Navigating Trump's 35% Import Tax, and how US Companies can Utilize "Parallel Manufacturing" to Grow Globally

Business leaders and supply chain management are deeply concerned on how proposed import taxes or border adjustments will impact their business.

CHAPEL HILL, NORTH CAROLINA, UNITED STATES, December 15, 2016 /EINPresswire.com/ -- As the jolt of Donald Trump winning the US election reverberated around the world, the media and blogospheres have erupted in commentary and opinions, fueled by tweets, rumors and speculation. One key topic of discussion has, of course, been US trade and bringing jobs back, the reversal of Carriers decision to move a manufacturing plant to Mexico, and proposed tax, or 'border adjustments' as they are often called, for US companies that have ranged from 35% to 45% (Trump has quoted both rates historically) to import foreign manufactured products.

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> *Greg Hayes, CEO United Technologies*

Without adding to that speculation, I want to provide my view on how CEOs / COOs and supply chain leaders need to approach this situation, at least theoretically for now, while the policies are being formulated and written. I also want to provide an overview of my model of "parallel manufacturing", that can be utilized by US companies to take advantage of both the low cost of global manufacturing, and the threat of import tariffs.

Firstly, I want to lay down some assumptions given Trump has not provided all the details in his plan. The first assumption the tax, whatever the rate, will apply to all products imported into the US, no matter if it's from American companies or foreign. The foundation for this assumption is if the tax only applies to US companies that have outsourced manufacturing overseas, automatically all foreign companies will have an instant advantage, crippling US companies and severely hurting the goal of bringing jobs back to the US. Of course, there is a long road ahead for Trump to implement the tax, and there is already heavy GOP resistance. But for this exercise, let's assume it proceeds at 35% (the lower of the two rates).

The second assumption is that raw materials and semi-finished materials are not included in the tax. The foundation for this assumption is based on commentary from Trump advisors, and the fact that most raw materials used in US manufacturing now, are sourced internationally, and assembled in the US.
As supply chain leaders, we all know that CEOs and COOs make their manufacturing decisions based on a balance of lowest cost and customer accepted quality. It is this cost focus that has resulted in the move of much manufacturing from the US to Mexico, China and other low cost labor locations. Moving manufacturing jobs back to the US would hence occur based on two key factors, the first is the falling costs of automation. The CEO of United Technologies, Greg Hayes told Jim Cramer on CNBC December 5th, in regards to the Indianapolis factory "we are going to make a $16m

investment in that factory… to automate to drive the costs down to be more competitive" he then concluded "what that will ultimately mean is that there will be fewer jobs". The second cost focus will be tariffs, and avoiding any major tariff or tax increase when importing products into the US, specifically the 35% import tariff or tax.

Most US companies that manufacture products overseas have two distinct set of customers, domestic customers and foreign customers.

Foreign Customers

For US companies that manufacture, let's say in Mexico, and then ship directly, or indirectly via a distribution network to non-US customers, nothing will need to change. Mexico has 45 free trade agreements throughout the world, including most of Central and Latin America, the EU and Japan. As such, it's recommended that US companies continue to move manufacturing into Mexico to service their foreign customer base. This will be similar with China, once the Regional Economic Partnership Agreement is in place.

US Customers

This is where US companies will need to review Trumps plan carefully to remain competitive. Based on our assumptions, raw materials will not be taxed, as such, the raw and semi-finished products used in final assembly should not attract the 35% tax Trump has quoted. Thus, final assembly can be conducted in the US to service their US customer base. Companies, like United Technologies, can be highly automated to keep costs down. The result is a US assembled product that abides by the assumed rules.

This approach will also add fuel to the "final assembly contract manufacturing" market, where specialist manufacturing companies based in the US will complete the final assembly on a contract basis. Contract manufacturing companies such as Celestica (based in Toronto, Canada) and Sanmina (based in South Carolina) already have plants in Texas and other places along the Mexico border as well as many other US locations.

This strategy will create parallel manufacturing strategies, whereby the same raw and semi-finished suppliers remain, allowing procurement leaders to keep their costs down by consolidating supply, however the final assembly will be conducted in parallel in two separate locations depending on where the customer is based. This model is used to a lesser extent with companies that supply the US government. They are required to manufacture the specific units sold to the US government in the US or other approved locations (such as Mexico) and not China. As such, many technology companies have final assembly for US Government customers in Mexico, and use China for the rest of their customers.

The final plan will obviously need to involve a deep understanding of the policy Trump plans to implement, and each companies' individual situation, customer base, product composition among other key factors. However, there is a path forward for companies willing to act quickly to retain most of their supply chain footprint and strategy, and engage in "final assembly contract manufacture" based in the US to avoid the excessive import duties posed.

Acting quickly is critical. Assuming there is a phase-in period for the 35% tax rate, there will also be an almost immediate increase in prices for products sold in the US. Those companies that have already adjusted their supply chain, and taken advantage of parallel manufacturing will be able to keep their prices stable, and position themselves to take major market share from both domestic and global competitors alike.

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