U.S.-CHINA TRADE WAR ESCALATES: TIME TO REVIEW THE EFFECTIVENESS AND EFFICIENCY OF SUPPLY AND VALUE CHAINS

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The “trade-dispute” between the United States and China is creating a lot of uncertainty in the market and a lot of opportunity for businesses to really think about their current business structures and practices. In early August 2019, President Trump announced that beginning September 1, 2019, his administration would impose a 10 percent tariff on US$300 billion of imports from China that have not yet been subject to new import duties. This did not include the US$250 billion of goods already hit with a 25 percent tariff.

That announcement was made shortly after U.S. representatives returned from China, where they had talks on a future trade deal. President Trump said in a series of Tweets that he was disappointed that China decided to re-negotiate the deal prior to signing in spite of signaling its agreement to the terms three months prior. Subsequently, he complained about China's waffling on its commitment to buy large quantities of U.S. agricultural products and lamented, in light of the current U.S. drug epidemic, that China continued to sell Fentanyl to U.S. consumers despite making promises it would stop doing so. President Trump described the new tariffs as “small” and said talks would continue. Later on the same day, President Trump suggested that the tariff rates could be set at 25 percent or higher and that China has four weeks to make a deal or the tariffs would go into effect.

President Trump's announcement was not unexpected and neither was China's retaliatory action wholly unexpected. The Chinese government let the yuan sink to its lowest level in 11 years and announced suspension of purchases of U.S. agricultural goods. The United States countered by labeling China a currency manipulator.

However, it would appear that China is back to the negotiating table within the four-week grace period stated by President Trump. On Tuesday, August 13, 2019, it was announced by China's Ministry of Commerce that Vice-Premier Liu He had been on a call with U.S. trade officials. Immediately following that announcement by China's Ministry of Commerce, the U.S. Trade Representative's Office announced that the United States will delay imposing the proposed 10 percent tariffs on some imports of China-made goods until December 15, 2019. The products whose tariffs will be delayed include technology products, such as laptops, mobile phones, computer monitors, and game consoles, as well as toys and some apparel and footwear products. The 10 percent tariffs on other items will proceed as per President Trump's original proposed date of September 1, 2019. While it is good to see that there is some relief in the tariff saga, we still think that the trade war will be around for the longer haul.

If there still are businesses taking a wait-and-see approach, hoping that cooler heads will prevail in the United States and China, they are among a dwindling minority.

Some businesses have seen this as an ideal opportunity to review their supply and value chains, explore new business models, and develop new service offerings to customers. Certain small/medium-sized manufacturers are collaborating with existing customers to expand into the toll/contract-manufacturing space; they are moving from being parts/components suppliers to taking on processing and assembly of finished goods for their customers.

As with any corporate restructuring, supply-chain realignment, or new project development, businesses will need to identify and balance different priorities. For some, the decision on how to diversify or what parts of their supply chain to transfer needs to be aligned with a strong focus on protecting their intellectual property. For others, the risk of the potential new location being subject to future tariff actions by the United States or China may be critical. Tax considerations, as is always the case, will also be critical to any restructuring of the supply chain.

There are also other considerations, such as order and payment flows and processes. Will customers insist on continuing to trade directly with a Chinese entity but require products manufactured outside China to be drop-shipped? In this scenario, the Chinese entity would find it difficult to receive payment for those goods. How would moving all or part of the operation to a third country (i.e., not China or the United States) affect raw materials sourcing? Can this become a winning move through more local sourcing or through taking advantage of tariff preferences under free-trade agreements?

Whatever the business rationale or priorities, any action to deal with the trade war should only be taken after a proper study of the options and risks. Our observations and comments are formed from our experiences in assisting businesses that had real- life experiences of restrictions and other issues faced under their new structures.

We have already written about the “Do's and Don'ts When Diversifying Manufacturing Operations” (Asia International Trade Alert, July 19, 2019), as well as commented on the questionable methods certain businesses have adopted to circumvent the additional tariffs in “Origin Fraud – When “Made in Vietnam” is not made in Vietnam” (U.S. and Asia International Trade and Manufacturing Alert, June 27, 2019). For U.S. companies operating in China, there is also an increased risk of Chinese regulators, including China customs, taking an especially close scrutiny of such operations and third-party suppliers and service providers. Businesses may want to undertake reviews of current and past operations to ensure full compliance with all customs and regulatory requirements in China.

