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## Trump tariff threat: A border issue, not (yet) a trade war

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Trade negotiators needn't panic, at least not yet, but others involved in border issues and drug enforcement have to spring into action. Donald Trump has wasted no time in throwing down the tariff gauntlet against imports from Canada, Mexico and China. But in this case, we're not yet looking at the much feared, permanent imposition of across-the-board tariffs. Instead, this social media posting was centred on border issues relating to the inflow of migrants and drugs from these three countries, and a pledge to impose punitive tariffs "until such time" as these countries put a stop to that. Given the damage that such tariffs would inflict, particularly on Canada and Mexico given their close trade ties with the U.S., the announcement looks like a move to get action on border issues and then declare a policy win for the President, rather than as the first iteration of the administration's trade policy. But it does warn of more challenging times ahead for Canada-US and Mexico-US relations.

- For Canada and Mexico, the threatened 25% tariff on all imports from those countries, which the President elect proposed to initiate by executive order after taking office in January, goes even beyond the 10-20% range postulated during the campaign. In contrast, and surprisingly, the posting pledged to add only 10% to existing tariffs on Chinese goods, less than the 60% tariff on all goods that the campaign had mentioned. A tariff at the 25% level would no doubt be a major shockwave for Canadian industry, but the affected players would include many US-based companies in industries, like autos, where these companies have integrated supply chains that cross both the US-Canada and US-Mexico border. Others that export to Canada or Mexico will fear retaliatory tariffs. So governments will come under pressure to do what it takes to either prevent these tariffs from being imposed, or have them removed very quickly.
- Mexico and Canada have already taken steps to assist the US in dealing with cross-border migrants, but clearly this is still a hot button issue for the incoming White House. In Canada's case, Trump's "border czar, Tom Homan, had recently cited America's northern border as an "extreme national security threat". Roughly 20,000 cross border migrants were apprehended by US border security agents over the prior year, although that pace has been slowing in recent months. The US has also expressed concern over a handful of potential terrorists attempting to enter the US over the years from the Canadian side of the border, which might be where Homan's concerns lie.
- Of course, these numbers are a miniscule fraction of what the US has been dealing with at its border with Mexico. That's also true in terms of the flow of fentanyl, where Mexico and China are more on the US radar screen. That said, Canada has become a modest net exporter of fentanyl, and authorities here have been uncovering more labs that have taken the place of imports, while still making use of ingredients sourced from abroad. Still, given that the drug is a significant public health menace in our own country, it shouldn't be difficult for Canada to make the case that it is making efforts to limit supplies and production on this side of the border.
- Trump isn't alone in raising these issues within his party. The Republican's Northern Border Security Caucus in the U.S. House has raised both migrant and drug flows from Canada over the last couple of years. That's clearly amplified the political noise in Washington sufficiently to reach Trump and others in his incoming administration.
- So where to from here? Canada wasted no time in setting up a call between Prime Minister Trudeau and President-Elect Trump only hours after his social media posting. That was aimed at showing that Canada takes this threat very seriously, and media reports cited officials saying that the talks were "constructive", with Trudeau pointing out the much lower number of migrants coming from Canada versus Mexico. Subsequent media releases from two Canadian cabinet members underscored the benefits of trade with Canada for the US, including as a supplier of oil, and the fact

that Canada places a high priority on border security. Mexico's strategy will no doubt be similar if more challenging given the scale of the border issues in the US south.

- What's less clear is the list of steps that Canada would have to take to satisfy Trump's conditions for removing (or not imposing) the 25% tariff, because the President-elect didn't spell them out. The Canada-US border is long, and has expansive sections that cut through sparsely-populated areas with no walls in sight. Where there are officially-monitored border crossings, Canada doesn't screen those exiting its country, as that job is left to Americans on the other side of the line. What we can offer is likely to be some combination of more patrols on our side of the border, enhanced efforts to combat terrorism threats and fentanyl production. That will likely be supplemented by an effort at educating the new administration on what actions Canada already takes to contain both migrant and drug flows.

Perhaps it's wishful thinking on our part, but our expectation is that this particular trade threat will ultimately go away. Once the new administration is in place, discussions on border security won't be done on the phone in a one-on-one with the President, but in face-to-face meetings that will bring in experts, including those in the new administration who understand the economic implications. We expect to get greater clarity from Homeland Security and law enforcement agencies on what they would like to see from Canada, with at least some understanding of what can realistically be done. The US business sector and other interested parties will also lean on the White House to find a way to resolve this issue pragmatically.

That said, even if this 25% punitive tariff doesn't happen, this won't be the last set of negotiations over trade and tariffs with the new White House team. Trump's willingness to brandish the tariff weapon so quickly, before even getting to his desk in the Oval Office, portends a long road ahead for both Canada and Mexico to preserve what they negotiated during Trump's first term. The uncertainties over future trade access to the US market could represent a significant drag on capital spending in Canada's export industries over the next couple of years, even if Canada and Mexico are able to ward off this immediate tariff threat by taking actions along the border.

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