

Five principles for a Canadian response to U.S. tariffs

By Glen Hodgson and Danielle Goldfarb

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The tariffs on steel and aluminum announced by U.S. President Donald Trump last week are uncalled for. Mr. Trump has announced that the tariffs are being imposed based on national-security considerations. The Canadian government should strive to negotiate an exemption to the tariffs on the grounds that Canadian steel and aluminum does not pose a security threat. However, if Canada cannot get an exemption, the government needs to be careful in how it responds.

As Canada is the leading exporter of both products to the United States, Canadian firms would be severely affected if these tariffs go into effect. Canada's response needs to be highly targeted to maximize political impact, minimize the effect on Canada and reduce the risk of an all-out trade war. We recommend a response strategy with five elements.

- **Use an arrow, not a hammer:** A broad-based approach of implementing retaliatory tariffs could hurt Canada, since Canada's economy is highly integrated with the United States. Even though Mr. Trump has also stated that steel and aluminum tariffs will only be removed after a new North American free-trade agreement is signed, Canada should not withdraw from NAFTA talks. Instead, a highly selective and targeted strategy has greater chances of political success in the United States, while minimizing the effect on Canadians. The strategy should also comply with world trade rules.
- **Minimize supply-chain disruption:** Canada and the United States make products together. Responsive tariffs will need to avoid highly integrated manufacturing sectors, such as auto manufacturing or the aerospace industry.

Imposing tariffs in these industries would be self-defeating.

- **Maximize political impact:** Responsive tariffs might focus on products and services from states and regions that are strongly pro-Trump. These regions would include the Rust Belt and the South – but not California or New York. Or retaliatory tariffs could focus on high-profile brands, as the European Union has suggested. The EU has already singled out American brands including Harley-Davidson (headquartered in Wisconsin), Kentucky Bourbon and blue jeans.
- **Minimize Canadian content:** Responsive tariffs should focus on U.S. goods and services with little Canadian content, to minimize the pain for Canadian suppliers to U.S. industry. The highly integrated nature of the two economies will make these difficult, but necessary, to identify.
- **Don't target key Canadian imports:** Canada should avoid applying tariffs on key imported inputs into Canadian production processes. We should also avoid targeting products that Canadian consumers tend to import. We might even identify products that have non-U.S. alternatives, and Canadian consumers can then try comparable products from other places.

U.S. business interests and most Republicans are already largely opposed to these tariffs. Canada should support their efforts in the hopes that Mr. Trump will backtrack. If the government of Canada decides to reluctantly apply highly selective retaliatory tariffs, it should proceed along the lines outlined above.

The tariffs Mr. Trump has announced signal that he is keen to grant trade protection to industries that ask, with little due process.

Canada needs to respond to deter future threats, but carefully, without risking further supply chain disruption and limiting the scope of a major global trade war.

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