Entrepreneur Elon Musk – the CEO of electric vehicle (EV) company Tesla – recently undertook a brief yet impactful visit to China, during which he met with senior officials, including Foreign Minister Qin Gang, and the ministers of commerce, industry, and information technology – all critical figures for Tesla’s operations within China. Additionally, he toured Tesla’s Shanghai Gigafactory and expressed his appreciation for the collective efforts put forth during the COVID-19 pandemic.

Unofficial images of Musk with CATL’s chair, Zeng Yuqun, spread on social media. China’s CATL is a global leader in EV batteries, and during the meeting Musk likely reviewed investment strategies for Tesla’s Megapack energy storage. While in China, Musk also likely discussed deploying Tesla’s autopilot technology in the country, while addressing issues of keeping Tesla’s driving data within China and potential military implications of its Starlink Project.

In contrast to the US government’s intent to repatriate capital and manufacturing, Musk aims to increase Tesla’s footprint in China’s EV and power battery sectors. Tesla’s share price soared during Musk’s visit.

This visit underlines China’s pragmatic diplomacy, engaging with American industry leaders despite tense China-US relations, signifying its differentiation between the US government and its business community.

From decoupling to de-risking

Musk has been quoted as likening China and the United States to conjoined twins, implying that decoupling the world’s two largest economies is not just costly, but potentially destructive. The significance of China to Musk is clear: China is not just Tesla’s second-largest market, but it also plays a crucial role in Tesla’s production capacity, contributing more than half of its global output. In 2022, Tesla’s Shanghai Gigafactory exported 271,000 vehicles, accounting for one-third of the factory’s total production.

The Shanghai government provided special policy and financial support to Tesla’s Gigafactory on one condition: the EVs sold in China had to incorporate at least 90 percent Chinese-made parts and components. Tesla achieved the goal by raising the percentage of its locally-sourced components, from 50 percent in 2019 to 70 percent in 2020, finally exceeding 95 percent in 2022.

Tesla leverages China’s vast manufacturing capacity, burgeoning car market, and cost-effective EV supply chain. Conversely, Tesla has invested significant effort in nurturing a local supply chain, particularly through aiding local suppliers in standardizing their products and processes. This, in turn, has indirectly contributed to the development of China’s extensive supply chain network in the EV sector due to spillover effects.
The process of producing EVs differs greatly from that of manufacturing internal combustion vehicles. Industrial incumbents, like Germany, the United States, and Japan have substantial advantages in engine technologies and transmission systems. In contrast, EV production is heavily reliant on electric motors, control systems, and batteries – areas where the automotive incumbents hold little competitive advantages. China has carved out a dominant position in the supply chain of the rapidly growing EV market.

The prospect of Tesla decoupling from China, especially considering China’s dominance in the EV supply chain and several critical minerals used in EV and power batteries, could entail substantial risk.

There are lessons to be gleaned from past experiences. For instance, Apple played a pivotal role in aiding China to establish a supply chain for smartphones, which subsequently paved the way for China’s advancements in smartphones, tablets, and other consumer electronic devices. However, recognizing the need to reduce its dependence on China, Apple later adopted a decoupling strategy.

Despite significant efforts to diversify and relocate Apple’s supply chain to countries like Vietnam and India, over 90 percent of Apple’s production still comes from China. A closer examination of the trade of value-added intermediate goods between China and Vietnam reveals that Vietnam’s production heavily relies on China’s supply chains, particularly for upstream materials and machinery as well as intermediate components and parts. To a certain extent, it appears that China has successfully extended its supply chains into nations where relocation has been carried out.

Recognizing the inherent challenges of decoupling from China’s supply chains, European Commission President Ursula von der Leyen introduced the concept of a ‘de-risking’ policy toward China. This approach was later echoed by US National Security Advisor Jake Sullivan. Contrary to the ‘decoupling’ policy – which, as the name suggests, encourages an independent supply chain free from China – the ‘de-risking’ approach aims to boost supply chain resilience and decrease dependence on China, especially in areas related to national security.

While they differ in their degree of reliance on China, the execution of both decoupling and de-risking policies necessitates similar strategies: domestic industrial policies that subsidize onshoring or nearshoring manufacturing, and international industrial diplomacy, which includes friend-shoring, forming supply chain alliances, and establishing critical mineral alliances. However, both these policies may be seen as departures from free market principles, and as such, the act of de-risking may introduce its own set of risks.

Government interventions, both at domestic and international levels, run the risk of fragmenting what was previously a unified global production and market network. Such actions could potentially incite inefficient and uncoordinated competition for subsidies among wealthy nations, leading to unnecessary redundancy and duplication within supply chains. This could subsequently result in elevated costs for consumers and increased carbon emissions.

Elon Musk’s visit to China carries symbolic weight at a time when policies are transitioning from decoupling to de-risking. Although it’s important to establish more coordinated alternative strategies (like China Plus One) as a safeguard, it’s becoming increasingly evident that China remains an essential part of the global network.

**Balancing economic losses and political gains**

In technology-intensive industries, there’s a paradox between competitiveness and vulnerability in supply chains. As a country becomes more competitive in the supply chains of such sectors – like the semiconductor industry in the United States and the electronics industry in China – the benefiting from global input of components, materials, and expertise based on their comparative advantages, it exposes vulnerabilities to natural disasters, pandemics, political instability, or war. In other words, striking a balance between competitiveness (efficiency) and resiliency (increasing redundancy) is difficult, particularly for countries with limited industrial capabilities and smaller domestic markets. These nations typically benefit from integrating their unique resources into global production networks and selling their products to the global market.

Smaller nations, thus, have limited direct incentive to withdraw from the global networks. While large powers may consciously opt for a decoupling or de-risking strategy, accepting potential economic losses, they stand...
to gain in other areas like global influence and political or technological leadership. Unfortunately, these non-economic benefits often do not extend to their smaller allies.

In the ongoing contest for technological supremacy between the two superpowers, the United States holds greater influence in numerous industrial sectors. This is attributable to its control over upstream resources like technology and intellectual property (IP), which often occupy ‘chokepoint’ positions in global value chains. Conversely, China predominantly excels in lower value-added production, where alternatives can be found (even if at significant costs). Consequently, China has a significant incentive to maintain the status quo of globalization. The United States, on the other hand, stands poised to gain more political leverage than China in the event of de-risking or decoupling, which could result in a lose-lose situation.

Facing potential chokepoints, such as those occurring in the semiconductor industry, China has adopted a proactive industrial diplomacy strategy. It has been actively reinforcing its political and diplomatic ties with friendly nations in Africa, the Middle East, and Central Asia to ensure a steady supply of energy and crucial minerals. On a corporate level, a mutually beneficial relationship between China and the global business community continues to thrive.

By welcoming Tesla’s investment and giving Elon Musk a high-profile diplomatic reception, China is sending a clear message that it remains open to foreign investment. This willingness to open its vast market to foreign investors is particularly noteworthy, especially at a time when the United States is increasingly adopting a more protectionist approach.

**Soft diplomacy**

China has been employing ‘soft diplomacy’ to bolster its foreign relations. Also known as public diplomacy, this strategy involves using cultural exchanges, sports, educational programs, developmental aid, and business links, as a means to enhance bilateral relations between nations. A standout example of China’s soft diplomacy is the ‘Ping Pong Diplomacy’ that occurred during the Cold War. In 1971, China extended a surprising invitation to the US table tennis (ping pong) team to visit China. This event contributed to the thawing the icy relations between the United States and China, ultimately leading to President Richard Nixon’s historic visit to Beijing the following year.

Similarly, hosting Elon Musk’s recent visit can be seen as an exercise in soft diplomacy, which offers a stark contrast to the ongoing freeze in hard diplomacy between the two nations. This is particularly noteworthy considering China’s ‘wolf warrior’ diplomatic approach, which, while rooted in political ideology, has not always fostered positive international relations for the country.

Soft diplomacy, particularly through the enhancement of economic connections and business collaborations, has the potential to alleviate tensions arising from decoupling or de-risking. Hard decoupling can promote self-reliance among geopolitical blocs or nations, which could potentially spark intensified competition, reminiscent of the situations leading up to the two world wars. Global interdependence may lessen the risk of such large-scale conflicts. The substantial challenges that nations face when trying to sustain a drawn-out war without access to a global production network were evidenced by Russia’s limited combat capabilities during its invasion of Ukraine due to disruptions in its industrial production.

Regrettably, the ongoing competition to establish independent industrial systems by geopolitical blocs based on political values may propel us toward a security dilemma. This scenario, where nations enter a self-perpetuating cycle of competition for self-sufficiency in their quest for security, could inadvertently escalate conflict, even if the initial intention was merely to enhance security.

Diplomacy plays a pivotal role in resolving conflicts between nations. When traditional diplomatic avenues prove inadequate, by fostering stronger economic ties and promoting mutually beneficial partnerships, soft diplomacy can help to build trust, facilitate dialogue, and mitigate the negative impacts of geo competitions. It is hoped that Elon Musk’s recent visit to China can serve such a purpose and inspire similar actions.

*Dr Marina Zhang is Associate Professor – Research at the Australia-China Relations Institute, University of Technology Sydney.*