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Bolstering Canada's Response to US Trade Threats

Second and Third Meetings of the C.D. Howe Institute Trade Crisis Working Group

The initial round of tariffs threatened by US President Trump against Canada and Mexico was implemented yesterday – 10 percent for energy products, and 25 percent for other goods. Already, as a result, a chunk of trade beneficial to businesses and consumers on both sides of the border has been halted.

Mr. Trump may ease up on some of the tariffs put in place by his Administration in some sectors in which the US economy is particularly vulnerable to cross-border trade disruption. This would be welcome economic news. But this would not redress the impact of the initial threat, nor reduce the probability of future and even greater threats from the United States. This new context – dramatically changed from the one that prevailed since World War II – needs to inform Canadian policy across the board.

What happened was a willful attack on Canada's economy, its businesses and its workers. Mr. Trump's initial round of tariffs was not proportional to any problem cited as the reason for invoking them – the illegal flow of immigration and fentanyl from Canada – and no measurable targets were set about these flows that Canada could meet to avoid the tariffs. They, and other threatened tariffs, were contrary to the CUSMA/USMCA agreement, which President Trump agreed to in 2019, and called “the best and most important trade deal ever made by the USA.”

Retaliation now will not get us very far in preventing future attacks. Canada's way forward is clear: it needs to de-risk its trading relationship with the United States by building a stronger East-West national economy, to complement the natural flow of North-South trade and help diversify its exports. And it needs to review the economic levers affecting investment in general, to ensure that Canadian producers are as competitive as possible despite the tariffs.

Of course, Canada needs to engage with Americans who are also being hit, to seek their support in overturning these tariffs. It also needs to imagine and prepare a plan for trade peace, no matter how distant one that would meet Canada's strategic objectives may seem now.



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The group agreed that the objective should be a durable regime of zero or low tariffs in North America that continues to recognize Canada's sovereignty and policy autonomy.

These are the key takeaways from the second and third meeting of the C.D. Howe Institute's Trade Crisis Working Group meeting on February 14, and on March 5, 2025, respectively.

Background

In addition to the tariffs levied on grounds of a US national emergency at the Canadian border, the group reviewed other tariff "layers" publicly contemplated by the Trump Administration. Renewed steel and aluminum tariffs (and now, copper wires and lumber) will be imposed against all countries because the Administration believes these industries are weakened by imports, and in turn that this weakness threatens US national security.

The President has also introduced "reciprocal tariffs" as an overarching principle of US trade policy. Reciprocal tariffs are ostensibly directed at matching each trade partners' own trade barriers against US products, in a bid to bring them down. But they pose a diffuse and insidious threat to the world trading system – being contrary to the Most-Favoured-Nation principle which underpins the WTO – and would be an administrative nightmare especially in view of the range of domestic measures, notably like domestic value added taxes,¹ and potentially any measure the United States defines as a barrier.

We will know more about what measures these tariffs target and how they might be calculated when interagency reports to that effect will be submitted to the President on April 1, 2025.

Members of the group noted that these tariffs would run counter to the current USMCA/CUSMA agreement reached under Mr. Trump's first presidency, which was approved by the US Congress in 2019 in a rare massive bipartisan vote² and came into effect in July 2020. The United States Trade Representative, in consultation with other agencies and departments, is to assess the impact of the agreement and make recommendations regarding continued US participation in it, also by April 1.

1 These taxes are not paid ultimately by importers but by final consumers in the country of purchase, just as sales taxes are (such as sales taxes applied in the US on Canadian products).

2 The vote in favour was 89-10 in the US Senate, and 385-41 in the House of Representatives.

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Some members of the group felt that this disproportionate attack aligned with the often-expressed intention of the US President to absorb Canada politically. Others felt that the tariffs announced on Canada and Mexico are meant to apply maximum pressure on Canada toward a “new economic deal” (a term used by President Trump), ahead of the scheduled trilateral review of the USMCA or CUSMA due to be completed by July 2026.

Either view suggests the need for a sharp pivot toward de-risking the relationship with the United States, from the viewpoint of Canada’s own economic and national security.

Fighting Back

Much has already been said about the political need to retaliate with tariffs or boycotts against US products (which many consumers have taken upon themselves to start). The group supports the need to send a message of resolve.³ But blanket retaliatory tariffs will hurt Canadians as well. Tariffs by Canada should be calibrated to minimize the hurt for Canadians, but also because it will be evident that US businesses and consumers will suffer from the tariffs their own country is imposing on their purchases, without needing much Canadian help to feel the pain. The Tax Foundation estimates, for example, that the entire suite of tariffs proposed by Mr. Trump would reduce US after-tax incomes by 1.7 percent, with the burden falling on low- and medium-income households. These well-analyzed effects will soon unfold in real time.

That said, the Government of Canada, and many governments across the country, have already announced retaliatory measures, ranging from tariffs on a portion of Canadian imports from the United States to pulling US products from the shelves of publicly owned liquor stores, and from reviewing procurement contracts with US suppliers to higher fees for ferry passengers disembarking in Canada.

Restrictions on some resource exports have also been mooted by some provinces – hurting American customers but risking Canada’s status as a reliable supplier. Some members proposed that services – a broad sector in which the United States register a large surplus with Canada – is ripe for retaliation by Canada, but this may in return result in the US targeting Canadian fast-growing Canadian services exports.

3 The question of export restrictions was discussed at the first meeting of the Working Group.

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The group considers that it is too soon to consider targeting certain US services for retaliation, unless key parameters concerning trade agreements – especially whether the United States officially pulls out of the USMCA/CUSMA – are known. It will consider and comment as appropriate on possible retaliatory measures in view of their long-term efficacy and strategic implications.

Canada's Message to Americans

The group supported expanded communications about the benefits of the Canada-US trade relationship, aimed at the Achilles' heel of the US position: the costs of tariffs on Canadian products for US producers and consumers, given that Canada is a significant supplier of industrial materials and parts to the United States. Unlike its trade with Asia, Europe and Mexico, the United States also runs an overall manufacturing trade surplus with Canada (see chart below), a not widely known fact which directly illustrates the direct contribution of the trading relationship with Canada to US manufacturing jobs.

The United States cannot easily replace these imports from its own production or other countries, as evidenced by the sharp rise in the price of lumber, of steel futures, and other commodities in the United States since the tariff announcements. It could more easily do so in the longer term, including by its own production – but not for the total of what it imports from Canada – or by shifting suppliers.

The group supports expanded communications by the Institute on social media targeted at receptive U. audiences, in addition to giving Canadian government officials ammunition they can use in their own information campaigns in the United States. Illustrating why a weak Canadian economy would be bad for the United States, why tariffs will not help the United States increase its manufacturing trade surplus with Canada and correcting the view that the United States “subsidizes” Canada, would be key themes for C.D. Howe Institute messaging.

Moving Now on Strategic Options Within Our Powers

Regardless of how the tariff threat plays out in the short-run, Canada needs to pursue a de-risking strategy on trade, coupled with an economic resiliency strategy domestically. One aspect of de-risking trade – reducing Canada's relative export reliance on the US market – was the topic of a presentation to the group by the former Chief Economist at Export Development Canada, Peter Hall. He showed that Canada did actually diversify away from the US market in the past 25 years, and that even greater geographical diversification in recent years would have helped exports from most Canadian provinces and industries expand faster than they did in practice. His final point was that future diversification is probable and powerful.

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But realizing this potential requires Canada to reverse recent poor trends in infrastructure investments – such as in pipelines and ports – and to modernize other elements of its supply chains, as proposed here. That said, members noted that diversification is not a plausible option for much of Canada’s manufacturing, unlike for many natural resources.

Members supported an accelerated project approval process for already inventoried nation-building projects⁴ that are ready to move ahead, both federally and provincially (many barriers related to permitting for example exist at the provincial level). This would require a reduction in federal-provincial regulatory uncertainty, along the lines recommended in a 2024 C.D. Howe Institute report. This group suggests that Canada emulate New Zealand’s year-old Fast Track Approval Process to achieve this goal. Coupled with reduced internal trade barriers,⁵ such projects can reorient some trade on an East-West axis, maintaining Canadians’ revenues in the face of reduced North-South opportunities. This work can and should start immediately, both federally and provincially (with BC showing the way by announcing the fast-tracking 18 resources projects in early February). For the same reason, the group continues to support the removal of internal trade barriers, prioritizing the removal of barriers to trucking transportation – for which there is a clear agreed upon list – as probably offering the biggest and quickest bang for the buck.

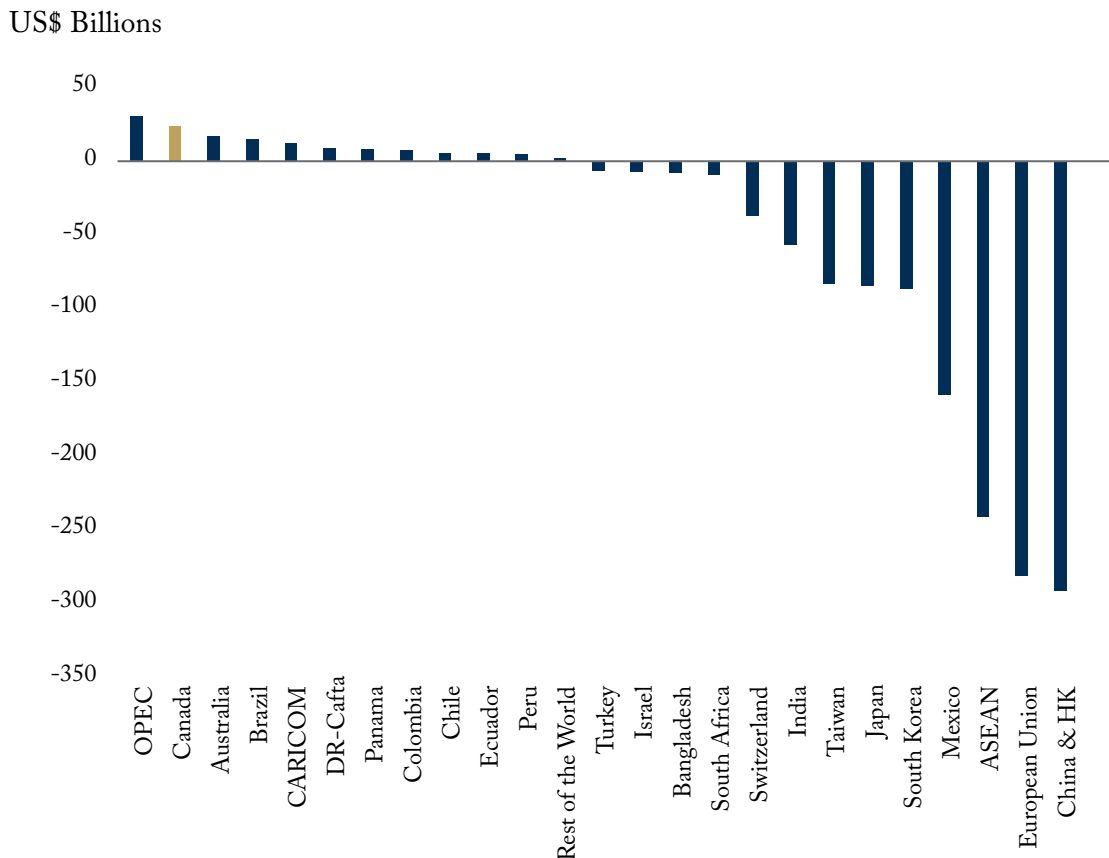
In the meantime, the group discussed how Canada’s industrial base could be protected through the crisis. The group supports Canadian governments taking measures to expand work-sharing through the Employment Insurance program, so that workers and companies can make it through the storm without losing the skills and experience they have invested in. The current environment in which trucks are being turned away before they reach the US border because of cancelled orders from customers not willing to pay the tariff, or in which the importer of record in the United States is Canadian and must put up the cash to pay the tariff, is likely to lead to immediate cash flow problems, especially for SMEs. The Canadian government should ensure that facilities are in place to support businesses through these cash flow problems that might entice them to move production to the United States instead. Monetary policy should play a supportive role, consistent with keeping inflation within its targeted range, as discussed here.

4 The total major projects inventory, a product of federal-provincial collaboration, is here: <https://natural-resources.canada.ca/science-data/data-analysis/major-projects-inventory>

5 The C.D. Howe Institute will publish separately on opportunities to reduce internal trade barriers.

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Figure 1: US Manufacturing Trade Balance, 2024



Source: United States International Trade Administration.

Concluding Remarks: Cooperation with Other Partners and Setting the Bar High

Members also discussed the desirability of Canada crafting a common response among WTO members in the face of US attacks on open trade. They noted that a common front might be difficult in the face of Mr. Trump’s attempts to pick the US trade partners off one-by-one, but that at least maintaining barriers as low as possible between them should be the goal. Furthermore, Canada can strengthen its own bilateral links by taking extra steps to conclude agreements that are already in advanced stages of negotiations – the agreement with the UK being the prime example.

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Although the contours of a possible agreement with the United States were discussed, it is premature to put something on the table unless and until the United States reveals, by its actions, that it is open to serious discussions. Unilateral concessions by Canada to postpone impending tariffs obviously worked once, but Canada cannot make one ad hoc concession after another, just to postpone a bad outcome which is coming anyway.

However, it is also possible that tariffs delayed will be tariffs avoided, if tariffs are seen to hamper the achievement of other US policy objectives, such as affordability and a competitive industry.

With the outlook for Canadian manufacturing highly dependent on access to the US market, and the United States also vulnerable, though less so, to the disruptions caused by tariffs and heightened uncertainty, Canada should not say no to yet another trade negotiation with the United States, though not at the expense of the domestic strengthening and resiliency agenda just outlined.

Canada's strategic objectives in any formal talks would be a continuation of the USMCA/CUSMA tariff-free regime, reduced uncertainty (e.g., no prospects of continuous annual review), and naturally, continued full Canadian policy autonomy befitting a sovereign nation. Right now, that seems a high bar for the US Administration to meet.

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Members participate in their personal capacities, and the views collectively expressed do not represent those of any individual, institution, or client.

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