# Research Institute - Insight

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#UK / #Politics / #Regulation

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# Brexit and batteries: new challenges for manufacturing

Looming deadlines for phasing out transition arrangements in the EU-UK Trade and Cooperation Agreement risk compounding challenges facing UK car manufacturing. Despite extensive lobbying, the EU seems committed to introducing the tariffs. A thorough review of UK-EU trade relations will likely have to wait until 2026 and a new government.

**Key Takeaways**

- Various transition arrangements designed to smooth the implementation of the EU-UK Trade and Cooperation Agreement (TCA) are set to be phased out on 1 January 2024.
- Tariffs would be imposed on electric vehicles (EVs) with more than 55% of parts sourced from outside the UK and the EU. This poses significant challenges for electric vehicle manufacturers that rely on battery imports from Asia.
- The UK is struggling to compete against the green industry subsidy programmes in the EU and US. This risks driving electric vehicle manufacturing abroad.
- The UK government has been lobbying hard for a delay or change to the tariff schedule. European trade bodies have also joined these efforts.
- However, the most likely outcome at this stage is that the new tariffs will be imposed largely as planned. While the UK government believes Brussels will grant an extension, the EU seems to see this as an opportunity to accelerate battery production and demonstrate to the UK the costs of being a "third party".
- A new UK government would have the opportunity to revisit aspects of the TCA in due course, but this will probably have to wait until 2026. Labour would likely prioritise delivering the minimal restrictions compatible with staying in the single market.

**New UK-EU tariffs are set be phased in on electric vehicle batteries from January 2024**

After a period of relative quiet in Brexit-related policy, trade with the EU is set to move swiftly up the list of headaches facing the government.

New tariffs are scheduled to be phased in from the start of 2024 as the transition arrangements agreed in the EU-UK Trade and Cooperation Agreement (TCA) expire.

New rules for EVs would require electric cars exported between the UK and the EU to have 45% of parts sourced from within the two regions, with those that do not being subject to a 10% tariff.

More stringent requirements would also be introduced for EV battery parts and the maximum non-UK-EU allowance for components will decrease again in 2027.

These will impact a significant proportion of EVs as manufacturers on both sides of the English Channel continuing to rely heavily on battery imports from Asia.

**Table 1: The EU-UK rules of origin become more restrictive over time**

| 2021-2023 (% of non-EU-UK material permitted) | | 2024-2026 (% of non-EU-UK material permitted) | 2027 onwards (% of non-EU-UK material permitted) |
|---|---|---|---|
| Electric vehicles | 60 | 55 | 45 |
| Battery packs | 70 | 40 | 30 |
| Battery cells | 70 | 50 | 35 |

Source: UK-EU Trade and Cooperation Agreement, abrdn, June 2023

### The UK could be hit hard by the imposition of tariffs

Although both the EU and UK will be negatively affected by the imposition of tariffs, the latter is likely to suffer from a withdrawal of manufacturing investment as producers shift their focus to mainland Europe.

The UK lags behind the EU in domestic battery production, having only one active production facility while construction of a second is currently under consideration. By contrast, 25 gigafactories are operational, under construction, or planned within the EU. Many of these have been partially financed through the Important Project of Common European Interest funding mechanism.

The UK government may struggle to keep up with the trend of active industrial policy other countries are adhering to and it has been clear that it will not be seeking to match the green industry plans of the US and the EU. Greater opportunities for subsidy elsewhere, inconsistent policy and a smaller market scale risk driving future investment out of the UK and towards alternative markets.

With battery production for EVs typically located close to car manufacturing facilities, basing battery production within the EU would drive future car manufacturing to the bloc.

This would leave the UK car industry focused on combustion engines and dependent on battery imports from the EU and Asia, which is unlikely to be viable in the long term. While these issues would likely be present without the introduction of additional tariffs, they may accelerate and exacerbate these risks.

The UK government is taking some steps to try and mitigate these concerns. Prime Minister Rishi Sunak and US President Joe Biden have agreed to begin negotiations on an agreement which would allow some critical minerals extracted or processed in the UK to count towards some of the tax credits available through the US Inflation Reduction Act. This will help the UK's critical minerals sector, but is unlikely to shift the dial for car manufacturers.

The EU has proposed the UK joins the Pan-Euro-Mediterranean convention as a solution to the imposition of the new tariffs. The pact currently includes 20 countries across Europe, the Middle East and North Africa and treats goods assembled in one country from parts made in another signatory state as originating in the exporting country, enabling them to avoid tariffs. This however would be unlikely to help address the impact of tariffs, as batteries are imported from Asia.

### Will the tariffs be implemented on schedule?

Imposition of the new tariff arrangements is being strongly criticised by UK and EU carmakers, which argue that it will harm EV production in both regions. For example, the European Automobile Manufacturers Association estimates that the change will impose €4.3bn in tariffs resulting in about 500,000 fewer vehicles being made. And it is calling for a delay of the imposition of the rules to 2027.

Meanwhile, there are significant political risks for the UK government if the policy goes ahead as planned. Car manufacturing employs 200,000 people in the UK, concentrated in 'red wall' seats in the North East and Midlands that were key to the Conservatives' electoral success in 2019. As such the government has been lobbying hard to delay or reform the TCA.

There could be reasonable grounds for doing so. The TCA was agreed before the Covid pandemic delayed progress in expanding UK-EU battery production, resulting in a higher than anticipated reliance on Asian batteries ahead of the phasing in of tariffs. And new tariffs risk increasing the cost of UK and EU manufactured vehicles for consumers, potentially affecting market share and slowing EV take-up in opposition to both climate and industrial policy objectives.

However, the EU has not demonstrated a willingness to delay the implementation of tariffs, which it sees as an opportunity to accelerate domestic battery production, in line with its goals to onshore green manufacturing set out in the Green Deal Industrial Plan. The only way the EU is likely to consider a delay is if EU carmakers, rather than the UK government, can demonstrate significant harm to future production as a result of the tariffs.

Relations between the UK and EU have improved since the Windsor framework was agreed earlier this year. However, the EU continues to be reluctant to revise trading agreements made as part of the TCA, seeing any potential trade friction as a necessary consequence of Brexit.

In June 2023 European Commission Maroš Šefčovič warned that "over time, increased divergence may bring even more costs and it will further deepen the barriers to trade between [the] EU and the UK." The EU remains committed to treating the UK as a 'third country' as per the terms of the agreement, which means significant concessions are unlikely.

**Financial services and food will also be affected by the end of transition arrangements**

Batteries are by no means the end of the story as the UK and the EU move towards full implementation of the TCA.

The UK government has published proposals for a new inspection fee of £20-£43 for food shipments coming from the EU as part of its plans to phase in border checks on good imports from 31 October 2023. This may add further upward pressure to food prices and slow the return of inflation to target.

In financial services, the UK's decision to grant passporting rights to European Economic Area-based financial services under the Temporary Permissions Regime (TPR) expires on 31 December 2023. Both will add additional friction to UK-EU trade if implemented as planned.

**The next government will have to make decisions on how to approach the review of the TCA**

The TCA is eligible for review from 2025, giving the next UK government the opportunity to attempt to reshape the terms of the deal.

The European Commission has indicated that it is unlikely to reopen talks until 2026 at the earliest. With a general election likely in 2024, this gap may provide an opportunity to make discussions more substantive rather than rushing negotiations shortly after the formation of the next government.

Labour has already stated it would use this opportunity to attempt to reduce trade barriers with the EU and introduce more regulatory alignment.

While both Labour and the Conservatives continue to oppose a return to the single market or customs union, any future Labour-led government is likely to be more comfortable with increasing regulatory alignment with the EU to reduce barriers to trade.

We will have much more to say on Labour's likely policy around EU relations and other matters in due course.

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