



Tariffs & Trade Agreements: What Banks & Businesses Need to Know 09/30/2019

Lately, there's been a lot of media coverage about tariffs and trade agreements, and some of our clients might be wondering how these policies affect their operations and vendor relationships. To answer this question, let's begin with a few definitions:

- **Tariffs** are taxes imposed on imported goods. Generally, they make it more expensive to buy imported products and they usually benefit domestic companies selling similar items.
- A **trade agreement** is the contractual arrangement countries negotiate with each other to establish tariffs. Trade agreements can be bilateral (between two countries) or multilateral (involving multiple countries).

Typically, tariffs are paid by the importer purchasing the products. Tariffs levied by the United States are paid to U.S. Customs at our ports of entry, with proceeds going to the U.S. Treasury. Tariffs imposed by other countries on U.S. goods are paid by the companies importing them. Historically, nations levy tariffs for two reasons: to raise revenue and/or to protect domestic industries from foreign competition.

Currently, tariffs generate about 1% of federal revenue. A key strategy for the U.S. is to shift from multilateral free-trade deals to bilateral deals that help secure preferential arrangements with strategically important trading partners. This policy shift led to the U.S. to withdraw from the Trans-Pacific Partnership. The current administration's view that trade deficits are bad also triggered the renegotiation of the North American Free Trade Agreement (NAFTA), and the 20-year-old United States-Mexico-Canada Agreement (USMCA), is now awaiting ratification by three participating countries. Under the new policies, the U.S. government levied tariffs to penalize foreign countries subsidizing exports or engaging in other practices the current administration deems unfair (i.e. intellectual property infringement). China, Canada, Mexico and several European Union countries have all responded with retaliatory tariffs of their own.

Businesses navigating choppy waters

Profitable businesses operating on thin margins could be pushed into the red as a result of the new U.S. policies and retaliatory reactions. Farmers are often caught in the middle with higher equipment prices tied to steel and aluminum tariffs, while demand for their soybeans and other crops plummets as a result of retaliatory tariffs from China and other countries.

While the U.S. government is providing farmers some financial relief in the form of subsidies, most businesses must create their own tariff management strategies. Retailers stocking common items such as sweaters, toasters, toys and beyond – much of which is made in China – cannot quickly pass costs onto customers as prices for these items are often set in advance, often set for three- to six-month periods.

Potential options for business owners

Switch suppliers: Switch to U.S. suppliers or to non-tariffed countries like Vietnam and Indonesia. Look for alternate products made of materials not impacted by the tariffs (however costs could go up significantly or quality could go down, and switching vendors takes time.)

Renegotiate agreements: Lock into favorable deals with suppliers to avoid higher costs down the road. However, avoiding long-term commitments may be advantageous if the tariff provides a competitive edge.

Adjust prices: Passing added costs to consumers will likely result in lower sales. If part of the cost can be absorbed, try to implement incremental price increases.



Stockpile impacted goods: Consider building up inventory before the tariff goes into effect. However, high inventories can negatively impact cash flow and associated storage costs.

Reduce expenses: Stay focused on profit margins. Consider reducing staff, focusing on non-tariffed inventory or seeking better ways of managing cash flow.

Communicate with experts: Build relationships with professionals who understand U.S. trade policy. Commerce can share the names of individuals who can provide guidance.

If you would like to learn more about international trade, please reach out to your CMG representative.

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