

# Tariffs, Trade and Tumult Canada's challenges ahead

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# Introduction

- ▶ Canada's economy faces huge challenges
- ▶ Domestic hurdles - fiscal pressures, stagnant growth, deteriorating health care, housing crisis
- ▶ External problems: a weakening international environment, unraveling of globalization
- ▶ An unwanted trade war with our major trading partner

# This presentation will focus on trade issues

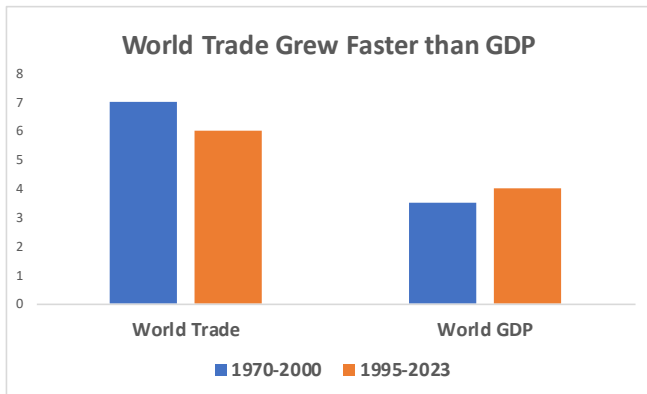
## Roadmap

1. The postwar trading system
2. The US tariff shock
3. The logic of tariffs
4. The impact on Canada
5. The way forward?

# Evolution of the global trading system

- ▶ GATT set up in 1947 under US leadership
- ▶ Tariff rates over 20% in 1950's
- ▶ Series of 'Rounds' - Kennedy Round, Tokyo Round, Uruguay Round..led to systematic and substantial trade liberalization
- ▶ Low tariffs 2-4 % in 21st C.
- ▶ Replaced by WTO in 1995
- ▶ Growth of bilateral trade agreements within WTO - e.g. Nafta 1993, EU single market 1991

Trade (globalization) has been central to postwar economic success



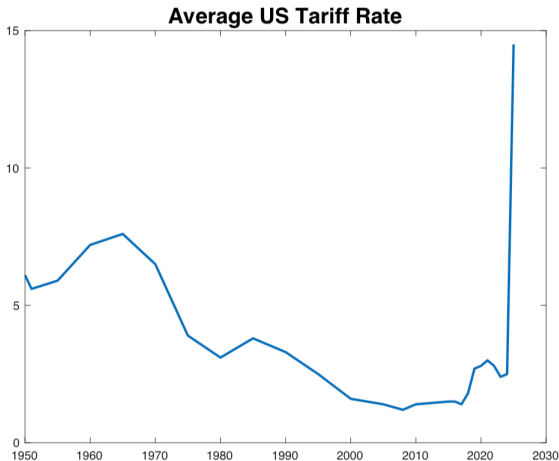
# Two key principles of GATT-WTO

- ▶ Most Favoured Nation (MFN)
  - ▶ All members are given equal treatment
  - ▶ Non-discrimination
  - ▶ This prevents trade diversion among other negative consequences
- ▶ Binding Tariff Rates
  - ▶ Members commit to tariff rates below the 'bound rates'
  - ▶ Allows for certainty and predictability
  - ▶ Path of tariffs known far into the future

# New US Announcements

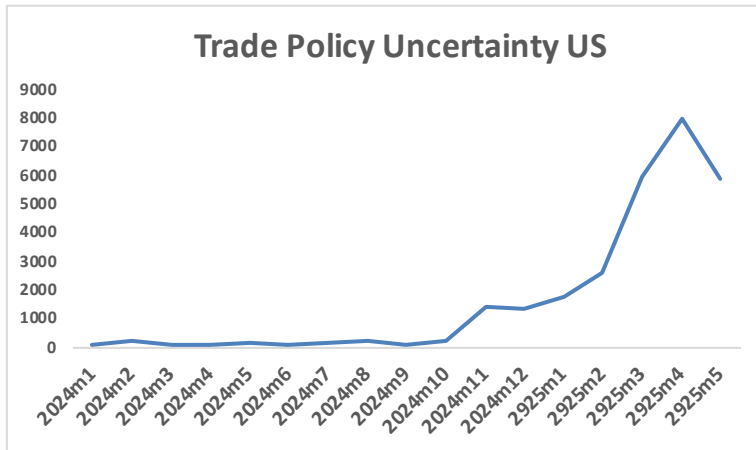
- ▶ Breaks both principles
  - ▶ High degree of discrimination
  - ▶ Abandoning all WTO and bilateral trade agreements
- ▶ Huge increase in uncertainty about future trade policy
  - ▶ Makes planning impossible
  - ▶ Uncertainty may be more costly than the actual level of tariffs

US average tariff rate now higher than any time since 1930's (..and counting)





# Big spike in measures of uncertainty in trade policy

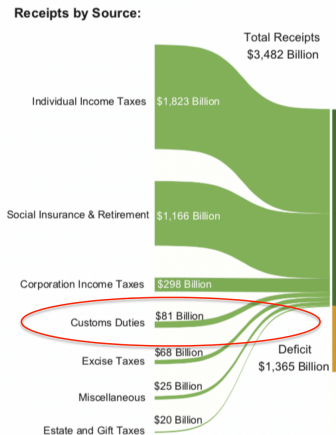


# What is the motive for US tariffs?

1. Fiscal - helping pay for new round of tax cuts
2. Trade - reducing the persistent US trade deficit
3. Industrial policy - reshoring manufacturing into the US
4. Some mix of all of these?

# Fiscal revenue

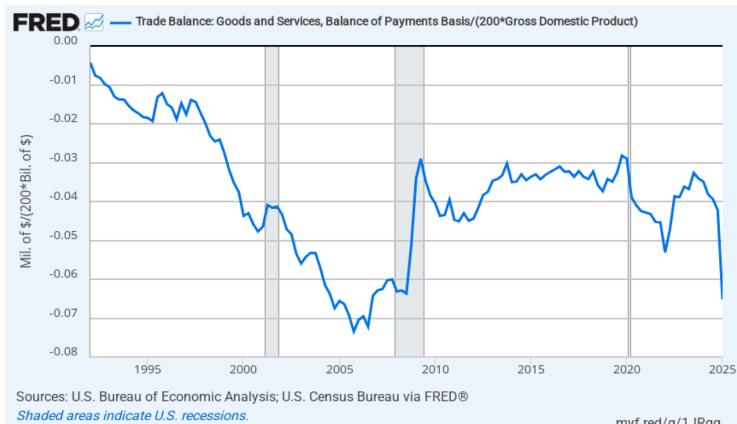
- ▶ Can tariff revenue help close the US deficit?
- ▶ US CBO suggests tariff revenue 2 trillion over 9 years 26-34
- ▶ Guess that annual revenue is 200b. But against a deficit of 2000b plus
  - ▶ So tariffs cannot close the deficit (or pay for tax cuts)
- ▶ Tariff revenue so far this year:



# Can tariff reduce the trade balance?

- ▶ Trade balance reflects deficiency of saving relative to investment
- ▶ Directly, tariffs unlikely to impact either of these
- ▶ Large capital inflows to US finance the trade deficit
- ▶ Tariffs do little to affect this - tariffs should make imports fall, but exports fall also

# US Trade balance

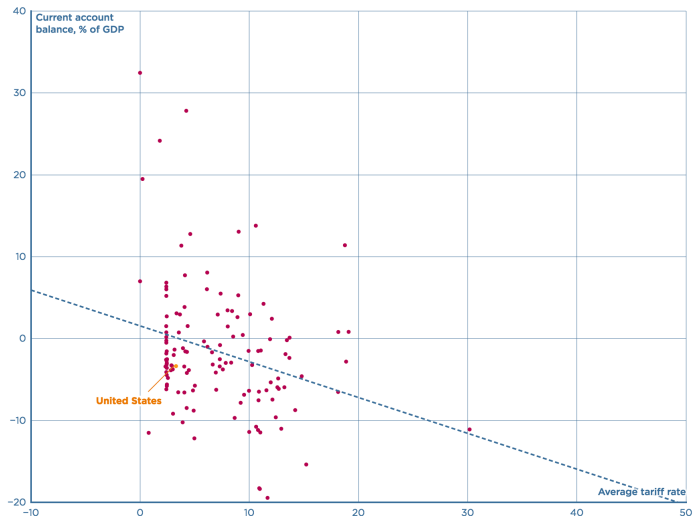


# Evidence from Gagnon PIES 2025

## ► High tariffs not associated with trade surpluses

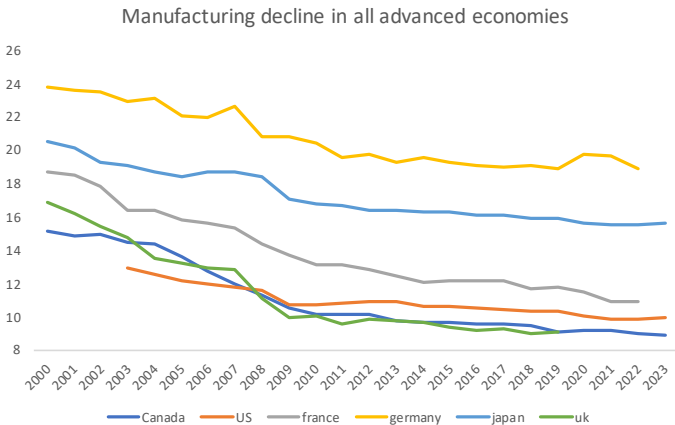
### Countries with higher tariffs tend to have bigger trade deficits

Trade balances and tariff rates, 2003–22



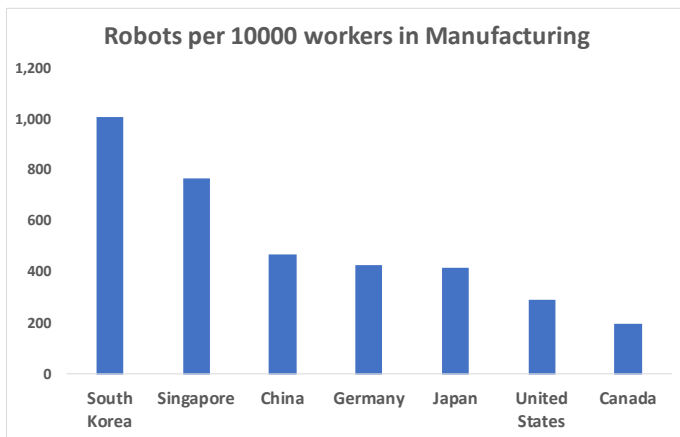
# Can tariffs revive manufacturing in US?

- ▶ Global fall in importance of manufacturing
- ▶ Driven more by technological change than trade



# Will new manufacturing create new jobs?

- ▶ New manufacturing industry likely to be much less labour intensive
- ▶ Currently 28 % of US manufacturing uses robots - over 50 percent are implementing
- ▶ Globally, robot density has doubled in the last 5 years





# Is there a case for tariffs?

- ▶ For fiscal revenue, tariffs more distortionary than sales tax or income tax
- ▶ For trade deficit, savings incentives, fiscal consolidation, or financial policies are a much better instrument
- ▶ For revival of manufacturing - targeted industrial policy
- ▶ One potentially valid argument - national security (economic or military) - but should be focused on narrow set of critical sectors

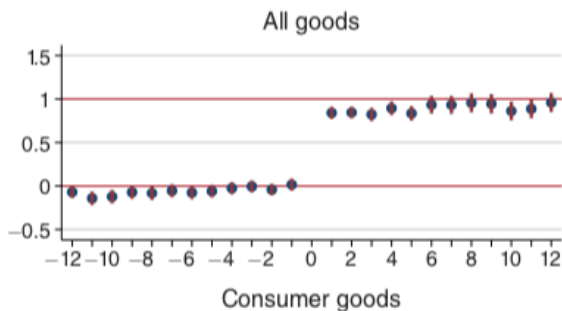
- ▶ Major motivation behind tariffs is social, not economic:  
US middle class malaise
  - ▶ Stagnation in real income, increasing inequality
  - ▶ Lack of social safety net
  - ▶ No ability to raise taxes to provide improved services
  - ▶ Tariffs represent a populist (false) solution (blame foreigners)
  - ▶ Effect will hurt most consumers who don't work in goods producing industries
- ▶ Tariffs likely to exacerbate rather than ameliorate inequality

# Who pays for tariffs?

- ▶ Classic issue in economics of taxation
- ▶ End user pays a sales tax
- ▶ But supplier may reduce prices to offset reduced demand
- ▶ Final burden depends on comparison of price elasticity of demand versus supply
- ▶ Will US consumer's pay the tax or will Canadian suppliers pay it?
- ▶ What is the evidence?

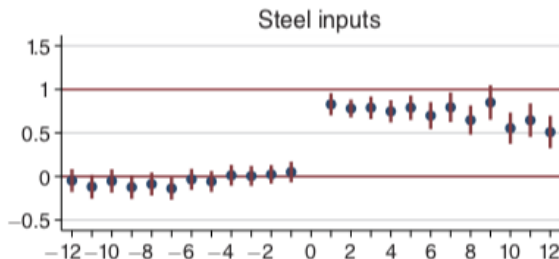
# Evidence from 2018 Trump tariffs

Evidence is that for all goods, US consumers paid the tariffs



# Evidence from 2018 Trump tariffs

However, for steel industry, sales prices did fall

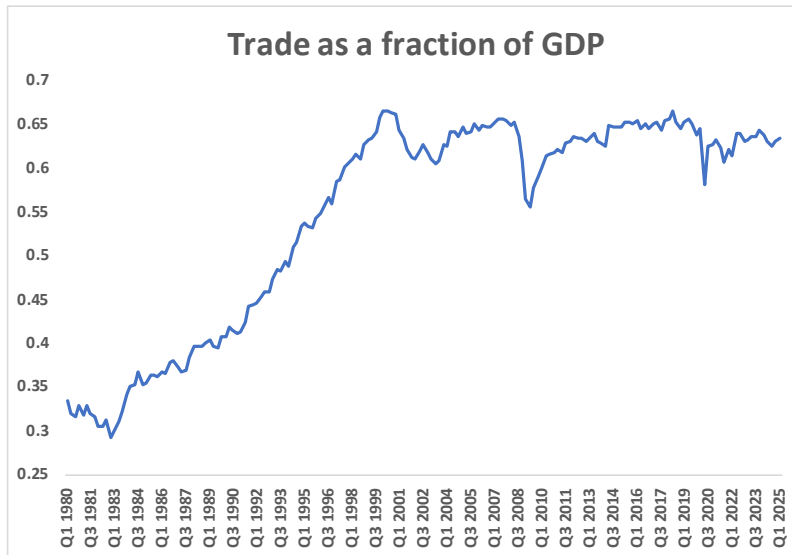


# Likely impact of tariffs

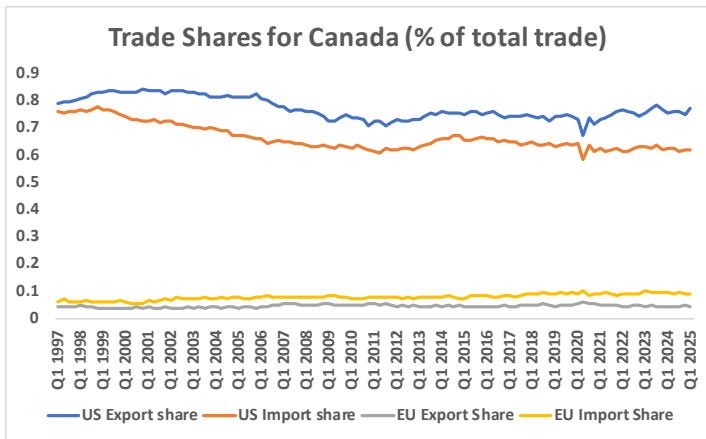
- ▶ Auray Devereux Eyquem (2025)
- ▶ Quantitative model of global economy
- ▶ 3 key implications
  - ▶ Tariffs likely to worsen US trade deficit
  - ▶ Inflation consequences of tariffs likely to increase policy rates - US GDP falls
  - ▶ Global supply chain represents a key channel propagating negative effects of tariffs
- ▶ Situation is much worse with global retaliation

## Canadian Context

- ▶ Canada benefited greatly from globalization
- ▶ Until 2000, trade ratio grew strongly



## But extreme reliance on US market



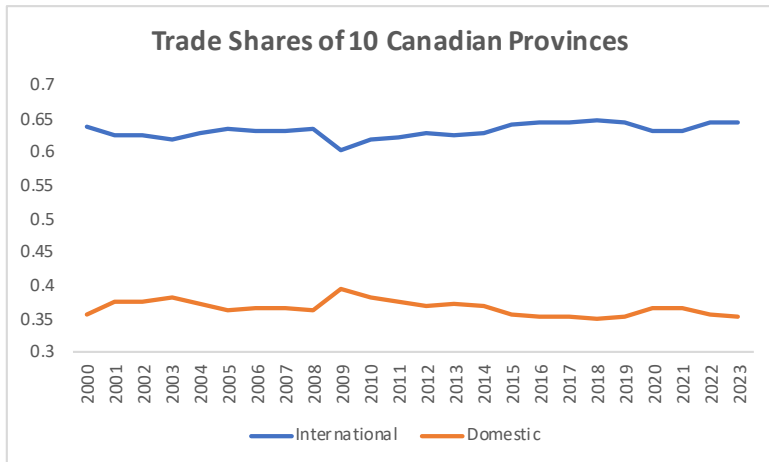


# US is less reliant on Canada in export market



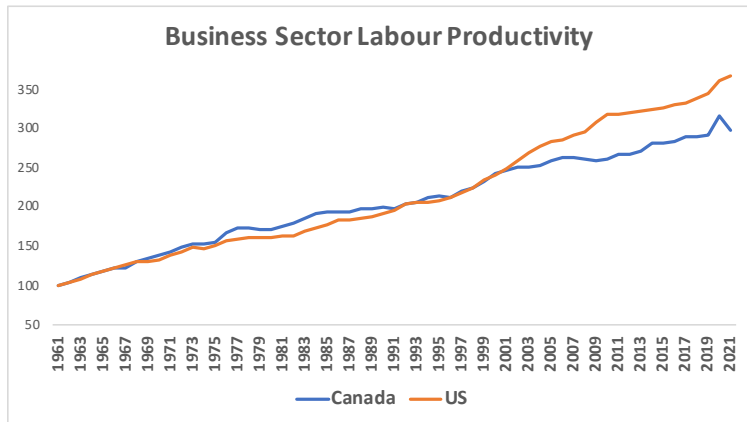
# Problem of internal trade restrictions

- ▶ Trade within Canada less than external trade

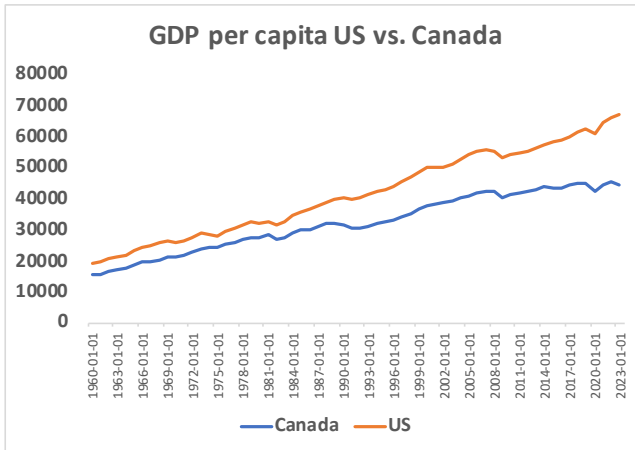


# Made in Canada problems

- ▶ Since 2000 Productivity has fallen behind US



# GDP per capita falls further behind US



# Way forward

- ▶ Need to work with US - no realistic scenario of decoupling
- ▶ Eliminate internal trade barriers
- ▶ Deregulation - need faster construction and large infrastructure projects
- ▶ Need more competition in many sectors
- ▶ Need openness to foreign investment
- ▶ Need faster adoption of new technologies