



De-risking as an economic strategy

Description

Maria Demertzis

Using a strategy of de-risking to deal with an increasingly fragmented world makes good economic sense. President von der Leyen first launched the strategy in a [speech](#) in March 2023. Since then, both the Biden administration and the G7 have embraced the idea.

Naturally, just one word is not enough to capture the real intentions of any given strategy. But as a way of summarising the motivation and predicting what it could achieve, de-risking constitutes a considerable improvement to both notions of decoupling and strategic autonomy.

The US continues to advocate decoupling as a way of dealing with China. The motivation behind this is to exclude China from the US market and therefore cut an important source of income for the Chinese economy. But a protectionist agenda is not easily justified on economic grounds, and it feeds into a vicious cycle that is sure to be harmful.

The EU had never believed that decoupling was either possible or desirable. But limiting dependence on China was a key part of the EU's thinking. Strategic autonomy became the catchphrase to capture the need to react to Chinese power. But the term itself is very elusive and soon started reflecting protectionist instincts like '[buy European](#)'. On top of that, autonomy as a concept does not resonate well with the urgency for global cooperation.

By contrast, de-risking is motivated by the need for diversification and leads to greater resilience. Borrowing from management science, de-risking is a way of caring for business continuity.

For example, energy diversification and accelerating the energy transition helps to minimise the dependence on one supply source or one geography. The Russian invasion of Ukraine demonstrated how vulnerable the EU became because of its reliance on cheap energy from Russia. While the cost motive for establishing partnerships was satisfied, a great part of the EU's economy relied on one source, greatly endangering Europe's 'business continuity', in other words, the ability to run its economy at the desired pace.

Shortening supply chains is another act of diversification that can be explained well by the need to guarantee business continuity. If a supply chain is too long and complex, it becomes unreliable and it therefore makes good economic sense to shorten it. Diversification is a good economic principle, without needing to invoke political motives.

But if de-risking is a strategy for moving away from optimising on costs only to optimising also on resilience, it can also be used as a cover for protectionism.

On this point, both the US and the EU have advocated policies that aim to re-shore some of their production, with little consideration of the damage done in terms of efficiency or, worse, in terms of upholding international agreements.

The US Inflation Reduction Act (IRA) provides a subsidy that has a local content component. It is a subsidy given to companies conditional on a component of the good (i.e cars) being produced in the US. This is in violation of global trade rules and greatly damages the ability to have a global system that is governable. Moreover, it stimulates protectionist reactions in a race to the bottom, which is detrimental to economic efficiency.

The Net Zero Industry Act (NZIA), put forward by the European Commission on 16 March 2023, has elements that can be seen as a protectionist reaction to the IRA. The NZIA aims to have 40% the EU's cleantech deployment needs produced domestically by 2030. These targets are [not credible and are possibly counterproductive](#). The EU may be able to meet these targets for some technologies, but it will be extremely difficult to do so for others and may even delay the green transition.

Globalisation allows businesses and countries to minimise costs by sourcing from further away. But as the world fragments politically, companies need to think about continuity as

well as costs. De-risking is a way to create resilient economic systems and is a good strategy to follow. But it must not be a tool for de-globalisation.

Maria Demertzis is a Senior fellow at Bruegel and part-time Professor of Economic Policy at the School of Transnational Governance at the European University Institute in Florence. The article is published by Bruegel and is also posted on the blog of the Cyprus Economic Society.