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THE EU'S ANTI-SUBSIDY POLICY TOWARDS CHINESE ELECTRIC VEHICLES:

NAVIGATING THE RISKS OF ESCALATING TRADE TENSIONS

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The EU's Anti-Subsidy Policy Towards Chinese Electric Vehicles: Navigating the Risks of Escalating Trade Tensions

On 13 September 2023, during her annual State of the Union address, European Commission President Ursula Von der Leyen announced the opening of an anti-subsidy investigation into imports of battery electric vehicles (BEVs) from China. Nine months later, after a long and arduous investigation, on 12 June 2024 the European Commission announced the imposition of additional customs duties on Chinese electric vehicles of up to 50% for certain brands. Implemented provisionally from the 4th of July 2024 onwards, this surtax is dividing European Union (EU) member states, which are now exposed to the risk of retaliation from China, raising the threat of a larger-scale trade war.

The EU probe against Chinese BEVs

BEVs are key for the EU in its efforts to tackle climate challenges and ambition to achieve carbon neutrality by 2050. The European Green Deal, the flagship policy of the European Commission's 2019-2024 term of office, aims to end net greenhouse gas emissions by 2050 and make Europe the first climate-neutral continent. This ambitious plan, divided into several priorities such as road transport, which accounts for one fifth of the EU's CO2 emissions, includes a ban on the sale of new petrol and diesel vehicles from 2035. BEVs are therefore the main alternative envisaged by the European institutions. Valdis Dombrovskis, the European Commission's Executive Vice-President in charge of Trade argues that BEVs are "essential to the ecological transition and to meeting our international commitments to reduce CO2 emissions."

At the same time, China has established itself as the leader in the electric vehicle sector over the last few years, becoming the world's leading manufacturer and exporter. China now represents 31% of global demand, a third of global production and produces twice as much as the automobile industry in the EU. Backed by its major industrial and critical mineral resources such as lithium, cobalt, and nickel, China has a surplus car production capacity of around 10 million vehicles a year, pushing national flagship enterprises such as CATC and BYD to export their production. Europe, in particular, is the preferred export continent for these companies, as the strict rules imposed by the EU on carbon emissions and the climate ambitions of its member states encourage the use of BEVs and as the United States imposed 100% import duties on Chinese BEVs. Chinese exports of BEVs to the EU rose from 133,000 units in 2019 to 667,000 units in 2023. This export trend could accelerate over the next few years, with the European Commission predicting that Chinese BEVs could account for 15% of the European electric vehicle market by 2025 if no measures are taken.

The EU launched its investigation to assess whether Chinese BEVs are being sold on the European market at artificially low prices in a process labelled as dumping by the European Commission. This entails a non-EU producer selling their products in European markets at lower prices than their own home market. Such actions are not considered illegal by the World Trade Organisation (WTO) unless the EU is able to demonstrate the negative effects of Chinese BEV's on EU electric vehicles producers, which the Commission concluded in its investigation. These sales prices are sometimes five times lower than models manufactured by European producers, as a result of Chinese government subsidy policies. These policies, encompassing for example export subsidies, tax breaks or consumer subsidies, are also the Chinese government's response to the economic slowdown currently stifling consumption of domestic products, with the objective of encouraging Chinese firms to export their vehicles abroad. Altogether, Chinese government subsidies for electric and hybrid vehicle manufacturers reached 57 billion USD between 2016 and 2022.

These policies, considered unfair by the European Commission, are of concern to European BEV producers. The steady increase in imports of Chinese electric vehicles could ultimately lead to a loss of competitiveness for European companies and increase the EU's dependence on China. In a sector as fundamental as electric mobility, it is the view of the EU institutions to prioritise a sustainable and resilient supply chain in order to not only secure Europe from future threats and crises concerning the withholding of critical resources as a strategic means of coercion, but also to reach the sustainable development goals that the EU has set out for itself and its member states. The investigation was therefore a way for the European Commission to ensure that its production remains in the hands of European producers and send a clear message to China.

Since it was launched, the investigation has experienced several difficulties. Firstly, there has been a lack of compliance from Chinese firms targeted by the investigation, accused by the European Commission of having provided insufficient information for the investigation to run properly. Provisional custom duties announced by the European Commission are divided between three major Chinese BEV manufacturers: BYD, Geely and SAIC, which have been charged with additional customs duties of 17.4%, 20% and 38.1% respectively. Other Chinese manufacturers that were not individually sampled but cooperated with the investigation saw their customs duties increase to 21%. Finally, non-cooperating Chinese producers of BEVs saw their duty increase to 38.1%. These duties will be added to the current applicable import tax of 10%. However, according to a Rhodium Group report, for the European market to become unattractive for Chinese BEV manufacturers, the European Commission would have to impose customs duties of between 40% and 50%, targeting specific firms such as BYD.

The risk of a trade war

A trade war is understood as a set of actions taken by companies or governments with the aim of obtaining or maintaining competitive advantages in the industrial and commercial spheres. After the opening of the investigation, China denounced the EU's behaviour as protectionist and expressed its great concern about this investigation, which could worsen economic and trade relations between the two partners and possibly lead towards a trade war. This reaction does not in itself come as a surprise, but follows a trend of straining relations between the two partners.

The trade relationship between the EU and China has often been the subject of much debate and stumbling blocks. The contours of this relationship are set out in the EU–China — A strategic outlook working document, jointly drafted by the European Parliament, the European Council and the Council of the EU in 2019. In this document, China is referred to as "a cooperation partner with whom the EU has closely aligned objectives, a negotiating partner with whom the EU needs to find a balance of interests" but also as "an economic competitor" and a "systemic rival." This triple categorisation was used by the EU to adopt a pragmatic and flexible strategy towards China in order to effectively defend its commercial interests while working towards a stable trade relationship. The latest agreement between the EU and China dates back to December 2020, when a Comprehensive Agreement on Investment (CAI) was concluded. This agreement, one of the most important investment treaties ever signed by China with a foreign partner, was primarily intended to offer European investors a higher level of access to Chinese markets in areas such as transport and digital technology, and to rebalance trade between the two actors. Although the treaty was hailed by the industry, it was never ratified by the EU. Indeed, less than three months later, the EU announced sanctions against Chinese entities accused of human rights violations in Xinjiang, followed by counter sanctions by China on "ten individuals and 4 entities on the EU side", including the Political and Security Committee of the Council of the European Union and the Subcommittee on Human Rights of the European Parliament. Since then, Sino-European relations have become more strained, also as a result of the Covid-19 pandemic and the outbreak of the war in Ukraine.

Despite these tensions, the European Union and China remain two of the world's biggest trading partners. Trade flows between the two powers have intensified sharply in recent years. Between 2011 and 2021, European imports from China almost doubled (to 86%), while exports to the People's Republic increased by around 76%. As of 2021, China is the EU's second trading partner, behind the United States, and the EU is China's biggest trading partner. However, China's strategy of upgrading its product assortment within European production chains, as well as domestic production of products that were previously subject to imports, is making trade between the EU and China increasingly unbalanced. For example, the trade balance between the EU and China reached almost 300 billion EUR in China's favour in 2023. The EU and its member states are heavily dependent on the Chinese market as a vital export market for European economies and as a supplier of strategic inputs such as scarce raw materials. Likewise, the trend towards the politicisation of trade and the polarisation of international relations, largely as a result of the Covid-19 pandemic and the war in Ukraine, is emphasising Europe's dependence on China. The policy of successive investigations the EU has been conducting for several years against Chinese products and goods, of which the one against Chinese BEVs producers is part, seems to be aimed at reducing this unfavourable trade balance. In 2023, investigations against Chinese goods increased significantly, with inquiries into Chinese exports of steel pipes, the food additive Lysine and flavouring component Vanilline.

According to the legal procedure, an anti-subsidy investigation is initiated when a European industry lodges a complaint with the European Commission alleging that imports of a product from a third country are being subsidised and are harming the European industry producing the same product. However, in special circumstances, the Commission may also initiate an investigation on its own initiative, if it has sufficient evidence of such imports causing injury to European industry. This is commonly referred to as an *ex officio* initiation. By choosing to announce the launching of the probe in her annual state of the union speech last September, Commission President Ursula von der Leyen gave the investigation a political flavour. The China subsidy investigation reflects not only current geopolitical and trade tensions around China but also internal EU politics. Launching an investigation into Chinese BEV producers just a few months before the European elections is no coincidence, and has potentially enabled the narrative of von der Leyen's re-election campaign to be fuelled by a message of support and protection for European industry. Moreover, choosing to focus only on three China-based carmakers (BYD, Geely, and SAIC) rather than western car producers like Tesla, which exports more EVs from China to the EU than any other producer, reinforced the political dimension of the probe. As trade wars involve a sensitive political dimension for legislators to use, none of the two partners wish to use the terminology. The tendency among Eurocrats to describe the EU's relationship with China in terms such as "de-risking" or qualifying China as both a cooperation partner and a systemic rival is a good illustration of this attitude.

China intends to retaliate with trade and economic measures, starting by targeting French liquors such as Cognac, as it regards France as the main supporter of the investigation. However, during Chinese President Xi Jingping's state visit to Europe in May 2024, he committed not to impose duties on it, at least not until the probe launched by Beijing is concluded. However, retaliatory measures are not confined to French liqueurs. China has also announced the opening of an anti-dumping investigation into imports of pork and pork-based products from the EU, threatening the European pork meat industry.

The European commission has already raised the spectre of a trade war. In a similar scenario in June 2013 former European Commissioner for Trade Karel De Gucht announced the imposition of punitive customs duties on Chinese solar panels. These tariffs, which were initially low (12%) for the first few months, then multiplied to reach almost 48%, a rate equivalent to the one now imposed on certain Chinese BEV producers. Unsurprisingly, the Chinese government retaliated by launching a large-scale anti-dumping investigation against European wine exports, putting pressure on the European Commission and forcing it to back out. Has the power balance changed more than a decade later? As De Gucht points out, member states' attitudes towards China have become more critical. The pandemic and the war in Ukraine have fuelled fears that the EU is too economically dependent on foreign countries. While 18 member states campaigned for the non-imposition of tariffs on solar panels in 2013, the consensus around protecting Europe's automotive sector is much more tangible. The loss of the European solar industry, which resulted in many European entrepreneurs being forced out of the market, is a precedent that the EU intends to learn from and wishes not to repeat, even if it means engaging in an intense trade struggle with China.

What are the prospects for the investigation?

According to the investigation procedure, definitive measures against Chinese BEVs must be imposed within four months of the introduction of provisional customs duties, i.e. in November 2024. In that respect, the European Commission is the only decision-making body. Nevertheless, to ratify these measures definitively, EU member states need to achieve a qualified majority of votes against the proposal, which is likely to be difficult to achieve given internal divisions on the issue. Indeed, as soon as the inquiry was announced, the German car industry expressed scepticism, criticising both the lack of coordination between EU member states and fearing potential retaliation by China against German products, given that China is the world's largest automobile market.

A week before the enquiry was launched, German Chancellor Olaf Scholz welcomed Chinese producers to the European market, stressing that the German industry must remain an export industry. Likewise, the heads of major car companies such as BMW, Mercedes-Benz and Volkswagen have clearly expressed their opposition to additional customs duties, arguing that they would not be "appropriate for strengthening the competitiveness of the European automotive industry" and could trigger a "major trade conflict." Other countries, such as Sweden and Ireland, have expressed caution without explicitly opposing tariffs. Hungary is another country reluctant to impose additional customs duties as it aspires to become the bridgehead for electric vehicles in Europe, especially Chinese ones. The country governed by Viktor Orban is currently the world's 3rd largest battery producer, just behind the United States but still a long way behind China. Chinese investors are flocking to Hungary, where they can find cheap labour, as well as accommodating environmental and fiscal standards. On the other hand, France and Spain are pushing for the implementation of definitive measures against Chinese BEVs. Italy, for its part, has called on the EU to pursue its initiative and imitate the United States, which has decided to impose a 100% tax on Chinese BEVs.

Given this wide spectrum of different EU member states' views, what does the commencement of the investigation bode for EU-China trade relations? With the heads of state and government of the member states having decided to reappoint Ursula Von Der Leyen as President of the European Commission, it is highly plausible that the introduction of provisional additional customs duties initiated during her first term in office will be transformed into permanent customs duties during her second term. The future of EU-China relations will therefore be determined first and foremost by the willingness of the two actors to cooperate jointly on specific trade issues. The EU will need to define a subtle new balance in order to improve its trade relations with China, taking into account both its desire for strategic autonomy and international openness.

In order to avoid a trade war, the search for a negotiated agreement could be the preferred solution, as was the case in 2013 with the anti-dumping investigation against Chinese solar panels. After harsh negotiations, the European Commission decided to exempt Chinese exporters from additional customs duties in exchange for the introduction of a minimum price for solar panels. However, such an agreement is unlikely in the case of BEVs. The major difference between the 2013 investigation and the current one is that the EU reacted too late, as the European market was already flooded with Chinese solar panels and European companies had already started to close down. Conversely, the European BEV market is still viable and can become competitive in the future if appropriate measures are taken by the European executive.

One of the solutions also considered by the European executive would be to use the looming threat of additional customs duties to stimulate Chinese BEV manufacturers to form joint ventures with their European counterparts, boosting investments in the European market based on shared technologies. Going down this road would, however, invoke an acknowledgement of China's technological advancement and expertise. According to the German Chamber of Commerce in China, 58% of German car producers expect their Chinese rivals to become innovation leaders in this sector over the next five years. The idea of joint ventures may nonetheless be relevant insofar as it would push Chinese firms to move more critical parts of the supply chain to Europe, rather than to just build assembly factories. This option would give Chinese firms the opportunity to set up their factories directly in Europe and join forces with a European manufacturer, enabling them to bypass customs duties and gain faster access to the European market. This environment would also be conducive to technology transfer and collaborative innovation, especially as some European manufacturers have already taken the plunge, such as the Franco-American-Italian manufacturer Stellantis which has formed a joint venture with China's Leapmotor, or Spain's EBRO-EV with Chery.

Yet, recent geopolitical developments have reduced the scope for cooperation between the EU and China. The objectives put forward in the "2019 EU–China — A strategic outlook" seem to have become outdated and unsuited to the new realities of the relationship between the two powers. Rather than opting for bilateral trade partnerships or cooperation agreements as suggested in the document, the ratification of such agreements is now likely to be more complicated. The EU could thus instead commit to a policy of cooperation with China through a regulated multilateral trade system such as the WTO. As an established normative and regulatory power, the EU must promote European standards more actively within multilateral organisations, favouring solutions based on international rules that are consistent with its institutional nature, with the aim of settling any trade disputes that may arise with China.

The traditional objective of EU trade policy is to guarantee fair conditions of competition. In this sense, the trade defence arsenal at the EU's disposal is specifically designed to respond to situations of unfair competition. In order to counter unfair trade practices by third countries, the EU can make subtle selective and pragmatic use of its trade defence instruments such as anti-dumping or anti-subsidy policies. Even if anti-dumping remains a key element of the EU's trade defence, a maximum use of these instruments should not be an ultimate objective, since they are used only in exceptional cases and entail both economic and political costs.

The breakthrough of Chinese electric vehicles in the European market has highlighted the need for the EU to strengthen its strategic autonomy, particularly in trade. Although this argument is not unanimously agreed upon by the member states, the increased competition with China and the return of war to the European continent in February 2022 make this agenda all the more pressing. While in 2013 the European Council conclusions focused on “strategic autonomy and trade defence”, in the context of the Common Security and Defence Policy (CSDP), the 2019-2024 Strategic Programme makes is essential for the EU to push forward the concept in terms of "promoting a fair level playing field, in particular in the field of trade". In concrete terms, safeguarding the EU's trade interests means reducing critical dependence on external supplies and making supply chains more resilient and able to obtain the raw materials needed to manufacture electric vehicles. The objective of the "de-risking" strategy initiated by the European Commission is to reduce the EU's economic dependence on China and other external actors, as opposed to the earlier “decoupling” policy advocated by Washington aiming to totally disengage.

The implementation of this de-risking strategy can also be interpreted as the consequence of a certain passivity, lack of foresight and policy ambition from the European automotive industry and the EU's research and development policies, which failed to identify the crucial role that electric vehicles would play in the future at an early stage. In fact, China's position as world leader is the result of a long-term endeavour investment policy which began in the early 2000s, when the electric vehicle industry was just a niche sector. Realising that it would be difficult, if not impossible, to compete with the internal combustion or hybrid vehicle industries, which were so highly developed in terms of innovation, China decided to take the profitable gamble of focusing on the production of BEVs. Between 2009 and 2022, for example, the Chinese government spent more than 28 billion USD on subsidies and tax breaks for electric vehicle producers in China. The European BEV industry also receives subsidies from the EU to support the development of BEVs in Europe, by funding battery factories for example. However, the EU cannot boast the same track record in terms of investment over the same period, especially as the first initiative to achieve mass acceptance and deployment of electric vehicles throughout Europe only dates back to 2016 with the “European strategy for low-emission mobility”. Similarly, countries with excellent producers of internal combustion or hybrid vehicles, including European leaders in the sector such as Volkswagen, Audi and Renault, had fewer incentives to invest in BEVs. As a result, European countries have fallen behind in the race for electric vehicles, which has not been offset by sufficiently substantial investment and research and development policies. Nevertheless, current trade tensions should not prevent the EU and China from working together in other geopolitical sectors where both actors have complementary interests. Pragmatic and reasoned cooperation on issues such as decarbonisation, global warming, disruptive technologies, health and agriculture are essential if the EU is to successfully pursue its strategic autonomy.

Balancing protectionism and trade efficiency

On the cusp of a trade war, the EU's imposition of anti-subsidy duties on Chinese BEVs highlights the tension between protecting domestic industries and maintaining stable trade relations. The risk of escalating trade tensions looms large, with potential economic repercussions for both sides. For the EU to achieve its carbon neutrality objectives and ensure the competitiveness of its BEV market, it must navigate these challenges carefully, fostering unity among its member states while balancing its trade policies with China. In the current environment, the EU's pursuit to become a more self-sufficient continent through a diversification of its supply chains and boosting local production is an important one for the EU. Lower dependency on China and other key suppliers would not only bolster continental security, it also minimises Europe's susceptibility to economic isolation. Moving forward, it is vital that Europe adopts a pragmatic approach when addressing Chinese BEVs; fostering relations for a reliable and stable, negotiated agreement which takes into account the simultaneous needs of both actors to defend their own markets. While a total rejection of Chinese electric vehicles seems unlikely, self-regulation of the European electric vehicle market seems more plausible. According to the European Automobile Manufacturers' Association (ACEA), despite some growth markets like Belgium, BEV registrations have fallen significantly in several major European markets: -18% in Germany and -10% in France while previously, the trend had been on the rise. This downward trend reflects the fact that European consumers are still cautious about taking the plunge into electric cars, whatever the nationality of the producers. The prospect of affordable electric cars from European manufacturers is also beginning to emerge, with brands such as Citroën, Volkswagen and Dacia now offering vehicles for around 20,000 EUR The production of less elitist European electric cars, coupled with a series of EU regulations to encourage domestic consumption, could eventually compete with the rampant production of Chinese BEVs and reintroduce fair regulation to the European market.

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