U.S. Tariffs and the Future of “China Plus One”

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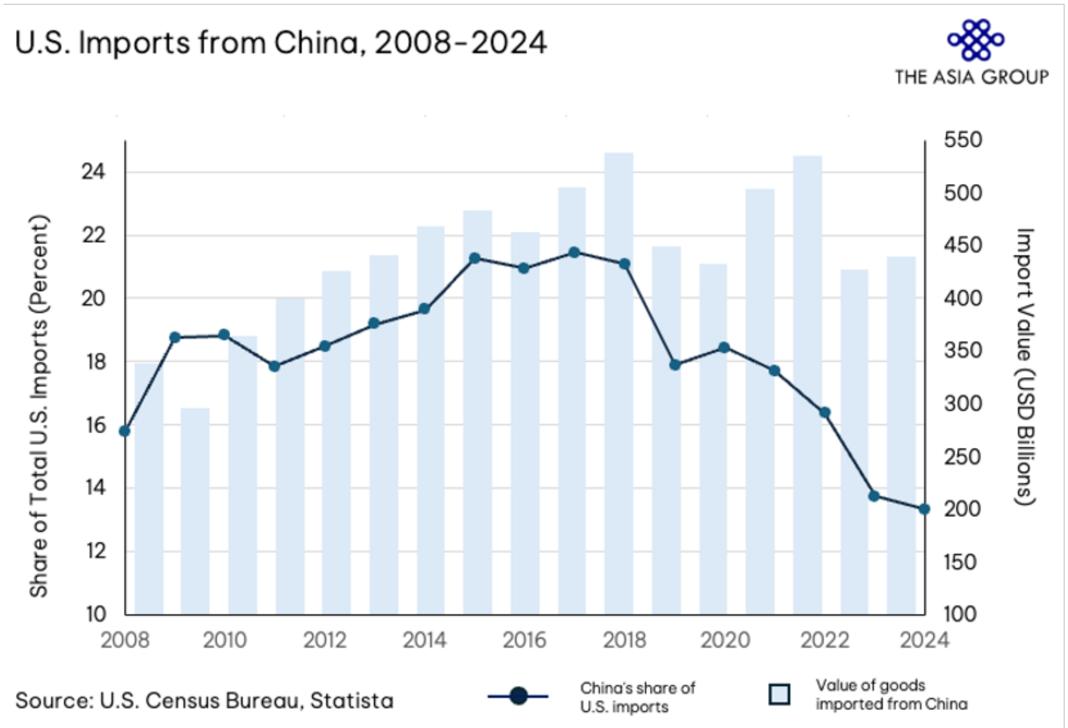
Produced by our Geopolitical Risk Practice, TAG GeoTrends analysis deciphers complex, multi-market geopolitical risks and offers actionable insights for navigating them.



Key Takeaways

- **“China Plus One” Under Pressure:** U.S. tariffs targeting Indo-Pacific trading partners are raising serious questions about the long-term viability of “China Plus One” (CP1) supply chain diversification strategies – impacting the manufacturing of semiconductors, autos, consumer goods, green technology, pharmaceuticals, and other strategic goods.

- **Preparing For Risk:** While the most salient Trump administration tariffs face legal jeopardy following last week’s ruling by the Court of International Trade (CIT), businesses should still prepare for a successful appeal – along with possible amplification of Section 232 and Section 301 tariffs unaffected by the CIT decision. Some semblance of Washington’s “reciprocal” tariffs will remain in force for the foreseeable future, negatively impacting the cost effectiveness of manufacturing in “Plus One” markets.

- **Critical Watchpoints:** In measurable net terms, the continued cost effectiveness of CP1 manufacturing will depend on the relative outcomes of U.S. tariff negotiations with China and the United States' other trading partners. This will directly impact the price competitiveness and operational feasibility of maintaining parallel supply chains versus operating within China itself. Additional unexpected shifts in U.S. tariff policy could quickly erode the advantages that initially made CP1 strategies attractive.

- **The Bottom Line:** While CP1 manufacturing is unlikely to disappear as a useful hedging strategy, the approach may become more costly to maintain, especially if Washington fails to ink trade deals with non-China trade partners or opts for further tariff measures. Therefore, businesses should seek incentives in "Plus One" markets to offset potential tariff costs and consider "China for China" or "Everyone but China" strategies alongside current CP1 efforts. These complementary approaches can help companies localize risk, preserve market access, and build structural flexibility into their existing supply chains.

"China Plus One" Redux

A China Plus One (CP1) approach is a supply chain diversification strategy aimed at reducing overreliance on China by establishing external production or sourcing capabilities to complement existing China-based assets. The main drivers of CP1 include post-COVID fears about supply chain security (exacerbated by the threats of armed conflict, economic coercion, and other geopolitical uncertainties); the increasing costs of manufacturing and operating in China; and growing incentives for multinational investment in "Plus One" markets.

At least three operational assumptions drive CP1 strategies: (1) that geographic dispersion avoids unique risks (especially from active or potential conflicts such as Ukraine, the Middle East, the South China Sea, and Taiwan); (2) that full decoupling from China is infeasible and/or undesirable but alternative markets can still provide comparable, "de-risked" manufacturing capacity; and (3) that supply chains are modular (i.e., product design and component sourcing can be disaggregated).

Over the past five years, the implementation of CP1 strategies across all industries in the post-COVID international system has significantly shifted the structure of global trade, accelerating the pace of geoeconomic fragmentation already resulting from the Global Financial Crisis and U.S.-China trade tensions. The decrease in U.S. imports from China in favor of alternatives from Mexico, India, and Southeast Asia after 2020 is illustrative of CP1-related supply chain shifts. In 2024, Chinese exports accounted for 14 percent of total U.S. imports, down from 18 percent in 2020 and a high of around 21 percent between 2015-2018. Meanwhile, U.S. imports from Southeast Asia totaled USD 352.3 billion last year, up 13.3 percent from 2023.

Negotiation-Dependent Risks

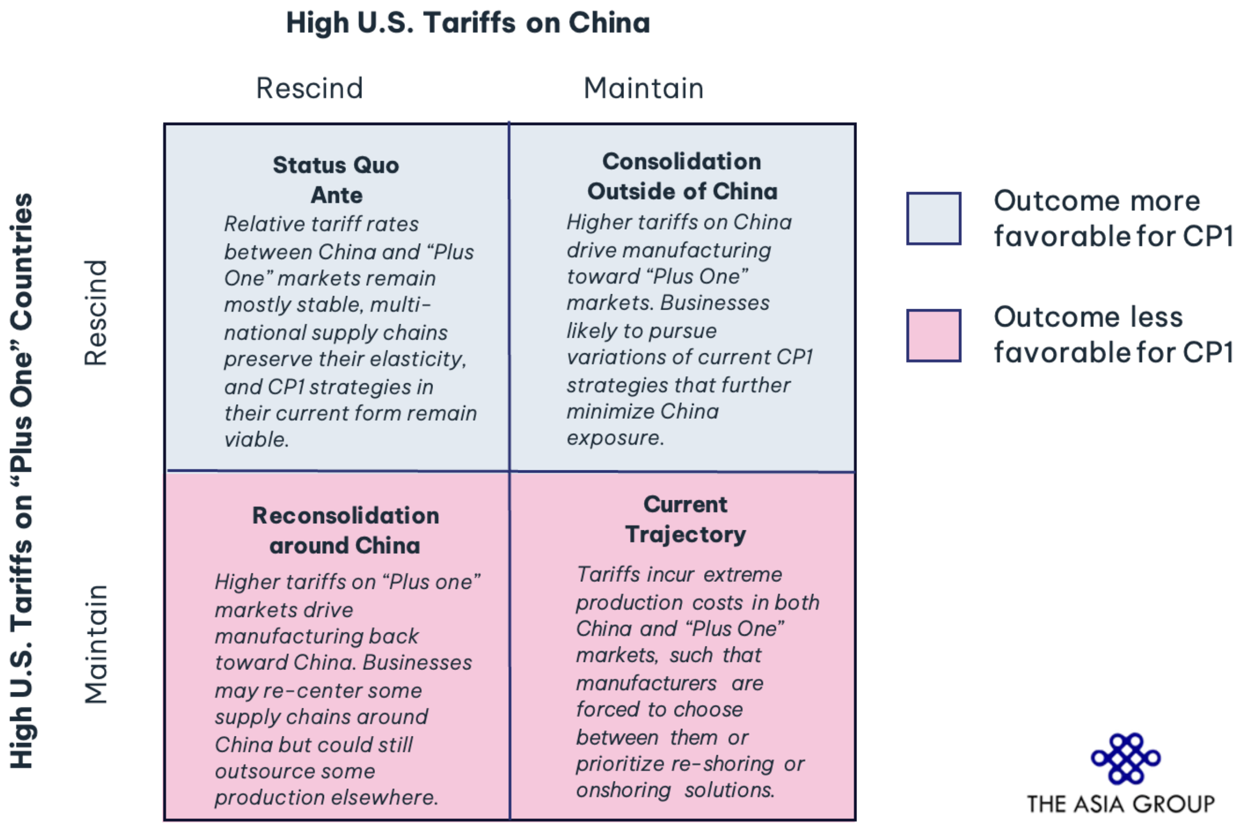
The continued utility of the CP1 approach in a post-tariff world will naturally depend on the outcome of ongoing negotiations between the United States, China, and other U.S. trade partners. If the United States fails to reach agreements with China and/or "Plus One" markets, some of the business rationale for CP1 may no longer hold. Watchpoints include:

- **Relative margins:** It may no longer be as competitive for multinational firms to manufacture components and products outside of China, especially if India, Indonesia, Malaysia, Thailand, Vietnam, and elsewhere face 25-50 percent tariff rates after the 90-day negotiating window expires on July 7. Given that CP1 expansion often requires upfront start-up costs in new markets, higher tariffs will make further diversification for export to the United States even costlier. Following last month's Geneva talks, estimates place aggregate U.S. tariffs on PRC goods between 40-51.1 percent (including sectoral carveouts). At these rates, producing most products entirely within China would only incur marginally greater tariff costs than producing in "Plus One" countries with high tariff rates, such as Vietnam's 46 percent.

- **Capabilities of "Plus One" markets:** The punitive economic effects of U.S. tariffs could hamstring "Plus One" partners trying to develop the infrastructure required to be an attractive investment destination. For example, Thai industry leaders estimate that 36 percent U.S. tariffs could incur a USD 24 billion hit to the country's economy. Losses of this scale will make it much harder for "Plus One" governments to invest in their development, especially if they are planning significant capital allocations to the United States (either as greenfield investment or purchases of U.S. energy, defense equipment, agricultural goods, and other products) in exchange for tariff relief.

- **China's economic environment:** A core element of the CP1 approach is that China is still an important market for foreign companies despite geopolitical uncertainty. If ongoing U.S.-China trade talks go south, Beijing could signal resolve by making escalatory moves that place multinational entities operating in China at risk, including probes, raids, export controls, sanctions, or additional tariffs. Such actions could make China prohibitively costly or risky for some foreign entities. As the good will built from last month's Geneva Talks continues to dissipate, China has already threatened to target U.S. companies with its

Anti-Foreign Sanctions Law and could conceivably reinstate prohibitions for entities proscribed on its Unreliable Entity and Export Control Lists.



As illustrated above, the future of CP1 largely depends on the interaction between the trade deals Washington strikes with Beijing and its other partners. Higher tariffs on Beijing correlate with increasing uncertainty in China's domestic economic environment, while higher tariffs on "Plus One" markets would likely hamper their economic development and reduce incentives for replicating China-based processes within their borders.

Better outcomes for CP1 would be a return to the pre-"Liberation Day" status quo ante and higher tariffs on China but lower tariffs on "Plus One" markets, while worse outcomes for CP1 would be reconsolidation around China or maintenance of the current trajectory (i.e., high tariffs on both China and "Plus One" markets). That said, companies may opt to continue with a CP1 strategy even if U.S. tariff policy significantly shifts trade costs given incentives to diversify against non-tariff threats (e.g., armed conflict), the continued attractiveness of the Chinese market, and broader concerns about U.S.-China decoupling.

Negotiation-Dependent Risks

The Trump Administration's Liberation Day tariffs marked a watershed moment in the global economy, signaling a fundamental shift from predictable and relatively open trade policy toward protectionism and fragmentation. Even if the tariffs are significantly rolled back, protectionist policies have eroded assumptions about U.S. reliability. Furthermore, analytic consensus suggests that the tariff floor has shifted toward a ten percent universal tariff rate, meaning that even successful negotiations would likely result in rates in the mid-to-high teens. Accordingly, there are several other risks to CP1's long-term viability that emerge regardless of how negotiations between Washington, China, and "Plus One" markets unfold:

- **Shifting trade flows:** Even if the Trump Administration settles for a substantial tariff rollback, its policies have prompted both U.S. and Chinese firms to urgently reassess global supply chains, intensifying competition in "Plus One" markets. As Chinese companies look for secondary markets to increase diversification, Beijing is also leveraging diplomatic engagement to help Chinese entities accelerate supply chain shifts. Thus, it is becoming increasingly difficult for non-Chinese firms to verify that alternative suppliers are truly independent of Chinese components or products —especially in Africa, Latin America, and Southeast Asia.

- **Reduced market access:** Rerouted trade flows induced by U.S. tariffs have also prompted a rise in protectionism for varied reasons, thereby increasing government-driven oversight of companies that operate across markets, including those with a CP1 strategy. For example, in Canada, consumers and the Canadian government have organized around a "Buy Canada" initiative, geared to disincentive purchases of U.S. goods in response to U.S. President Donald Trump's rhetoric and trade terms. Further adding to scrutiny, several countries are working to prevent a surge in Chinese imports that might damage performance of domestic companies. India, for example, is aware that China seeks alternative markets to navigate U.S. tariffs and has deepened its review of suspected surges in Chinese exports to support domestic companies. Other countries will likely follow suit.

- **Tension between global expansion and domestic investment:** Ongoing trade negotiations have also complicated relations between "Plus One" governments and their domestic industries. Regulators face increased pressure to support private sector investments abroad to diversify supply chains (and, for U.S.-bound investments, help reach a compromise on tariff relief). At the same time, mass capital outflows have also triggered greater insistence from the public that more must be done to support domestic investment. These at times disparate demands on individual companies' investment strategies could divert resources from a CP1 approach toward local development. This may mean that both domestic and geopolitical concerns, and not just economic realities, could play a larger role in determining supply chain investment decisions.

Implications for Business

- **For companies that have yet to develop a CP1 strategy, finding the right "Plus One" partner may get more complicated:** Uncertainty surrounding the outcome of U.S. tariff negotiations complicates the search for viable "Plus One" partners. As companies reassess their global footprints, it is increasingly difficult to identify alternative markets that offer both cost-effective production and long-term policy stability. A country that appears attractive today could become less viable if it is later targeted by new U.S. trade restrictions. This volatility raises the strategic risk of overcommitting to a single market and underscores the importance of flexible, multi-market strategies that can adapt as trade dynamics evolve. Companies should continue to hedge by spreading operational exposure across jurisdictions.

- **Firms that already have CP1 strategies may move more towards "China for China" or "Everyone but China" strategies:** Amid growing trade uncertainty and regulatory divergence, companies should consider bifurcated supply chain models —localizing operations within China to serve the Chinese market or relocating value chains to serve global markets without reliance on Chinese inputs. The "China for China" approach entails building self-contained operations—including R&D, manufacturing, and distribution—entirely within China to minimize exposure to cross-border trade friction and regulatory barriers. The "Everyone but China" strategy involves ringfencing supply chains to exclude China-based components or partnerships altogether. While both strategies come with costs (such as duplicative infrastructure) they offer a pragmatic fallback against the mounting geopolitical and policy volatility should CP1 approaches become untenable.

- **Regardless of whether they already have a CP1 or alternative strategy in place, all businesses should search for local incentives to offset tariff costs:** As tariff pressures intensify, businesses should actively monitor and capitalize on fiscal and regulatory programs offered by "Plus One" countries aimed at attracting foreign investment and deepen their integration into global supply chains. Many governments in Southeast Asia, South Asia, and Latin America are rolling out targeted measures — such as tax holidays, customs duty exemptions, land subsidies, and fast-track permitting — to position themselves as alternative manufacturing hubs. Engaging early with local officials and industry associations can also unlock favorable packages or public-private partnerships that enhance long-term value. For firms navigating uncertain tariff regimes, these localized benefits may provide critical buffers that make diversification strategies more financially sustainable.

*This report was co-authored by **Nick Ackert** and **Hannah Feldshuh**.*