RECONNECT CHINA

POLICY BRIEF 17

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Beyond Tariffs & Subsidies - How China's EV Dominance is Shaping EU Trade Strategy

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Executive summary:

Over the past years, China has propelled itself as the world's biggest car manufacturer and exporter, overtaking Germany and Japan. Most notably, China has become the world leader in electric vehicles (EVs). In response to this rising EV production and export capacity, several countries have implemented tariffs on Chinese EVs in an attempt to localise manufacturing. The EU has also imposed tariffs on Chinese EVs despite internal and external opposition. American and European policymakers have justified this stronger trade stance on the basis of so-called "overcapacity" and the argument that Chinese carmakers are propelled to market dominance due to excessive subsidies. This paper refutes this narrative in the specific case of electric vehicles, arguing that while direct subsidies did play an important role, they are not the singular reason why China's EVs have become globally competitive. Furthermore, there is currently no overcapacity in EV manufacturing. Rather than purely subsidy-oriented, China's momentous rise is due to wide-spanning policy measures. This strategy included tariffs, local content requirements, and measures inducing vertical integration within the value chain as well as internal competition between Chinese car manufacturers. Nevertheless, European tariffs on EVs – used in a strategic and considerate manner in combination with increased investments in local value chains – can be a useful policy tool to localise manufacturing and create a level playing field, contributing to European and Chinese competitiveness in EVs alike.

Policy recommendations:

- *Implement tariffs to provide European automakers with breathing room to innovate, build up, and commercialise EV supply chains.*
- *Keep European automakers exposed to global competition and innovation, particularly from China, to enhance competitiveness.*
- *Encourage Chinese investments in Europe's EV sector, ensuring value-added production and technology development locally, rather than mere assembly.*
- *Leverage China's Li-ion battery overcapacity to reduce short-term production costs while improving EU battery production and innovation capacity.*
- *Invest in local battery and chip ecosystems to reduce long-term dependencies.*

Introduction

To meet the Paris Agreement goals (2015), between 75 and 95 percent of new passenger vehicles sold by 2030 need to be electric. [1] Therefore, in 2022, the European Commission set the goal to completely phase out internal

combustion engine (ICE) cars by 2035, making way for biofuels, hydrogen, and electric vehicles (EVs). However, European car manufacturers have been dragging their feet in developing EVs. All the while Tesla, and a myriad of Chinese brands have taken charge of this emerging industry. Over the past years there has been a meteoric rise of Chinese auto exports, making China one of the world's largest exporter of cars in only a matter of years. In 2023, China exported 4.43 million passenger cars, a surge of 66% from 2022, according to Chinese customs data.[2]

CHINESE INDUSTRIAL POLICY

China's car dominance did not happen overnight. It is the result of a decades-spanning industrial strategy, initially with mixed success. Whereas direct subsidies indeed played a pivotal role in the indigenous development of electric vehicle brands, it is important to note that multiple industrial policy measures were implemented, complementary to one another.

In the early stages of China's Reform and Opening Up period in the 1980s, China's authorities were actively trying to lure in Western car manufacturers through Joint-Ventures (JVs). In these JVs, China and Chinese firms were required to hold a minimum share of 50 %. The majority of leading non-Chinese automotive manufacturers went along with this, with the prospect of obtaining a slice of what was already by 2009 the largest car market in the world.[3] In essence it was a barter trade: non-Chinese brands were provided with market access to the largest (and growing) auto market in the world, while Chinese partner companies could benefit from acquiring the technology, expertise, and knowhow of manufacturing high-quality cars.[4] Under JVs Chinese automakers grew comfortable assembling cars for said European, American, Korean, and Japanese brands. This model made China a major car producer – though initially for the domestic market.[5] It was only in late 2016 that Chinese auto exports – overwhelmingly ICEs from Western, Japanese, and Korean brands that had set up factories in China – took off.[6] For Chinese companies, this JV-model contributed to a rapid growth of automotive industrial capacity, and – more importantly - entrenched China's automotive manufacturing prowess within global automotive supply chains.

EV SUPERPOWER

Although China became a major producer of internal combustion engine (ICE) cars, its domestic brands struggled to match the innovation capabilities of their Western, Korean, and Japanese competitors. While Western manufacturers dominated the ICE market, the most transformative change in Chinese car manufacturing would occur not in this area but with the rise of electric vehicles (EVs). Already in 2001, the State High-Tech R&D Development Plan – also branded "863 programme" – included the development of electric cars in its industrial objectives, which were implemented and reiterated during three successive Five-Year Plans.[7] The 'Sputnik moment' of China's EV industry is widely acclaimed to be the 13th five-year plan (2016-2020). Branded as "Made in China 2025", this industrial plan focused on moving up the value chain by abandoning old heavy industry and moving into innovative industries. In this plan, electric vehicles were highlighted as among the ten target sectors. And it was not only climate objectives that drove this rush towards EVs. By 2013 China had become the world's largest oil importer.[8] The prospect of reversing this import dependency towards transport energy independence would be an appealing prospect for China's authorities in the race to net-zero as well.

Subsidies have played a large part in the rise of Chinese EVs, with China's industrial players benefiting from state-guided subsidies into strategic sectors. According to an estimation by the American Center for Strategic and International Studies (CSIS), from 2009 to 2023, Chinese government subsidies for the EV industry cumulatively totalled USD 230.8 billion.[9] This study applies a wide definition of "subsidies", comprising a wide variety of industrial policy support measures that includes rebates, sales tax exemptions,

infrastructure subsidies, R&D grants, and government procurement spending.

Notably, subsidies were implemented in conjunction with regulatory changes like the dual credit system. In this regulatory framework, Chinese automakers were, since 2017, encouraged to manufacture an incremental share of their fleet as EVs.[10]

These subsidies were conditional. Chinese EV manufacturers qualified for subsidies only if their batteries had been sourced from Chinese manufacturers. Between 2016 and 2018, the Chinese Ministry of Industry and Information Technology published an annual list of approved EV battery suppliers. This list included 57 manufacturers: all of them were Chinese.[11] Non-Chinese brands were never banned out-right from the Chinese market, but Korean battery companies LG Chem and Samsung SDI were effectively barred from competing against local manufacturers who were supported by the Chinese state. Due to this regulatory measure, domestic battery manufacturers were assured that they could sell their Li-ion batteries to the hundreds of local car brands. These practises are still ongoing and are not limited to batteries. The automotive chip supply was also set within the boundaries of local content requirements. In 2024, the Chinese Ministry of Industry and Information Technology has required carmakers to source up to a quarter of their chips from domestic suppliers by 2025.[12]

Besides encouraging regulation and subsidies, tariffs have played a pivotal role in scaling up the domestic Chinese car manufacturing capacity. Up until 2017, when the US tariffs on auto imports were at 2.5 % and EU tariffs at 9 %, the Chinese tariffs were at 25 %, making for a substantial barrier for automakers to export to China.[13] It was only in 2018, in the midst of the US-China trade war, that import tariffs for foreign made automobiles were cut from 25 % to 15 %. This move was an effort to sway German Chancellor Merkel closer to China in view of President Trump's tariff hikes.[14] At the same time, tariffs on imports of US-made autos were raised to 40%. Most notably, import tariffs for auto parts were cut from 10% to 6%, facilitating China's rising role in the automotive assembly line, as lower tariffs on imported components made it only more attractive for global manufacturers to do much of their final assembly in China.[15]

The renewed Chinese tariff strategy and growing demand of the Chinese market acted as a catalyst for American car manufacturers to build even more (American branded) cars in China. Chinese authorities played along with this, but with a slightly different approach. Rather than copying the joint venture playbook from the ICE-era, EV pioneer Tesla was granted special privileges to set up shop in Shanghai in 2019. This allowed entrepreneur Elon Musk to build a Tesla Gigafactory as a "wholly foreign-owned subsidiary" – without a JV – at lightning speed.[16] Henceforth, Chinese manufacturing suppliers and battery companies could easily tap into the supply chain of the most advanced EV-maker in the world.[17] Moreover, Chinese authorities aimed to create a "catfish effect": by introducing Tesla—a major "catfish"—into the "tank" of the Chinese automotive industry, they sought to accelerate the pace and competitiveness of domestic manufacturers.

Just before the pandemic, a 10% stake investment made in 2008 by the American conglomerate Berkshire Hathaway—worth USD 230 million at the time—in a then small EV company began yielding significant profits.[18] Without ever having manufactured a single ICE car, the company Build Your Dreams (BYD) became a prominent rival to Tesla on Chinese highways.

Competition between Chinese EV companies has been fierce ever since. Although Chinese car manufacturers were supported by ample subsidies and shielded from foreign competition through the abovementioned tariffs, Chinese EV companies were facing a fiercely competitive landscape within China, where the amount of new EV producing companies ballooned each year. This internal competition with Tesla and other Chinese EV companies, combined with the effective local content criteria for subsidies, inspired Chinese EV producers to focus heavily on strong vertical integration – overseeing a supply chain from mining over battery manufacturing to car assembly.

In 2020 the State Council announced the New Energy Vehicle (NEV) Industry Development Plan (2021-2035), which established a framework for the development of NEVs from 2021 to 2035. This plan was mainly aimed at promoting the use of NEVs, improving charging infrastructure, and strengthening integration between NEVs and the power grid.[19]

investments has been directed at the "new three" growth drivers: electric vehicles, batteries, and solar panels, offsetting the investment shrinkage in the real-estate sector.[20]

This dynamic raised concerns among American and European policymakers, who from 2023 onwards have been warning about the issue of Chinese "overcapacity".[21] Whereas there are clear legal

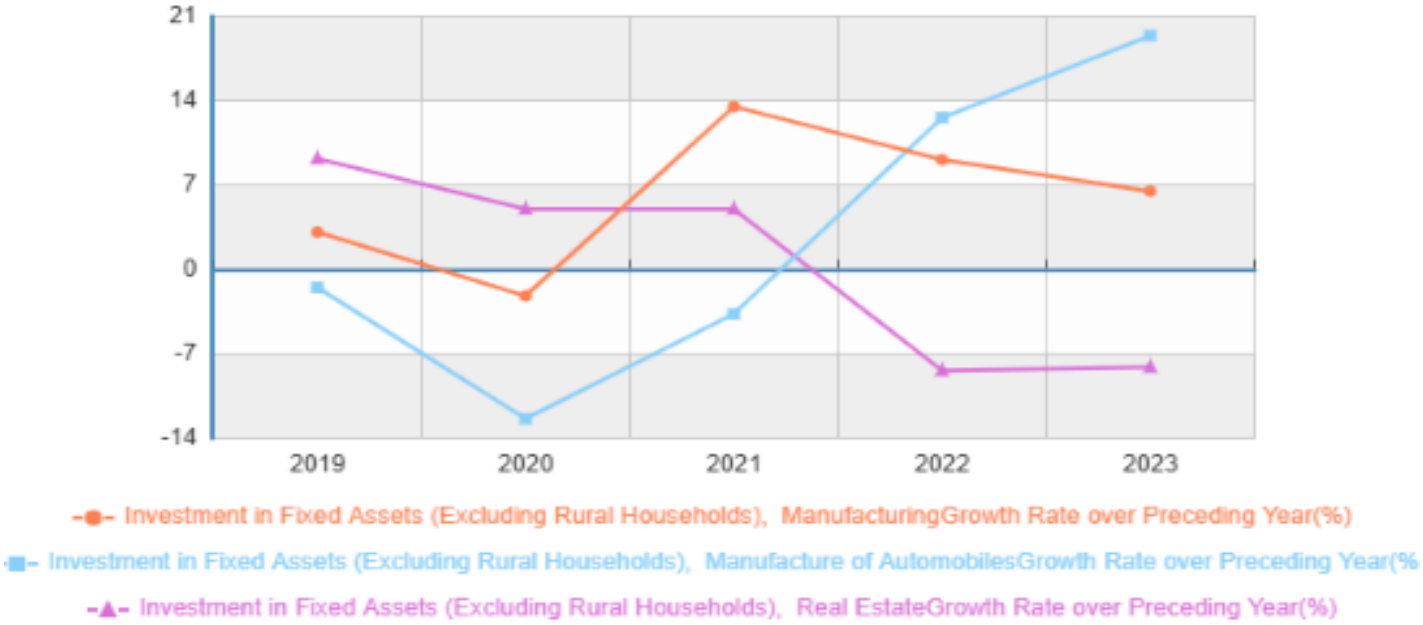

Figure 1: National Bureau of Statistics China

OVERCAPACITY

China's next phase of industrial strategy emerged during the pandemic, as the country faced economic growth challenges beginning in 2020-2021. Alongside reduced consumer spending due to strict zero-COVID policies, the economy was further strained by a property crisis triggered by the 2021 collapse of real-estate giant Evergrande. This negative cycle prompted Chinese policy makers to once again double down on investments and provide loans for building up even more manufacturing capacity (see Figure 1). A significant part of this emboldened focus on industrial

definitions and conditionalities for subsidies within WTO rules – on which the EU appeals for the new tariffs on Chinese EVs – there is no such clear, legal definition for "overcapacity".[1] [21]

The lack of a universally accepted legal definition in trade disciplines does not mean that overcapacity as such does not exist. Broadly speaking, overcapacity can be interpreted in two ways: excess capacity compared to production, and excess capacity compared to demand.

[1] The concept of overcapacity is often confused with "overproduction." While related, they refer to different metrics. Overcapacity emphasizes the capacity aspect—how much *can* be produced—while overproduction focuses on the output—the amount actually produced.

In the former case, overcapacity is a situation whereby factories' production is underutilised: a factory produces less than its plant is designed to produce. This can be a temporal or a structural phenomenon. Temporary overcapacity is a normal part of market cycles: for a brief period of time factories increase production capacity. Typically, market dynamics discourage firms from investing in capacity expansion without adequate demand to justify it. Therefore, under ideal market conditions, any temporary excess capacity tends to correct itself naturally. Structural overcapacity, on the other hand, happens when companies continue to expand production without the threat of loss-making. This can happen due to a lack of (market) pressures to operate efficiently.[22] The People's Republic of China, which identifies itself as a socialist market economy, follows a government-directed economic development strategy that does not consistently adhere to traditional market pressures. Hence, overcapacity – temporary as well as structurally – occurs regularly within the Chinese market, as it is the case in – among others – the Chinese steel industry.[23]

The most obvious metric to explore overcapacity is the Industrial Capacity Utilisation Rate (ICUR), which is the ratio of actual output to production capacity. While a 100 % utilisation rate seems ideal, it is unsustainable in the long run. An economy is usually best served between 80 and 85 %. This way, companies run at sufficiently high capacity to turn profits, but can have some spare capacity when there is an uptake in demand, preventing supply shocks. For reference: Europe's average capacity utilisation rate from 1985 to 2024 is at 81.03 %.

By these metrics, China has been consistently underutilising its industrial capacity compared to its output. This is not a novel phenomenon that started with the pandemic. As a matter of fact, China never utilised more than 80 % of its industrial capacity – *ever* (see Figure 2). Suffering from a steep decline during the early stages of the pandemic (as all major economies did), the ICUR rebounded quickly to pre-pandemic levels. From mid-2021 onwards, however, when the increased investments in industrial capacity materialised, we can observe a slight decline of ICUR (i.e. a rise in overcapacity) – but also here: this is not unique to China. China's industrial utilisation rate was at 73.6 % for the first quarter (Q1) of 2024: its lowest point since the pandemic hit the country. While fluctuating, the conclusion here is that China's industrial overcapacity (or unutilised industrial capacity) is currently at a quarter of its entire industrial base.[24]

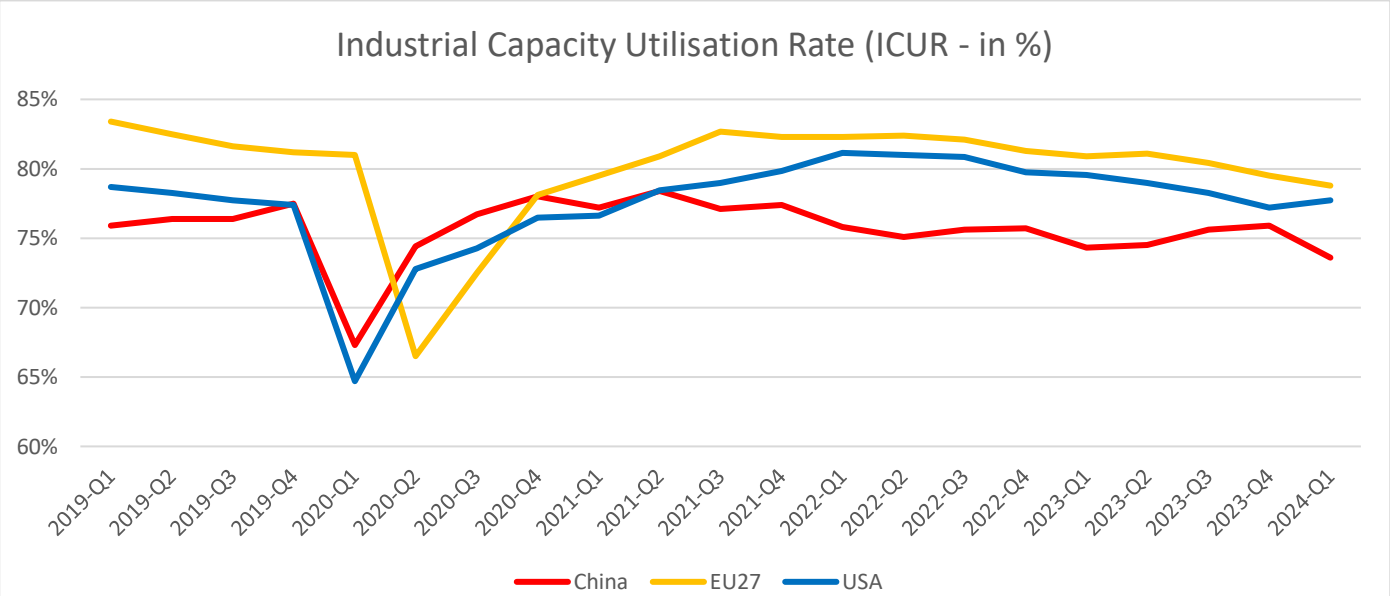

Figure 2: Federal Reserve Bank of Saint Louis, Eurostat, China National Bureau of Statistics

As noted above, overcapacity can also be referred to in respect to demand. In this setting, overcapacity means that the production capacity significantly surpasses what the market can absorb, leading to an unsustainable supply-demand imbalance. Measuring overcapacity relative to demand is complex because it involves market forecasts, consumer behaviour patterns, and external economic factors. Unlike ICUR, which compares output to capacity, demand-based overcapacity requires continuous market analysis to capture demand volatility. This is especially relevant for sectors where consumer demand fluctuates rapidly, where adoption rates are influenced by policy incentives, infrastructure, and technological advances. Also in this iteration, overcapacity can be either temporary or structural.

Chinese authorities are openly acknowledging the risk that excess capacity poses towards the overall economy[25]. The most common approach to counter this excess capacity in loss-making sectors has been the unleashing of market forces. The car manufacturing industry is no exception in this. Whereas there were roughly 500 registered EV makers in China in 2019, this amount was scaled back in 2023 to 100 EV manufacturers.[26] A further contraction of the myriad of Chinese brands is bound to happen in the Darwinian struggle that is China's form of capitalism.

AUTOMOTIVE OVERCAPACITY?

Overall car manufacturing industrial capacity utilisation rates are below the average ICUR across all industrial sectors (see Figure 4). This includes manufacturing for both NEVs as well as ICE vehicles. When ICUR was at its lowest point since the pandemic at 73.6 % in Q1 2024, automotive manufacturing was well below that, at 64.9 %.[27]

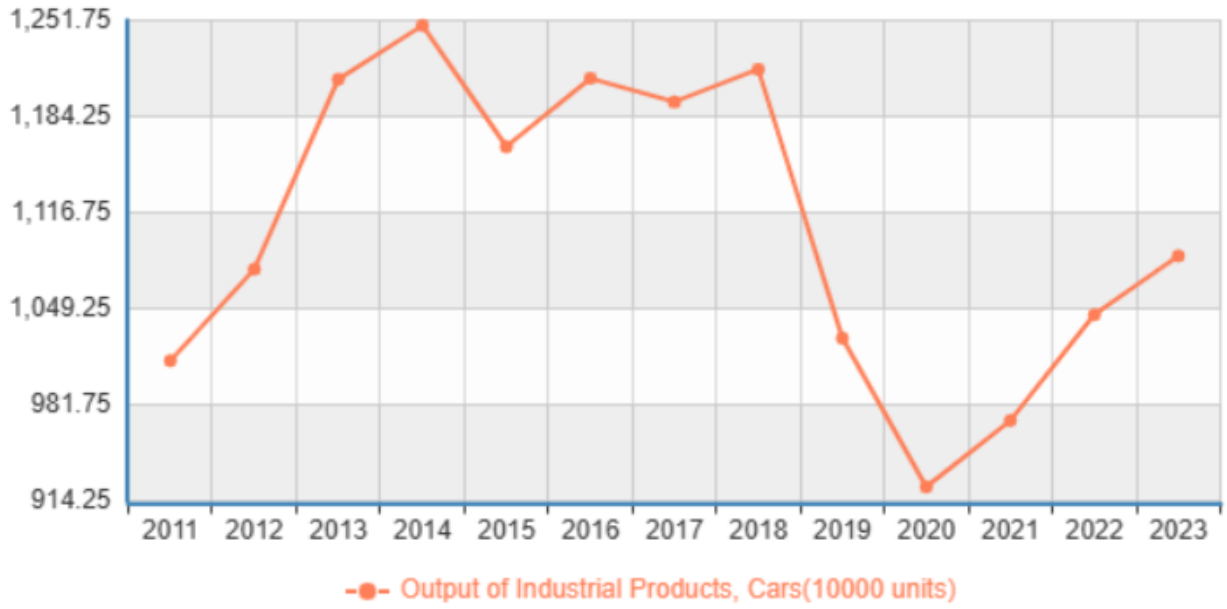

Figure 3: National Bureau of Statistics China

These statistics do not entirely reveal the imbalanced growth within the Chinese car industry. Paradoxically, the rapid Chinese transition towards EVs is indeed creating overcapacity in the Chinese car manufacturing sector, but it is not the EV manufacturing capacity that is causing this disequilibrium. Notably, companies focused on EV manufacturing are largely spared from this overcapacity. Quite the contrary: the most high-end EV factories in China are working at full capacity.[28]

Delving deeper into the data, 15 % of car factories in China has accounted for nearly half (47%) of all output. Both BYD as well as Tesla have a capacity utilisation rate of 80% or more. The ICE manufacturers in China are faltering and are suffering from low utilisation rates. Many of these are from non-Chinese brands, being built under a JV-model over the past decades.[29] Examples of this trend: after six years Hyundai had to sell its USD 1.15 billion factory in Chongqing at a severe loss as its sales for ICE cars in China had been tumbling.[30] In 2023, Stellantis sold its Jeep factories in China back to Dongfeng Motors.[31]

Up until recently, Western brands – through their JVs – had the upper hand in China. The mood switched in the summer of 2022, when Chinese brands overtook non-Chinese JVs in market share (see Figure 5). [32] To conclude, rather than a consequence of EV overproduction, industrial overcapacity in the car industry is a symptom of the collapse of demand for the legacy ICE sector.

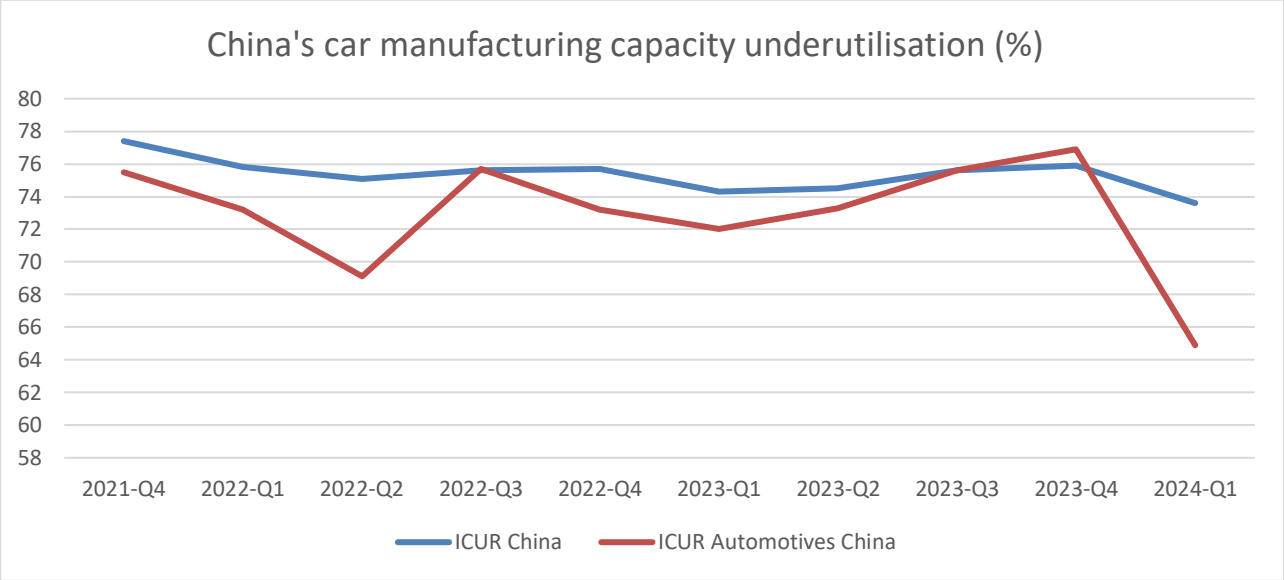

Figure 4: National Bureau of Statistics China

Consumption

The sheer vastness of its population rendered China the largest car market in the world since 2009. However, the average number of passenger cars per inhabitant is still rather low. As per capita car ownership in the EU is at 0.57, in China it is at less than half the European rate (0.23). [33] The Chinese car market itself is still far from saturated. Even though production has been on the rise since the end of the pandemic, China's overall car manufacturing production output is below the most recent peak of 2017-2018 (see Figure 3). [34] Both data points put China's automotive export boom in perspective. In absolute numbers, China's auto exports are a mere side-show to the domestic sale of automobiles. Although the share of exports is rising, over 80% of all China-produced cars are still absorbed by Chinese consumers (see Figure 6). This Chinese consumer has been shifting towards New Electric Vehicles [35], with NEV sales reaching over 40 % of the total sales market by 2024.[36] In early 2024, Chinese consumers owned over 20 million "New Energy Vehicles" [37] . While an undeniably large number, as a proportion of total NEV ownership in China, it accounts for only 6.07 % out of the entire Chinese domestic car fleet. This makes for a lower share of NEV penetration than in Belgium, and provides still ample growth opportunities for NEVs in China. [38] Furthermore, 2023 proved to be a pivotal year for Chinese EVs, as it was the first year in which NEVs were sold without support from national purchase subsidies. [39] Nevertheless, many tax exemptions and non-financial support, as well as provincial support measures for industrial capacity, have remained in place.[40]

Although purchasing subsidies are being phased out, demand has remained high. Consumers have plenty of choice between a multitude of EV offerings from a wide variety of brands that were started during the heydays of the EV subsidies. Over a hundred companies are currently seeking to outcompete each other over market share. This has led to an intense price war between Chinese EV brands. It is estimated that just 19 of the current 137 Chinese EV companies will be profitable by 2030.[41]

It was not only Russia that rose prominently as a destination of Chinese cars. Also Mexico and Saudi Arabia became important markets for Chinese cars since the pandemic, accounting for 12 and 7 % of all Chinese car exports, respectively.

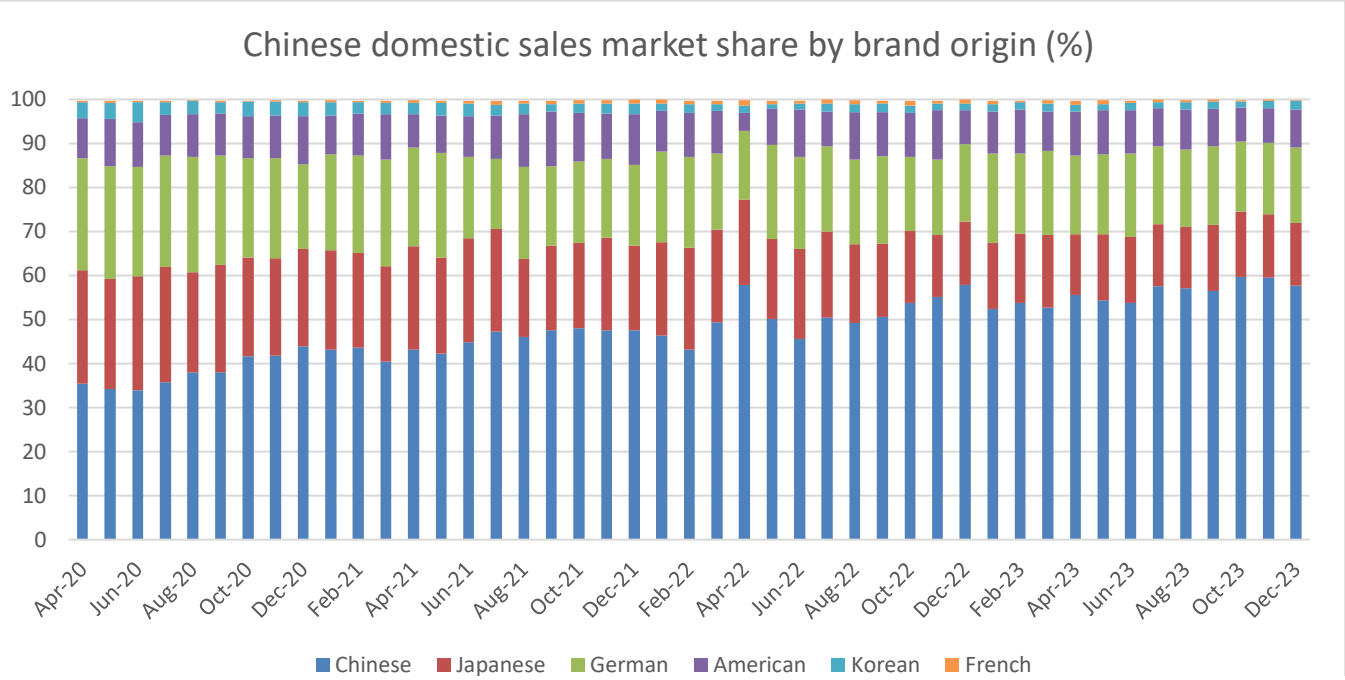

Figure 5: National Bureau of Statistics China

The untethered appetite for NEVs by Chinese consumers, fuelled by the various offerings despite declining fiscal benefits – has been mirrored by a decreased eagerness to purchase ICE cars. This created an oversupply of legacy ICE-powered cars and manufacturing facilities. These cars could not all be inventoried and eventually had to find their own markets, setting the scene for an increase in ICE exports. In effect, Chinese ICE exports were helped by Western sanctions on Russia, as a significant portion of these overproduced and inventoried Chinese-made ICE cars were exported to Russia after the exodus of Western car makers there.[42] At the time of writing, a quarter of all ICE exports out of China since February 2022 went to Russia (see Figure 7).

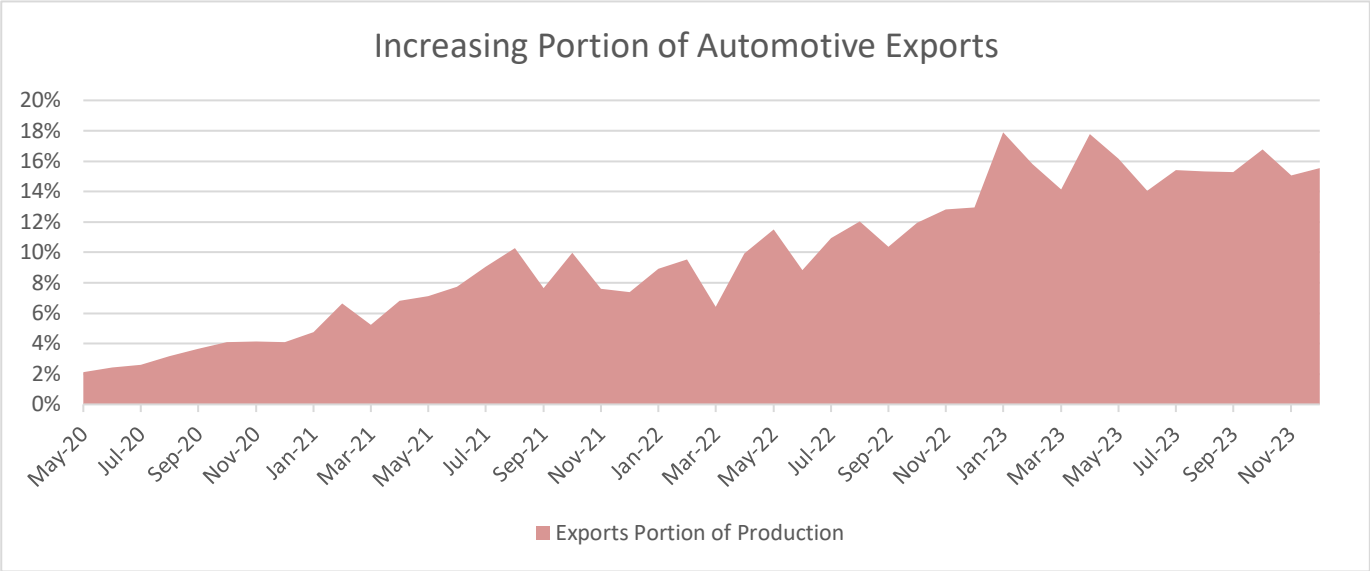

Figure 7: China Association of Automobile Manufacturers

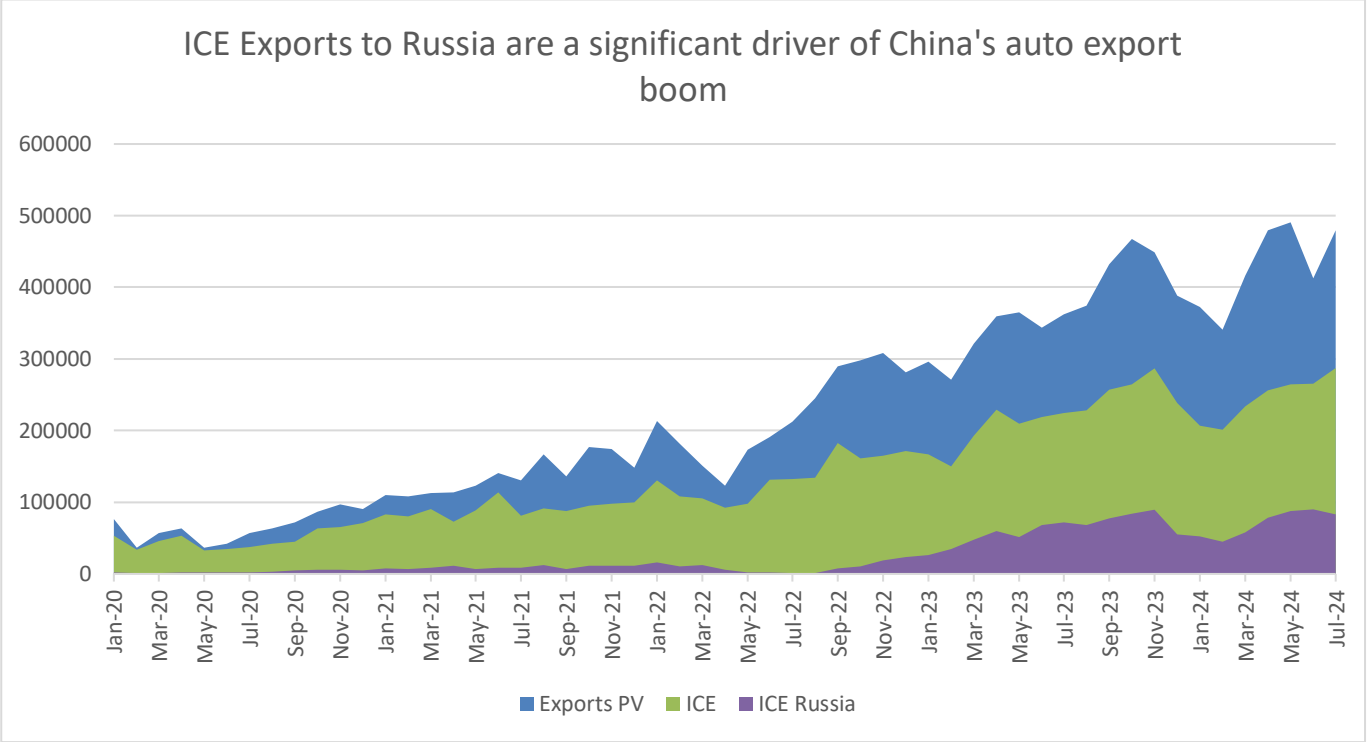

Figure 6: General Administration of Customs of the People's Republic of China

IMPACT ON EU

Although China's rise as a worldwide auto exporter is due to offsetting its mothballing ICE inventories, the bilateral EU-China trade figures paint a different picture. Of all China's automotive exports to the EU27 since 2021, 70 % are EVs.[43] Out of all the EV exports out of China since 2021, 31 % went to Europe, making it the single largest market for Chinese EV exports by a large margin.[44]

Taking into account that half of NEV sales over the past decade took place in China, the EU and the US are the second and third largest markets for NEVs, accounting for respectively 29 and 17 %.[45] And while the USA is effectively barring NEV imports from China, Europe is bound to become the only market for Chinese EVs in the short term (see Figure 9).

This impacted the EU auto market, resulting in the highest increase in imports from China in 2023 compared to the year before (EUR 3.5 billion, 36.7% more than in 2022) across all sectors.[46] Moreover, in 2023 almost a fifth of EVs sold in Europe were made in China, and prospects for 2024 amount to one in four.[47] This development sets alarm bells ringing in Brussels. Over 14 million Europeans work in industries dependent on the auto industry. Arguing that global markets were in danger of being "flooded with cheaper Chinese electric cars", Commission President von der Leyen announced the launch of an anti-subsidy investigation into Chinese EVs during her 2023 State of the Union address.[48]

In June 2024, the investigation reached its conclusion. Based on the results of this investigation, the Commission concluded that "the BEV value chain in China benefits from unfair subsidisation, which is causing a threat of economic injury to EU BEV producers".[49] As a consequence, the Commission implemented countervailing duties (CVDs) against the flood of Chinese cars, based on anti-subsidy rules within the WTO.[50] In a vote in the EU Council in October 2024, countries opposing increased import tariffs against Chinese EVs failed to gather enough support to halt the CVDs.[51]

Whereas the Commission has followed up on a variety of anti-subsidy and anti-dumping probes over the past years – not solely against China – the EV case represents the highest trade case against China in over a decade.[52] Although the Commission enacted its investigation ex officio – unprompted by industry complaints – it is widely acknowledged that the EU executive has been pushed by the French government.[53]

In reaction to the Commission's announcement, China's Ministry of Commerce (MOFCOM) urged the EU "to immediately correct its wrong practices", stating that the duties "lack both factual and legal basis." [54] Chinese Communist Party and State-affiliated media outlets have branded the European move as "jeopardiz[ing] the EU's own goals of green transition and collaboration in addressing climate change on a global scale." Furthermore, Chinese counterparts responded with a frenzy of retaliatory investigations and tariffs, ranging from alcoholic beverages to large ICE cars, as well as dairy and pork imports.[55] Moreover, China filed an official complaint at the WTO.[56]

Despite Chinese pressure and ongoing negotiations aimed at reaching a compromise to avoid higher tariffs, European member states granted final approval to the proposed tariffs on Chinese electric vehicles (EVs), which took effect on 31 October.

TARIFF ORDER

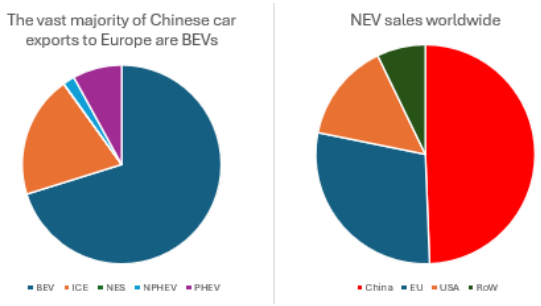

Figure 8: General Administration of Customs of the People's Republic of China; International Energy Agency

Tariffs have a retaliatory but also a knock-on effect for industrialised economies. As more markets impose tariffs to restrict Chinese electric vehicle imports, industrialised economies face mounting pressure to implement similar measures to protect their own markets from being dominated by an increasing proportion of ever cheaper Chinese imports.

In May 2024, US President Joe Biden quadrupled tariffs on electric vehicles from China to 100 %, effectively blocking any prospects of future imports of Chinese EVs to the US. In August 2024, Canada followed suit and implemented 100% tariffs on Chinese-made EVs as well.[57] The possibility of Chinese-branded cars entering through assembly plants in Mexico will be blocked by a proposed rule that will ban all Chinese "connected vehicle" technologies – software and hardware.[58]

Although North American countries are following the USA in this, it is, however, not only Western countries shielding their emerging EV manufacturing sector: countries around the world have been taking charge of their EV imports.

Already since July 2022, the Turkish government put 10 % additional duties in place on EV imports from all countries except for the EU and FTA-linked countries. These duties were raised specifically on Chinese EV imports to 40 % in March 2023.[59] On June 8th 2024, Türkiye announced the expansion of tariffs on all cars (not only EVs) imported from China. The Turkish Ministry of Trade announced duties of 40 % (with a minimum of EUR 6,500) to be levied on every imported Chinese automotive vehicle from July 8th onwards.[60] Notably, Türkiye has a vast network of FTAs in place, providing leeway for Chinese auto manufacturers to avoid tariffs by setting up shop in Türkiye and exporting Turkish-made, Chinese-branded EVs to Europe.[61] Important to note is that, up until now, Turkish restrictions on Chinese autos have neither translated into a domestic production boom, nor succeeded in suppressing a surge of imported Chinese vehicles.[62] However, talks are under way. Following up on reports of the latest tariff hikes, Chinese EV manufacturers BYD and Chery started talks with Turkish authorities for factory investments in the country.[63] Given Türkiye's customs union agreement with the EU, Turkish-built Chinese cars could be provided access to the European market in the long-term.

The same pattern was repeated in Brazil. In September 2023, the Brazilian government announced that it would end a tax exemption for importing electric vehicles, to be followed by gradually raising the duty to 35 % over three years.[64] Due to the gradual nature of the duties, passenger car imports to Brazil have been on a steep rise in the first half of 2024, with Chinese vehicles accounting for around 40 % of the total.

Producer:	EU tariff rate (on top of 10% baseline):
BYD	17%
Geely	18.8%
SAIC	35.3%
Tesla	7.8%
Other cooperating companies	20.7%
Other non-cooperating companies	35.3%

The EU's decision to impose trade barriers on Chinese electric vehicles (EVs) is thus not an isolated action: it is part of a broader global trend. By raising tariffs, investment can be further attracted and local manufacturing boosted vis-à-vis relying on imports. However, there are some important considerations. EVs typically use twice as many semiconductor chips as ICE vehicles.[65] Moreover, batteries account for 30% to 40% of an EV's total value,[66] meaning that the assembly process alone contributes only about half of the total value in EV manufacturing. For smaller economies focused solely on local growth, this might suffice. However, for the EU, a global economic powerhouse with ambitions to lead in clean technology and enhance the competitiveness of its domestic brands, deeper involvement in battery production is crucial. Dominating this high-value segment would not only generate greater economic value but also secure supply chains and establish the EU as a frontrunner in the EV industry, establishing and empowering European companies.

Conclusion

This paper dug deeper into how Chinese market dominance in EVs came about in such a short timeframe through a highly effective industrial policy. However, China's rise to global competitiveness in electric vehicles (EVs) is not solely due to direct subsidies. China's success stems from a comprehensive and strategic set of policy measures enforced at the local and national level, including tariffs, local content requirements, and value chain integration, which together have driven the industry's growth towards international competitiveness. Moreover, this paper contends that there is no current overcapacity in Chinese EV manufacturing, although this is the case for China's internal combustion engine (ICE) manufacturing sector. Furthermore, Europe's recent iteration of tariffs on Chinese-made EVs was discussed, as well as reactions from other countries towards the avalanche of Chinese automotive exports.

POLICY RECOMMENDATIONS

Europe needs to be clear-sighted about what its objectives are. For an effective tariff policy, entrenched in a comprehensive industrial policy, trade-offs will need to be made. To paraphrase Dani Rodrik: the more things we aim to achieve, the less likely we are to get them.[67] Competitiveness of European brands, employment opportunities, and investment in green technology capacity all need to be improved while scaling down the risk of weaponisation of trade or becoming irrelevant in the development of this emerging field. The experience of China can be a valid lesson on how to become a leader in EVs.

1. FOSTER COMPETITIVENESS

Chinese manufacturers did indeed benefit from subsidies, an accommodating tariff and regulatory environment. However, besides this, the key to Chinese EV manufacturers' success has been internal Chinese competition – between companies and provinces alike, as well as the huge size of the internal market. Chinese brands would not be where they are on the world stage if they had not been exposed to the world's fiercest EV market at home. Embarking on an industrial policy backing European automakers without exposing them to the leading-edge technological innovations – as the American government is currently undertaking – will harm our industry severely.

European car manufacturers need China, for its market, but also for its expertise. In the latest business survey carried out by the German chamber of commerce in China, out of all sectors, the automotive industry stands out with the strongest investment intentions in China (63%), mostly due to the intention to remain competitive within the Chinese market. Another important aspect is the fact that 69% of German automotive companies reckon Chinese competitors are leading in innovation or will do so in the next five years.[68]

2. SCALE UP INVESTMENTS FROM CHINESE CAR MANUFACTURERS IN EUROPE

As China's EV story has shown, tariffs – when engaged in a measured and strategic manner – can be an effective policy tool, creating breathing room for domestic car manufacturers to scale up local industrial capacities, develop their own technologies and limit the competitive price advantage from Chinese EVs. When President Von der Leyen announced starting the EV probe, several Chinese companies were already present in Europe and indicated that their footprint was set to increase. BYD is already present in Hungary,[69] Chery has signed a joint venture with Spain's Ebro-EV Motors to open its first site in Spain,[70] and Geely has indicated that it will shift part of its EV production to Belgium.[71]

These are positive developments that strengthen the automotive manufacturing capacity in Europe, but caveats should apply. First and foremost, arrangements should be made to ensure that these factories for Chinese brands in Europe are indeed manufacturing plants rather than mere assembly facilities for Chinese component imports. Value creation on the mid- and up-stream should be considered as well. Clear-eyed investment rules for green technologies should be negotiated within the EU and with Chinese counterparts to ensure a level playing field, supply chain security, and intellectual property protection.

China's overseas direct investment rules make it difficult for even well-established car and battery manufacturers to invest abroad. These intend to minimise the risk of uncontrolled capital outflows, but are often reflected by an arduous and bureaucratic process.[72] To enhance policy alignment, future trade negotiations should incorporate a review of Chinese outbound investment regulations. This would establish a framework that reduces restrictions on Chinese greenfield investments and joint ventures in green technologies—particularly in areas such as electric vehicles (EVs) and lithium-ion (Li-ion) batteries—within Europe. These investments should be permitted under stringent EU Commission anti-subsidy guidelines to ensure fair competition and regulatory compliance. This way Chinese companies are allowed to grow and expand, while the EU can benefit from increased capacity and local production in a level-playing field.

3. Leverage Chinese overcapacity

Whereas there is arguably little-to-no overcapacity in the Chinese EV-sector, there is no doubt that there is overcapacity in China's Li-ion battery sector. China's battery production capacity is currently at twice the demand levels. Based on announcements for further capacity expansion, this overcapacity is only set to surge, reaching fourfold demand by 2027. [73] This overcapacity has driven down production costs, rendering EU-made batteries 11 % more expensive.[74] In 2022, the price for batteries produced in China was $127 per kWh compared to $169 per kWh in the EU, making the EU one third more expensive. Due to the Inflation Reduction Act (IRA), the US could produce batteries at prices as competitive as in China.[75] In the short term, Europe has no other option than to import batteries from China.

4. Confront supply chain risks

In the long-term, however, Europe should get serious about developing its own battery supply chains, especially for the next generation batteries. Chinese authorities have proven not to be shy about restricting graphite supplies to Sweden – home of battery cell developer Northvolt – while exports to Poland and Hungary have soared. Not coincidentally, Hungary and Poland are countries where Chinese battery manufacturer CATL and other Chinese battery plants have been set up.[76] These risks should be confronted and addressed. Hence, in the medium-to-long-term, investments in a local battery ecosystem – raw materials, cathodes, cell components, and battery assembly – , but also chip manufacturing should be encouraged to scale down import dependency.

In opening up towards Chinese EV manufacturing investments, European authorities should make sure that supply chain risks are being cushioned by increased burden sharing between member states through, for example stockpiling on critical raw materials necessary to build Li-ion batteries.

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