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TARIFFS ON CHINESE EVS AND IMPLICATIONS ON ENERGY TRANSITION

The only thing we have to fear is fear itself.

Franklin D. Roosevelt

In May, the US announced tariffs of 102.5% on imported Chinese electric vehicles (EVs). One month on, the EU has also announced provisional tariffs on Chinese EV imports and Canada is considering raising similar levies. Such measures will not only create economic winners and losers but could also have profound implications on the world's transition to a net-zero economy.

Tariffs' benefits uncertain

Generally, the net impact of tariffs on the economy of the country that imposes them, in terms of output and employment, could be uncertain.

Tariffs provide protection for some domestic industries and encourage import substitution. That could increase employment and domestic income. However, those industries with large exposure to the tariffs could suffer a decline in employment due to rising input cost and possibly become subject to retaliatory tariffs. If these downside effects were to negate or even overwhelm the positive impact from import tariff protection, that could result in a net negative effect on growth. Indeed, the US Fed's research using the 2018 US tariffs found that the net impact on US growth and employment was negative, *ceteris paribus*.

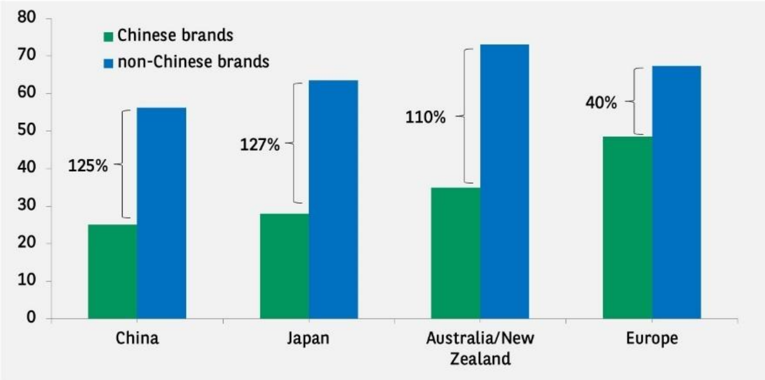
EU tariffs & China

China exports no EVs to the US at this point. So, the Biden administration's EV import tariff is essentially symbolic. However, the EU's provisional tariffs could have material impact: Chinese EVs accounted for almost 20% of the EV market in Europe in 2023, and the share is expected to rise to 25% in 2024.

Furthermore, the estimated 40% cost advantage of Chinese EVs in the European market is much smaller than in other markets (Exhibit 1). If the EU goes with a 35%-40% tariff rate, that could eliminate China's competitive advantage in the European market.

The sustainable investor for a changing world

Exhibit 1
Average EV price by market ('000 euros)



sources: MS, BNP Paribas Asset Management Data as of 2023

The EU's new tariffs are provisional because they might be reduced if Chinese producers prove that they get lower subsidies than the EU has estimated. Furthermore, if China could reach an agreement with the EU to reduce the volume of Chinese EV exports to Europe, the new tariffs may not be implemented at all.

Winners and losers

The tariff obstacle many prompt some Chinese EV makers to consider locating their production facilities to the US and export from there. That could help create jobs and boost manufacturing and tax revenues in the US. However, such incentive of the Chinese firms could be offset by the US government's hawkish policy on Chinese investment in the US.

So, the primary victims of the tariffs appear to be Chinese EV exporters in terms of profits and jobs. But the tariffs will likely also hit European and American consumers as domestic producers could raise EV prices, or keep them high, in the face of less competition. Producers from smaller countries could also suffer as they could face higher competitive pressure from China if it diverts its exports to Europe and the US to other markets. There may also be a higher risk of larger countries imposing protectionist measures.

Impact on energy transition

Crucially, by making EVs dearer in Europe and the US than they would otherwise be, the tariff protection would delay the transition from conventional air-polluting fossil-fuel powered cars. Since EVs can play an important in the world's transition to a net-zero economy, arguably, some subsidies for EV production are a second-best policy.

Furthermore, in the absence of a sufficiently high global carbon tax to incentivise energy production and consumption transition, a globally efficient subsidy rate for EV production should be set high enough to encourage the transition. From this perspective, tariffs on EVs are a distortion to this balancing policy act and the global initiative of net-zero transition.

Finally, the new tariffs could create two opposing forces in the global markets. On the positive side, shutting Chinese EVs out of the European and US markets could prompt China to export EVs elsewhere, especially to the Belt and Road Initiative countries, enabling those countries' consumers to access cleaner transportation and thus supporting the net-zero initiative.

On the negative side, although the diversion of China's EV exports to countries with small domestic automobile industries will only have a limited negative impact, the adverse effect on countries with a large automobile industry could be significant as their EV manufacturers would come under greater competitive pressure. These countries may feel the need to follow the European and American tariff moves, which will erode the global energy transition initiative.

Net-zero, a secular trend

Despite the ebb and flow of government policy, net-zero transition is a secular trend. It will get stronger with a clearer direction than it does today when the global powers finally find a way to cooperate on a common energy transition policy via a combination of an EV subsidy scheme, a common tax on carbon emissions, and a common mechanism for allocating the emissions.

The private sector can play a critical role in the energy transition process. As pools of capital that can be allocated across a range of assets, investment funds can be used to direct substantial financial resources towards sustainable and green initiatives.

Market estimate puts the financing needs for the net-zero transition at over USD6 trillion a year between now and 2030, with transportation and energy systems having the biggest funding needs. However, global climate financing was estimated at only a little over USD1 trillion in 2022. The huge funding gap underlies the attraction of energy transition as a long-term investment theme.

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