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Tariffs, trade, and uncertainty: The Impact of Washington's economic strategy and geopolitical objectives on Canada

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Introduction

The good news is that President Trump has decided to delay the tariffs on Canada and Mexico for another month.

While President Trump is expected to take an aggressive stance on tariffs, targeting specific sectors, he remains hesitant to impose tariffs on all imports from major trading partners whose economies are deeply interconnected with the U.S., such as Canada and Mexico (although China may be a different story). There are three main reasons for his reluctance.

1. Such a move would likely trigger significant political backlash from many states, businesses, and members of Congress from both sides of the aisle
2. It would almost certainly lead to a protracted legal battle over whether the president has the authority to unilaterally impose tariffs on all imports without congressional approval
3. Broad-based tariffs could have serious consequences for the U.S. economy, including instability in financial markets, disruptions to supply chains, and rising inflation—all of which would run counter to President Trump's electoral promise to lower costs and maintain a strong economy

The bad news is that the longer the threat of tariffs and trade negotiations persists, the riskier investing in Canada and Mexico will become for companies looking for guaranteed access to the U.S. market.

Rightly or wrongly, the President believes that Canada and Mexico have not taken his threats seriously and feels the need to continue threatening tariffs to prove he is not bluffing. He views it as a strategy to force them to the negotiating table on a range of issues, including migration, drug smuggling, alignment with U.S. geopolitical positions, and reforms to the U.S.-Mexico-Canada Free Trade Agreement.

President Trump aims to achieve the following objectives:

- Rebuild manufacturing, which he views as critical to increasing military and economic power. To achieve this goal, President Biden favoured subsidies, while President Trump relies more on tariffs.
- Require allied countries to contribute more to national defence and, where Canada and Mexico are concerned, enhance border security as well.
- Renegotiate the USMCA to further limit China's presence, not only in the U.S. market, but throughout the trade zone.
- Generate revenue to make up for at least some of the shortfall that will result from the extension of Trump's 2017 tax cuts and from other new ones.
- Use the threat of tariffs as a way to gain access to protected foreign markets.

The risk of never-ending negotiations

The ongoing negotiations and the persistent threat of tariffs create uncertainty that could have a profound long-term impact on the stability businesses need to make investment decisions. Trump highlighted this concern in 2018 during the renegotiation of NAFTA.

"Nobody is moving into Mexico. As long as NAFTA is in flux, no company is going to spend a billion dollars to build an automobile plant. I told the Mexicans we can negotiate forever; as long as we have this negotiation going, nobody is going to build billion-dollar automobile plants […] We're getting pretty close to a deal. It could be two weeks, it could be three months, it could be five months; I don't care."[1]

Conclusion

President Trump is well aware that Canada's deep economic and political ties with the United States leave little room for any significant divergence on geopolitical, regulatory, tariff, defence, and fiscal policies—especially in a world of growing protectionism and rivalry among the major powers.

It is important to note that this state of affairs predates the Trump administration. For example, when the Biden administration imposed a 100% tariff on Chinese EV imports and a 25% tariff on Chinese aluminum and steel, Canada quickly followed suit. Similarly, when the United States introduced massive subsidies for key domestic industries, Canada responded by implementing comparable measures. Finally, Canada signaled its willingness to exclude Mexico from the USMCA if Mexico did not agree to reduce Chinese imports and investments.

[1] "Trump says he's in no hurry to finish NAFTA. That's good because it may take awhile," Washington Post, April 12, 2018

The fact that Canada is part of a free trade zone and normally enjoys good trade relations with the United States makes it an attractive destination for globally oriented companies looking to establish operations in North America and export to the United States. Without these advantages, Canada loses much of its shine and its relatively small market could probably be served just as easily from the United States or some other location.

This means that the longer the trade negotiations over tariffs and the renewal of the USMCA drag on, the riskier it will be for companies seeking unfettered access to the U.S. market to set up shop in Canada, and the weaker our negotiating position will be. From this perspective, the sooner we reach agreement on the issues in question the better off we will be.

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