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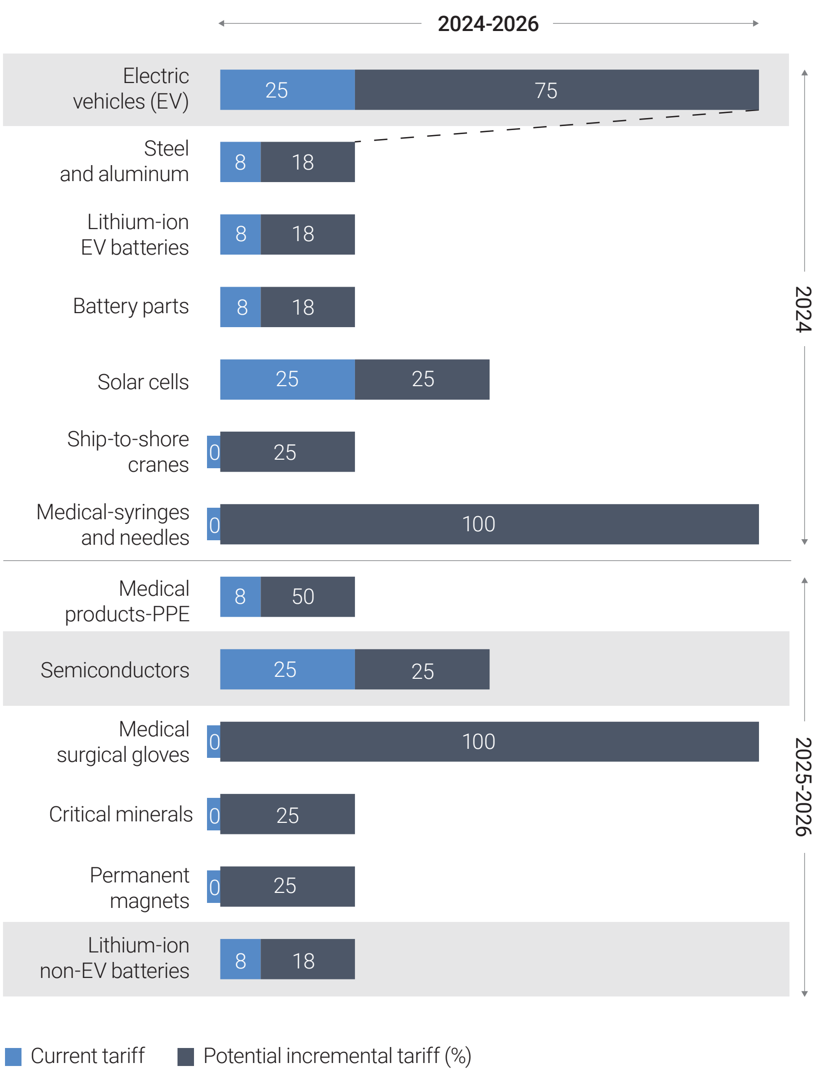
THE IMPACT OF TARIFFS

Drivers, key trends, and future implications for global supply chains

U.S. tariff and trade policy changes implemented in 2018 and continued under successive administrations (figure 1) will continue to drive major global supply chain shifts in 2025 and beyond. The outcome of the 2024 U.S. election makes this issue even more crucial for companies operating in the U.S. market. Affected industries—particularly automotive, electronics, clean energy, retail, and consumer goods—will need to fast-track efforts to reconfigure their supply chains to sustain growth and profitability.

FIGURE 1: FOLLOWING THE U.S. PRESIDENTIAL ELECTION, WE ANTICIPATE ADDITIONAL TARIFFS BEYOND THE EXISTING ONES AND THOSE ALREADY PLANNED FOR 2025 TO 2026[1]



Economic Implications

- Higher import costs for materials and components
- Rising consumer prices from tariff cost pass-through
- Reduced imports and increased trade tension

Supply Chain Disruptions

- Diversifying supply chains to avoid tariffs
- Potential supply chain delays and product shortages

Competitive Dynamics

- Shifts in global competitiveness (e.g., semiconductors, EVs)
- Production moving to regions with lower tariffs

Strategic Considerations

- Business realignment – Production relocation
- Risk Preparedness – Plans for future tariff changes

Source: White House Press Briefing, May 14th, 2024

The incoming administration's proposals for broad tariffs of up to 60% on all goods imported from China[1] are expected to accelerate shifts in the global supply chain as U.S.-based manufacturers continue to diversify their supply base (figure 2).

However, these tariffs seem likely to be implemented in a targeted way across all trade partners, to achieve a range of strategic objectives for the U.S., including:

- Addressing trade deficits
- Promoting strategic industries and protecting vulnerable ones
- Supporting domestic manufacturing
- Leveraging geopolitical influence
- Diversifying supply chains

The recent announcement by the incoming Trump administration of 25% tariffs on all imports from Mexico and Canada, and 10% additional tariffs on imports from China confirms their commitment to tariffs as a foreign policy tool, which can be implemented quickly, potentially using the International Economic Emergency Powers Act (IEEPA).

These proposed tariffs will affect key trade partners, including China, Mexico, Canada, and Vietnam, to varying extents. As business leaders explore options for diversifying their supply chains, it's crucial they assess the current conditions in these countries and how they may change under different tariff scenarios. Understanding these dynamics, along with the rationale behind the targeted product categories, will be essential for making informed decisions moving forward.

U.S. administrations have multiple legal pathways to impose tariffs, which include executive orders, and measures introduced through legislation and passed by Congress. Because these mechanisms vary in how quickly and broadly they can be applied, the timing of tariff changes is often uncertain. This volatility underscores the importance of proactive supply chain risk mitigation, and agility in strategic planning.

IMPACT OF TARIFFS ON KEY TRADE PARTNERS

Trade deficit shifts may be a key factor in how tariffs are imposed to prevent companies from bypassing tariffs as they move production or sourcing from one geographic location to another. For example, while the trade deficit with China, $400B in 2018, has decreased by 9% annually to date, it has increased 20% annually with Vietnam and 14% annually with Mexico over the same period (figure 2).

FIGURE 2: U.S. AND CHINA RELATIONS, ALONG WITH TARIFFS, HAVE SHIFTED TRADE FROM CHINA TOWARDS OTHER COUNTRIES SUCH AS VIETNAM AND MEXICO

			COUNTRY WISE CHANGES (2018 VS. LTM SEPTEMBER 2024)					
	TOTAL U.S. TRADE DEFICIT		TRADE DEFICIT W/CHINA		TRADE DEFICIT W/VIETNAM		TRADE DEFICIT W/MEXICO	
SELECT KEY INDUSTRIES	2018 ($B)	CHANGE (%)	2018 ($B)	CHANGE (%)	2018 ($B)	CHANGE (%)	2018 ($B)	CHANGE (%)
Auto and industrials	$273	22% ▲	$71	(23%) ▼	$3	308% ▲	$28	110% ▲
Consumer products	$7	483% ▲	($1)	(1490%) ▼	$1	90% ▲	$8	101% ▲
Electronics	$351	42% ▲	$245	(31%) ▼	$13	400% ▲	$37	113% ▲
Home goods	$63	12% ▲	$38	(42%) ▼	$5	172% ▲	$4	78% ▲
Retail	$129	(2%) ▼	$63	(36%) ▼	$19	34% ▲	$1	(85%) ▼

Monitoring the current and future relations with key trade partners is critical for making informed decisions about supply chain moves

Note: change calculated as of Sep 2024

1. China braces for tensions with Trump on tech, trade, Taiwan | AP News

CHINA

The U.S. is expected to continue its firm approach toward China, with the announcement of an additional 10% tariffs on imports across the board. During the previous Trump administration, tariffs were imposed on over $350 billion worth of Chinese goods. Despite partial easing under the Biden administration, tensions remained high on several fronts, including semiconductors and AI technologies. Goods related to defense and critical infrastructure are also expected to be impacted. Further tariffs on Chinese solar panels and EV components may be imposed to protect the U.S. auto and emerging U.S. renewables industries.

MEXICO AND CANADA

The incoming administration has announced 25% tariffs on goods from Mexico, which has the second-largest trade deficit with the U.S., as well as potentially on other countries with significant and growing trade deficits. Additionally, they have signaled plans to renegotiate the USMCA, creating further uncertainty about the advantages of Mexico-based nearshoring. The tariffs announced on Mexico and Canada could also be used as a negotiating platform for this purpose.

Tariffs on Mexico and Canada are also being used to negotiate border-related issues. However, given how deeply Mexico and Canada are integrated into the North American supply chains of many industries, these tariffs will be particularly disruptive. Industries like automobiles and auto parts, as well as agricultural products from Mexico and groceries and other commodities from Canada will be impacted, leading to price pressure for consumers.

VIETNAM

Vietnam emerged as a key beneficiary of U.S.-China trade tensions, but with this success comes scrutiny, as more U.S.-based companies have begun sourcing from Vietnam. Tariffs could be strategically applied to specific sectors if trade imbalances grow.

As with Mexico, Chinese manufacturing firms heavily investing in Vietnam is seen as a potential path to tariff avoidance by the new administration. For example, electronics—a key driver of the China deficit at over $170 billion in 2023—decreased by 6% annually, while the deficit with Vietnam has grown by 32%.

The previous Trump administration had expressed concerns over trade imbalances and alleged currency manipulation by Vietnam in 2020. Vietnam was cleared post investigation but remains on a 'monitor' list.[2]

IMPACT ON INDUSTRIES AND PRODUCTS

Knowing the level of trade imbalances and geopolitical relations in countries that are key trade partners is important for understanding the strategic rationale behind decisions to levy tariffs on selected industries and product categories.

As the U.S. government looks to using trade policies to diversify supply chains by reducing overreliance on a single country, they often evaluate tariffs at the six-digit HS code level, focusing on commodities where trade deficits are widening or where trends indicate a negative shift. In 2018, the U.S. trade deficit with China for electronics and auto and industrials exceeded $300 billion. Tariffs addressing these categories forced American companies to look for alternate vendor bases; the trade deficit for the last twelve months ending September 2024 was less than $225 billion, a drop of roughly 30%.

2. U.S. finds no major trade partners manipulated currencies

Additionally, protections for intellectual property, national security interests, and the need to protect vulnerable categories from unfair trade practices, while promoting strategic industries, are the other key drivers behind product-specific policies. See figure 3 for a list of potentially impacted industries and categories:

FIGURE 3: EXPECTED TARIFF IMPACTS ON SELECT INDUSTRIES AND PRODUCT CATEGORIES

INDUSTRY	CATEGORIES IMPACTED	IMPACT
Apparel	Synthetic and poly-based materials sourced from China may be included	Cotton-based apparel to continue expansion in South and Southeast Asia; nearshore LCCs in LATAM and Caribbean; synthetics could follow
Energy and renewables	Solar panels and other renewable technologies	Potential further increase in costs for solar installers
High-tech	Semiconductors, 5G components, AI-related technology	Focus on U.S. domestic manufacturers
Plastics	Resin-based materials of petroleum origin	Increased demand for U.S. production could lead to upward pressure on resin prices. Retaliatory tariffs can impact U.S. exporters
Pulp and paper	Paperboard, tissue papers, and packaging materials (corrugates and container boards)	International price volatility which can permeate U.S. market
Metals	Primarily steel, aluminum, zinc, and lead	U.S. producers in construction, automotive, and industrial products could see their input costs increase
Pharmaceuticals	Active Pharmaceutical Ingredients (API) and Key Starting Materials (KSM) for key therapeutic areas like pain management and antibiotics	Could drive investment to U.S.-based manufacturers as well as India-based generic pharma marketers and CDMOs
Defense and security	Defense and security-sensitive products	Focus on domestic manufacturers and protection of technology IP
Consumer goods	Food & beverage–ingredients, components, and packaging. Personal care items	Accelerate shift to nearshore low-cost regions like LATAM and Caribbean
Retail and household goods	Hard home goods and consumer durables	Accelerate shift to Southeast Asia and nearshore low-cost alternatives to Mexico such as LATAM and Caribbean

TARIFF AND RISK MITIGATION STRATEGIES

Following the imposition of new tariffs in 2018, the trajectory of U.S.-China relations and the further expansion of tariffs have been pushing trade towards a 'China+1' strategy, with Vietnam, Mexico, and India serving as the most likely plus-one options. However, even this strategy may need to be rethought soon, particularly if proposals for across-the-board tariffs are adopted, for instance, impacting companies who are nearshoring to Mexico for competitive materials and finished goods costs.

We believe that companies should evaluate options to further reduce and mitigate risks by considering both short-term and long-term actions:

Short-term actions

In the short term, there are several steps that need to be taken to provide relief within a 3 to 6-month period:

Negotiate tariff exemptions and reductions

Companies should seek and may be granted relief through government lobbying activities or participation in trade reviews. This is generally possible for commodities with a limited supply of sourcing options.

Implement first sale

By negotiating 'first sale' prices, companies can reduce taxable import values by utilizing lower initial prices through intermediaries.

Duty re-engineering/classification

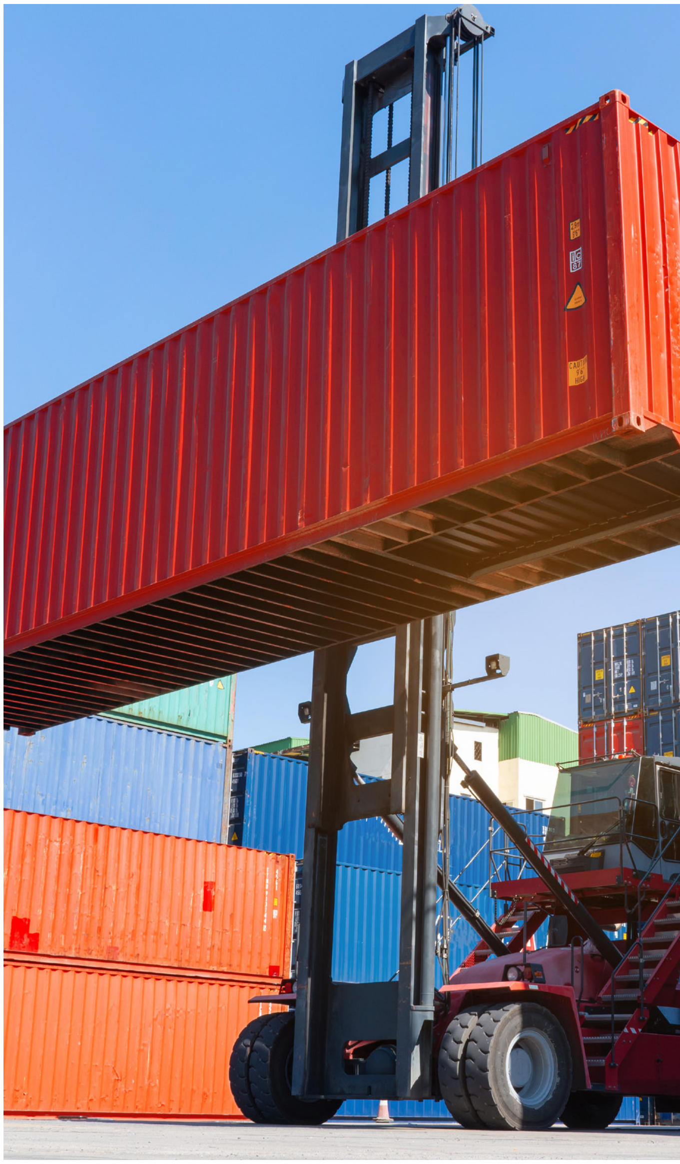
Evaluate end-use, and reconfigure or explore qualifying alternative materials that may not be subject to duties, or qualify for lower duty rates.

Optimize current supply chains

Reconfigure supply chains to optimize tariffs by importing goods partially assembled in low-tariff regions like India, South Korea (KORUS FTA), and Indonesia.

Free trade zones/duty drawback

Leveraging bonded warehouses and free trade zones to defer or reduce tariff payments is especially valuable for industries like automotive, electronics, chemicals, and plastics, with high volumes of imports, or goods that undergo further processing, assembly, or distribution.



Long-term strategies

Longer-term strategies fall into three categories: supply network optimization, innovation in material and process, and collaborating with trade bodies and regulators. These actions typically start bearing fruit in a 6 to 12-month period.

Supply network optimization

Companies must consider supply network optimization with a broader goal of supply chain resiliency.

Build redundancy and develop alternate sourcing options

Companies should develop sourcing options from multiple suppliers across different regions.

Companies should explore alternatives in Southeast Asia, India, or Latin America to reduce reliance on China, Mexico, and Vietnam. Start with dual sourcing, creating options to optimize volume allocation in the future.

While considering shifting production closer to U.S. borders (e.g., Mexico, Canada), consider logistics costs and responsiveness. Nearshoring can also benefit from trade agreements like the USMCA, which provides tariff advantages for North American goods. However, this strategy will need to be evaluated against any changes to the USMCA and other trade agreements.

Invest in domestic production and technologies

Companies can capitalize on government incentives for reshoring manufacturing operations. Long-term investments in automation and skilled labor development can offset higher production costs in the U.S.

By partnering with innovators, companies may be able to gain access to new solutions and cutting-edge advancements in materials, packaging, agriculture, and biopharma that can be locally developed and manufactured. For example, an auto battery manufacturer can partner with a domestic EV cell maker to set-up a joint venture to build a factory and offset the cost of cell processing through available subsidies.

Innovate processes and materials

Explore new fiber, content, material, or packaging that are not included in tariff classifications, are exempted, or have domestic sources.

Collaborate with trade bodies and regulators

Build coalitions with affected industries and governments to make the case for trade liberalization, or to negotiate sector-specific tariff reliefs.

ACT NOW TO MITIGATE FUTURE DISRUPTIONS

The tariffs imposed during the previous Trump administration significantly altered global trade dynamics, reshaping U.S. relations with key trading partners. As the U.S. continues to grapple with trade deficits, national security concerns, and domestic manufacturing goals, companies must proactively implement both short-term and long-term strategies to mitigate tariff impacts. By leveraging diversified supply chains, renegotiating terms, and nearshoring, businesses can better navigate the complex global trade environment while staying competitive.

AlixPartners

CONTACT THE AUTHORS:

Richeek Maitra
Director
+1 617 378 8093
rmaitra@alixpartners.com

Abhijit Boora
Director
+1 906 370 5095
aabhijit@alixpartners.com

Vandana Panwar
Vice President
+1 202 769 7240
vpanwar@alixpartners.com

Venky Ramesh
Director
+1 773 900 3253
vvenkateshramesh@alixpartners.com

OTHER CONTRIBUTORS

Sudeep Suman
Partner & Managing Director
+1 347 510 8629
ssuman@alixpartners.com

Marc Iampieri
Partner & Managing Director
+1 267 253 7889
miampieri@alixpartners.com

Steven DuBuc
Partner & Managing Director
+1 248 797 1122
sdubuc@alixpartners.com

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