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Intelligence MEMOS

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From: Stephen Beatty
To: Trade War Observers
Re: BACK TO THE FUTURE: CHINA QUOTA EDITION (II)

Mark Carney's rapprochement with China that would see an initial influx of 49,000 Chinese electric vehicles has prompted an uproar from Canada's auto sector, as we outlined in Part One.

All that turmoil might have been avoided if Canada had just followed the advice from last year's C.D. Howe Institute E-Brief in which I made the case that Canada should reclaim the principles that drove the original Canada-US Auto Pact:

"Here's the idea: in response to any US tariffs that are ultimately applied, Canada should impose a surtax on imports of US light-duty vehicles (i.e., passenger cars, minivans, SUVs, and light trucks). At the same time, auto manufacturers currently assembling vehicles or manufacturing major powertrain components in Canada should be provided with duty remission proportionate to their Canadian production."

Canada ultimately did impose a surtax and did offer remission to local producers. However, rather than making remission proportionate to local manufacturing (e.g. make one vehicle here for every vehicle imported under remission), Ottawa decided to base remission benefits on historic import levels, subject to a reduction if local production fell.

In other words, the remission afforded to companies was disproportionate to their manufacturing footprint and there was no incentive to grow that investment.

Like the 2024 China surtax that imposed 100-percent tariffs, the federal remission program was due for review and renewal.

That offered a solution to both problems. Institute the original remission proposal with the United States and then offer to let remission holders include a certain volume of imports from China in their remission entitlement.

All the companies currently manufacturing in Canada have JV partners in China and this flexibility would show an opening to China while reinforcing the industry's north-south orientation. Any vehicle from China would have to meet Canadian safety and cybersecurity standards and could not be transshipped to the United States as it would remain a product of China.

Combine that with a reference of the general China tariff to the Canadian International Trade Tribunal and Canada would signal its openness to making adjustments while avoiding poking the US bear prior to the CUSMA review later this year.

Canada controls the quota with China and still has the opportunity to recast the current remission program on US vehicles into a performance-based standard, so it is not too late to address this issue through a hybrid remission and quota allocation policy.

As a simple waiver of duties imposed to counter foreign protectionism, this policy has a number of benefits:

- it involves no Canadian tax expenditures;
- it supports the domestic manufacturers who are harmed by foreign trade actions; and
- it offers the possibility of lower costs and improved choice for Canadian consumers (the number of a company's imports from China could be deducted from their remission entitlement for the year to maintain the balance between domestic production and imports).

That said, time is of the essence, and Canada needs to make some decisions before our trading partners force our hands. The Prime Minister's observations from Davos may be right. The old rules of trade may be behind us. But we need to carefully choose where we head next.

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