Economics

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US Elections and trade policy: What's at stake for the US and Canada?

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Trade policy is now front and centre in the US federal election, particularly for observers in Canada. Should he win, Donald Trump is promising a turn towards increased protectionism. Kamala Harris has come out against a broad increase in tariffs, but hasn't been critical of the existing protectionism when it comes to China, and her record as a Senator shows a tilt towards tougher environmental standards in trade deals. A lot is at stake for Canada, but we see reasons to hope that we'll steer clear of some of the darker scenarios out there.

From Biden to Trump, or Harris

The 2024 Republican platform is clearly protectionist, but there's a chance that some of its measures are a negotiating stance rather than a final objective. A proposed Reciprocal Tariff Act pledges to raise US import tariffs where these are lower than tariff plus non-barriers imposed on US exports, but that's intended to push other countries into "fair and reciprocal trade deals".

America's current trade pact with Mexico and Canada (USMCA) was signed during Trump's presidency, a deal he praised at the time. But Trump often scores results by eying the overall trade balance, and America's deficit with both Canada and Mexico has widened in recent years (Chart 1). While that captures stronger domestic demand in the US that pulled in imports, it raises concerns that USMCA wouldn't get an easy pass from a Trump administration in a review scheduled for 2026.

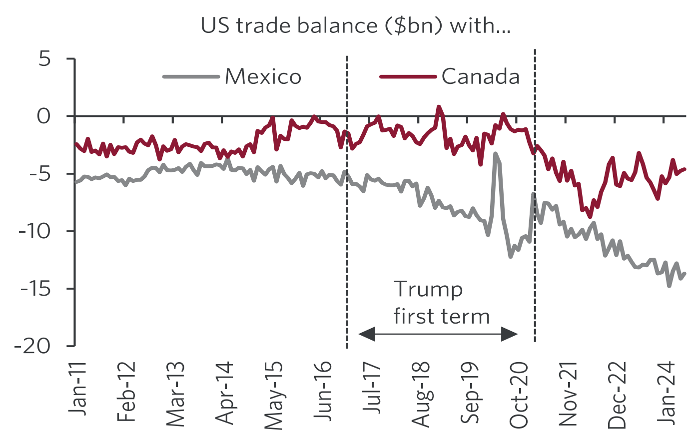
That won't be a full renegotiation of its provisions, and there will be pressure from US business interests to retain the USMCA. Instead of a full reworking, we're more likely to see some fine tuning, or side deals in which Canada and Mexico crack open some doors for US exporters. More troubling, Canada and Mexico were not given an automatic exemption from the GOP platform's call for "baseline tariffs," and Trump has mused about either a 10% or 20% rate. Still, at least with Mexico and Canada, that might just be a negotiating chip, rather than an end point objective, given that it would be in direct conflict with the USMCA deal.

Elsewhere, the platform calls for large (purportedly 60%) tariffs on Chinese goods, and banning imports of "essential goods" from China. While the objective is to wean America off of Chinese products, that's not going to happen in a hurry. In many goods, China starts with a dominant share of global capacity, as its factory sector is now larger than that of the next 10 largest manufacturing nations combined.

While not in the official platform, Trump has also mused about using tariff revenue to fully replace income taxes, but the math wouldn't add up. The $2 trillion or so in income tax revenue can't be offset by a tax on roughly $4 trillion in imports, given that tariffs in the 50% range would ultimately dry up import volumes, and therefore tariff revenues, materially.

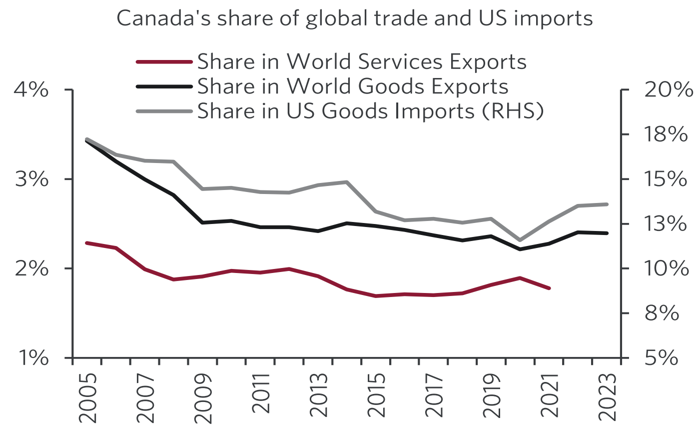
The Biden Administration has seen fewer frictions with Canada, although countervailing duties were recently increased on softwood lumber. But Biden retained Trump tariffs on Chinese goods and increased them on items tied to energy transition, a move that Canada will be replicating on Chinese EVs. Massive trade-distorting US subsidies for chips and renewable

Chart 1: US trade deficits with Canada and Mexico have widened since Trump's presidency



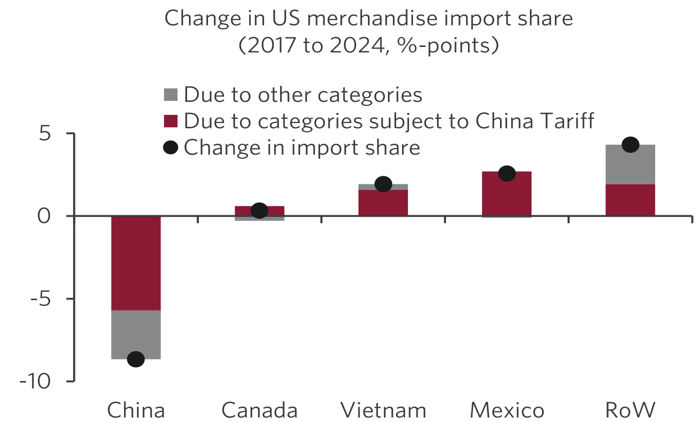
Source: BEA, CIBC

Chart 2: Canada's share in global trade has bottomed out



Source: UNCTAD, OECD, US International Trade Commission, CIBC calculations

Chart 3: Canada has modestly benefitted from Trump's China tariffs, but less than others



Source: US Census Bureau, CIBC calculations

Note: Trump tariff items aggregated to the HS6 level

energy products aren't in the spirit of trade pacts, and pushed Canada into an expensive effort to ante up subsidies to its EV sector, and a move to impose its own heavy tariffs on Chinese competitors.

As a Senator, Harris opposed the USMCA and Trans-Pacific trade deals due to insufficient environmental protections. But she also cautioned that foreign retaliation for US protectionist measures end up hurting American farmers and other exporters. On the campaign trail, she's been critical of Trump's tariffs when running for president in 2024, on the grounds that they would be a tax on consumers. Her track record suggests that Harris will be clearly less protectionist than Trump, while likely retaining the protectionist tilt on trade with China.

Canada in a re-globalizing world under Harris

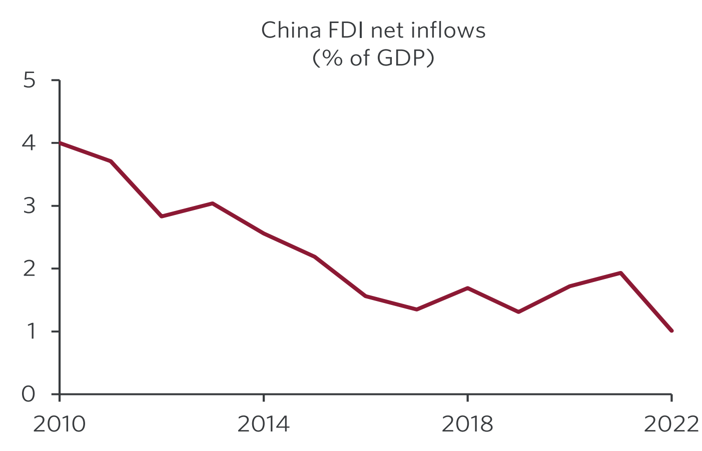
That implies that under Harris, we'll see a continuation of some of the trends in place since higher tariffs were imposed and other trade frictions with China deepened in 2017. We'd describe that trend as a "reglobalization" more than "deglobalization", featuring a diversion of trade from China to other trading partners, in part in response to US tariffs, and in selected areas, a shift to local US production supported by domestic subsidies.

Canada hasn't been among the big winners in that shift, but its been able to hold ground, after a protracted period in which our share of the US and global market had steadily deteriorated. Our share of total US imports, and of global trade, has essentially levelled off (Chart 2). Canada appears to have gained some market share in areas where Chinese goods were hit by tariffs (Chart 3), by being integrated into US goods production. It's also been helped by the fact that prices for Canadian manufactured exports have generally been firmer than those from countries that are largely exporting tech products.

While Canada earlier saw a reduction in its US share in some finished goods, particularly in autos, it's been holding ground as a source of inputs for US production. That would be of increased importance if the US, in a Trump administration, raises tariffs on foreign manufactured goods in an effort to boost US production, as long as Canada retains the exemptions from such tariffs under the existing USMCA deal. It also underscores the importance of maintaining a North American content rule for goods like EVs that are benefiting from US subsidies for purchasers of such products.

China's share with the US has weakened. Some of that has come in lower-value-added, labour-intensive items, where China is being usurped by countries that are further back on the economic development scale, where labour is even cheaper. Fears of trade-war disruptions, and uncertainties over China's policies towards private enterprise, have also factored in this shift. Foreign direct investment in China sits at only 1% of GDP, having been as high as 4% of GDP back in 2010 (Chart 4).

Chart 4: Foreign companies are shying away from China



Source: World Bank, CIBC

But tariffs were clearly part of the story. American imports of goods not subject to tariff have risen in dollar terms since 2016, although not enough to maintain their share of total imports. Within that group, however, some advanced technology products have continued to see rapid growth, largely because these are products for which substitutes, either US-made or non-Chinese imports, aren't yet widely available. But Chinese goods subject to US tariffs, imposed by Trump but left in place by Biden, have experienced outright declines in exports to the US, particularly those hit with a 25% duty (Chart 5).

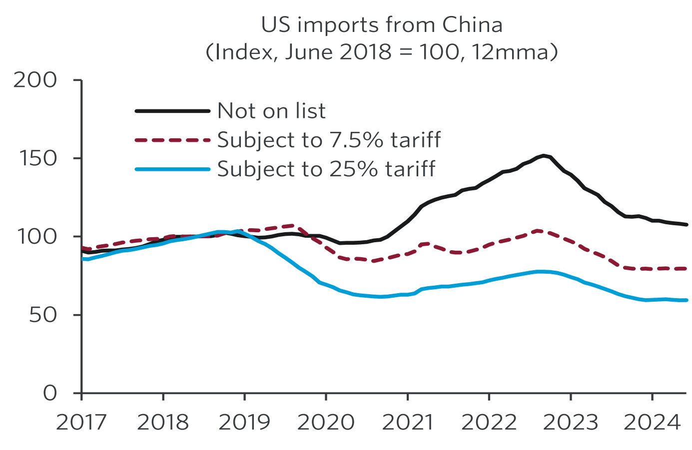
How far could Trump go?

Should Trump gain the White House, the concern would be that the backdrop for Canadian exports would deteriorate significantly. Exports no longer take up as much of Canada's economy, as a larger services economy and homebuilding has left 20% of Canada's value added destined for foreign buyers, down from 30% in 2000. But we're still a much more trade-oriented economy than the US, so the adage that we're sleeping next to an elephant that can roll over and inflict a lot of pain still holds.

Trump's steel tariffs in 2018 are stark reminder of that pain, and it was worse than most people most realize. Canada's exports to the US of manufactured metals dropped by 35% in a year, shaving off about 0.5% from nominal GDP (Chart 6). No small part of that was prices, with some research suggesting steel exporters bearing close to half the cost (Amiti et al, 2020). These tariffs lasted for a short while and had they been held in place long-term, the indirect economic damage in terms of jobs lost and spillovers into other sectors would have been greater, as producers downsized in the face of the weakness in their revenue stream.

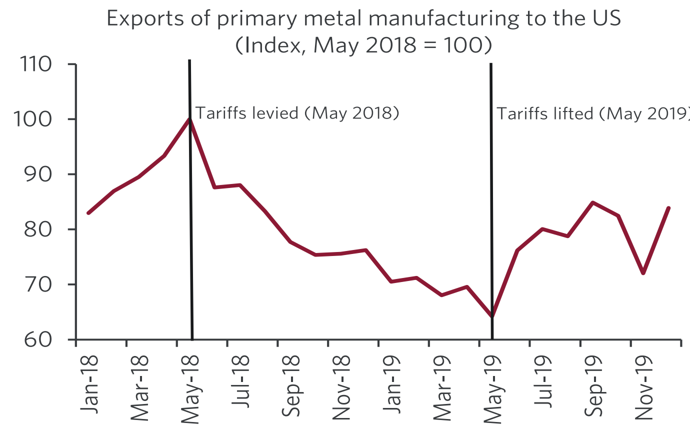
Applying tariffs of 20% on all of Canada's US-bound exports would entail broader economy-wide impacts, as would the retaliatory tariffs that Canada would likely impose on imports from the US. Over the long term, tariff barriers would incent companies to seek US locations rather than those in Canada for

Chart 5: Tariffs have had a big impact US imports from China



Source: PIIE, Census Bureau, CIBC

Chart 6: Trump's steel tariff hurt Canada more than most appreciate



Source: Statistics Canada, CIBC calculations

products destined for the American market, or could require the offset from a cheaper Canadian dollar or lower wages on this side of the border.

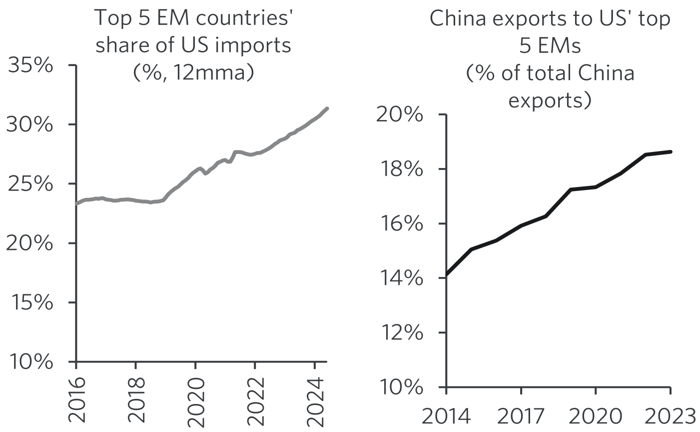
What gives us some comfort is that the most hawkish versions of Trump's trade agenda would entail enough self-inflicted wounds that we suspect, as noted above, that these are threats aimed at leverage with trading partners, rather than a realistic depiction of where policy would head, and a populist pitch designed to appeal to voters in America's industrial heartland.

For one, there is substantial evidence that import tariffs are significantly borne by Americans rather than by the exporting country. Unlike what we saw for Canadian steel producers, who bore about half the tariff cost, a prominent study found a full pass-through of the Trump tariffs on China to US firms, although the results were more mixed on the extent that these were borne by retailers in lower margins, or by final consumers (Cavallo et al, 2021). An analysis by the Peterson institute suggests that a 60% tariff on China, and a 20% tariff on all other imports, would raise living costs by about 4% of the typical US household's after tax income. A US Fed study found that American manufacturers were negatively impacted by the cost increases they faced when tariffs were imposed on imported steel and aluminum that they used as inputs.

The economic literature also shows material deleterious impacts on US exporters associated with retaliatory tariffs imposed by others. And even without that impact, because the US dollar would tend to climb in the face of weaker imports and continued inflows into US dollar assets, the trade balance would likely not improve, in line with the widening we've seen in the deficit since 2017. Nor did tariffs on China stand in the way of a further slippage in US factories' share of total employment, which reflects mechanization and productivity gains. All of this casts doubt on a scenario in which the US imposes significant tariffs on all of its trading partners.

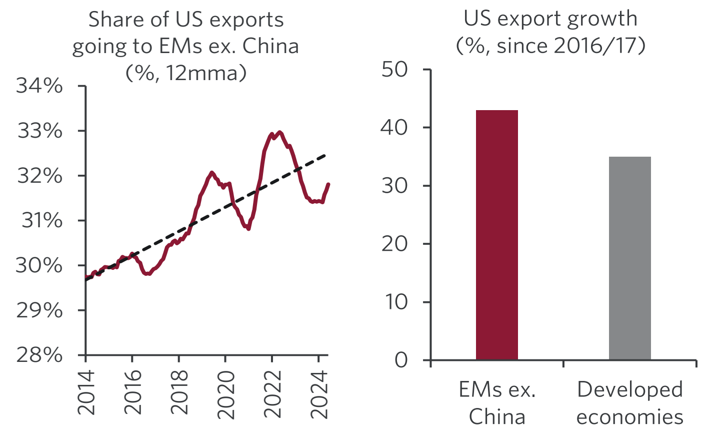
Even if the objective is more geopolitical, and aimed at China, trade developments suggest that tariffs alone might not shut the door to Chinese goods in the US, or at least those produced

Chart 7: US indirectly more dependent on China through EMs



Source: World Trade Map, Census Bureau, CIBC

Chart 9: US exports increasingly destined for EMs



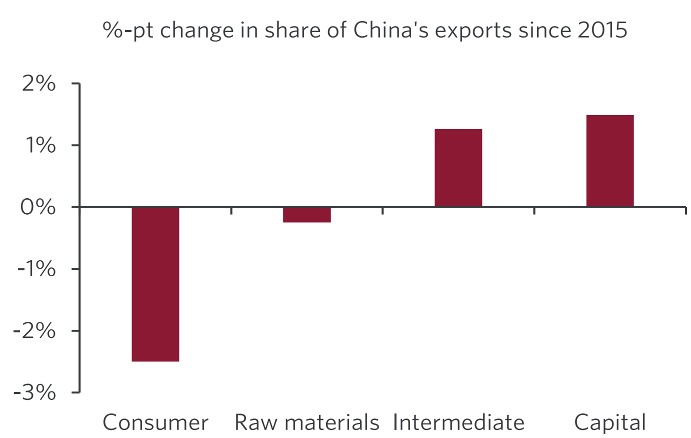
Source: Census Bureau, CIBC

by Chinese-owned firms, nor will it necessarily weaken China's global trade share. Instead, in the reglobalization trend, China is redirecting its exports, and its foreign investment, to countries like Mexico, Vietnam, India and South Korea that are gaining share in the US market.

Chinese FDI in those countries, as measured by AEI's China global investment tracker, has accelerated by 65% since 2016, notably faster than the pace seen before the imposition of tariffs. The same goes for growth in Chinese exports to those countries, notably Mexico and Vietnam. In fact, 65% of the growth in Chinese shipments since 2015 has come from developing economies, with the top five markets accounting for a fifth of growth, or three times the amount of growth driven by the US (Chart 7).

While some of that would include products aimed at final consumers in those countries, who are gaining purchasing power as their economies advance, it also captures China's efforts to make inroads as suppliers to manufacturers that then export final goods to the US market. That has shown up in a shift in the composition of China's exports, with gains in capital equipment and intermediate goods at the expense of finished consumer goods (Chart 8).

Chart 8: Chinese exports supplying factories elsewhere



Source: World Bank, CIBC

While the US could try to close that backdoor by imposing large tariffs on these other emerging economies, doing so would risk retaliatory steps that would jeopardize American exporters' access to some of the world's fastest growing markets. Emerging markets outside of China now account for close to one third of total US exports (Chart 9, left). And since 2016, US exports to EMs (ex. China) have risen by 43%, much faster than exports to the developed world (Chart 9, right).

All of this is reason to suspect that, should Trump win, an all-out trade war, which will not be in the US interest, is less likely to be the end game for American policy. Widespread tariffs would hurt US consumers, risk retaliatory actions by America's trade partners that would impede US exports, and slow global growth.

Even so, for Canadian exporters, the outlook still looks to be less concerning, with fewer downside risks, with a Harris electoral victory. In either case, preserving the trade access provided under the USMCA deal will be important in giving Canada a role as a supplier to the US economy as the reglobalization process continues to take shape.

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