Life Sciences Outlook: The Impact of Tariffs

The implementation of tariffs by governmental administrations can be a tool to protect, even boost, domestic industries, but they can also cause significant financial and operational difficulties to downstream, and ancillary companies. The life sciences industry is particularly sensitive to the disruptive effects of tariffs as increased pricing ripples through each stage of the manufacturing process with disruptions manifesting in various forms, such as increased costs, supply chain uncertainties, and market competitiveness challenges. This article explores the multifaceted impact of tariffs on life sciences companies, providing insights into potential risks and strategies for mitigation.

UNDERSTANDING TARIFFS AND THEIR OBJECTIVES

TYPES OF TARIFFS

Ad Valorem Tariffs: The most common type of tariff that is levied as a percentage of the value of the imported goods or services. For example, 10% tariff on automobiles.

Specific Tariffs: Charged as a fixed fee per unit or weight of imported goods. For example, $5 on a pair of pants.

Compound Tariffs: A combination of ad valorem and specific tariffs.

OBJECTIVES OF TARIFFS

Protecting Domestic Industries: Shielding local manufacturers from foreign competition. This can protect primary manufacturers, but harm downstream businesses and ancillary industries.

Revenue Generation: Providing a source of government revenue. A tariff is a tax paid by the business who imports raw materials and products. Companies offset tariff costs through higher consumer prices, which can reduce overall sales and result in lower generated revenue.

Trade Retaliation: Responding to unfair trade practices by other countries. Imposing tariffs can lead to retaliation that could lead to a trade war that affects manufacturers, downstream and related industries, and customers.

IMPACT OF NEW TARIFFS ON LIFE SCIENCES COMPANIES

1. Increased Production Costs

Tariffs on imported raw materials such as steel and aluminum can lead to higher production costs, squeezing profit margins. Increased costs for imported components can disrupt the cost structure of manufacturing processes.

2. Supply Chain Disruptions

Most pharmaceutical and medical device products result from an internationally connected supply chain, and sourcing materials may become more difficult and expensive, ultimately increasing existing drug shortage problems. Adjustments in supply chains to avoid tariffed goods can result in logistical complexities and higher transportation costs.

3. Market Competitiveness

Manufacturers may need to pass on increased costs to consumers, affecting competitiveness in both domestic and international markets. The U.S. healthcare system will be highly impacted as fee and reimbursement schedules for government programs like Medicare and Medicaid are already fixed and won’t account for any cost increases resulting from new tariffs.

4. Operational Adjustments

Companies may need to diversify or relocate their supply chains to mitigate tariff impacts. Manufacturers might invest in local production facilities to avoid tariffs, which can involve significant capital expenditure and time. The timescale for relocation could prove extensive, given the highly regulated landscape.

ANALYZING IMPACT

Recent studies of the impacts of tariffs on the pharmaceutical, life science, and medical device industries in the United States reflect that the total tariff measures could increase from $0.5 billion to nearly $63 billion annually.[1]

PHARMACEUTICALS

Proposed Tariff: The Trump administration announced plans to impose tariffs of at least 25% on the pharmaceutical industry.

Impact: The U.S. Food and Drug Administration (FDA) shared data in 2019 that illustrated the reliance of the U.S. on foreign active pharmaceutical ingredient (API) manufacturers. The data revealed that 72% of API facilities supplying to the United States were overseas, with 13% in China.[2] Additionally, 47% of all generic prescriptions in the United States are supplied by India.[3] Imposing tariffs on pharmaceuticals has greater implications than just the economic impacts. Imposing tariffs could amount to a violation of the World Trade Organization (WHO) rules. According to the 1994 Pharma Agreement, signed by Canada, the European Union, Japan, China, Norway, Switzerland, and the U.S., most pharmaceutical products and substances used to produce them are exempt from tariffs.[4]

MEDICAL DEVICES

Proposed Tariff: In addition to imposing tariffs on medical devices that have historically been exempt from tariffs, the administration reinstated a 25% tariff on steel and certain steel derivatives and increased tariffs on aluminum from 10% to 25%.

Impact: China is the biggest steel-producing country, accounting for 54% of world steel production in 2024.[5] Both steel and aluminum are widely used in the medical field due to their unique properties. Stainless steel, particularly surgical steel, is known for its corrosion resistance and biocompatibility, making it ideal for surgical instruments and implants. The medical device industry's heavily regulated nature creates challenges to finding alternative materials that meet the same safety and efficacy standards as these metals. Titanium is often used as a popular substitute for implantable devices. However, the cost of this alternative metal would still feel the impact of tariffs as China is the world's largest producer of titanium.[6]

72% of Active Pharmaceutical Ingredient (API) facilities supplying to the U.S. are overseas

47% of all generic prescriptions filled in the U.S. are supplied by India

69% of medical devices marketed in the U.S. are manufactured solely outside the country[7]

COVERAGE IMPLICATIONS

Directors and officers (D&O) liability insurance can be activated if a company's leadership fails to adequately plan for the impact of tariffs, potentially leading to financial harm, regulatory scrutiny, or shareholder lawsuits. Key considerations:

POTENTIAL TRIGGERS FOR D&O CLAIMS DUE TO TARIFF MISMANAGEMENT

1. Failure to Disclose Material Risks

If executives do not properly disclose the financial impact of tariffs on earnings, supply chains, or operations, shareholders or regulators could allege misrepresentation or inadequate risk disclosure.

2. Breach of Fiduciary Duty

Directors have a duty to act in the best interest of the company. If they fail to implement risk mitigation strategies (e.g., diversifying suppliers, adjusting pricing models, or securing alternative contracts), stakeholders may claim negligence.

3. Stock Price Drops & Shareholder Lawsuits

If poor tariff planning leads to significant revenue declines, cost overruns, or supply chain disruptions, investors might sue, claiming mismanagement led to financial losses.

4. Regulatory Investigations & Fines

Companies that fail to comply with new tariff regulations could face government inquiries, fines, or penalties, which could trigger D&O coverage for defense costs.

OTHER RELEVANT INSURANCE COVERAGES

Trade Credit Insurance: If tariffs disrupt supply chains or business relationships, resulting in customer defaults, this coverage could help mitigate financial losses.

Business Interruption Insurance: If tariffs cause operational delays or supply shortages, leading to lost revenue, depending upon policy provisions, this coverage might be applicable.

Errors & Omissions (E&O) Insurance: If a company provides consulting or advisory services (e.g., financial, legal, or trade advice) and miscalculates the tariff impact, it could be liable for professional negligence.

Companies should proactively assess their D&O coverage terms to ensure they include tariff-related risks. Reviewing policy exclusions and engaging with insurers early can help mitigate potential claim denials. If your operations are particularly exposed to tariff risks, you may need customized risk management strategies.

STRATEGIES FOR MITIGATING TARIFF DISRUPTIONS

1. Supply Chain Diversification

Source materials and components from multiple regions to reduce dependency on tariffed imports and identify and qualify alternative suppliers to ensure supply chain resilience.

2. Cost Management

Absorb a portion of rising cost of the increased costs to maintain market competitiveness and implement lean manufacturing practices to reduce overall production costs.

3. Market Strategy Adjustments

Adjust pricing strategies to balance cost recovery and market competitiveness and explore new markets to offset losses in tariff-affected regions.

4. Advocacy and Engagement

Collaborate with industry associations to advocate favorable trade policies and engage with policymakers to communicate the impact of tariffs and seek relief measures.

CONCLUSION

Tariffs pose significant challenges to life sciences companies, affecting costs, supply chains, and market competitiveness. By understanding the nature of these disruptions and implementing strategic responses, manufacturers can mitigate the adverse effects and navigate the complexities of a tariff-impacted environment. Proactive planning, supply chain diversification, and effective cost management are essential to maintaining resilience and sustaining growth in the face of new tariffs.

AUTHORS:

KRISTA HARTIN
Vice President and Life Sciences Practice Leader

JEN SHERIDAN
Vice President and Manufacturing Practice Leader, Advanced Industries Specialty

CONTRIBUTOR:

BRIAN BOVASSO
EVP and Managing Director, Executive Risk Solutions

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