

## **Response of the Defeated: EV protectionism in advanced economies\***

**C. P. Chandrasekhar**

In early October, in a show of pique, a European Commission proposal to impose additional tariffs of up to 35.3 per cent (on top of the pre-existing 10 per cent) on electrical vehicles (EVs) imported from China, was passed by a majority vote in the European parliament. With that vote, Europe joined the US in the effort to use high tariffs to block imports from China. The US has, typically, responded to China's success in EV manufacture by raising tariffs to as high as 100 per cent despite lower imports of Chinese vehicles. It has also used national security as a reason to shut out Chinese imports, alluding to electronics allegedly equivalent to smartphones being embedded in Chinese EVs.

The Commission's proposal was clearly in response to the spike in EV imports from China into Europe, and a rise in the market share of Chinese firms, especially BYD. There are two factors driving increased imports from China. The first is that the country has competitive advantages as a location, which benefit not just Chinese companies but also firms like Mercedes and Tesla that manufacture in China to serve European markets. The second is that Chinese EV makers like BYD are ahead in terms of technology, which allows them to offer cheaper products of better quality.

As a result, one in every five vehicles sold in the EU last year came from China. But the country was not the only source of imported automobiles; it contributed just 300,000 EVs to the 10.5 million cars sold in the EU. This speaks of the huge replacement market for EVs open to anyone willing to up their game and win buyer support, including producers from the EU. The issue is not just Chinese competition, but the backwardness of the European industry.

But in the case of both the US and Europe, the inability to face up to being overtaken by a "newcomer" in an advanced technology area seems to be the factor driving the protectionist turn. The case made for tariffs is that Chinese production is outcompeting local firms because of subsidies being offered by the Chinese state to its own producers, allowing the latter to sell below cost and win market share. That justification does not carry any weight because it is not only imports of EVs produced by Chinese firms that are doing well in European markets but also those produced by European firms with manufacturing facilities in China. To argue that China would hugely subsidise even foreign firms to ensure increased production in the country does seem a stretch.

Problems facing EV producers in Europe stem from other factors, not least of which are non-competitive costs and quality disadvantages. Costs of EU producers have risen further because of a fall in capacity utilisation and loss of scale economies as these firms lose market share to more competitive rivals in a slowing Chinese market. Some like Stellantis, that produces Peugeots and Chryslers, have reportedly lost out even in the US because of overpricing their cars.

Not surprisingly, there is disagreement within Europe and in the US on the wisdom of the protectionist response. Germany and Hungary, for example, voted against the proposal for fear that Chinese retaliation would harm their exports to that country. European EV manufacturers too are unhappy. They not only fear that their Chinese manufacturing facilities would lose an important export market, but that China may

respond in ways that affect their sales in that country. Overall, 10 member states voted in favour of the tariff hikes, five against, and 12 abstained.

In the debate that preceded the final decision, non-Chinese producers were vocal in their opposition. To appease them, differential tariffs have been imposed on different manufacturers. Following protests from Tesla, for example, the tariff on cars of the company imported from China into Europe were hiked by only 9 percentage points to 19 per cent. The lower discriminatory tariff, arrived at through a non-transparent special investigation into Tesla's China operations based on a request from the company, has been justified with references to benefits provided by the Chinese government, such as access to land at subsidised rates, income tax concessions and lower battery prices.

Chinese EV manufacturers like BYD and Geely, on the other hand, were subjected to maximal hikes based on the presumption of having benefited from higher subsidies and on the grounds that they did not cooperate adequately with the pre-hike investigation by the Commission. If the Chinese had demanded similar information from European or US producers, they possibly would have been accused of industrial or regular espionage.

The Chinese government, as expected, has responded aggressively, saying that it had provided "tens of thousands" of pages of evidence to establish its case against the accusation of unfairly subsidising exports, and to argue that Chinese EVs were cheaper because of "factors such as industrial scale, comprehensive supply chain advantages and intense market competition." It does have a case, inasmuch as a fundamental feature of dumping, which is lower prices in export markets as compared with prices at home, does not hold. Chinese EVs are much cheaper in the Chinese market than in European markets. BYD's Seal U model reportedly sells for €20,500 in China and €42,000 in the EU. Despite the higher price, Chinese exports outcompete the products of many European firms. Not surprisingly, China has filed a complaint against the protectionist tariffs at the World Trade Organisation and begun retaliatory probes into dumping of French cognac and EU pork in Chinese markets.

It is interesting that retaliation from Europe to alleged dumping comes not through competing subsidies to ones it claims China is providing but through protectionist tariff hikes. Fiscal conservatism that has overwhelmed the elite-dominated parties of both the Right and the Left is clearly an explanation for that. It is also telling that these elites (and those in the US) do not see cheaper Chinese EVs as "more of an opportunity than a threat" as an editorial in the conservative Financial Times characterised them. Cheaper EVs can make a significant contribution to realising the EU's declared goal of phasing out cars with carbon emitting combustion engines by 2025. The volume of EVs required to meet that goal is so high that European and US manufacturers will be hard put to deliver enough vehicles, and at affordable prices. Rather than rely on China's production and price advantages in the area, the Commission has resorted to punitive tariffs. It has chosen to conceal its pique over being overtaken by the technological superiority of an "upstart" rival by imposing protectionist tariffs on specious grounds that defeat its own pretentious decarbonisation goals.

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