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Tariffs – Impacts & Risks for Business

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Overview

Tariffs have been a major topic in the news over the past few weeks, therefore, I would like to provide some useful and timely information. As you are aware, these are duties or taxes placed on items imported or exported between two countries. The amount of a tariff on any given product needs to be absorbed by anyone or all of the three participants in the product stream – the initial supplier or seller, the intermediate recipient / manufacturer of the product and / or the final product consumer. What portion of a tariff that is passed on to the final consumer will be determined by the intermediate consumer/manufacturer of the final product. For an example, an automaker in the U.S. receives parts or car components from a supplier located in another country. These items are subject to the tariff and that cost is almost certainly added to the production cost for the automaker. The question now is how much, if any does the automaker pass on and/or absorb. This will be a function of the company's financial position, market position, and strategy for target profitability rate.

Reciprocal tariffs are also taxes or duties; however, these are a means of evening trade balances between two countries as they are based on the concept of "what you charge me I will charge you". This type of tariff has the same impact on the seller, intermediate, and final consumer as a regular tariff. The advantage, however, is that it has an impact on the Trade Balance of the country, in this case the goal is reduce that deficit for the United States. To put this in perspective, the trade balance represents a portion of the country's Gross Domestic Product (GDP). GDP is a measure of the country's total output of products and services. This measure is utilized when setting policy, in financial market decisions, and by business executives in setting forth future strategic goals. The average GDP growth for a normal economy would be around 4 – 4.5% per year. Changes to the GDP reflect in essence the health of the economy. In looking at impact of trade – import/export activity on GDP over the last decade, it ranges from 23-29%. When there is a favorable trade balance or what's called a trade surplus, it increases the GDP. Conversely, the negative or deficit trade balance reduces GDP.

Let's Talk About Trade Deficits

To fully appreciate the role of trade it is important to understand the components of Gross Domestic Product or GDP as it is commonly known. GDP has four major components: goods & services, government spending, export/import, and consumer spending. The U.S. is the world's third largest exporter with this component making up 10% of the GDP, therefore, when this segment is running a deficit, it has an adverse impact on GDP. According to the data from the U.S. Census (census.gov/foreign trade/historical) records, the U.S. has been running trade deficits for many decades as imports outpaced exports, however, the growing deficits began in the late 1990's and continues through the current period. Specifically, trade deficits began to increase significantly in 1998 when we experienced a 53% increase in the trade balance due to a 5% increase in imports with a relatively stable volume of exports. This shift was fueled by consumer goods, industrial supplies, and the capital goods components. This trio of components has continued to grow significantly through 2024 and caused the trade balance deficit to grow from - $166,140 (million) to -$918,416 (million). There are a limited number of solutions to reduce the deficit, and they are:

- Reduce reliance on imports
- Increasing Exports
- Imposing a tariff policy

A strategy can include a combination of all three solutions. In doing so, a country can begin to work down the deficit spending on this GDP component while increasing its' own production level of exported products and building a healthier environment for productivity of goods currently being imported.

Current Talks on Increased Tariffs

Currently, in what appears to be a dual strategy to reduce trade deficits and improve border security related to fentanyl traffic and national security, the U.S. is considering 25% tariffs on certain goods from Mexico, Canada, and China. Reciprocal tariffs are also being implemented/considered on other countries that will assist in balancing the trade deficit as well. Currently the United States' three most significant imported products (those representing the largest percent of trade) from these countries are:

- Electrical, electronic equipment
- Machinery, nuclear reactors, boilers
- Toys, games, sports

To understand the impact on the final consumer we researched to determine the primary products/services that make up the import trade with these countries.

Importing Country	Total Value of Imports 2024 (In U.S. Dollars)	Top Imports Making Up 50% of Total	Value of U.S. Exports for 2024 (in U.S. Dollars)	Trade Deficit for 2024
Mexico	$509.96 Billion	Vehicles other than railways, tramways Machinery, nuclear reactors, boilers Electrical, electronic equipment	$334.04 Billion	-$175.92 Billion

China	$462.62 Billion	Electrical, electronic equipment Machinery, nuclear reactors, boilers Toys, games, sports requisites	$143.55 Billion	-$319.07 Billion
Canada	$421.21 Billion	Mineral fuels, oil, distillation products Vehicles other than railways, tramways Machinery, nuclear reactors, boilers	$348.41 Billion	-$72.80 Billion
Total	**$1,393.79**		**$826.00**	**-$567.79**
Total Imports/Exports for 2024	**$4,110.00**		**$3,191.59**	**-$918.40**
Top 3 as a % of Totals	**33.9%**		**25.8%**	**61.7%**

Source: www.tradeeconomics.com/united-states/imports

What are the primary exports from the United States to each of these top trading partners for the year 2024?

Country	% of U.S. Exports Sent	Tops three Products Exported
Canada	17%	Vehicles other than railways, tramways Machinery, Nuclear Reactors, Boilers Electrical, electronics Mineral fuels, oils, distillation products
Mexico	17%	Machinery, Nuclear Reactors, Boilers Electrical, electronics Mineral fuels, oils, distillation products Vehicles other than railways, tramways
China	7%	Electrical electronic equipment Mineral fuels, oils, distillation Oil seed, oleagic fruits, grain, seeds, fruits Machinery, Nuclear Reactors, Boilers

Source: www.tradingeconomics.com/united-states/exports

It is clear from the data that China, one of the top two importers to the U.S. is also the country receiving the least (of the top three) exports. This represents a significant trade imbalance as they make up more than half of the total.

Economic Impacts From Tariffs

In addition to increasing the U.S. revenue received from tariffs there are a few other significant impacts from the use of tariffs. There are four potential impacts: influence on employment and employment rates, currency valuation, foreign investment, and influence on international relationships.

Employment impacts can be complex to identify as it depends on the structure of the economy as well as the products/services being imported. Meaning, for those sectors that are directly competing with imported goods, manufacturers/producers could likely see an increased need for workers as reduction of or more costly imports may lead to increases in consumer demand for "American Made" products. This puts manufacturers in a position requiring scaling up production as well as the need for additional staff. Conversely, other sectors may not be impacted in the event there are no competitive products being imported.

Another aspect of employment that is critical to meeting product demands when imports are reduced is the need for workers with specific skill set. The availability of potential employees could be in question as there may be a need for training that could increase the time it takes businesses to gear up for increases in demand.

The imposition of tariffs can affect **currency valuation** for the U.S. Should the demand for foreign products continue at today's level, it is possible that the price for imports could increase as duties are added to the existing cost. This would result in a potential for the inflation rate to increase. It would only work to our advantage if 1. Demand for the products was reduced or 2. If American businesses could respond quickly with substitute products at a reasonable price. If the latter occurred, the impact on the dollar would be negligible. The bottom line is when demand is not reduced and there is a decline in currency valuation, it can have an impact on inflation rates. The converse is if the imports become too expensive, customer habits and needs may change if U.S. businesses cannot supply a reasonable substitute product.

The dynamics of **foreign investment** impact are complex. The trade deficit could signal an overall weakness in the economy and country. In this environment the government needs money to fund internal projects as well as business expansion. It could, however, be positive if the deficit is related to high growth potential fueled by consumer demand. This is particularly true as consumer spending was the largest component for 2024. Consumer demand does correlate with foreign investment potential as it creates an attractive investment climate.

The final impact is related to **government policy for global trade relationships**. Countries with continuous, long-term trade deficits can gain an advantage as this deficit is indicative of a large import environment. This scenario is generally fueled by consumer demand, which is what we are experiencing today. Tariffs are applied in this scenario the economy could experience short-term issues but in the longer term could have see a positive impact on foreign investment as foreign businesses seek to continue selling their product without the application of tariffs.

Risks Businesses May Face

In this type of transitory environment, businesses have risks that can significantly alter their product mix, production capabilities, and profits. Below are some of these risks:

- Production facility changes required to accommodate new product mix or increases in demand.
- Lack of skilled workers that can meet new production changes in technology and/or shifts in demand.
- Supply chain issues resulting from reliance on imported raw materials.
- Lack of capital investment dollars to make necessary production line adjustments.
- Consumer retention and satisfaction ratings may decline in the event products are not available or substitute products don't meet their expectations.
- Inability to provide "Made In America" products that are cost competitive.

These are risks manufacturers already face but could be increased due to the impact of tariffs. This could require a heightened monitoring process on the part of producers to identify increases in these risks and provide appropriate and swift mitigation. Get details on a process that allows for near-real time identification, management and continuous monitoring of risks in the book "Risk Management and Key Performance Indicators" (available on Amazon.com) or contact Proactive Risk Solutions LLC at prorisksolutionsllc@gmail.com to schedule a presentation outlining this approach.

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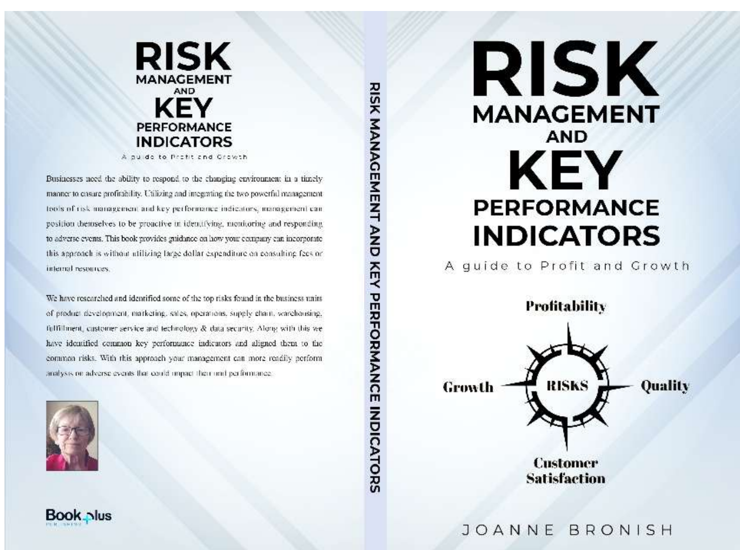
About Proactive Risk Solutions LLC

We are an advisory business that specializes in Risk Management, Technology Requirements and Implementation, and Operational issues. Approaching problems in a proactive and out-of-the-box approach, we believe our role is to support your efforts for issue resolution. Our services include:

- Presentations covering pertinent and timely business topics
- Articles and publications offering timely information on current business issues
- Advisory Services that allow us to partner with your company's business experts in finding proactive and unique solutions

Our Sr. Consultant, Joanne Bronish, has over 25 years of experience in these areas of business. Her accomplishments include: publications, development of a risk assessment framework, operational management, software requirements, testing and implementation, and piloting a KPI system by developing a pilot application. Additionally, she has a BA majoring in economics and an MBA.



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