

# ASG ANALYSIS:

## EU Probe Into Chinese EV Subsidies Points to More Difficult EU-China Trade Relations Ahead

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### Key takeaways

- On October 4, the European Commission launched an investigation into state subsidies for Chinese-made electric vehicles (EVs). The probe stems from increasing EU concern that the European auto sector will be eclipsed by less expensive Chinese cars as the sector shifts toward EVs, where China holds supply chain dominance. The investigation is supported by France, whereas Germany and its auto industry are skeptical for fear of Chinese retaliation.
- In recent years, Chinese EV companies have made significant inroads in European markets, where they receive a preferential import duty and square well with EU climate goals. This trend has intensified in 2023 amid economic downturn in China, with Chinese EV exports soaring and contributing to a record-high EU trade deficit with China.
- Chinese-made EVs, both from Chinese and European brands, enjoy a massive price differential in the EU. While state subsidies play a role in this price gap, the success of Chinese companies is also honed by a decades-long focus on developing EV technology and supply chains. This effort has seen billions of dollars poured into R&D initiatives that have generated cutting-edge IP and human capital at leading EV companies across the supply chain.
- The EU and China are no strangers to trade spats, having previously engaged in a similar dispute in 2013 over subsidies for Chinese-made solar panels. While the EU and China resolved that dispute via a negotiated settlement, early indicators suggest this is an unlikely outcome for the EVs case. The official announcement of the EV investigation specifically references the 2013 settlement as a failure by the EU to protect its emerging green industries. Additional investigations into Chinese wind and steel subsidies are also possible.
- Moreover, the overall status of EU-China relations has deteriorated since 2013, when it was generally marked by hope for mutual market access and investment flows. Ten years later, with the EU seeing these promises as unfulfilled while China tacitly supports Russia's war in Ukraine, the context is far less forgiving. Aside from the subsidy investigations, the EU is also preparing new curbs on exports of sensitive technologies to China.
- Beijing has called the EU's investigation "blatantly protectionist" and stated that it will have consequences for the EU-China trade relationship, but these statements have had little effect on EU leaders. This indicates a potentially more confrontational road ahead for EU-China relations before a bilateral summit in December where EU leaders will stick to their guns while hoping to avoid a tit-for-tat trade conflict with China, the bloc's largest trading partner.

## State of play

On October 4, the European Commission formally launched an investigation into Chinese state subsidies for the electric vehicle (EV) industry, particularly focusing on cars produced by Chinese companies BYD, SAIC Motor, and Geely. In her initial announcement of the investigation weeks earlier, European Commission President Ursula von der Leyen spoke forcefully about the need for fair competition as Europe invests in its future industries. Von der Leyen's attention to EVs is rooted in the importance of the auto sector in Europe—which accounts for 7 percent of the workforce—and the mounting concern that European automakers are lagging in EV development and rollout. European companies often find themselves undercut by less expensive Chinese EVs made cheaper to some degree via state subsidies, but also as the result of innovation and the economies of scale of a large domestic market. EV prices in the EU and China boast a substantial gap, with those in China averaging \$34,350 (€32,000) versus the EU's \$60,434 (€56,000). Concerns about this price gap and what it could mean for Europe's all-important auto sector have reached a fever pitch this year as Chinese EV makers, seeking to expand beyond heavily saturated EV markets at home, increasingly set their sights on Europe as an export market. In the first half of 2023, Chinese companies exported nearly 350,000 EVs to nine European countries—more than they exported to the entire EU in all of 2022. In the last five years, EU imports of Chinese-made cars have quadrupled.

The investigation underscores deepening fault lines in the EU-China relationship. This relationship, once predicated on access to markets and investment flows that stood to benefit both sides, has come under increasing strain in the past several years as the EU has grown warier over what it considers an unfair economic playing field with China. Moreover, Beijing's handling of the Covid-19 pandemic and its continuing economic support for Russia has further reinforced the European perception of China as a strategic competitor. The EV investigation suggests Brussels is now more willing now to push back against Beijing but is also trying to strike a fine balance, having already developed several new geoeconomic tools in recent years aimed to protect itself against what it considers unfair Chinese economic competition or security threats.

More recently, the European Commission has proposed a new European Security Strategy that seeks to 'de-risk' trade ties with China including through beefed up foreign direct investment (FDI) screening legislation, new outbound FDI screening tools, and new export controls on sensitive technologies. However, some member states such as Germany think the Commission is going too far. This follows heated intra-European debates, especially between Germany and France, on how far-reaching the EU should be in protecting Europe's EV industry. France, whose national car companies lack a significant share of the Chinese EV market, has called for a more robust European approach, consistent with President Emmanuel Macron's repeated push for stronger "European sovereignty." At home, France has already implemented an EV tax credit scheme with updated eligibility rules that de facto exclude Chinese cars. In contrast, German auto companies still see China as a lucrative, albeit more competitive market, and are reluctant to push back against China in ways that could trigger Chinese retaliation against German car companies. Other smaller EU member states remain more on the fence, with some tacitly supporting the Commission's investigation while others share Berlin's concerns.

While the EU and China are no strangers to trade spats—having previously settled 2013 disputes over subsidies for solar panels and telecom equipment—this current row over a strategic industry appears less likely to resolve itself and may also be accompanied by parallel EU investigations

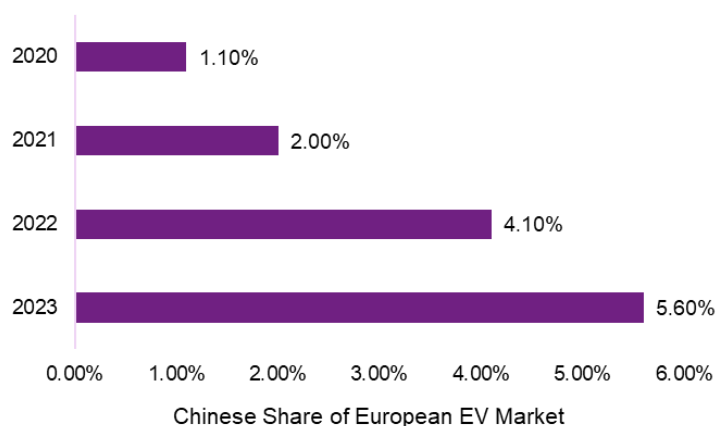
into subsidies in the Chinese wind and steel industries. It also comes as the EU and the U.S. are attempting to resolve bilateral trade issues and forge new avenues of cooperation on a range of technology and economic security areas following the EU-U.S. summit in Washington on October 20 (for more, see [ASG Analysis: EU-U.S. Summit Fails to Deliver Any Trade Wins](#)). It is notable that Biden administration trade officials have expressed support for the EU's China EV subsidies investigation while Washington and Brussels continue to seek to address the effects of the U.S. Inflation Reduction Act (IRA) tax credits on European EVs.

The Chinese government, for its part, has called the EU's investigation "blatantly protectionist" and stated that it will have consequences for EU-China trade relations. In the past, the promise of Chinese market access insulated the EU-China relationship from the worst effects of European concerns about Chinese non-market practices, geopolitical alliances, and human rights abuses. Now, with domestic car brands dominating the Chinese market where companies like Volkswagen once made a quarter of their sales, the context for resolving disputes is far less forgiving. Meanwhile, plans are moving forward for an early December EU-China summit in Beijing, where discussions on subsidies will likely feature even as EU leaders will be keen reassure Chinese counterparts that Brussels is not seeking a broader trade conflict with China.

## Chinese EVs: A growing force in the EU market

Chinese EV makers' push into Europe comes as the sector faces declining prospects in China alongside the achievement of enormous domestic EV production capacity. Since China's hurried exit from zero Covid at the end of 2022, the Chinese economy has sputtered in fits and starts, revealing structural weaknesses such as high youth unemployment and overreliance on an unpredictable property sector that have kept consumer spending low. At the same time, China at the end of 2022 completed the phase out of national-level consumer subsidies for electric vehicles, resulting in a slump in EV sales. Despite this downturn in economic activity specifically related to EV sales, China still has developed a massive EV industry. According to one estimate, China's EV production—estimated at 50 percent of the global total—exceeds demand by about 10 million vehicles a year, comparable to two-thirds of total North American production in 2022.

Figure: Chinese EVs Gradually Gain EU Market Share (2020-2023)



Source: Jato Dynamics  
Data excludes imports from China by Western brands, 2023 data represents Jan-July

Faced with the dilemma of offloading this excess capacity, Chinese EV producers see the EU as an attractive option, especially as the EU is pushing to quickly decarbonize transport. Chinese-made cars often produced by EU brands, enjoy a fairly low import duty of 10 percent (compared to 27.5 percent in the U.S.), barely making a dent in their price competitive status. Additionally, while Chinese company investment and partnerships with U.S. auto firms in the EV sector have come under scrutiny in the U.S.—as demonstrated by the high-profile political spat over Ford's planned EV battery plant in the U.S. using IP from Chinese battery giant CATL—these companies' investments have been better received in Europe, where policymakers have typically understood

the need to use some Chinese technology given the dominance and substantial lead Chinese firms hold across EV supply chains and manufacturing. Several Chinese EV companies, such as industry leader BYD, have announced plans to establish manufacturing plants in Europe, with European carmakers such as Volkswagen having also established partnerships with Chinese EV battery companies. Furthermore, increased sales of EVs square well with EU climate goals to phase out internal combustion engine vehicles by 2035, adding another pull factor attracting Chinese companies to the market.

In addition, European automakers have also seen their fortunes decline in China as domestic Chinese auto companies—many of them EV focused—occupy a greater market share. German carmakers have seen their market share in China drop from 24.6 percent in 2019 to 19.1 percent in 2022. While corporate headquarters for these companies are based in Germany, the effects of a declining European auto sector would be felt more broadly, with many of these companies having production facilities across the continent. Even as China remains a vital market for European automakers, their increasing challenges in China add to concerns as they confront Chinese encroachment in the auto sector at home.

## China's path to EV dominance

Beijing has long identified EVs as a strategic industry, touting the sector as an R&D priority as early as 2001. This decades long lead—hitting when EV and hybrid cars were considered nonviable in mainstream auto markets in Europe and North America—is one reason why Chinese producers today enjoy a vast lead.

From 2009 to 2022, the Chinese government handed out close to \$30 billion in EV subsidies to improve battery capacity and manufacturing. While China has relied on some foreign technology transfers to support its EV industry, Chinese companies such as CATL, BYD, and CALB hold their own leading-edge IP from years of research and work in this sector. Furthermore, Chinese entities hold over 50 percent of active patents globally for sodium-ion batteries, generally considered to be the next generation of EV batteries, surpassing former industry leaders in the U.S. and Japan.

Many of the measures above—such as supporting businesses and funding R&D in industries considered both strategic and green—would to an extent be considered fair competition in the EU. However, the shrinking market share for European producers in the China EV market coupled with the recent surge in Chinese EV exports to Europe has changed the EU's willingness to act.

## What to watch next

Looking forward, the European Commission has nine months to complete the investigation and propose provisional measures (e.g. tariffs, price measures). Four months after the provisional measures, the EU can approve definite measures. This timeline, which could be up to 13 months, puts the next steps squarely in the middle of the EU's political reshuffle, after the European Parliament elections and appointment of a new Commission President, but before the December deadline for a full new commission to be seated and agenda set.

With the EU and China headed toward a potential standoff, some experts have pointed to recent history as an indication of how this might proceed. Days after von der Leyen's address, Pascal Lamy, the former director-general of the World Trade Organization (WTO) said in an interview that he expects the EU and China to address the situation via "price undertaking"—the method used to resolve the EU's 2013 allegations that China had dumped \$28 billion of state-subsidized

#### **Next up: Wind subsidies?**

After the announcement of the EV investigation, European Commissioner Didier Reynders mentioned that the EU is strongly considering opening a similar investigation on Chinese windmill subsidies. The European wind industry has been pushing the Commission for an investigation for some time, noting that the EU's fledgling green industrial policy will be moot if they do not target Chinese subsidies. An announcement of the investigation is likely to come before the end of the year.

solar panels. This solution, in which exporters raise prices to bring their goods in line with local products and thus get to reap higher profits—is seen by some as an attractive alternative to tariffs, in which funds instead go to the state.

Despite price undertaking's past success, several indicators suggest that the EU is less likely to be amenable to compromise this time and would rather choose to impose countervailing duties on EV imports from China (possibly as high as 20 percent to address the price differential between Chinese and European EVs), likely also affecting European companies making EVs in China. For one, von der Leyen's speech specifically called out how China's subsidies

for solar panels led to bankruptcy for many young European firms, signaling dissatisfaction with how this dispute was handled. The EU is also actively considering launching a similar investigation against the Chinese subsidies for its wind power industry. Additionally, the EU-China relationship is substantially different from 2013—when the promise of trade and investment cooperation combined with some Chinese willingness to entertain discussions of human rights, made a dispute over solar panels appear ancillary. Today, by contrast, with China seeking self-sufficiency at home and market growth abroad, Europe's ability to maintain solid footing in an emerging green industry—not to mention a core industry for economic powerhouse Germany—is a cause that appears more worthy of firm action.

While at first glance a trade issue confined largely to the auto sector, the EU's possible implementation of tariffs or other confrontational tactics towards Chinese EVs or other sectors such as wind power could have consequences for European companies operating across industries in China. Although China's deep trade ties with the EU in other sectors would likely temper Beijing's response on a geopolitical level, the adoption of a more confrontational stance by the EU could erode some of the leniency and goodwill often shown toward EU companies in China compared to their U.S. competitors. These trends point to a growing number of risks to address and strategic decisions to consider regarding European companies' operations in China. These will certainly be top of mind for von der Leyen as she and European Council President Charles Michel plan to meet Chinese counterparts in Beijing next month.