Bill's Building Blocks

How Are Tariffs Paid?

Dollar Tree, Inc., a public enterprise, operates Family Dollar Store and Dollar Tree discount variety stores in the United States and Canada. The Dollar Tree segment ended its 2018 fiscal year with eleven billion in revenue across 6,650 stores with a 64.2% cost of goods sold. Dollar Tree sells every item at a fixed price of $1.00, and 42% of those items are imported mostly from China. I use Dollar Tree as the application project in my NYU Supply Chain Engineering class. A Chinese product with a factory price of 56.0 cents and a logistics cost of 8.2 cents has the landed cost of 64.2 cents. Suppose a 10% tariff is imposed. Then the factory price becomes 61.6 cents and the landed cost is 69.8 cents which exceeds Dollar Tree's COGS target by 5.6 cents.

Tariffs are initially paid to U.S. Customs by the Importer of Record and not by the Exporter. The Importer of Record is often a third party relationship with the importing company. The Importer receives the tariff for payment one of three ways. The first and most direct way is when the tariff is added to the price of a single imported item. Secondly, the tariff payment may be spread over the purchase of multiple items making the exact increase hard for the Importer to discern. And third, the Importer may receive a separate tariff invoice from the Importer of Record after receiving the physical items.

The Importer has three ways to deal with the cost of a tariff. First, the Importer can pass the cost of the tariff on to the Customer by raising the product's price. Second, the Importer can absorb the cost of the tariff by taking a lower profit margin. Third, the Importer can search for an equivalent source of supply from another country imposing a lower tariff. This is not possible for sole sourced items. Spending internal resources to identify and qualify an alternative source of supply is expensive in both opportunity cost and calendar time. Worst case, the Importer may decide to drop the product.

	Export Company	**Import Company**	**End Customer**
Raise Prices	No impact unless sales drop	No impact unless sales drop	Pays the tariff with a higher product price
Absorb Cost	No impact	Pays the tariff with a lower profit margin	No impact
Change Suppliers	Complete loss of sales	Very expensive and time consuming	Some supply disruption

A price can be raised immediately, while changing a supplier takes a long time. The bottom line: Tariff hurts the End Customer or the Importer before hurting the Exporter.

©2019 William T. Walker, CFPIM, CSCP-F, CLTD-F, CIRM has 40plus years of practitioner experience, authored *Supply Chain Construction* and *Supply Chain Architecture*, and teaches Supply Chain Engineering at NYU Tandon and Demand Planning at Rutgers. He is a 35plus year APICS member and APICS E&R Foundation past president. Email: wt_walker@verizon.net