AT A GLANCE

European Parliament

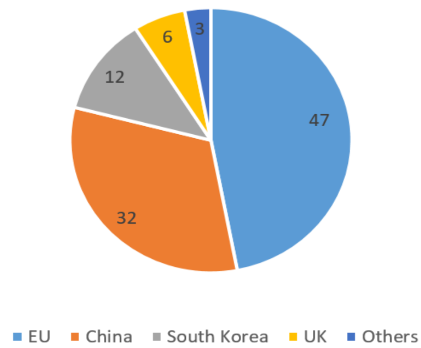
EU – UK rules of origin for electric vehicles and batteries

The EU and the UK are key automotive trading partners. After the UK left the EU, the two parties concluded a Trade and Cooperation Agreement, committing them among other things to a progressive increase in the EU and UK content in the electric vehicles (EVs) and EV batteries they trade, to avoid tariffs. As the European EV batteries sector is not sufficiently developed, the parties have agreed to extend the current rules until 2027.

EU and UK car markets

In 2022, the United Kingdom (UK) was the EU's second biggest export destination for cars, accounting for 17 % of total exports, halfway between the United States (23 %) and China (15 %). Between 2002 and 2022, the EU had a surplus in its car trade with the UK; this surplus peaked at €26 billion in 2015, falling to €17 billion in 2022. The EU is the UK's largest market for total vehicle imports and exports (see chart).

Share of UK EV market in 2022



Data source: ACEA Factsheet, 2023.

Importantly, both parties have legal commitments not to sell new cars with combustion engines from 2035 onwards. The volume of trade in EVs is already significant. In 2022, the UK exported more than 47 000 EVs to the EU with a total value of €1.2 billion. In the same year, the EU exported nearly 140 000 new EVs to the UK, worth €5.1 billion. In 2022, there was a total of 642 000 EVs in the UK, compared with over 1 million in Germany and a total of 3 million in the EU as a whole.

Post-Brexit EV trade framework

Following the UK's withdrawal from the EU, the two parties signed a Trade and Cooperation Agreement (TCA) laying down the rules governing trade between them, with effect from 1 May 2021. Annex 5 of the TCA contains transitional product-specific rules for electric batteries and EVs. These include provisions on rules of origin – the criteria for establishing that a product is of EU or UK origin and therefore qualifies for the preferential trade regime under the TCA. For EV battery packs or battery cells to be recognised as being of EU or UK origin – and therefore eligible for zero tariffs – certain percentages of their value must originate in either the EU or the UK. These thresholds were set to increase progressively over the years, so as to phase in a full rules-of-origin regime from 1 January 2027 (see Table 1). Vehicles and batteries that do not meet the requirements face a 10 % tariff at either the EU or the UK border.

Table 1 – TCA requirements for content originating in the EU/UK

	1 May 2021 to 31 December 2023	1 January 2024 to 31 December 2026	From 1 January 2027
Vehicle value	40 %	45 %	55 %
Battery pack	30 %	60 %	70 %
Battery cell	30 %	50 %	65 %

Data source: EU-UK TCA.

Major developments since 2020

The rationale behind the rules was to incentivise investment in domestic battery manufacturing capacity. However, the rules were agreed prior to the emergence of major social and economic developments that had a strong disruptive effect on the EU and UK supply chains and automotive sectors. Disruptions started with the COVID-19 pandemic and were further exacerbated by Russia's war of aggression against Ukraine. The resulting shortages (in particular of semiconductors) and shocks to both demand and supply caused problems for both the EU and the UK automotive sectors. More recently, these sectors have faced increased

EPRS | European Parliamentary Research Service
Author: Marcin Szczepański, Members' Research Service
PE 757.643 – February 2024

EN

competition as a result of a number of new external subsidy support schemes, such as the US Inflation Reduction Act, diverting investment in battery ecosystems away from the EU and the UK. Prices of raw materials have also soared owing to shortages coupled with rising global demand.

China has given massive support to its EV industry with a mix of under-priced loans, equity injections, purchase subsidies and government contracts. Experts accuse the country of disregarding global trade rules and applying forced technology transfers. The EU has recently launched an anti-subsidy investigation into imports of Chinese EVs. The global market share of Chinese EVs is growing: in the EU, it has recently risen to 8 % and may reach 15 % by 2025. In the UK, it has soared from 1.7 % in 2019 to nearly 32 % in 2022.

According to the European Commission, these factors have 'led to a situation where the scaling-up of the European battery ecosystem has been slower than initially anticipated'.

European Parliament

In a 23 November 2023 report on the implementation of the EU-UK TCA, MEPs called for reasonable solutions to be found for EV rules of origin, given the difficulties encountered by EU manufacturers in sourcing parts, in particular batteries, from within the EU. It pointed out that any exception would risk shifting investment away from the EU and should be assessed in the light of the European economic security strategy. The Parliament also encouraged the UK to consider re-joining the Regional Convention on pan-Euro-Mediterranean preferential rules of origin (PEM Convention). The convention, signed by the EU and 21 countries, facilitates trade by making rules of origin simpler and more flexible.

Extension of the original rules

Under the EU-UK TCA, the first increase in thresholds for domestic content were supposed to apply from 1 January 2024. In the run-up to the deadline, EU and UK carmakers issued numerous warnings signalling that they could not meet the heightened requirements. The European Automobile Manufacturers' Association (ACEA) estimated that a 10 % tariff could cost the industry €4.3 billion, potentially reducing EV production by nearly 500 000 units. Higher EV prices (as much as €4 100 per vehicle) would likely benefit China, which despite paying the 10 % tariff has steadily increased its market share in both the EU and the UK by offering cheaper cars. Market analysts also pointed out that the EU is growing increasingly dependent on imports of cheap Chinese EV batteries, with the Chinese battery companies' EU market share set to increase from 30 % to 50 % between 2023 and 2027. ACEA argued that EU and UK EV supply chains were not ready to fit within the thresholds.

On 6 December 2021, having listened to the views of industry and the UK government, the Commission submitted a proposal to the Council with a number of palliative measures. One of these was a one-off extension – until 31 December 2026 – of the first set of rules of origin featuring the lowest thresholds (left column in Table 1). From 1 December 2027, the final, most stringent rules of origin would apply as originally set (right column in Table 1). The effect of the extension would be the removal of the 1 January 2024 tariff cliff edge. Another measure was the introduction of a lock-in mechanism to prevent any further changes from being made before 2032. To help industry prepare for the higher requirements applicable from 2027, a third measure involved setting up a dedicated instrument for the battery value chain under the Innovation Fund, with a financial envelope of up to €3 billion. After the Council approved the proposal on 21 December 2023, it was adopted by the TCA Partnership Council on the same day.

Views and outlook

The extension of the current rules was met with overwhelming approval from the automotive industry in both the EU and the UK. The UK in Changing Europe research consortium stated that 3 years was a limited time window that might not be enough to scale up the EV industry sufficiently. Michael Gasiorek from the University of Sussex Business School argued that PEM Convention membership would be beneficial for the UK automotive industry, particularly in light of the tariffs, while not serving as a silver bullet capable of removing post-Brexit trade obstacles. Niall Moran from Dublin City University stressed that the shortage of raw materials facing both EU and UK battery makers presented a strong case for integrating their supply chains. It is however unclear whether such a rapprochement is possible, or if EU-UK relations are to remain indefinitely within the limits of the TCA.