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Eco-Economic Balancing Act: The EU's Approach to the China EV Trade Dispute

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The European Commission unveiled in June the long-expected preliminary results from the ongoing anti-subsidy investigation into Chinese Electric Vehicle (EV) manufacturers. Applicable from July 5, 2024, a new provisional tariff regime will apply to EV imports until November, when the EU Council at the latest must have voted to either make the tariffs permanent or lift them, pending the results from the 13-month probe. However, reactions to the Commission's initial findings have varied widely within the EU, and it also remains disputed how the tariffs will impact EU competitiveness and trade relations with China. This issue brief elucidates the origins of the EV probe, the challenges facing the EU's auto sector, initial tariff impacts and strategic goals, and the nascent political reactions to the probe.

Introduction

EU auto manufacturing employs nearly 14 million workers, accounting for over 7 percent of GDP and a significant share of exports. In 2022, the entire EU exported a record-high 158 billion euros worth of cars, contributing to a net trade surplus of 96 billion euros.[1] For comparison, China was the sixth largest auto exporter that year, exporting 41 billion euros worth of vehicles.[2] Two years later, China is gearing up to overtake Japan to become the world's largest auto exporter,[3] having ascended global car export rankings rapidly and especially so in the next generation battery electric vehicles segment.

In addition to various supply-side incentives, Chinese regulators have since the mid-2000s used a wide array of policy tools to facilitate EV development and adoption, including a "dual credit" fuel consumption trading system, consumer tax rebates favoring domestically produced cars, exemptions from smog-alleviating road space rationing policies, and considerable charging infrastructure support.[4] Though still facing complaints over intellectual property rights issues and market access barriers, the government has gradually opened up the cloistered auto market to foreign competition, removing foreign ownership restrictions in 2018 and phasing out EV purchase subsidies in 2022.[5] These measures have contributed to China's emergence as the world's largest EV market and rapid advancement up the value-added chain. Chinese auto manufacturers alone accounted for nearly 60 percent of global EV sales in 2022, and three of the world's top five largest EV makers are all based in China.[6]

While most of China's EV sales have hitherto been domestic, this production capacity is turning abroad. After a price war so intense that the Ministry of Industry and Information Technology had to intervene against "reckless" price-cutting,[7] Chinese EV manufacturers are consolidating and turning outward from their saturated home market towards Europe. Not only does the EU have the world's second-most developed EV charging infrastructure after China, but it also has a well-developed luxury car segment, lower tariffs and local input requirements than most emerging markets, and a commitment to phase out conventional internal combustion engine (ICE) cars by 2035. Rhodium Group has assessed that several leading EV models can be sold at premium mark-ups of ~50-112 percent in Germany compared to in China.[8]

The EU Commission estimates that Chinese-produced EVs accounted for 8 percent of the total EU EV market in 2021, up from a half percentage point in 2019, with the potential to reach 15 percent in 2025.[9] Underscoring the momentum, new EV registrations from China increased 25 percent year-on-year between January and April 2024.[10] BYD has set a target to double its production capacity between 2023 and 2026 and to single-handedly capture 10 percent of the EU market by 2030, having overtaken Tesla as the world's largest EV maker. According to Rhodium

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Group, China-headquartered EV-makers could have the capacity to ship 500,000 cars abroad annually by 2025, increasing to as much as 1.7 million in 2026.[11] Though not all this capacity would be bound for Europe, the EU would likely be most directly affected as a primary export market. For comparison, about 10.5 million new vehicles were registered in total in the EU in 2023.[12]

The Anti-Subsidy Probe

Announced by Commission President Ursula von der Leyen in last September's State of the European Union Speech, the EV anti-subsidy probe was politically charged from the beginning. Normally anti-subsidy probes are launched at the behest of a formal request from industry, but this was an ex-officio investigation initiated directly by the Commission in a high-profile speech.[13] Invoking Europe's past loss of its solar panel industry, von der Leyen warned that global markets were being "flooded with cheaper Chinese electric cars" whose prices were kept "artificially low by huge state subsidies" and distorted the EU Common market.[14] EU Internal Market Commissioner Thierry Breton had also recently warned against replacing old fossil fuel dependencies with new technological ones, including for EVs, stressing the EU needed to "remain an industrial leader that exports European products and technologies – but not our jobs."[15]

The Commission thus initiated the investigation which, albeit vigorously opposed by German auto-industry, was actively lobbied for by France in preceding months.[16] The Commission's official complaint made three allegations regarding Chinese state support – that there were direct transfers of funds to the EV manufacturers in question, that there was government revenue foregone or not collected, and that the public sector provided goods or services for less than the adequate market remuneration. To address the allegations, the investigation set out to gauge the level of state subsidies potentially involved and then, if needed, apply commensurate countervailing duties to level the playing field.[17] Subsequently launched in October, the probe specifically narrowed its investigation to three major representative EV manufacturers: BYD (Build Your Dream), Geely and SAIC Motors.

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Despite protests from the Chinese Chamber of Commerce, the three companies were broadly cooperative, although to a point, with Commission complaints that provided information had been insufficient, thereby risking higher default tariffs. In turn, some of the automakers and Chinese trade officials criticized the investigation as flawed and demanding information on suppliers not readily available or deemed commercially sensitive.[18] Still, EU Trade Commissioner Valdis Dombrovskis said the investigation was progressing steadily, with preliminary findings possibly ready by early June.[19]

The politically sensitive announcement was subsequently postponed until after the imminent EU Parliament elections, when the Commission provisionally concluded that the "battery electric vehicles (BEV) value chain in China benefits from unfair subsidization [...] causing a threat of economic injury to EU BEV producers." On top of the EU's 10-percent base-line import tariff, the Commission announced preliminary levies of 17.4 percent for BYD, 20 percent for Geely, and 37.6 percent for SAIC, with all cooperative yet unsampled companies receiving a weighted average of 20.8 percent, and uncooperative producers receiving the maximum residual duty of 37.6 percent.[20] These preliminary calculations have since been slightly tweaked downward, albeit still subject to adjustments following a consultation period. And while they came into provisional effect on July 5, the Commission has since decided not to collect tariffs retroactively before permanent rates are written into law. [21]

Notably, these countervailing duties apply to only pure-electric cars, which make up a small portion of China's EV exports, with plug-in hybrid electric vehicles (PHEVs), fuel cell electric vehicles (FCEVs), and battery components exempted.[22] However, the Kiel Institute estimates that the total tariffs could reduce imported Chinese EVs by around 42 percent, with negligible long-term impacts on vehicle prices.[23] Member-states will have until October to decide whether to lift or confirm the provisional duties based on the probe's final findings.

Reactions

Chinese officials have been critical from the probe's inception, vowing to firmly "safeguard the rights and interests of Chinese enterprises" and reserving the right to file a WTO lawsuit against any veiled "protectionism."[24] Chinese critics posit that, though temporary imbalances in supply and demand exist, the scale of the green transition and rapidly rising global EV demand necessitates scaled up production capacity.[25] They further argue that while legacy counterparts in Europe over the last decade cheated on emissions-tests and lobbied legislators to delay the demise of the ICE engine, Chinese manufacturers gained many new competitive advantages, including economies-of-scale production, lower energy costs, in-house ship carriers lowering transportation costs, high degrees of vertical value chain integration, and rapid battery technology innovation.[26] When President Xi Jinping met Ursula von der Leyen and French President Emmanuel Macron in May 2024, he rejected that there was such thing as China's industrial "overcapacity problem."[27]

The displeasure with the probe has materialized in other parts of the trade relationship, characterized by carrot-and-stick tactics. Chinese officials are said to have floated an offer to lower auto import tariffs from 15 to 10 percent in line with EU levels, with hopes of reaching a mutually acceptable solution quickly.[28] Moreover, at the end of the official consultation period, industry representatives offered five so-called "undertakings," including voluntary restrictions on price and volume.[29] Meanwhile, China lodged a formal WTO complaint in August[30] and had previously launched anti-dumping investigations into EU pork and liqueur exports.[31] State-owned media have also mentioned the potential for 25 percent counter-tariffs on imported large-engine ICE cars.[32] The preliminary anti-dumping investigation into EU-origin brandy has identified "substantial damage" to local industry, but stopped short of levying provisional tariffs immediately.[33] Caught in the cross-fire, these sectors at risk are especially important to several key member-states, including central backers of the EV tariffs such as France, Italy, and Spain.

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Unless an amicable negotiated settlement can be reached before the probe's end in November, the imposition of tariffs looks likely. Blocking the Commission's proposed final tariffs would require a qualified majority of 15 member-states representing 65 percent of the EU population in the Trade Defense Instruments (TDI) Committee. Thus far, Italy, France and Spain – which collectively represent 40 percent of the EU population – have supported the tariffs;[34] Hungary has condemned them,[35] while Germany, Sweden, and Ireland have cautioned against trade war escalation and protectionism.[36] Only four capitals actively voted negatively in a non-binding confidential advisory vote in July, with 11 member-states, including Germany and Sweden, abstaining in support of continued negotiations.[37]

The latter concerns have predictably been raised by industry groups as well. For instance, the German car industry association VDA has criticized the tariffs' side effects. While the preliminary tariff range of 17-37 percent is high by historical precedents,[38] China's largest EV manufacturers still have ample space to adjust pricing given current profit margins – unlike some of their European counterparts with joint ventures in China whose export-oriented business models could be jeopardized.[39] Additionally, the European Association of Automotive Suppliers warns that while tariffs can temporarily protect EU manufacturing at home, they will undermine international competitiveness in other markets, necessitating other proactive policies and dialogue to avert trade war escalation.[40] Chinese EV makers are already making swift inroads in emerging markets, with BYD production facilities announced or planned in Brazil, Mexico, Pakistan, Thailand, and Uzbekistan.[41]

Supporters of a more muscular response have upbraided the tariff critics, charging concerned politicians and industry organizations with placing short-term corporate and national economic self-interests over EU credibility.[42] Echoing the Biden administration, others have warned of a second economic "China shock" risking productivity losses and "significant deindustrialization."[43] Nevertheless, the Commission's range of options appears limited. As outlined by Rhodium Group, tenuous national security invocations related to EV technologies would infringe on member-states' national competencies, and Chinese companies only need access to one member-state to effectively enter the rest of the single market. Neither would restricting foreign-made cars from purchase incentive programs make any meaningful difference as they are already being phased out. And while other hypothetical responses include temporary WTO-compatible safeguards against all EV imports and a review of the 2035 ICE car phase-out target, such approaches could take years and jeopardize the green transition and the Commission's narrow parliamentary majority.[44]

The End Goal?

The diverging debates beg the question of what the penultimate goal is. For its part, the Commission has clarified that it seeks a differentiated, targeted approach from that of the United States, where the Biden administration has imposed a prohibitive 100 percent EV tariff to exclude all Chinese EV manufacturers.[45] While U.S. Commerce Secretary Janet Yellen has urged the EU to follow suit, Ursula von der Leyen has underscored the EU's commitment to fair competition and addressing complaints proportionally in line with WTO rules.[46] Though supporting wider WTO reform, the EU has long opposed the U.S. unilateral obstruction of the organization's dispute settlement mechanism, with von der Leyen urging change through "design – not by destruction."[47]

Despite divergent European views on the limits of economic de-risking, the Commission's view appears to reflect an understanding of the tariffs as a source of leverage rather than an end in themselves. The goal is not to entirely exclude Chinese companies – as Washington pre-emptively has – but to ensure competitive neutrality and incentivize responsiveness to EU trade concerns, while keeping an open door to inward-investments from manufacturers that are ready to establish production in Europe on the EU's terms.[48] Such an approach aims to keep manufacturing jobs within the union, move a greater share of the global EV value chain to Europe, and ensure a degree of technological knowledge transfer to local workers and partnering companies.

While an ironic reversal of European companies' past entries into China, wherein Beijing initially mandated joint ventures with local auto companies, such a model might emerge also in Europe, even if not mandated at a regulatory level. Joint ventures and partnerships have already existed for a long time between European manufacturers and counterparts from Japan and South Korea, including the Renault-Nissan-Mitsubishi Alliance, BMW Group and Toyota, and (previously) Toyota-Stellantis. For Chinese manufacturers, such partnerships could similarly reduce costs and speed up market access, while also alleviating frictions with EU governments. And while there have been heightened concerns over Chinese takeovers of European companies in the last decade, such acquisitions have receded back to 2012 levels, with companies increasingly preferring to instead partner with local counterparts.[49]

Since the launch of the EV probe, there has been a slew of new announcements of EV factories planned for the EU. Franco-Italian-American Stellantis N.V. has partnered with Chinese Leapmotor to establish the joint venture Leapmotor International JV in the Netherlands, with operations set to begin in September 2024.[50] Spain's EBRO-EV has signed a joint venture deal with China's Chery Auto to produce EVs in Catalonia.[51] Majority-owned by China's Geely Holding, Swedish-based Volvo has announced that existing factories in Belgium and Sweden will switch to make EVs this decade, with a new factory underway in Slovakia.[52] Volkswagen-partnered Xpeng Inc. is in the initial stages of selecting a site in the EU for localized production.[53] BYD's first Hungarian EV factory is expected to start production in 2025, with new EU-based data centers planned to alleviate data security concerns.[54]

This expansion push extends beyond the EU to the wider customs union, with a new BYD EV plant set to be established in Türkiye.[55] The Turkish government is also in talks with Cheery, SAIC, and Great Wall Motor about localized production.[56] Additionally, battery producers CATL and Envision AESC have signaled intent to establish gigafactories in Hungary, Germany, France, and Spain,[57] with other manufacturers considering production in Morocco, which has liberalized trade agreements with the EU and U.S.[58]

Looking Ahead

A much better outcome for the global green transition at the macro level would have been jointly agreed common pro-climate subsidy schemes for EVs and a common carbon tax.[59] Yet, in their continued absence, solutions will need to come from trade negotiations and carefully crafted policy responses that account for not only EV manufacturing in the EU and China, but also the rest of the world. Pending the final anti-subsidy probe investigation results, the near-term outlook will likely be influenced by China's receptiveness to EU concerns in ongoing consultations,[60] the degree of escalation in parallel trade probes, and whether EV exports continue to surge even amid the preliminary tariff announcements. The EV issue is likely to sit near the top of the agenda at the upcoming 11th EU-China High-level Economic and Trade Dialogue in September. And while a blocking of a final imposition of tariffs looks currently unlikely, hesitant member-states can be expected to weigh on the Commission to possibly dilute the response.

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