Intelligence MEMOS

From: Jon Johnson and Daniel Schwanen

To: Canadians and Americans Concerned About Inflation

Date: May 19, 2022

Re: **Lower Trade Restrictions Would Counter Inflation**

Inflation remains on a tear, reaching 6.8 percent in Canada and 8.3 percent in the US in April. Inflation had not been that high in about 40 years, save for a brief spike when Canada introduced the GST in 1991. As a result, as reported by Statistics Canada yesterday, Canadian wage earners are quickly losing purchasing power.

In a March Policy Brief, the Peterson Institute for International Economics likened US inflation exceeding 7 percent as the "political equivalent of a house on fire," citing "igniting a wage-price spiral akin to the 1970s and 1980s that can be curbed only by deep recession." The brief maintains that the US should look to trade liberalization for inflation relief, stating that a "2 percentage point decrease in tariff-equivalent barriers could reduce CPI inflation by 1.34 percentage points."

The brief lists the approximate 2021 import value affected by high inflation at $610.5 billion. Interestingly for Canada, the brief recommends temporarily waiving antidumping and countervailing duties (that doubled last November) on imports of Canadian softwood lumber. Clearly, more open trade would benefit both US consumers and Canadian producers – a win-win.

In a May 2 interview with the Milken Institute, however, US Trade Representative Katherine Tai maintained that the Policy Brief was based on a what she characterized as Globalization 1.0 that assumes that trade liberalization is good and that focuses on trade flows, efficiency, and the consumer.

Ms. Tai maintained that the pandemic has underscored the fragility of the Globalization 1.0 model and that the US needs to move on to a new Globalization 2.0 model that takes other factors into account, such as the effect of a policy on workers and not just consumers. Judging from these comments, the Biden administration is not likely to follow the Peterson Policy Brief recommendations. And yet, evidently, high inflation rates are cutting deeply into workers' pockets.

We have a similar situation in Canada: federal policies continue to impose very high tariffs on certain sectors, which in turn deprives families of hundreds of dollars per year in purchasing power. Despite the fact that food inflation (sitting at 8.8 percent in April 2022) is an increasing concern, the federal government continues to maintain its tariff rate quota system on dairy products that ensures that prices of these products remain high.

Canada agreed in CUSMA to expand market access for various categories of supply managed products, which would have eased the pressure. However, the federal government has yet to come up with a tariff rate quota regime for these products that bypasses control of import quotas by the dairy industry itself, which denies Canadian consumers and other users of dairy even the little relief they could expect from the trade agreement.

Canada has already been found in violation of the agreement by the first-ever CUSMA dispute settlement panel, after a complaint by the US. Now, Canada is facing a similar complaint about how it allocates dairy import quotas by New Zealand under the CPTPP.

While "freedom" is the hot-button word of Canadian politics in 2022, we don't see most Canadian political leaders lining up to offer Canadians relief from high government-enforced prices.

Trade restrictions (high tariffs, tariff rate quota regimes, antidumping and countervailing duties, etc.) are of course only one of many factors that can cause high prices.

But with governments raising barriers against agricultural trade, we may soon find out that Globalization 1.0 was actually much better for Canadian families than Globalization 2.0. The conclusion in the Peterson Brief that trade liberalization could help to reduce US inflation also applies in Canada.

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