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## What's Your Apparel and Footwear Tariff Strategy?

By Rosemary Coates, Reshoring Institute - 09/11/2018

***What should your company be doing to avoid or mitigate penalty import tariffs?*** Nearly 6,000 Harmonized Tariff Schedule (HTS) item classifications have been identified for the imposition of a 25 percent penalty tariff on imports from China. Even though many apparel and footwear classifications have escaped the penalties so far, the future of new tariff classifications is uncertain. Recently targeted products include sporting goods and some apparel items. Will your products be next?

The goal of the Trump Administration is to tax upwards of \$200 billion worth of goods coming to the United States and there is no way to determine what categories, products, or countries might be targeted next. The processes the U.S. Trade Representative is using for selecting items is unclear, which makes apparel and footwear importers rightfully nervous. Import tariffs are adding cost, but no value to global supply chains. In the end, it's consumers who will have to pay increased prices as the cost of goods are passed along the supply chain and more protectionist measures are implemented by the Trump administration.

It appears that the trade wars aren't going to end anytime soon, either. In fact, there is some discussion about targeting additional countries and additional classification categories. Section 232 tariffs apply to aluminum and steel as of June 1, 2018. Section 301 penalty tariffs on Chinese imports are in three tranches: Section 301 penalty tariffs on Chinese imports (List 1 (<https://ustr.gov/sites/default/files/enforcement/301Investigations/List%201.pdf>)) July 6, 2018; Section 301 penalty tariffs on Chinese imports (List 2 (<https://ustr.gov/sites/default/files/enforcement/301Investigations/List%202.pdf>)) August 23, 2018; Section 301 penalty tariffs on Chinese imports (List 3 ([https://ustr.gov/sites/default/files/301/2018-0026%20China%20FRN%207-10-2018\\_0.pdf](https://ustr.gov/sites/default/files/301/2018-0026%20China%20FRN%207-10-2018_0.pdf))) September 6, 2018. What countries or what items might be next is uncertain.

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Whether or not these tariffs will be effective in addressing the long-term policies of foreign governments is anybody's guess. In the meantime, they are likely to affect your current supply chains. How should you respond? What is your tariff strategy?

### **Declare a new country of origin?**

It's important to understand that if your goods are on the list of 6,000 items, you cannot avoid paying the penalty tariffs on importing these goods into the United States. You should work with your customs broker to determine if your imports are on any of the lists. If the country of origin (COO) is China, the penalty tariffs apply. Period.

Transshipment via another country will not change the country of origin or help you avoid paying the penalties. We've heard tales of Chinese manufacturers suggesting that trans-shipping via Vietnam or Singapore and declaring these places as the COO will avoid the 401 tariffs. But this is illegal under U.S. Customs Regulations (CFR 19) as the COO must be the place where the goods are manufactured or substantially transformed, not where they are trans-shipped.

### **Should you buy more inventory?**

Some of our clients have been stockpiling inventory in advance of the tariffs going into effect. The result has been worldwide shortages of parts and overstock of finished goods for wholesalers and retailers. This bullwhip effect adds unsustainable costs in global supply chains. In addition, hoarding inventory ties up working capital and may put a stranglehold on your company's ability to operate. In industries with rapid product development, seasonality, and trends such as fashion or electronics, inventory becomes quickly obsolete, so buying too far in advance is a losing proposition with mark-downs and sell-offs.

### **Perhaps use a foreign trade zone?**

Perhaps you are considering the use of a Foreign Trade Zone (FTZ) to substantially transform fabric or component parts into a finished product and a new HTS number, or to avoid paying duty until you are ready to import. Unfortunately, certain provisions in Section 301 require payment on the value of the Chinese component content regardless if you are now importing transformed finished goods from the FTZ. Even if you ship products from the Zone directly to Mexico or Canada under NAFTA provisions, the China penalty tariffs still apply. With NAFTA negotiations currently underway and on unsteady footing, the future of tri-lateral trade in North America is uncertain.

### **Consider moving sourcing or manufacturing to an alternate country?**

Some apparel and footwear companies are scrambling to move as much production as possible to other production sites in Vietnam, Indonesia, India, Thailand, Myanmar, Bangladesh, or other low-cost countries. While the 301 tariffs don't apply to importing from these countries so far, the future application of new tariffs on additional countries is uncertain. In addition, productivity rates in other low-cost countries can be as much as 20 percent to 30 percent lower than in China. In the final economic analysis, it may be more cost-effective to keep production in China and pay the penalty tariffs.

### **Return manufacturing to the United States?**

Returning or establishing manufacturing in the United States is our favorite strategy at the Reshoring Institute (<http://www.ReshoringInstitute.org>). We are currently helping several clients identify locations and determine the economic feasibility of manufacturing here. Over the long term, this is a good strategy, especially when your customers are in the United States. But it takes time to reestablish manufacturing in the United States. A new factory location must be secured, new workers hired and new distribution channels must be established. For apparel and footwear manufacturers, sourcing of fabrics and notions is still likely to be from foreign countries, and setting up operations in the United States could take as long as 12-18 months. In the meantime, if you must source fabrics and notions from China to support U.S. production, you will still be stuck paying the penalty tariffs.

Use of American contract manufacturers is also a possibility, but apparel and footwear companies must keep in mind that if fabrics come from China, the 301 tariffs still apply to imports. If the CM is buying fabrics on your behalf, they will surely pass the increase in cost on to your company.

### **Can you pass increased costs to your customers?**

In the end, consumers always pay the price for increasing tariffs as these costs are passed-through to customers by importers. Economists tell us that sooner or later, consumers will balk at increased prices and stop buying or limit buying expensive goods. We know that a large portion of the apparel- and footwear-consuming population is price sensitive. Most apparel companies simply cannot or will not absorb the additional cost of goods sold that are burdened with 25 percent tariffs, and instead will tack on the increased costs to the selling price of finished goods. As long as all of your competitors are doing the same, this is no problem. But if some competitors can sell for less, you may see an unfortunate drop in demand for your products, due to non-competitive pricing.

### **Exports**

Exports to other countries are also affected. Trade wars mean that countries will retaliate with their own import tariffs on American goods. Unfortunately, retaliatory tariffs are often meant to hurt economic sectors unrelated to U.S. tariff categories. For example, U.S. 301 tariffs may apply to electronic goods imported from China, but Chinese import tariffs apply to soybeans or almonds. Is apparel and footwear next?

Keep an eye on what is happening in export markets. It is difficult to predict how other countries will react to U.S. protectionist policies.

### **Develop your strategy**

No matter what your opinion about trade wars, it's in your best interest to develop a strategy that will work for your company as U.S. trade policy changes and targets different imports. Examine all of your options and be ready to make changes if necessary.

Let's all hope the trade wars are over soon.

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