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EMERGING TRADE TRENDS

Protectionism.

Snapshot

- U.S. President Donald Trump has introduced significant new tariffs, advocated for Buy American policies, and threatened to terminate NAFTA.
- Globally, protectionist actions such as tariffs have declined, though less visible restrictions such as product standards and data restrictions are of concern.
- Canadian exporters should take actions to mitigate against the risks of NAFTA termination and other protectionist actions while also aggressively pursuing markets outside of the United States.

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Background

Many are concerned that protectionist actions are on the rise. Protectionism means restricting international trade to protect local businesses from foreign competition. These actions can take the form of tariffs, import quotas, product standards, or local content rules, among other measures.

U.S. President Donald Trump has taken or threatened to take numerous protectionist actions. These include threatening to terminate the North American Free Trade Agreement (NAFTA), introducing new tariffs, pushing a Buy American approach to exclude foreign suppliers, making it more difficult to travel to and from the U.S. with certainty, and withdrawing from the TransPacific Partnership (TPP) trade negotiations. In March 2018, President Trump announced he would introduce 25 per cent and 10 per cent tariffs on steel and aluminum, respectively.

With 70 per cent of Canadian exports destined for the United States, U.S. protectionism is especially problematic for Canadian businesses. These types of measures could badly hurt Canada's sales to its most important export market and have a sizable negative impact on overall economic growth. Moreover, new U.S. tariffs could lead to a trade war, threatening regional and global economic stability, in which Canada and Canadian businesses also have a strong stake. The U.S. stance on migration, with restrictions on travel for those from certain countries, also creates uncertainty for Canadian companies selling services in the U.S. market.

The end of NAFTA in particular would deal a blow to Canadians and the Canadian economy, directly and in terms of consumer and business confidence. The Conference Board of Canada estimates that both U.S. and Canadian economies would be weaker and households would be worse off.[1] Canadians would face higher prices, reduced international competitiveness, and lower demand from the U.S. Most of this impact would take place relatively quickly, with higher prices for imports from the United States. A lower dollar and interest rates would cushion the blow, but economic growth and job growth would slow and might even go negative for a short time.

The impact of the steel and aluminum tariffs would also be significant for Canadian businesses. As the leading exporter of both products to the U.S., Canadian exporters would be severely impacted if these tariffs are put in place. In contrast to previous U.S. tariffs, these current tariffs are not specific to steel and aluminum, but are rather broad-based.

1 Stewart, Matthew. *The Impact of a NAFTA Dissolution on Canada's Economy.* Ottawa: The Conference Board of Canada, 2018.

Given that steel and aluminum are major industrial inputs used in autos, machinery and equipment, beverage cans, and many other products, the impact on the U.S. economy would also be negative. Moreover, trade partners that have been impacted globally—including Canada—have promised retaliation, so the overall impact could go far beyond the initial tariffs. All sides lose with a trade war.

Another example of the negative impact of protectionist tariffs is the U.S. decision in early 2018 to impose tariffs on imported solar panels and washing machines, in response to a petition by two struggling U.S. solar panel manufacturers.[2] The tariffs, which apply after a certain import quota has been reached, are significant, at an additional 50 and 30 per cent for the first year for washing machines and solar panels, respectively.[3] As a result, in the U.S., consumers will now have to pay more for these products, clean energy development will slow, and employment in solar panel distribution and installation will fall.[4] Chinese businesses have driven down the price of solar panels in line with fossil fuels, and these tariffs essentially prop up a U.S. industry that Chinese businesses have out-competed.[5]

These decisions to impose tariffs on steel, aluminum, solar panels, and washing machines send a signal to other U.S. industries that the President is eager to grant discretionary trade protection, and will lead to a flood of these requests.[6] The result will be increased uncertainty, more costs imposed on the U.S. economy, and more retaliation.

The steel example is not an isolated incident for the United States. The World Trade Organization (WTO) keeps track of trade-restricting measures globally. Though the U.S. has long been active in imposing anti-dumping tariffs[7], the WTO data show that the U.S. has, in fact, increased the number of such tariffs it has imposed, from a total of 19 in 2016 to 49 in 2017 (for the 12-month period ending in July of each year). The U.S. also has a long history of local content requirements, such as those under the Buy America provisions. For example, highway projects funded by the federal government must use iron and steel produced in the United States. President Trump's promises to impose Buy American policies in new infrastructure spending are, therefore, a continuation of a long-time policy direction.

Is this just a U.S. phenomenon? A more nuanced picture emerges globally. While the WTO data show that protectionism is an ongoing issue, it is not necessarily worsening. Countries introduced far fewer measures restricting trade—such as increased tariffs, import quotas, and local content requirements—in the 2016–17 period than in any of the previous four years. (See Chart 1.) This was true both for the number of actions taken and for their value. Moreover, governments globally introduced even more trade-facilitating measures (such as reduced tariffs or a simplified customs process) than trade-restricting measures over the past four years. On average, countries imposing anti-dumping tariffs did so at a pace

2 Office of the U.S. Trade Representative, *Fact Sheet: Section 201 Cases: Imported Large Residential Washing Machines and Imported Solar Cells and Modules* (Washington: Office of the U.S. Trade Representative, January 22, 2018), https://ustr.gov/sites/default/files/files/Press/fs/201%20FactSheet.pdf.

3 Ibid.

4 Chad P. Bown and Junie Joseph. "Solar and Washing Machine Safeguards in Context: The History of US Section 201 Use," *Peterson Institute for International Economics Blog*, October 31, 2017, https://piie.com/blogs/trade-investment-policy-watch/solar-and-washing-machine-safeguards-context-history-us-section.

5 James Temple, "Trump's Solar Tariffs Shoot US Clean Energy in the Foot," *MIT Technology Review*, January 22, 2018), https://www.technologyreview.com/the-download/610041/trumps-solar-tariffs-shoot-us-clean-energy-in-the-foot/?utm_source=newsletters&utm_medium=email&utm_content=2018-01-23&utm_campaign=the_download.

6 Chad P. Bown and Junie Joseph, "Solar and Washing Machine Safeguards in Context: The History of US Section 201 Use," *Peterson Institute for International Economics Blog*, October 31, 2017, https://piie.com/blogs/trade-investment-policy-watch/solar-and-washing-machine-safeguards-context-history-us-section.

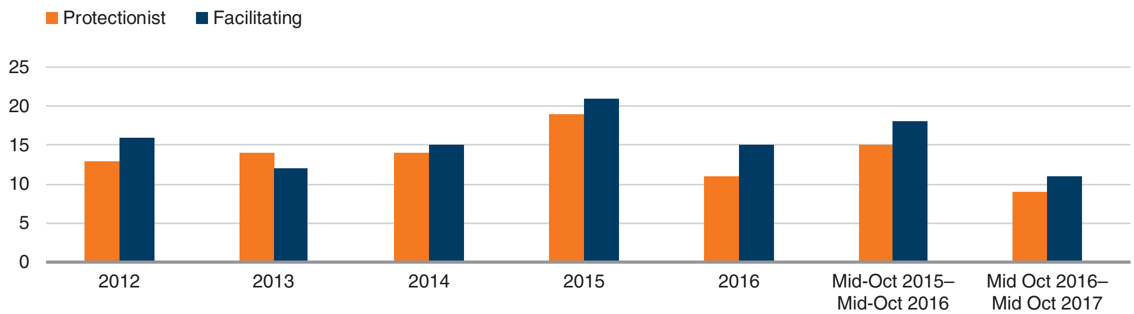
7 Duties that a government imposes on foreign imports that it determines are priced below fair market value.

of 10 per month globally over 2016–17, but this pace has, in fact, decelerated slightly, compared with the previous four years. Taken together, this suggests that global protectionism is ongoing, but on the whole, it has not been rising.[8] However, there are also less visible restrictions of concern. Non-tariff measures such as product standards or local content requirements, restrictions on data flows, and potential restrictions on the movement of people can all have negative impacts on trade. These measures are more difficult to assess and see, but could be an increasing area of concern.

Chart 1

Protectionist Measures Versus Measures That Facilitate Trade in World Trade Organization Countries

(average per month)



Note: This does not include trade remedy measures (e.g., anti-dumping).
Sources: World Trade Organization; The Conference Board of Canada.

8 World Trade Organization, *Overview of Developments in the International Trading Environment Annual Report by the Director General* (Mid-October 2016 to Mid-October 2017), (Geneva: World Trade Organization, November 16, 2017), https://www.wto.org/english/news_e/news17_e/trdev_04dec17_e.pdf.

Challenges and Opportunities

The uncertainty associated with protectionism can pose a major challenge for businesses trying to export to the U.S. and globally. It may also present opportunities to improve NAFTA.

Challenge: The Uncertainty Associated With U.S. Protectionism

The U.S. steel and aluminum tariffs were announced with little due process, in contrast to previous rounds of U. S. tariffs. President Trump threatens to withdraw or cancel NAFTA on a regular basis but it is not clear if he plans to follow through. This type of one-off approach rather than a more rules-based approach makes it difficult to plan.

Opportunity to Modernize NAFTA

The NAFTA renegotiation represents a threat, but also an opportunity. The deal is now 24 years old and has not adapted to the digital realities of how business operates in 2018. The renegotiations offer Canada, the U.S., and Mexico the chance to safeguard and advance business interests. (See Table 1.)

Table 1
Five Principles for a NAFTA 2.0

Maintaining a trilateral agreement with the U.S. and Mexico
Improving the cross-border mobility of business people
Maintaining North American content rules in the auto sector and obtaining a permanent waiver from Buy America provisions, while being prepared to ease protections in supply-managed sectors
Adding an e-commerce chapter in the agreement
Modernizing elements of the agreement, such as rules-of-origin, investor-state dispute settlement, and labour and environmental standards

Source: The Conference Board of Canada, *NAFTA 2.0 and Canada: Upgrading a 20th Century Deal for a 21st Century World.*

Navigating the Trend

Rising U.S. protectionism and the ongoing nature of protectionism globally requires strategies to mitigate against the risk of new tariffs and related supply chain disruption. In particular, businesses should:

Use New Technologies Strategically

- **Diversify markets.** A key way to lessen the effect of the protectionist actions of the U.S. or other countries is to enter or expand into new markets. The scale and growth potential of opportunities in Asia and elsewhere globally is massive. Though these markets are more distant geographically, many are growing much more rapidly than the United States. Canada has also just completed trade agreements with the European Union and the TPP-11 countries. Given that the U.S. does not have agreements with either group means that Canadian companies will face less U.S. competition in these markets.
- **Seek allies in the U.S.** Since U.S. protectionism essentially harms that country's economic interests, Canadian companies need to ask their U.S. partners to advocate for freer cross-border trade. Business takes place across the shared border, with partners essentially making things together in an integrated supply chain. Penalizing Canadian trade essentially penalizes U.S. trade and would lead to job losses in the United States.
- **Keep calm and carry on.** If President Trump issues a NAFTA termination letter, it is most likely a negotiating tactic to extract concessions. Even if the threat is real, it would be the beginning of a long process to leave NAFTA, not an immediate withdrawal. Each of the three countries can exit NAFTA with six months' notice but, in that interim period, NAFTA is still in place. Many elements of the agreement would require Congress to eliminate them. So, with enough pressure from U.S. business interests and Congress, the agreement could end up being officially terminated by the President, with its provisions still in force. Moreover, protectionist actions globally have been going on for a long time, with the data suggesting that protectionism is not on the rise. Protectionist actions are an ongoing feature of the global economy that companies need to prepare for and mitigate against.

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