

Intelligence MEMOS



From: William B.P. Robson
To: Canada's Trade Warriors
Date: April 7, 2025
Re: **NEXT UP: A FIGHT WITH TRUMP OVER THE GST**

The “reciprocal” tariff rates announced by Donald Trump on last week were worse than expected – not only because they were high, but because the calculations behind them were absurd.

The idea that a country’s trade balance with the United States at any particular time tells us how fair or unfair its trade practices are – or what tariff rate would reduce a trade deficit with that country to zero – is so goofy that it is hard to imagine a sensible conversation with the people who came up with it. Since US trade partners, Canada among them, have little choice but to try and engage, we need to refresh on the specific policies that President Trump and his entourage previously complained about.

Those policies included straightforward barriers to US exports such as tariffs and quotas. More awkwardly for the negotiations we and others will have with the United States, they also included value-added taxes (VATs) such as the federal goods and services tax (GST) and the harmonized sales taxes (HSTs) that most provinces levy alongside it. It will be hard to accommodate the United States on those taxes – indeed, we should not.

Relying more on the very taxes Mr. Trump dislikes would strengthen us as we weather a prolonged period of US economic antagonism.

The value-added taxes of trading partners – especially European countries, whose rates are higher than ours – have been a target of American complaints for years. Among the talking points the Trump administration uses to pump up its base – and likely themselves – is how buyers of cars shipped from the US to the European Union pay double-digit VATs, while buyers of cars shipped from the EU to the US pay no VAT. The administration would likewise complain that Canadians pay GST and HST on the products they buy from the US, but Americans pay no GST or HST (just local taxes) on the products they buy from Canada.

Like so much in Mr. Trump’s approach to international economics, the notion that VATs unfairly penalize imports and promote exports is superficially plausible, yet totally baseless. All sales taxes, including those of many US states and cities, work that way. Buyers of Canadian products subject to US sales taxes pay them to the governments that levy them, while buyers of US products subject to Canadian taxes pay them to our governments. Either way, the taxes apply equally to imported and domestic products. There’s no discrimination against imports and no subsidy to exports.

Good luck explaining that to Mr. Trump though. The American federal government levies no general sales tax. It relies disproportionately on personal and corporate income taxes – and, lately, on unsustainable borrowing – to finance its spending. US state and local sales taxes (like those that still exist in British Columbia, Saskatchewan and Manitoba) are old-fashioned ones that apply to intermediate purchases before sale to the final consumer. That type of sales tax can raise costs throughout the value chain. This “cascading” effect bakes different amounts of tax into final products, which is distortionary, and raises the end price of products not formally subject to tax – notably exports, which makes them less competitive.

A smart US tax reform would establish a federal VAT, using the proceeds to finance cuts to US personal and corporate income taxes and reduce borrowing. Ironically, the higher tariffs with which Mr. Trump wants to finance his tax cuts act like old-fashioned sales taxes, also cascading through the value chain every time products cross borders. That is even more distortionary, and bakes tariff-related costs into US products, including exports – as US producers of steel- and aluminum-containing goods are already noticing, and as US producers of myriad other goods and services will notice in the coming weeks.

It is easier to anticipate that the Mr. Trump will complain about VATs than it is to anticipate a response that would satisfy him. Whatever he thinks, Canada must not respond by making its tax system less efficient.

The United States does have legitimate complaints about foreign protectionism, such as Canada’s dairy cartel, which impedes US exports, hurts Canadian consumers and makes domestic production of dairy products uncompetitive.

But for the White House to use tariffs as a cudgel to force Canada, or anyone else, to change its tax system is utterly illegitimate, and means that its trade war against the rest of the world is likely to go on until the damage done at home by it and other rash acts of the Trump administration make Americans themselves revolt against it.

For Canada, the prospect of a protracted period of US trade aggression makes some measures – notably retaliatory tariffs and fiscal bailouts of affected industries and workers – less attractive. We cannot convince Mr. Trump he is wrong, and we cannot bear the economic cost of a tit-for-tat trade war that lasts as long as it takes for enough Americans to realize he is wrong. We need to attract and retain talent, boost investment, and raise productivity. We need to get more efficient and competitive. And if getting there means relying more heavily on the GST and HST to lower personal and corporate incomes taxes and reduce borrowing, we should push back against Mr. Trump’s economic illogic and do that too.

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