Intelligence MEMOS

From: Brian Livingston

To: Canadian Governments

Date: March 13, 2025

Re: **Holding the Line on Pre-Tariff Pricing**

How to fight a tariff war?

Canada's main response to Donald Trump's tariffs on Canadian products has focused on retaliatory tariffs that will hurt US exports to Canada, on the theory that adding to the existing self-inflicted pain of US tariffs will encourage Donald Trump to drop them.

There is a more direct response: Making sure that US importers bear the entire cost of the new US tariffs.

Mr. Trump insists that tariffs will be paid by foreign exporters and will not raise costs for the US economy. This may be linked to Mr. Trump's statement that he does not need anything that Canada produces. But facts contradict that statement.

Let's take a simple hypothetical of a good for which the pre-tariff sale price is $100 and stays at $100 post-tariff, meaning the US importer pays the $25 tariff, for a total of $125.

In President Trump's view, the Canadian exporter should reduce its sale price to $80. The US importer pays a $20 tariff, and still only pays a total of $100. The Canadian exporter in effect is paying $20 to the US government.

However, the US has a very real need for certain Canadian goods, particularly goods that are not produced as part of complex cross-border supply chains, such as many resources-based products, for which the US has no immediate and realistic alternatives of supply at the price Canada is able to supply them.

Governments don't export and import goods, companies do. The actual mechanism for allocating this tariff burden will be contained in the sale price in the many agreements between the Canadian exporter and the US importer.

The strategy is to use this bargaining power to insist that the sale price of the goods remains at the pre-tariff price. Put another way, it should be the US importer that pays the tariff.

The specific steps would be:

1. Governments would contact the Canadian companies negotiating the sales agreements for each category of exports.
2. The exporting companies would tell the governments whether US importers are asking them to discount their price to share in the burden of paying the tariff.
3. If no discount is demanded by the importer, Canada will not suffer any loss (no harm, no foul, as they say in basketball). No further action needed.
4. If there is a reduction in the pre-tariff price, governments will encourage Canadian exporters not to reduce the sale price. If the Canadian exporter says that it will suffer more economic damage from no sale versus a sale at a reduced price, then Canadian governments should offer to indemnify the Canadian exporter for losses caused by no sale, over and above any general support offered to companies who are cutting back production due to the inability to lower their price and still stay in business

The result of the government action in step four above is that the Canadian exporter is simply declining to sell its goods due to a failure to agree on a sale price. It is not (repeat not) a government decision to terminate supply. If the US importer reconsiders and agrees to the pre-tariff price, then supply is restored.

If there is no agreement on a sale price, then the Canadian governments would provide a financial backstop to pay for damages due to the lack of a sale.

This strategy could complement retaliatory tariffs, and it would be reviewed periodically to see if it is working or not. This would limit the government's financial exposure.

If the US importer dislikes the fact that the cost of imports has risen, then it can go to its government and ask that the tariff be removed.

This last point builds on the belief that Canada's strongest allies are in fact the many businesses importing goods subject to tariffs, as there is a growing sentiment that many US businesses (both large and small) are increasingly worried about the effect of tariffs on their business.

The theory from the Canadian point of view is that the US importer (and by extension, the US economy) has more to lose than we do by forgoing these products altogether. For example, no potash means no fertilizer and less crop yields. Similar scenarios hold for the other goods.

This strategy would raise awareness in the United States of what is at stake in the trade relationship. Are there risks? Yes, there could be further retaliation. But as we have seen this week, that's what is happening no matter what action is taken.

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