'Atmanirbhar Bharat' ('self-reliant India') became popularised, first in reference to the Covid-19 pandemic's disruption of international supply chains, but soon gaining a wider connotation: India achieving technological self-sufficiency, self-reliance in the defence industry, less dependence on international supply chains, and a positive overall trade balance. This time however, unlike after Independence, initial foreign investment and technology transfer is supposed to play a crucial role in attaining self-reliance – bringing together India's longer-term ambition with other countries' short-to-mid-term goal of reducing dependence on China.

Finally, in addition to general self-reliance, the specific goal of decreasing dependence on certain specific partnerships is also present in Indian strategy – again, independent of, but in line with the current discourse around de-risking. Its armed forces long dependent on Russian military hardware, since around the mid-2010s India has significantly increased the profile of Western partners, such as the U.S., France, and Israel in its arms imports. New Delhi also pressed hard for securing joint development projects with both Russian and Western partners in order to indigenise its defence industry. On the trade and investment front, not unlike in Western countries, India's overwhelming negative balance of payment towards China and the presence of Chinese companies in strategic sectors have come under increased scrutiny in New Delhi. In recent years India has launched investigations against or outright limited Chinese investment in areas such as automotive manufacturing

or telecommunications. Such steps and sentiments aside, bilateral trade between China and India has grown robustly in recent years, hitting new record in 2023. This, however, is widely perceived in India as a liability and a worrisome trend, rather than the welcome element of a multi-vectoral global strategy. While India readily hedges its partnerships with Russia and Western powers, this hedging does not extend to China, which is unequivocally seen as India's number one foe and a shared concern with the United States and its allies.

Conclusions from a Hungarian perspective

In order to better understand the derisking phenomenon and its implications for Hungarian foreign policy, the following observations are worth highlighting. Firstly, managing the risks arising from foreign economic relations is a legitimate and well-established activity at both corporate and country level. This is true even if the activity causes harm to the interests of other states or entities. Apart from the rise of China, the pace of technological development alone makes it necessary to increase the protection of national economies and to manage the growing risks. The instrument is also being used by Hungary, since its policy of Opening to the East can be interpreted as a kind of derisking, even if it is not specifically directed against Western countries. The motivation of Opening to the East was to reduce the risk of dependence on Western economies with slowing or stagnating growth. The same can be said of the expansion of North-South gas transport options, which was a strategic goal of Hungarian foreign policy well before the outbreak of the war in Ukraine. China, which is the most critical of the derisking efforts of Western countries, has itself been using this tool for a long time, so it is worthwhile for Hungarian foreign policy communication to distance itself from Beijing's double-standard rhetoric.

Secondly, from the point of view of Hungarian foreign policy, which advocates the widest possible connectivity, it is welcome that the US has also moved from decoupling to derisking regarding China. Of the two, derisking can be seen as the basic concept, which can result in diversification, partial restriction, or a complete decoupling. Despite the 'softening' of Washington's approach, US policy towards China will never be described by a single concept or category because of the complexity of the two countries' relationship. Due to its position as a global superpower, the US also sees a different risk in China's rise than the EU, Japan or South Korea, whose derisking strategies share many similarities, including fewer instruments targeting directly China.

Thirdly, in shaping the domestic foreign policy stance, it is worth considering that all major powerhouses in the global economy, including Beijing, are using the means of restricting economic relations for derisking purposes. And the process is set to accelerate simply because of the dynamics of global politics and economy in recent years (incredible pace of technological development, vulnerability of supply chains, race for critical raw materials, war in Ukraine, etc.), partly independently of China. The main message of Hungary's foreign policy communication should therefore be to keep derisking within reasonable limits, to narrow the scope of affected sectors and to avoid extensive decoupling of the Western and the Chinese economy.

Fourthly, in the current environment, Hungarian interests are best served in terms of preserving economic connectivity if the EU can avoid being forced into a 'China-derisking model' that serves maintaining the USA's global superpower position. Hungarian foreign policy can best contribute to this if it supports the EU in implementing a derisking strategy that seeks to reduce exposure to China, while focusing on the vulnerability of supply chains, the establishment of a level playing field and the strengthening of the technological competitiveness of European companies.

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