Using Tariffs As A Geopolitical Weapon

The Uncertainty and Risk to Global Supply Chains

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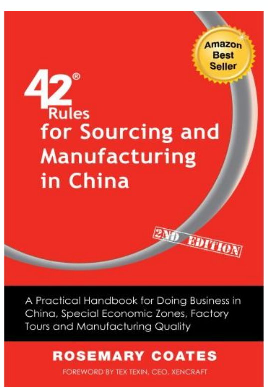

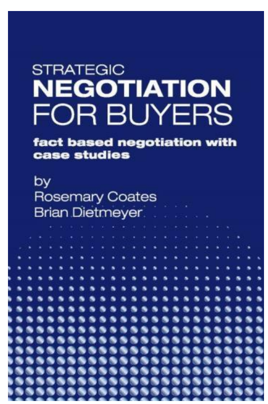

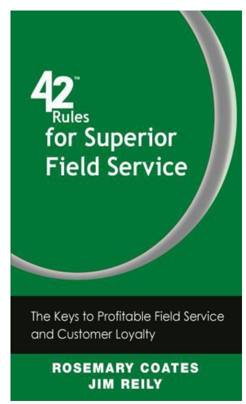

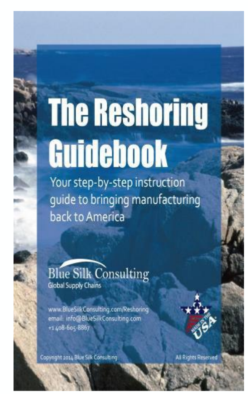

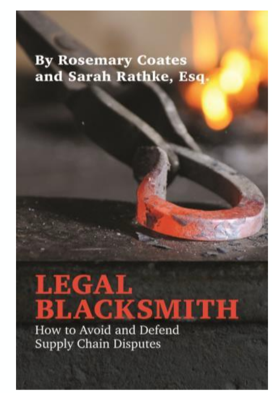

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1. Provide research and consulting for companies bringing manufacturing back to America
2. Provide experiential education for university students to learn about global sourcing and manufacturing

Our Student Interns

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What was the original purpose of tariffs?

- **Revenue Generation:**

Before the establishment of the federal income tax in 1913, tariffs were a primary source of revenue for the U.S. government.

- **Protection for Domestic Industries:**

Tariffs, by increasing the cost of imported goods, aimed to make domestically produced goods seem more competitive and encourage the growth of local industries.

- **Early Examples:**

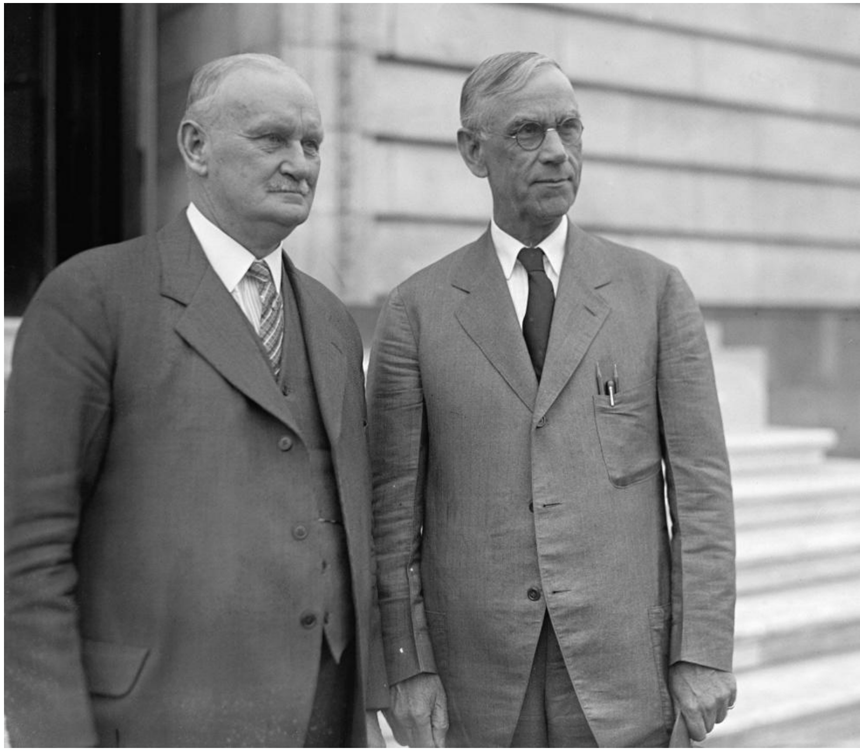
The Tariff Act of 1789, one of the first major pieces of legislation passed after the ratification of the Constitution, explicitly stated the need for tariffs to support the government, discharge debts, and encourage domestic manufacturing.

- **Modern Use:**

Today, tariffs are still used, but they are not a major source of revenue for the U.S. government, and their primary purpose is often related to trade negotiations, retaliatory measures, or protecting specific industries.

Disastrous Results – The Smoot-Hawley Act

- Tariff Act of 1930 implemented protectionist tariffs on US imports
- Average 20% tariffs on 890 items
- Many economists opposed tariffs, but President Hoover signed anyway
- Many countries retaliated with their own tariffs –particularly Canada and Mexico
- Commonly blamed for severely deepening the Global Great Depression
- Significant foreign policy damage



Senator Smoot, Representative Hawley

Trump tariffs used as geopolitical weapon

- Force other countries to do what the Administration wants:
  - Stop drug shipments from coming across the border
  - Stop illegal immigration
- Stop de minimis shipments
  - Less than $800 – USA
- Punish China – now 45%- 60% tariffs
  - U.S. currently imports $438.9 BILLION from China
  - Who actually suffers?
- Unpredictable – many changes, delays
- *“World no longer trusts the U.S.”* – CEO of a water equipment company
- **Prices will rise on products across America**

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Current State of the Trump Tariffs as of March 27, 2025

- Additional 20% Tariff on All Chinese Goods

- Applicable on goods " that are entered for consumption, or withdrawn from warehouse for consumption, on or after 12:01 a.m. Eastern Standard Time on March 4, 2025." These tariffs are IN ADDITION to the 2018 25% on Chinese goods in general, and 15% IN ADDITION on aluminum and steel.

- 25% Tariff on Canada - Paused until April 2, 2025
  10% On certain energy imports still applicable and current

- 25 % on Mexico - Paused until April 2, 2025
  Imported steel and aluminum goods subject to Sec 232 will be subject to the normal duty rate (15%) PLUS the supplemental duties

- President Trump confirmed new tariffs on additional countries will be announced on April 2nd. These so-called reciprocal tariffs will be 15-25% These tariffs are cumulative - in addition to tariffs products are already subject to.

- China and Canada have issued retaliatory tariffs, and Mexico will announce updates after April 4:
  China is levying a 10-15% tariff on agricultural imports and certain other products from the USA effectiveMarch 12th. Proteins, grains, cotton, soybeans, produce, and dairy products are all affected – targeting U.S, farmers

- Canada has issued a 25% tariff on roughly $21B worth of products now with plans for tariffs on $86B more if the proposed tariffs go forward on April 4. 2025. Florida orange juice, appliances and other household items, beer, wine, coffee, and bourbon are some of the products exported from the US into Canada that are affected.

Tariffs add COST, but no VALUE to goods crossing the border
Is this another Smoot-Hawley?

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Graphical Research Results – Interviews with 18 senior executives across America – here's what they said

Industries and regions included in the survey

- Semiconductors
- Textiles
- Power generation
- Medical devices
- Audio equipment
- Industrial equipment
- Printing
- Sports equipment

- Engineering
- Machining
- Consumer electronics
- Medical equipment
- Freight forwarding
- Construction equipment
- Water equipment
- Fuel cells

Locations: Upstate New York, NYC, Toronto/Maine, Minneapolis, Silicon Valley, Santa Monica, San Diego,

Summary of Responses

- 94% of the companies are importing finished goods or intermediate goods/spare parts.
- Importing companies are mostly passing on tariff costs to customers through higher prices. Some are absorbing costs (82% and 74%)
- 67% are developing or identifying domestic sources.
- 28% are using Foreign Trade Zones to delay tariff payments
- 78% are seeking alternate supply sources – mostly in the U.S.
- 44% are moving out of China – mostly to India, Mexico, and Vietnam
- 22% are redesigning their products to avoid foreign parts

Notable Quotes

"Our capital investments are frozen because we don't know what to expect"

Summary of Responses - cont'd

- Capital investment and hiring are mostly frozen until the tariffs and the economic outlook is stabilized.
- Uncertainty in tariffs and geopolitics are creating chaos in global operations, especially in the electronics industry.
- Companies prefer to manufacture in the U.S. but cannot make the economics work.
- Companies are working to increase domestic sourcing.
- Companies recognize they will have to raise prices to customers.
- Some companies are stuck, and others are modeling alternate strategies:
  - Prepare multiple alternative approaches and "what-if" scenarios
  - Assessing geo-political risks – particularly China and Taiwan
  - Moving manufacturing to alternate low-cost countries (Mexico, India, Vietnam)
  - Increasing domestic sourcing
  - Reshoring manufacturing to the U.S.
  - Working with forwarder/broker to review import classifications, potential for duty drawback, use of foreign trade zones, and other trade strategies
- **Strategies are C-level decisions**

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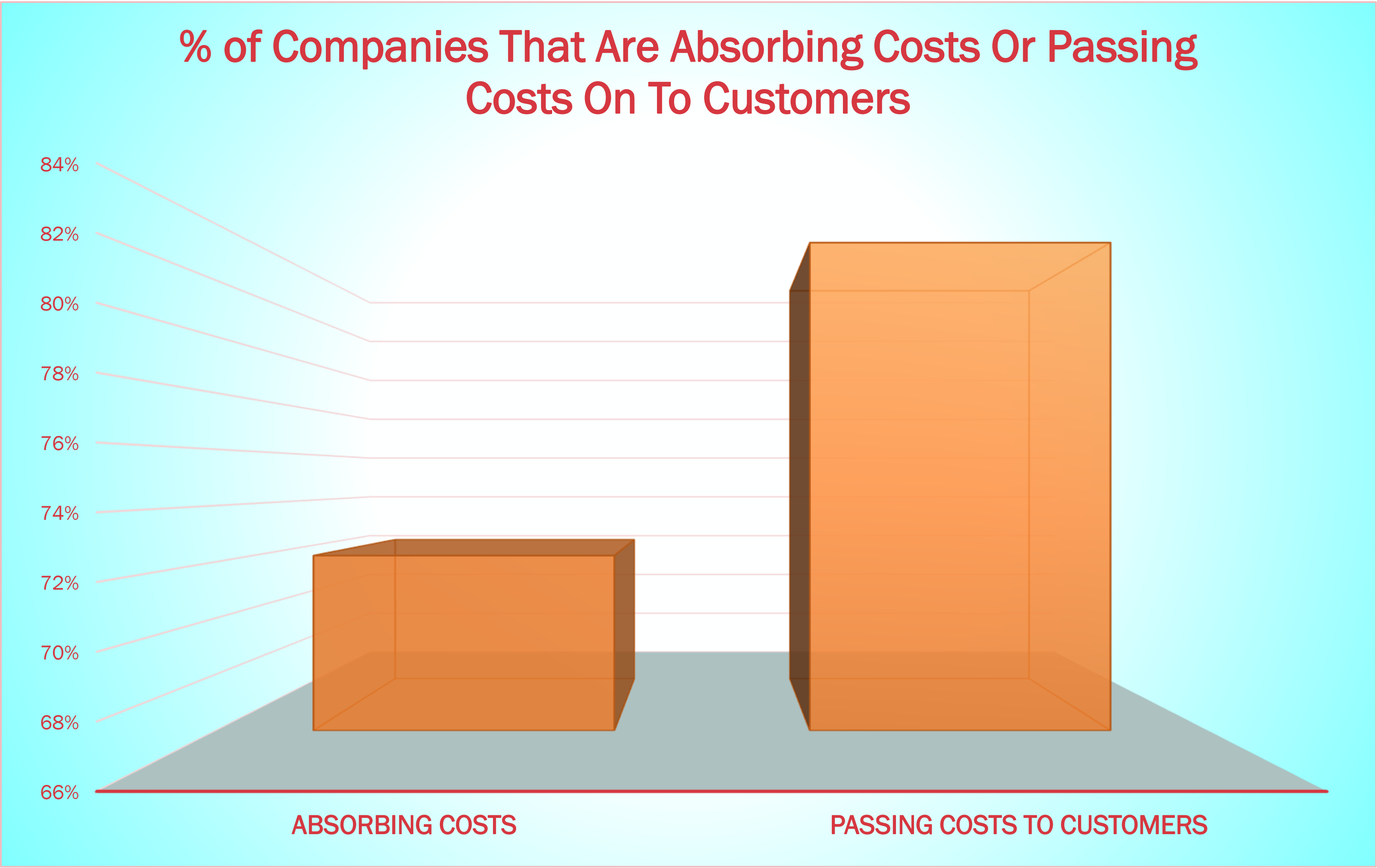
Importing Finished or Intermediate Goods

Absorbing Costs or Passing Costs to Customers



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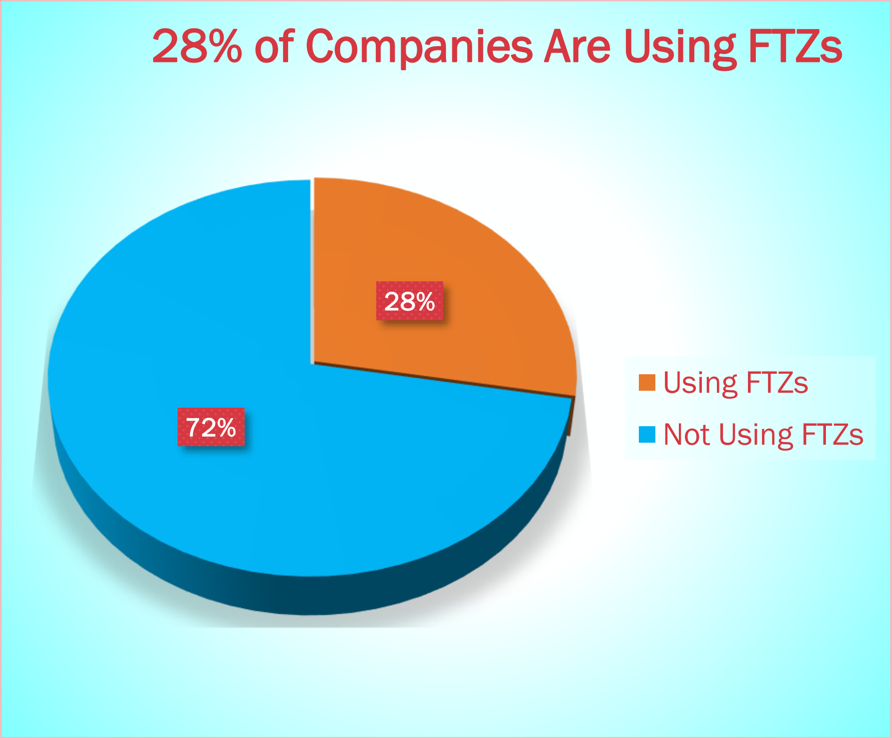
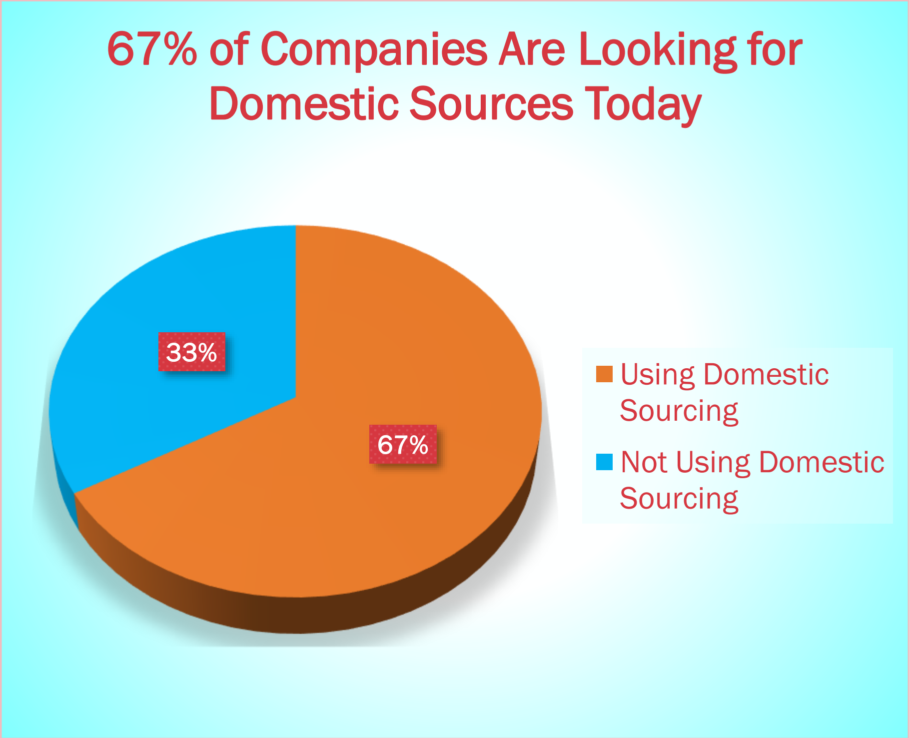
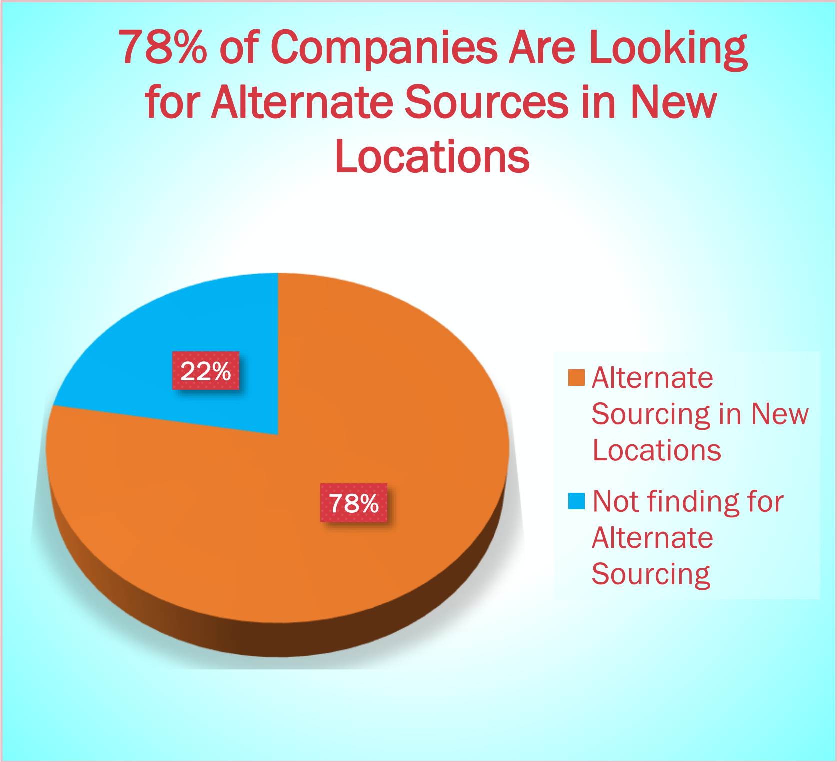
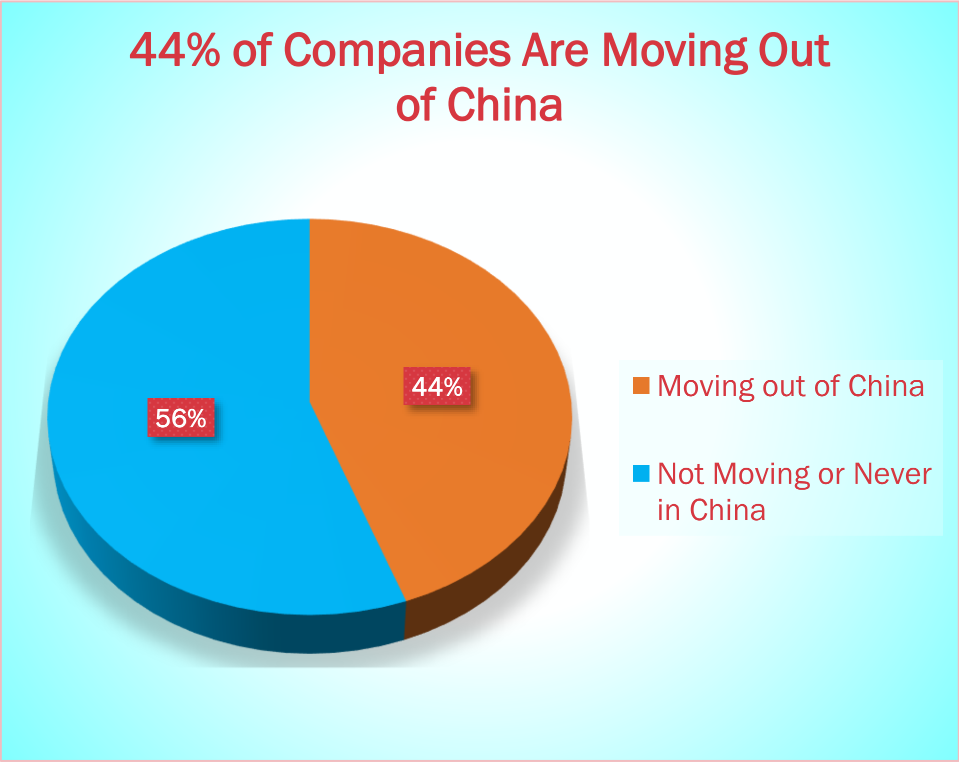
Companies using FTZs / Domestic Sourcing





Finding Alternate Sourcing / Moving Out of China





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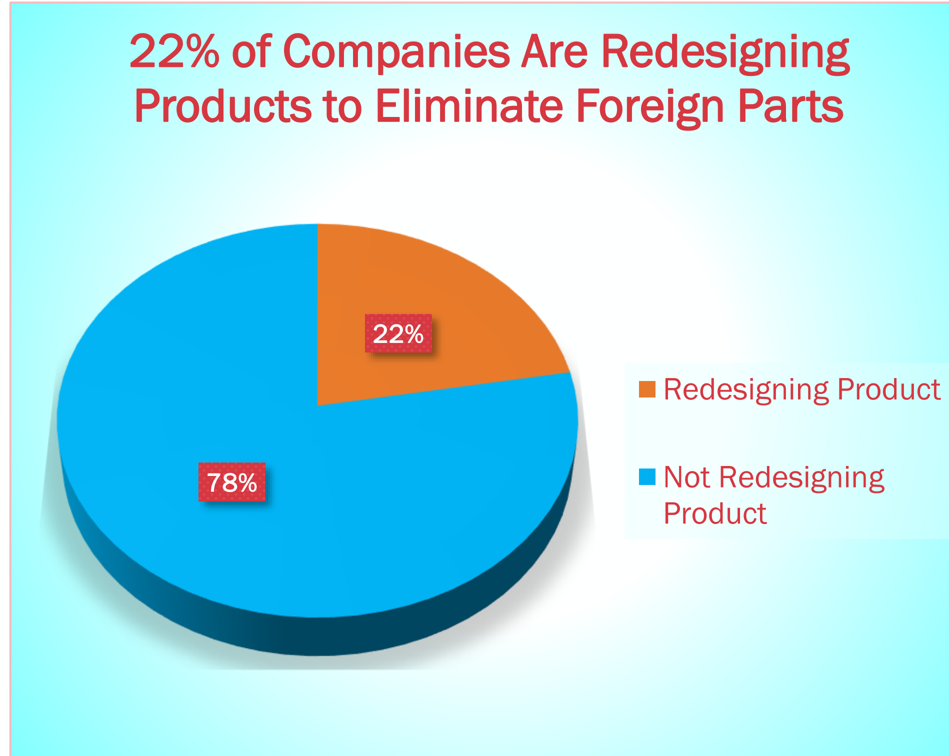
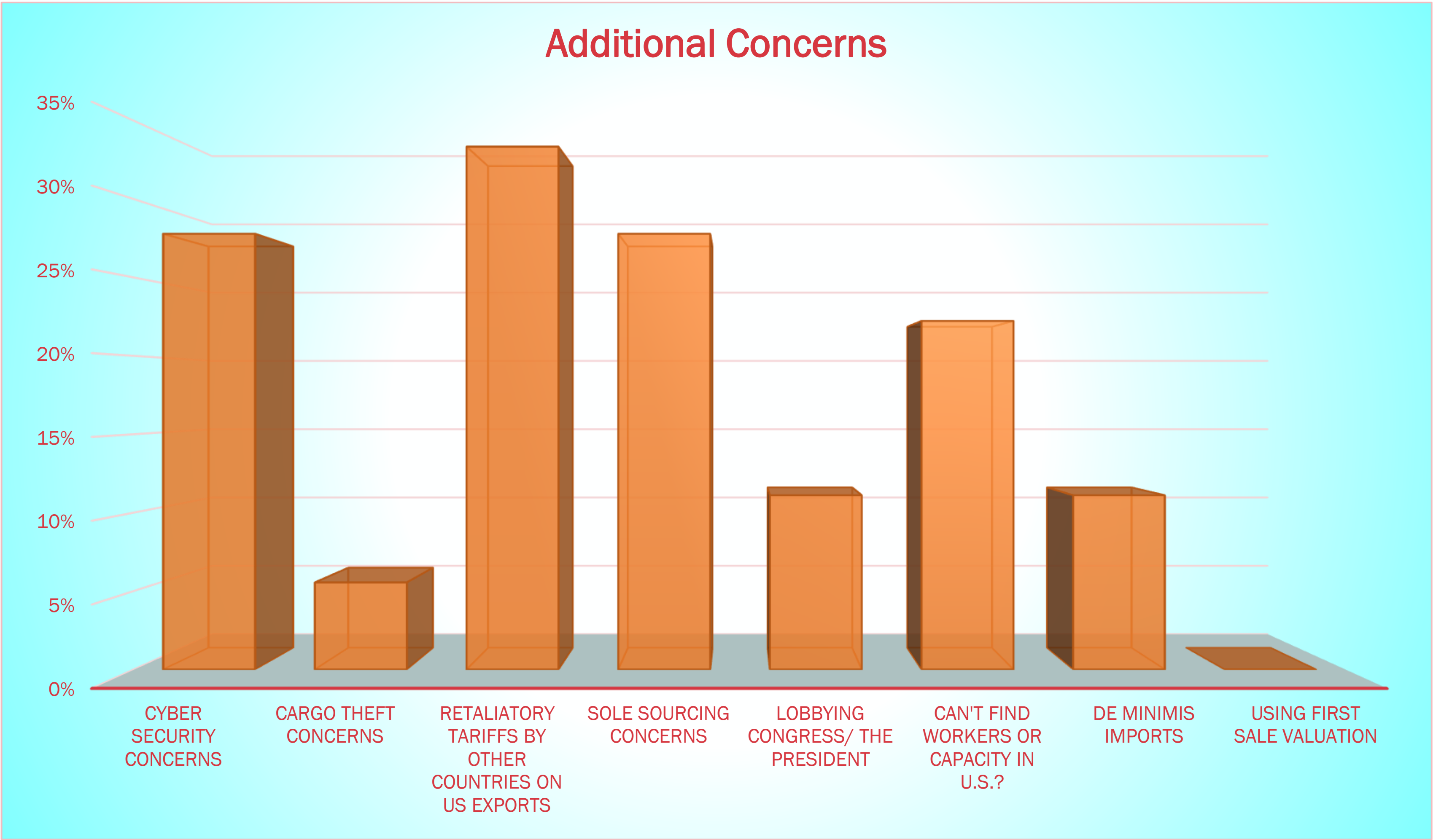
Moving to Alternate Locations / Redesigning Product



Additional Concerns



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Responding to the Tariffs

Develop a plan of action in response to the tariffs

- Stay abreast of the news on tariffs and geopolitics
- Work with your Customs Broker to review import classifications, potential for duty drawback, use of foreign trade zones, and other trade strategies
- Prepare multiple alternative approaches and “what-if” scenarios. Develop several plans including alternate locations, detailed steps to take, a timeline, a budget
- Assess geo-political risks – particularly China and Taiwan. Prepare a plan to source elsewhere, develop new suppliers. Stay current with news
- Move manufacturing to alternate low-cost countries (Mexico, India, Vietnam)
- Aggressively look for U.S. sources of parts, develop new suppliers
- Reshore manufacturing to the U.S.

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APPENDIX

Strategic Alternatives to Addressing the Tariffs

U.S. Customs Strategies

Substantial Transformation

- Even if certain components continue to be sourced from China, a finished product may qualify as non-Chinese if subsequent manufacturing operations constitute substantial transformation. This transformation may take place in another country with lower duty rates.
- There is a mistaken belief that simply moving production from China to Mexico automatically exempts the products from U.S. tariffs. It does not. The product must undergo a fundamental transformation to qualify for tariff exemptions and a tariff shift.
- Transshipment from another country (e.g. shipping from China to Singapore to the U.S.) does not change the Country of Origin. China tariffs still apply.

Tariff or Duty Engineering

- Tariff engineering is a legitimate and strategic approach to modifying products to qualify for more favorable tariff treatment. Evaluate tariff schedules to identify opportunities for product modifications that could result in a different classification and, consequently, a lower duty rate.

U.S. Customs Strategies cont'd

Harmonized Tariff (HTS) Reclassification

- A review of tariff classification should be conducted periodically, especially if products are revised or reengineered frequently.
- Imports may qualify for more favorable tariff treatment without requiring physical changes to the product, simply through proper classification under the Harmonized Tariff Schedule (HTS). The HTS contains thousands of product categories, each governed by complex classification rules. Given this complexity, similar products are often classified differently, resulting in significant differences in tariff liability.
- In some cases, breaking a product into separately classified components can reduce or eliminate Section 301 tariffs. Some products may qualify as "kits" under customs regulations, which can affect duty rates.

Duty Drawback: Reclaiming Paid Duties: Refund Opportunities

- The duty drawback program allows importers to reclaim duties paid on imported goods that are later exported or destroyed under customs supervision.
- There are several types of duty drawbacks:
  - **Direct identification drawback** - refunds on specific imported materials that are later exported, either in their original condition or as components of a finished product.
  - **Substitution drawback** - allows refunds based on exports of similar domestic goods rather than the exact imported items, simplifying record-keeping
  - **Rejected and unused merchandise drawback** applies when imported goods are returned to the seller, destroyed, or exported without being used.

U.S. Customs Strategies cont'd

First Sale

- The First Sale Rule allows duties to be assessed on the price paid in the first sale of a multi-tiered transaction rather than on the final price paid by the U.S. importer.
- For example, a Chinese manufacturer may sell to a Hong Kong trading company, which then sells to a U.S. importer at a marked-up price. The duty can then be calculated on the lower first sale price rather than the final U.S. sale price.
- To qualify, transactions must meet specific legal criteria:
  - First sale must be a bona fide transaction, not a paper arrangement.
  - Goods must be clearly destined for U.S. at the time of the first sale.
  - The transaction must be conducted at arm's length, meaning the pricing reflects fair market value, even between related parties.
  - Comprehensive documentation of both transactions must be available for customs review.

Foreign Trade Zones

- Foreign Trade Zones (FTZs) are designated areas under CBP supervision where goods are considered outside U.S. customs territory for duty purposes. When goods are transferred out of the FTZ and into the commerce of the U.S., duty is due and payable, essentially deferring duty.
- Privileged imports into the FTZ allow the duty rate applicable at the first date of entry into the FTZ, even if the goods come out of the zone under a new duty rate later.

Relocation Strategies – Where Should You Go Now?

Many countries still export products to the United States tariff-free or with low tariffs, (as of March 27, 2025), including the following:

- **Mexico and Canada: under USMCA – this may change on April 4, 2025**
  - *Advantages:* Nearshoring advantages, proximity to the U.S. market, established manufacturing infrastructure.
  - *Disadvantages:* Susceptible to new U.S. tariffs, increasing labor costs compared to other regions. Crime in Mexico

- **Vietnam, Thailand, and Malaysia:**
  - *Advantages:* Lower labor costs, growing manufacturing capabilities, strategic location in Southeast Asia.
  - *Disadvantages:* Increasing U.S. scrutiny, potential supply chain vulnerabilities, evolving regulatory environments. These countries are near to full capacity, making it hard to find factories with capacity

- **India, Indonesia, and the Philippines:**
  - *Advantages:* Large labor pools, growing domestic markets, potential for cost savings.
  - *Disadvantages:* Potential infrastructure challenges, logistical complexities, varying levels of regulatory compliance, and crime.

- **Taiwan and South Korea:**
  - *Advantages:* Advanced manufacturing capabilities, technological expertise, strong intellectual property protection.
  - *Disadvantages:* Higher costs compared to other Asian countries, potential geopolitical risks.

Contract Manufacturing Strategies

Viable Alternative

- Contract Manufacturing may be a viable alternative. Many CMs have multiple world locations where manufacturing could be shifted when needed.
- Contract Manufacturing Models and Considerations
  - Full outsourcing of manufacturing
  - Partial outsourcing
  - Modular manufacturing

Key Factors for Successful Contract Manufacturing

- Clearly defined agreements
- Regular audits and oversight of manufacturing and purchasing practices
- Production specifications and pricing
- Quality control measures
- Intellectual property protection
- Compliance with U.S. import regulations
- Ownership of tools, molds, and equipment
- Dispute resolution mechanisms

Inventory and Domestic Sourcing Strategies

Notable Quotes

"We are asking our Chinese suppliers to give us a discount – at least 50% of the tariffs"

Building Inventory is a short-term solution

- Additional investment in working capital
- Avoid future increases in tariffs
- Risk of obsolescence, shelf life
- Additional warehouse cost/space

Redeveloping a supply base in the U.S. can take up to 18 months

- Many suppliers moved to China and shut down in the U.S. over the past 25 years. New suppliers have to be developed
- New technologies have been introduced – suppliers may have to retool
- To be cost-competitive, automation should be introduced
- May require investment by the supplier and the customer to build a new production line

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Reshoring/Nearshoring Strategies

Determine your cost structure and how much of your product cost is attributable to labor.

- If labor is more than 50% of costs, look for a source in a low-cost country such as Mexico, Vietnam, India
- If labor is a small percentage of cost of the product, or the production can be automated, it is possible to manufacture in the U.S.

Look for incentives and funding in Federal, State and Local communities to support reshoring.

- Work with local Economic Development organizations such as MEPs and others

Research "Made in USA" labeling requirements – Federal Trade Commission

Reach out for assistance from the Reshoring Institute for site selection, supply base development, and consulting to help you bring manufacturing back to America

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