Podcast Transcript

Roadblocks or Reroutes? How Will President Trump's Tariffs Impact the Automotive Industry

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Kattman: Welcome to Rev Up!, a podcast series focusing on the people and issues driving the fast-paced automotive mobility industry. With a view on the future of mobility, the discussions on Rev Up! will offer insights on the realistic and the futuristic of this evolving industry. I'm Amy Kattman, and you're listening to BakerHosts.

On today's episode of Rev Up!, our host, Ashley Hess, a partner and co-leader of BakerHostetler's Automotive Mobility Industry team, is discussing the impact of the recently announced tariffs on the automotive and mobility industry. Ashley is joined by BakerHostetler partner Mike Snarr, co-leader of BakerHostetler's

International Trade team. Let's listen to Rev Up! Where the Rubber Meets the Law.

Hess: Welcome to Rev Up!, our podcast focusing on the automotive and mobility industry. My guest today is Mike Snarr, an International Trade partner at BakerHostetler. Mike, why don't you introduce yourself to our listeners and tell us a little more about your background and your practice?

Snarr: Thanks, Ashley. I'm the co-leader of the International Trade practice at BakerHostetler. I'm in our Washington D.C. office, where I'm a partner, and I've been with the firm getting close to 25 years. My practice focuses on helping clients deal with customs and international trade regulations and also dealing with litigation over tariffs that are adversely affecting their business. It is great to chat with you.

Hess: Yeah. Mike, it is great to have you, and I want to start by sharing with our listeners, and with you, actually, why I chose this topic for today's episode. So, last week I attended a conference where there were a large number of attendees who were attorneys from other countries, and specifically a large number of Canadian lawyers and lawyers from Mexico. And the two most discussed topics at this conference were AI, Artificial intelligence, and tariffs. So, it was clear to me that I should have a trade attorney on the show, and we should talk about generative AI. How does that sound for our agenda today?

Snarr: Tariffs are all over the news and I feel like the popular kid at the dance right now, so I'm happy to chat about that as much as you'd like.

Hess: Obviously I'm joking about talking about generative AI. But why are tariffs the hot topic right now? Just tee the golf ball up for you and let you tell our listeners why this is a hot topic.

Snarr: President Trump has been saying for quite some time during his campaign, and we know from previous experience when he was in office that he is a strong believer of tariffs as a tool of policy. And he thinks about this in a couple of ways. One is that by imposing tariffs, he can help shape policy in negotiations with other countries in order to accomplish certain goals he wants to achieve. Maybe it is reducing immigration problems at the border or addressing fentanyl smuggling concerns.

A second reason why he is a fan of tariffs is that he believes that they can help raise revenue. And as he is looking at the possibility of reducing taxes in the United States, he is looking at tariffs as a possible source of additional revenue. He also likes tariffs because he thinks that they help domestic manufacturing to have more of a level playing field in their competition with foreign producers and that this provides manufacturers opportunities to grow jobs and to potentially raise their prices and that it will incentivize companies to come to the United States to grow the manufacturing base. Those are core principles for him, and he's been influenced by a number of advisors, including his previous U.S. Trade

Representative, Bob Lighthizer, as to those views and he is looking to implement them very quickly in the new days of his administration.

Hess: Yeah. And this, again, I was just at this conference, he announced that he was going to implement the tariffs. He did, and we'll talk about that in a second. And I know there's been a pause here, but the reason they were such a hot topic was that he announced that as of last Tuesday, he was going to implement these tariffs on Canada, Mexico, and China. They were going to be 25% tariffs on steel and aluminum import and there were going to be additional tariffs on imports from Canada, Mexico, and China. Twenty-five percent imports on, or tariff on imports from Canada and Mexico and 10% tariffs on imports from China. And if I take a step back and, obviously, steel and aluminum are important in the automotive industry, and if I were to say, hey, Siri, what are three countries that are most intertwined with the U.S. automotive sector in terms of where the United States imports most of its auto parts, automotive parts from, the answers would probably be Canada, Mexico, and China. So, this is incredibly impactful in the automotive industry.

Snarr: Yes. The, North America has had an integrated manufacturing system in the auto industry from the early days of NAFTA and companies have become very dependent on that. So, the impact of steel and aluminum and tariffs, generally, on imports coming into the United States from North American countries is huge. And his announcement yesterday of additional steel and aluminum tariffs today and other reciprocal tariffs later on also could have a significant impact. Some of the countries that are our most significant trading partners are also our most significant trading partners when it comes to the auto industry. Europe, Germany in particular. South Korea and other countries. There is a very significant impact, potentially, on that industry.

Hess: Yeah. Well, so let me start with a couple of simple questions here. The first one is going to be what is a tariff and the second question is how does a tariff actually work in practice? Tell our listeners what actually happens here.

Snarr: Sure. A tariff is, it is, also called a customs duty, is a tax that is imposed when you import goods, bringing them into the United States. It is a tax that is paid to U.S. Customs and Border Protection, and in the early days of our country, the country really depended on that revenue long before we had income tax as the source of money for generating revenue to operate the country. So, the U.S. Customs and Border Protection has an obligation to protect this revenue as it looks at enforcing customs duties on goods that are imported. The person who pays a customs duty is the importer.

Customs has a term called the importer of record. And so, if you want to import things into the United States, you have to register with Customs to let them know that you're the importer of record. You provide them your taxpayer ID number and you have to set up a customs bond that is set an amount that will help cover some of the liabilities if you don't pay your customs duties when you're supposed to. And in most cases, the importer of record is a U.S. company who is looking to bring in a product from another country that they're buying from a foreign manufacturer. Now in some cases the importer can be a foreign manufacturer and quite often in Canada and Mexico that can be the case, that a manufacturer in Canada who is sending products into the U.S. and negotiates a sale with a U.S. customer might register itself as the importer of record and might be responsible for paying those duties to U.S. Customs in accordance with that role.

Hess: Let me pause you there. So, it is the importer of record that is going to pay the tariff?

Snarr: Yes. So, the importer of record has an obligation to identify the correct classification of goods and the country of origin of those goods and to declare the value of those goods. And based on those three things, you can determine what the duty is that applies. So, the United States has a customs code, a tariff schedule, and based on the classification of the goods, there are duty rates that apply to importing those goods. And in some cases, the country of origin might make a difference as to the duty, which we could discuss in a little bit more detail, and then that duty rate that is associated with the classification of those goods is multiplied by the value that is declared to Customs. So, that is the work that the importer of record does, and when they do that work and submit that information, they also provide the duty that applies to that product being imported.

Hess: Okay. But just to clarify this, the importer of record could be the buyer or the seller.

Snarr: Yes. In most cases it is the buyer, but quite often in North America, Canadian sellers, Mexican sellers who are working on deals with United States, they may agree to assume the responsibility of the customs clearance and to serve as the importer of record. And so, they would be the ones to pay the duties to U.S. Customs. Now, the fact that they pay those duties doesn't mean that you, as a customer in the United States, are not feeling the financial impact of that, because if it becomes more expensive then to sell the good to the customer in the United States, the manufacturer, who is acting as the importer of record, either has to eat that cost themselves, or they're going to increase their prices, and you as a customer in the United States are going to pay a higher price to the foreign manufacturer. Or, if you the customer are the importer of record, then you have an additional cost because you then are the one who are paying the duties to U.S. Customs.

Hess: Yeah. So, let's dive in here quickly because you've touched on something that I've read in the papers, I've heard in the news, and it makes good sense to me at a theoretical level, but I want to get your opinion on this. Everyone says that the raising tariffs is going to create a trade war. That it will cause inflation and that it is going to cause higher prices to the consumer because the manufacturers will simply pass along this increased cost that you're talking about to consumers, and I would like your opinion on that. And just, is that the way this works? Is that what we should expect?

Snarr: Yes, that is the way it works. It is a basic economic principle. Any type of additional cost that you have for what you're trying to sell to your customer, you're going to want to raise your price so that you can capture that cost so that you can protect your profit margin. The only reason you wouldn't do that is if you are competing in a scenario where you can't raise that price because you're going to lose the sale altogether. And in that case, you may decide to absorb that cost. But you're not going to be able to absorb it for very long if it is something that is going to last for a couple of years going forward.

Hess: So, let me pause you there because I think you're touching on the component of this that is sometimes ignored when people are explaining tariffs or the way Trump is using the tariffs. Is that, theoretically, if there is a tariff in place, the price of parts for the ultimate manufacturer is increased, they are going to pass that along to the consumer. That is going to create inflation and higher prices to the consumer that the consumer is just going to pay. But if we inject some reality into this, what might happen is that as the price goes up, the consumer elects to do something different. They're going to buy fewer goods. They're going to buy a cheaper good, or they may delay a purchase, and that is where there is some economic pain on the manufacturers of the ultimate product or the parts, and I think when we talk about tariffs as a tool, it is a tool to then start a negotiation so that we can fix other issues, whether they're economic issues or trade issues or you mentioned fentanyl coming into the country is one of the issues that's been raised by President Trump. And so that is something that, I think it is good to clarify is that using these tariffs, at least in the short term, can be an effective way of getting other countries to come to the bargaining table and negotiate different deals with us, trade deals and otherwise.

Snarr: Yes, if you look at the example of Colombia from a couple of weeks ago, the United States was sending a military plane with detained immigrants to Colombia, and Colombia had objections about the way that they were being sent back to Colombia and had decided that they were not going to accept them on the terms that the Trump administration were operating under. And so, President Trump announced by social media that he was going to increase tariffs by 25%, maybe higher, immediately on all goods coming from Colombia and other consequences. And that was in January, and Colombia's biggest export product to, one of the biggest export products to the United States is fresh cut flowers.

We have Valentine's Day coming up on February 14. And so, for a seasonal market like that, February 14 is a date that Columbia cannot miss to export their products. And so, if consumers in the United States had to pay a lot more for flowers for Valentine's Day, they might not be buying them from Colombia. They might be buying them from some other supply that was not subject to that tariff, or they might decide to buy chocolates instead, if they decide that is something cheaper to buy. So, it does have an impact on the businesses in the other country because they could potentially lose a sale or they may have to decide that, or they may not sell quite as much, or they may have to absorb some of the costs in order to go through with the sales they're anticipating.

Hess: One other question I'll ask you with regard to the application of tariffs. In automotive manufacturing, especially with the United States, Canada, and Mexico, parts or goods may go across borders multiple times. And in an instance like that, what is subject to the tariff that is at the overall product, just the components that are added in a specific country and that value-add component? What does it apply to?

Snarr: When you import a product, that product is identified by its customs classification code. And there is a duty rate that corresponds to what that product is. So, that product might be made of 25, 100, 200 different components, but it is the product itself as a whole, identified by the tariff code, that is subject to the tariff or duties that apply. When you import a product into the United States, you may ship it out across the border and import it back in, and as a general rule, each time you import something, it is subject to the customs duties or tariffs that apply to that product.

There have been some exceptions to that. If you import something and you then export that, you incorporate that imported good into something that you export to another country, you can claim something called duty drawback and you can submit a claim to Customs to say that you'd like a refund of the duties on the things that you imported because you've just exported them back out of the country. The tariffs that President Trump has started to impose on Canada and Mexico and China have been drafted in such a way that duty drawback is not eligible, making it more difficult to take advantage of that duty-savings technique.

There are some other types of duty-savings techniques that are available. If you export something from the United States to Canada or to another country of any, doesn't matter which country, and then you bring it back in and it hasn't been changed, maybe it is just something that's been repaired, there is a provision in the customs code that you can do that, so you don't have to pay duty when it comes back into the United States. That provision, it is called 9801, it is still available, notwithstanding these Canada and Mexico tariffs that have been proposed. They're rather similar provisions to reduce the duty liability when you have something that is going across the border, maybe for a certain level of processing or manufacturing that doesn't really change the good before it comes back into the United States.

So, there are some of those things that are still available, but you can see from the orders that have been drafted for Canada, Mexico, and China that the administration is trying to really limit the amount of exceptions that there are for those tariffs. We often have been asked what sort of exclusions are there from these tariffs, because when President Trump first imposed tariffs on China in his first administration, there was a whole process of requesting exclusions for different types of products, but that process started to wind down and there have not been very many continuing exclusions for that. And for these tariffs that have been proposed now, there has been no establishment of an exclusion process for them, so they cover everything that would be coming from those countries.

Hess: Very good point. Alright, Mike, so, we've covered some of the basics of how a tariff works, how it is paid, and I think we've even talked about some of the theory of why the Trump administration is using the tariffs and how this may play out. So, let's now talk about the individual countries and maybe of the three we've mentioned, on one hand, we're going to have Canada and Mexico and maybe on the other hand, we're going to have China. But maybe we tackle Canada and Mexico first. The ultimate goal here, in terms of the tariffs that we have in place, what are we trying to accomplish? What does this mean for perhaps a renegotiation of the USMC and what can our listeners be looking for? What might they expect in the coming months?

Snarr: I think the first thing that the President is trying to do is just establish that he has some negotiating leverage with Mexico and Canada and that he has the means to influence them on policies that he wants to accomplish, whether those are economic policies or trade policies or other types of policies. And I think he wants to demonstrate that to Canada and Mexico, as well as demonstrate that to the United States in the early days of his administration. The USMCA agreement was something that was renegotiated. It was NAFTA originally and it renegotiated in the first Trump administration. And when that agreement was renegotiated, one of the goals of the Trump administration was to require a higher level of domestic manufacturing within the United States and Mexico and Canada in order for goods to qualify for lower duty treatment under that agreement. Having more domestic content from the United States and the other countries is going to make it so that it will help U.S. manufacturers, companies doing business in North America more, and they'll have to have those components made in the United States as opposed to having components made in part coming from other countries, say from China to Mexico, as part of that process.

Hess: And that is most likely going to spur more economic activity in the USMCA countries in terms of maybe M&A activity where manufacturers are looking to acquire facilities so that they can produce those products or more of those base products in those three countries and perhaps is more greenfield investment?

Snarr: Yes, exactly right. It is an attempt to try and make the North American trading group be more dependent on itself and to make it more difficult for China to enter into that supply-chain stream through the back door. One of the concerns, not just of the President but also of the U.S. Congress, is that China has, notwithstanding the tariffs that have been put on China to make it harder for them to ship goods to the United States, they have been investing in manufacturing in Mexico. They have been sending materials, particularly aluminum and steel, from China to Mexico. And having those components refabricated, remanufactured, into something that would be a product of Mexico and that therefore it might qualify for trading under the USMCA agreement as duty-free. And that then we're starting to see more product originating from China, coming through Mexico or from Canada, into the U.S. market and competing on the best terms that are terms otherwise reserved for Canadian manufacturing, Mexican manufacturing, and U.S. domestic manufacturing.

Because of that concern, the administration, and Congress as well, has been looking at legislation to deal with this, is looking for ways to limit China's ability to, in effect, take advantage of the USMCA agreement by near-shoring its manufacturing in Mexico or by shipping goods to Mexico that are then recycled or refurbished in a way that they can come into the U.S. market.

Hess: Yeah. It is a very good point. Something I want to touch on briefly here. It is related to what we were discussing earlier is this, tariffs are a hot topic right now, but President Trump is certainly not the first or the only president to ever use tariffs, and other nations have used tariffs on U.S. goods. In some ways, as a lay person, I think what is the big deal here and why are we hearing so much about this if tariffs have been used by other presidents and have been used by other countries. What is unique about this situation?

Snarr: One of the concerns, domestically, we have U.S. manufacturing that is not necessarily buying finished goods but buying inputs for their manufacturing from other countries. So, if the concern about tariff policy is we want to help U.S. manufacturing, there is some tension there with U.S. manufacturing that relies on inputs that are really only made in other countries, and there is some products that are just not made in the United States anymore. That manufacturing, if it existed, has picked up and left.

So, companies go and they qualify suppliers in another country, and they establish agreements and there is a ramp up to get a very good quality product that you can rely on to then have that be imported into the United States. And that supply chain, then, is being disrupted by the tariffs. And so, that creates a cost that hurts our manufacturers, potentially, in the United States and if our manufacturers are then making a finished good that is more costly and they're competing with that finished good against finished goods from other countries, it, in effect, is putting them at a disadvantage because it is imposing costs on them to then compete with finished goods from other countries that aren't necessarily subject to those tariffs, particularly if they're trying to export those goods to other countries.

So, one aspect of it is that there is really some harm in terms of the costs in competition for U.S. manufacturing, notwithstanding that it is presented as a policy to help manufacturing. The other concern is that tariffs have been the subject, customs duties have been the subject of negotiations internationally since the end of the Second World War and through a series of agreements called the Uruguay Round Agreements. But over the last 10 years, the United States has essentially withdrawn from that dispute settlement process by refusing to appoint new judges to what is called the WTO Appellate Body. And so, that has taken this legal process in order to manage an agreed level of reduced customs duties and has put it on the sideline. And we're seeing the President now taking policies that would increase those tariffs that previously could have been the subject of tariff retaliation in an administered process under the WTO system.

Hess: I think your point, Mike, is that by withdrawing from this, the normal adjudication function isn't in place. And so, is that what is, would you assert that is what is allowing President Trump to use tariffs as a tool here? That he brings people to the table because the normal route for adjudication of these issues is no longer, it no longer applies?

Snarr: So, in essence, you have a period of time where countries had agreed to a level of customs duties and tariffs, and to keep them maintained at that certain level. We're starting to see, with this administration, really a withdrawal from that and a number of measures that are now opening the door for an acceptance in the international community of tariffs being something that can fluctuate and increase with less predictability. And that has a cost to it for transactions worldwide. It has cost to the U.S. companies who are manufacturing, who rely on imports at a certain duty rate. It has a cost for manufacturing when you're selling to another country and all of a sudden, your product is priced out because of an increased tariff so you don't have access to that market anymore. So, these costs make the business transactions more expensive and just create a lot of disruption and less predictability for the industries that are affected by them.

Hess: Yeah. What is the best advice right now for a manufacturer in the United States? Is it wait and see? Is there going to be turbulent times and we need to have more definitive path forward? What are we telling clients right now?

Snarr: On the policy side, I think there is an anticipation that an agreement will be reached with Canada and Mexico that will not require a continued imposition of 25% of tariffs. Now that is some speculation, but that, there seems to be some anticipation about that being the result. But from their perspective, if entering into a trade agreement doesn't give them protection from significant tariffs that are imposed without any authority under the agreement, then what is the incentive for entering into that trade agreement?

Canada and Mexico have free trade agreements with other countries. They may have to start looking to those other countries as primary markets for their supply if there is too much risk and uncertainty about dealing with the United States. In terms of other things that we're telling clients that they can do, one thing is that you can look at your supply agreements and see whether you might ask your suppliers to be the importer of record. So, if you're buying something from Canada where you're the importer of record, you might ask them to assume that responsibility. They assume the risk of the increase of those tariffs, and they deal with all of the fallout of it.

Now, that doesn't mean that you have protected yourself from cost increases, because they may have to increase their sale price, if, in effect, they're assuming a 25% increased cost, but it can potentially help you in terms of your planning. That is not something that you have to, you don't have to deal with the tariff itself. You don't have to worry about going to your customs broker and having your customs broker say you now have to increase the customs bonds to cover your duty liability. It just shifts some of that responsibility to the supplier if they're willing to accept it.

Another thing we're telling companies to look at is to look at the terms of your agreements to make sure that you understand what they say about who is responsible for the cost increases. Do, is, have you agreed to allow your supplier increase the price on this product given the contingency of an increase in tariffs or what is happening in the market. It is something to think about in terms of the negotiations that you have as to who is going to bear that risk in your contracts with your suppliers going forward.

Hess: So, Mike, I want to spend just a little bit of time also focusing on China and as I said before, I think on one hand you have Canada and Mexico in this discussion. On the other hand, you have China. What is unique about the relationship with China that makes it different in terms of the tariff discussions and what should we expect going forward? And to compare this to what you just said about the relationship between the U.S., Mexico, and Canada, sounds like there is going to be a renegotiation in 2026 of USMCA. What is going to be the resolution in terms of our relationship with China?

Snarr: The President, his advisors, and probably most of the Congress, this is probably one thing that Democrats and Republicans actually agree on, is that China is a serious concern for trade and economic risks into the future for a number of different reasons.

One of the concerns that they have is that there is just this great overcapacity of production in China that cannot meet the Chinese market, and we're talking about electric vehicles that are produced probably twice as many as they can possibly ever consume in China, and for a long time there has been discussion and concern about overcapacity in the production of steel and aluminum, which is why President Trump and his first administration invoked a national security basis for imposing tariffs on steel and aluminum. China has to have some place for these products to go, and that means that they may be selling those products at prices that are detrimental for any of our competitors in the United States. And there are also concerns about Chinese government subsidies and costs of production and so on. One of the reasons why China is different is because of this great overcapacity problem and the non-market economy aspects of working with China in an economic framework.

In addition to that, there are the other concerns with China that are more geopolitical concerns about information being gathered from the United States and held and used by Chinese government entities, whether that information is coming through TikTok, whether it is coming from an electric vehicle that is gathering information about you. That is a serious concern. Forced labor is another concern, that the weaker population in China are being required to work under terms that are just unacceptable as forced labor conditions. And so, we've seen in the last three or four years an increase in authority for U.S. Customs to detain goods that anywhere in the supply chain may have been made in whole or in part in the Xinjiang province, where the Uyghur population is located, or by entities that are put on a list as identified entities that use force labor somewhere in the supply chain.

And broadly speaking, the President and his advisors have emphasized a policy of decoupling the supply chain with China because of the economic and strategic and other political risks the Biden administration talked about de-risking the supply chain and the Biden administration did not remove the tariffs that initially President Trump had imposed. They maintained them, even defended them in court. But they were using a number of different tools and not necessarily putting as much pressure on China as maybe the Trump administration would. Companies have been looking at alternatives to manufacturing in China for their supply chains. And so, they've looked at other countries in East Asia. They've looked at Mexico. And one of the things that companies need to think about is that if you are looking to an Asian manufacturer as a source of supply, first of all, there is a time that it takes to get that established and you're qualifying a new supplier, and they may not have the same capacity for that manufacturing. They may not have the same quality.

But an additional concern is that Chinese investors, owners, and manufacturing have moved to other countries to set up new manufacturing there because they see what's been happening with U.S. policy over the last few years. And the United States has concerns about subsidies from the government of China being passed through these investors that may go to another Asian country to set up a new manufacturing facility. United States has even started cases to a plot to provide countervailing duties to offset what they call transnational subsidies where, let's say, the Chinese government provides different incentives, tax breaks, other types of assistance, to a Chinese business that then opens a new manufacturing facility in another country. The Department of Commerce is looking at cases where they're investigating those things as subsidies to provide a basis for imposing tariffs to offset those subsidies.

Something for companies to think about as they're looking at re-shifting their supply chains to other countries is to make sure they understand where the capital is coming from, who those investors are, and to address any possible concerns about Chinese ownership of those facilities that might create a carry-on risk that they were originally trying to avoid by relocating from China.

Hess: Mike Snarr, thank you for being on Rev Up! Where the Rubber Meets the Law. It's been great having you.

Snarr: Thank you, Ashley. Great to speak with you. Really appreciate it.

Kattman: Thank you, Ashley and Mike, if you have any questions for Ashley or Mike, their contact information is in the show notes. As always, thanks for listening to BakerHosts.