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Global trade redefined: Defence

**Dealing with tariff
uncertainty**

July 2025





This report has been developed in collaboration with the Strategy& team, PwC's global strategy house. Together, we transform organisations by developing actionable strategies that deliver results.

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could happen next*

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Introduction

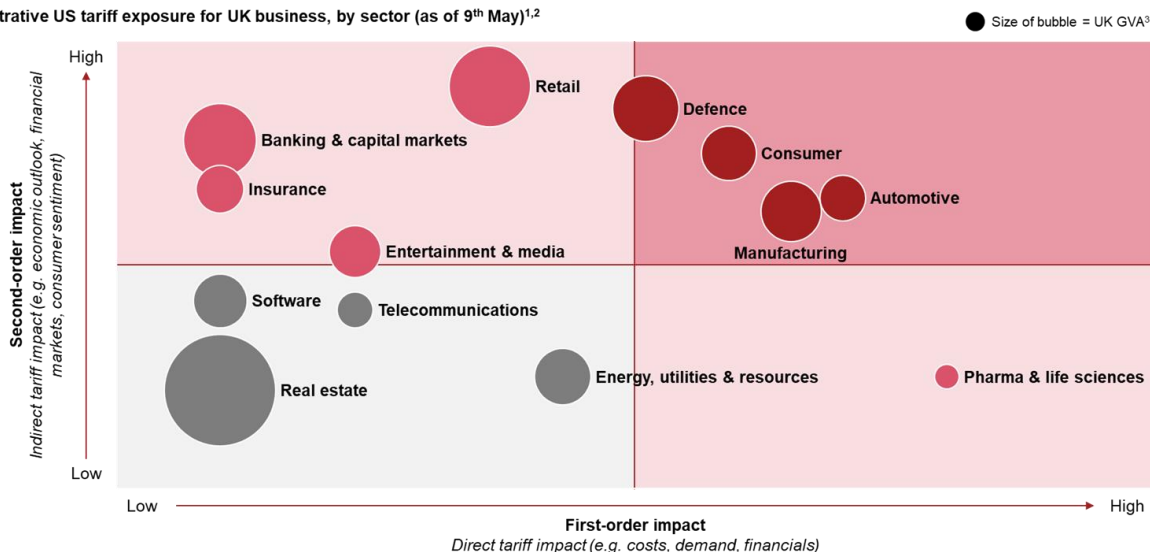
The imposition of tariffs under the Trump administration has heightened strategic uncertainty for the UK defence industry. While direct impacts are limited, due to the UK's role as a net importer and its specialist subsystem exports to US-led programmes, the broader geopolitical shifts are significant. Protectionism and national sovereignty concerns have prompted reassessments of defence partnerships, challenging the established order within NATO and the EU.

The highly regulated nature of the sector buffers it from immediate impacts as it is time consuming and expensive to move to alternative supply chains for critical elements of major defence programmes. Either through limited supply (e.g. small numbers of global suppliers with the required depth of capability) or constrained demand (e.g. supplier or part embedded in regulatory approval), the level of supply chain inertia is likely to mean the defence sector is less likely than others to move quickly to reconfigure affected supply chains. In those areas where change may be possible, limited visibility into extended supply chains often adds to the uncertainty, complicating proactive strategic changes. As the industry adopts strategic patience amid political volatility, the second-order impact of the US tariffs is likely to be a doubling down on developing sovereign capability within the UK and European defence supply chain and a reduced reliance on the US. Short-term strategies include diagnosing supply chain exposure and exploring alternative markets, while long-term plans focus on investing in domestic capabilities, collaborating with international partners, and pursuing strategic M&A to enhance defence autonomy and competitiveness.

Some common industry actions:

1. Assess first-order impact versus second-order impact
2. Understand variation by sector within an industry and interdependencies across industries
3. Adopt a mix of 'no regret moves' in the short term and strategic choices in the longer term
4. Identify both risk mitigants and growth opportunities
5. Embed ongoing resilience to respond to geoeconomic shocks

Illustrative US tariff exposure for UK business, by sector (as of 9th May)^{1,2}



Notes: 1. Estimated tariff impact assumes measures stay in place for a prolonged period, in line with Strategy's 'Break and reorder' scenario; 2. Featured sectors account for c.60% of UK GVA (Gross Value Added); 3. Estimated 2024 GVA based on ONS data

Assessing the situation

On 2 April 2025, the US administration announced a sweeping package of tariffs on imported goods. This marked the beginning of a tumultuous period, during which sector-focused tariffs have been implemented, pauses have been extended, and tariff letters have been issued. Businesses continue to face a materially more volatile and uncertain global trading environment as a result.

What happened on ‘Liberation Day’?

An Executive Order introduced a dual framework of US import restrictions: (1) broad-based ‘baseline’ tariffs; and (2) targeted ‘reciprocal’ measures. The UK was subject to the 10% baseline rate, while other partners were subject to much higher rates.

These tariffs sat alongside a number of product-level distinctions (e.g. automobiles, steel, and aluminium), and exemptions (e.g. pharmaceuticals and critical minerals).

Activity in overdrive

On 9 April, reciprocal tariffs were paused for 90 days - creating a window for intense diplomatic engagement between the US and its main trading partners.

As only three ‘agreements’ were reached within the initial 90-day window, this pause has since been extended to 1 August. This extension was announced alongside the issuance of formal ‘tariff letters’ which confirmed and, in some cases, revised rates.

While these letters provided clarity, they have also sparked new complexities. Some countries such as Japan and Brazil saw steep increases, while others received conditional relief. Countries must now consider how to respond, either through acceptance, retaliation, or renewed deal-making efforts.

It remains unclear exactly what will happen next as we pivot from a predictable trading environment into uncharted territory, but it is evident that **global trade is being redefined**.

Extended fragmentation

While the initial focus has been on goods, trade disruption is likely to spill into other domains. For instance, some service sectors may see sharper regulatory divergence, while others trend towards regionalisation.

Labour mobility, too, is under pressure. Migration constraints and shifting geopolitical alliances are limiting access to global talent pools, while heightened restrictions on knowledge exchange and capital flows risk slowing innovation - particularly in sensitive areas like AI and tech.

These shifts may feel abstract for UK businesses, but they carry real implications. Fragmented capital markets could restrict cross-border investment, divergent data standards might hinder digital growth, and scaling innovation across borders may become more challenging.

Businesses that once optimised for cost and efficiency must now account for robustness and agility - embedding **resilience** as a guiding principle across supply chains, partnerships, and talent strategies.

Organisations must adapt to this redefined world, with success likely to belong to businesses that can bridge the divides that others can’t yet see.

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Trade is the hinge between economic theory and political reality. When it swings, the whole house can shake.”

Barret Kupelian, Strategy& and PwC UK Chief Economist

What could happen next

The contours of a new trading system

While US trade policy remains volatile, there are three defining themes which we expect will underpin the future path. Most notably, it is our view that stronger protectionism will be a guiding principle for the US - a stance which may continue to evoke retaliatory action across the globe.

As the direction of trade policy becomes clearer, businesses must shift from reactive decisions to long-term strategic planning. This means developing investment strategies, risk management frameworks, and supply chain designs that build resilience against potential future changes.



US protectionism is here to stay

Enhanced US protectionism is likely to remain for a number of reasons:

Political sensitivity – the White House has framed the tariffs as a national security issue, making it difficult to roll back policy.

Tax revenue – tariffs may generate up to 6% of total US federal income in 2025.¹

Business backlash – businesses that have adapted operations in response to tariff announcements would be stung by policy U-turns.

New measures – even if the US decides to move beyond tariffs, other protectionist measures such as domestic subsidies or local content requirements, may be considered.



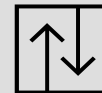
Shields will vary by sector

Policy specifics will evolve over time, but the US is likely to 'shield' particular sectors:

Tariffs will focus on industries where the US sees domestic opportunities, such as steel, automotives, and semiconductors.

Priority industries are likely to evolve over time, as the US administration better understands domestic capability and international reliance.

The US is open to carving out exemptions for partners who are willing to negotiate, as illustrated by the trade agreement reached with the UK.



Policy will remain dynamic and unpredictable

US policy will continue to evolve at pace, and is likely to remain somewhat unpredictable:

Dynamic – the US weighted average tariff rate has fluctuated through 2025, with continued volatility likely.

Unpredictable – ongoing Section 232 investigations into steel and aluminium hint that fresh measures could drop without warning.

Escalating – if threats towards trading partners such as Brazil, Mexico, and the EU materialise, the US weighted average tariff rate could climb to c.35% by 1 August 2025.²

Less credible – some Wall Street commentators have viewed US announcements as negotiation tactics rather than true policy direction, with policy credibility further eroded with each cycle of delay and de-escalation.

Notes: (1) January 2025 Congressional Budget Office projections – prior to the announcement of Liberation Day tariffs (2) US weighted average tariff rate reflects the average tariff imposed on goods imports to the US, considering both country-specific and sector-specific rates due to be implemented on 1 August. **Sources:** WITS, the Budget Lab at Yale, Reuters, Congressional Budget Office

Taking stock of tariffs

Understanding the impact on the defence sector

A perspective on the sector overall

The imposition of tariffs under the Trump administration has introduced considerable strategic uncertainty for the UK defence industry. While direct, first-order impacts appear limited due to the UK's position as a net importer and its export focus on specialist subsystems integrated at Tier 2* and Tier 3* levels into US-led programmes, the broader consequences are more far-reaching and impactful.

The core concern is the second-order impact: a shifting geopolitical landscape characterised by rising protectionism, a renewed emphasis on national sovereignty, and a growing desire across western nations, including the UK, to reduce reliance on foreign, particularly US-based, defence infrastructure. The rhetoric accompanying the Trump-era policy stance has exacerbated this uncertainty, prompting reassessments of longstanding defence partnerships within NATO, the EU, and globally.

The highly regulated nature of the defence sector acts as both a buffer and a constraint. On the one hand, it tempers the short-term fallout by limiting supplier substitution and protecting existing contractual relationships. On the other, it entrenches dependencies, especially on US technologies and systems, that are difficult and slow to unwind. Moreover, the opacity of extended supply chains, particularly beyond Tier 2*, makes it challenging for most UK defence firms to accurately assess or quantify the financial impact of trade policy shifts.

This lack of visibility, compounded by political volatility and uncertainty around the permanence of US policy, makes proactive investment or strategic repositioning challenging. With firms hesitant to commit to large-scale capex or reconfiguration of supply chains amid what may be a transitory policy posture, the industry is effectively in a holding pattern. In this context, strategic patience is prevailing, but at the cost of agility and long-term resilience, creating an uncomfortable position as the global defence order continues to evolve.

There is also the prospect of dual use and military designated ITAR components and technology being restricted to previously approved third party countries if the US chose to lever it's position. This could leave complex non US systems and products vulnerable due to their componentry.

**Tier 1 (primary suppliers providing major systems or components directly to OEMs or defense agencies), tier 2 (suppliers providing components or services to tier 1 suppliers), and tier 3 (suppliers offering more specialised parts and services to tier 2 suppliers)*

Segment	Primary Impact	Secondary Impact
OEMs		
Systems Manufacturer		
Sub-systems Manufacturer		
Component Manufacturer		

With limited platform exports to the US from UK Original Equipment Manufacturers (OEMs), recent tariff announcements will likely have limited primary impact to their business operations and outlook. In the longer term, the rearmament of Europe in response to the 'America First' posture (including tariffs) will likely lead to increased capital flow to European OEMs and Systems manufacturers.

For subsystem and component manufacturers in the UK that are part of the supply chains for US defence programmes, the imposed tariffs will likely have a primary impact requiring them to consider available mitigation options. Such tariffs may lead to a reconfiguration of those supply chains in the longer term. The question in the short term is likely to be, who will be asked to absorb the immediate inflationary cost increases of the tariffs – the supplier or the customer?

Taking stock of tariffs

Assess the impacts and short term actions

Tax and operational assessment

While the medium to long-term structural impact on the defence sector may ultimately be significant, such shifts are likely to unfold gradually. Any operational responses or strategic interventions will need to be carefully phased over time. In the near term, however, the immediate priority for defence operators is to thoroughly assess and quantify the tariff implications from a tax and operational perspective. The following actions can be taken now and may have a meaningful impact on your business's overall exposure.

- 01 Conduct/validate impact assessments, including understanding the physical product / material flows.
- 02 Review eligibility for tariff exemptions and exclusions, for example goods in transit before 12.01am EDT on 5 April 2025. HTSUS heading 9808 provides a potential mitigation strategy for articles for use of the U.S. government. These are subject to additional requirements and presentation of documents to qualify.
- 03 Understand the country-of-origin rules and place where goods are substantially created.
- 04 Understand the value build up of the price to ensure the custom value is correct and review cost components.
- 05 Consider from a transfer pricing perspective that intercompany product pricing is correct and that any revised pricing (of product or wider services) adheres to the arm's length principle (and aligns with customs considerations).
- 06 Consider the US specific valuation principles.
- 07 Review contracts to confirm whether they include a tariff cost adjuster / escalator in terms of cost
- 08 Consider the impact on any changes to the above on the income tax position in the US and other jurisdictions.



Navigating the potential fallout

Short and longer term actions you should take

There are several short and longer-term moves that the defence industry can consider to respond to the evolving market situation. Reach out to us to discuss which strategic options can best protect your business and how to approach your implementation plans.

Short-term 'no regret' moves	Moves to capture maximum value over the longer term
<ul style="list-style-type: none">Consider the tax points noted on the previous page, and evaluate the impact on income tax, transfer pricing and tariffs (taking a holistic tax view).	<ul style="list-style-type: none">Invest in domestic production and technology capabilities to reduce dependency on foreign suppliers and enhance the sovereignty of UK defence capabilities.
<ul style="list-style-type: none">Conduct a thorough diagnostic to understand the supply chain footprint and exposure to US tariffs and identify vulnerable areas and potential cost implications / commercial risk.	<ul style="list-style-type: none">Collaborate with trusted international partners, such as NATO allies, to share resources and capabilities and ensure collective security and capability.
<ul style="list-style-type: none">Access comprehensive data on suppliers and contracts and review the contractual terms related to tariffs and price adjustments.	<ul style="list-style-type: none">Pursue strategic M&A opportunities to acquire local or regional capabilities that are currently sourced from the US or that can provide a competitive edge in the defence market.
<ul style="list-style-type: none">Explore alternative markets and suppliers, particularly within Europe, to mitigate the risks of supply chain disruptions and diversify the customer base.	<ul style="list-style-type: none">Monitor the changing dynamics of international trust and collaboration, and adapt the defence procurement strategies accordingly.
<ul style="list-style-type: none">Understand the ITAR status of subsystems and componentry and any potential destination impact that may occur.	<ul style="list-style-type: none">Consider the overall tax model (customs, transfer pricing, direct and indirect taxes) implications and impact of any supply chain reorganisation so as to fully evaluate the options through an integrated business and tax perspective.
	<ul style="list-style-type: none">Produce ITAR free versions of products and systems.

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In a sector where tempo, timing, trust and transatlantic partnerships have been the backbone for past success, US tariffs on UK defence imports risk undermining the integrity of supply chains, causing programme delays and weakening the interoperability that underpins the allied security ecosystem.”

Ian Hillier, PwC UK Aerospace and Defence sector leader

Key contacts

Contact us to discuss how best to respond to the changing rulebook for global trade.



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