Navigating the Impact of China Tariffs

U.S. tariffs on Chinese goods have been a heated point of discussion in recent months. From one day to the next, the threat of impending tariffs continues to shift... and the U.S. continues to brace itself for the potential implications. **So how can your organization effectively prepare?**

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In our latest whitepaper, Navigating the Impact of China Tariffs, we address how organizations can better prepare themselves for uncertain times through the implementation of simple, easy-to-follow best practices. Furthermore, we will provide guidance that:

- Puts the issue/s concerning tariffs in context
- Assesses the Macro/Micro impact
- Provides prudent mitigation steps
- Offers alternatives to China import options

The goal of the tariff is to make imports less desirable, or at least less competitive, versus domestic goods and services. It's an artificial way of affecting free trade and competitive advantage. Now is the time to take control of how tariffs could affect your business, and your bottom line.

China Tariffs in Context

In 2015, the Chinese Premier Keqiang published the "Made in China 2025" plan[1]. The plan was designed to elevate China's manufacturing capabilities and focus from generally low value-added products (40% V.A.) to high tech products (70%+ V.A.). Pharma, aerospace, automotive, semiconductors, and robotics are just some of the specific industries targeted. The plan intends to elevate China's stature as an economic powerhouse and in so doing, grow its per capita GDP wealth.

The issue that the United States and other highly industrialized countries have with China's plan is how China intends to achieve its ambitious goals. China has been accused of corporate espionage and stealing foreign intellectual property (I.P.). Also, they have been trading access to their markets through partnership arrangements that allow the Chinese partner access to manufacturing technologies and I.P. not currently employed in China.

As a result, these activities have raised the alarm for security risks that China has posed. As distasteful as tariffs are, it is one of the few issues that has garnered bipartisan U.S. political support in recent years as a tool to level the playing field - and it appears to be having some initial effect on the China economy.

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The Macro Impact

Supply Chain Shifts

China manufacturers are seeking to mitigate risks by shifting manufacturing facility investment opportunities to other countries throughout Malaysia and India. Vietnam manufacturing facilities investments are up 70% year over year (YOY). Foreign investment in Vietnam rose over 86% in the first quarter of 2019 alone[2]. The pitfalls of this longer-term strategy include driving land/facility/wage costs up and intensifying skilled labor challenges. Also, the ROI calculus becomes more fluid and dependent on the longevity of imposed tariffs.

Near-term Costs

The economic forces of supply and demand will likely play out on several levels. As China manufacturing capacity becomes more available with sourcing shifts to non-tariff countries, it will apply pressure on China manufacturers to reduce pricing to mitigate tariffs if they want to keep their factories running. The government is highly concerned with keeping people employed. China will seek other customers for their products. However, finding consumer demand elsewhere is not easily accomplished. In most cases, markets in equilibrium assume a met demand. In turn, there are typically higher costs.

Mid-term to Long-term Costs

If the trade war continues, the China nuclear option – the sell-off of U.S. Treasuries that finance U.S. debt – exists as a possibility. This option would result in about a $500 billion sell-off of U.S. debt, nearly half of the total $1.12 trillion the U.S. owes. The nuclear option would have a significant impact on China's aspirations and its "Made in China 2025" plan. As a result of moving forward with this plan, exports would become more expensive as the value of the dollar weakened[3]. Also, other nations would likely purchase a good portion of U.S. debt, such as Germany and Japan, where current yields are far below U.S. treasury levels.

The latest developments of the trade war include a planned 10% tariff on $300 billion worth of goods for China imports on September 1, 2019. However, a reprieve is now in effect until December 15, 2019 for about $156 billion in tariffs for specified consumer electronics and toys citing the impact on the upcoming holiday season[4]. American companies sourcing from China will really feel the sting from the new decision even with the postponement. For the first half of 2019, the trade war has caused a $31 billion decline in Chinese imports compared to the same time frame last year.

The Micro Impact

The impact on China manufactured products applies to select items. For this reason, the U.S. will favor a phased-in approach for alternate sourcing implementation. However, alternative sourcing availability will be strained in the near term, as investments and facilities ramp up in regions outside of China.

China manufacturers are exhibiting a willingness to mitigate the tariffs by reducing pricing to their U.S. customers to keep their plants running. Ultimately, if your current price for a tariffed item is "X," and the related tariff for that item is 25%, your new rate will fall between "X" and "X+25%", depending on the variable economic forces in play and your negotiating ability.

Sourcing Guidance

Now is the time to speak with your current China import sources about potentially mitigating tax on items they source, even if it's just reducing overall pricing. If needed, explore other manufacturing countries of origin for your China imports. As a step further, tariff re-engineering may need to be considered. Tariff re-engineering involves adjusting product design to reclassify a product under a lower-duty category. Although the process of tariff re-engineering is quite involved, it is considered legitimate if appropriately executed. Tariff re-engineering makes the most sense for those items that drive a substantial portion of your China imports dollars.

Also, a good distributor partner will provide the transparency required to separate product price and tariff taxes. For instance, if your organization does not import directly but source China made items from a distributor, track high product tariffs for before and after tariff accounting. Discuss the accounting treatment of tariffs and their separation outside China product price. Also, communicate to your customers and offer the same transparency you request of your suppliers where appropriate. As an added tactical short-term approach, consider building inventory on higher dollar value items.

Conclusion

In closing, please don't consider merely changing your harmonized tariff code without re-engineering first. The U.S. Customs and Border Protection agency has one of the most sophisticated databases among all U.S. government agencies. The databases can identify a change in harmonized tariff codes readily, based on your organization's import history. Trans-shipping is another risky tariff avoidance measure that some organizations opt to use. Shipping China-made products out of China to a non-tariff country and then sending it into the U.S., claiming that the source was the non-tariff country is illegal and subject to hefty fines. Use the strategies outlined here to help minimize negative impacts imposed by tariffs.

Know the players involved in effective import negotiations with existing and new suppliers. Ensure that your methods are ethical and in compliance with tariff regulations and requirements. Weigh the potential outcomes of the short and long-term implications before launching your specific tariff mitigation strategies. Today's preparation for navigating tariff reductions will set your organization up for better trade negotiations and success tomorrow.

About the Author

Mark Rehl has 24 years of operating experience in various leadership roles. He was in consumer products manufacturing for 18 years, responsible for operations and manufacturing. He worked his way up to President/COO and held a seat on the Board of Directors.

Rehl has a B.S. in Business Administration from S.U.N.Y. at Buffalo School of Management and an M.B.A. from Georgia State's Executive M.B.A. program.

He serves on the Board of Directors for Never Alone, a not-for-profit community outreach organization, and has also served as the president for the G.S.U. EMBA Alumni Association.

Sources

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