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Gaming out trade negotiations with the United States

By Angelo Katsoras

Introduction

This report examines what the broad contours of Canada's new trade relationship with the United States will be, with a focus on the aluminum, steel, automotive, agriculture, and defence sectors.

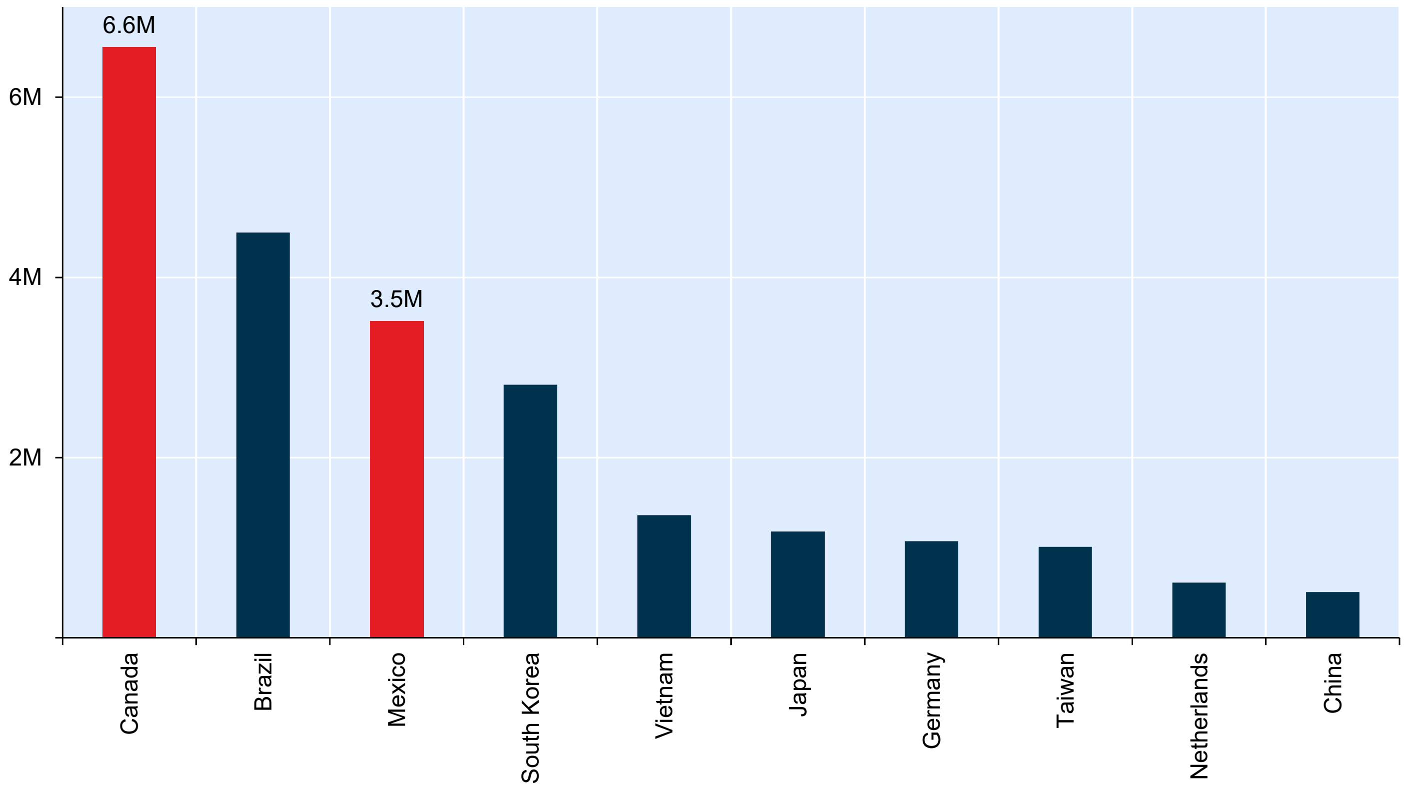
What future for Canada's aluminum and steel sectors?

The Trump administration is justifying its tariffs on Canadian steel and aluminum imports—recently increased from 25% to 50%—with the need to bolster U.S. production in key industries and reduce the trade deficit.

In 2024, about 25% of the steel used in the United States was mostly imported from the countries below.

Mexico and Canada accounted for almost 40% of US steel imports last year

U.S. imports of steel mill products (Net tons), 2024

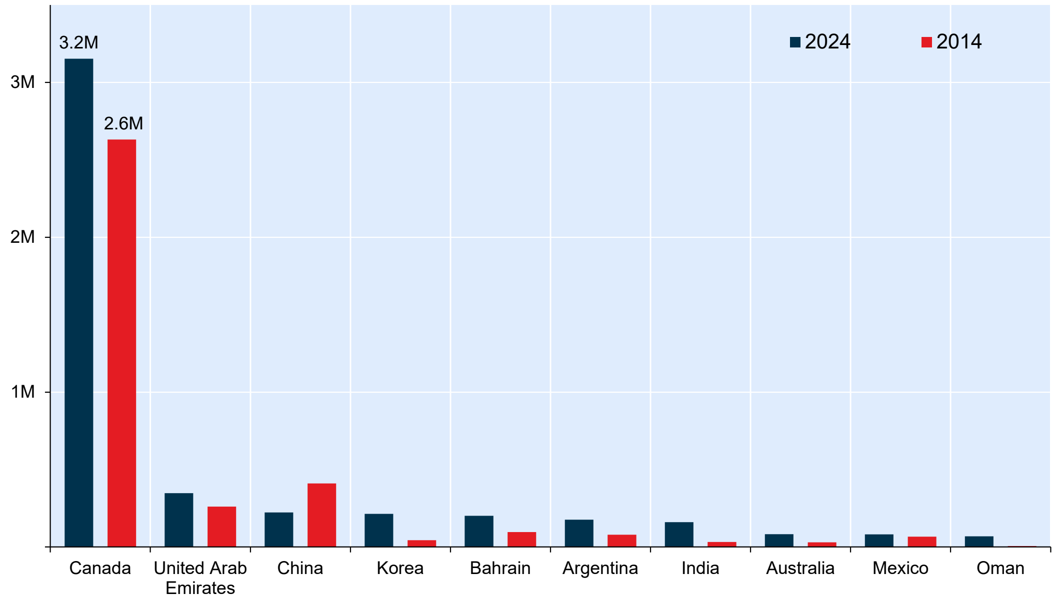


NBC Economics and Strategy (data via American Iron and Steel Institute and U.S. Census Bureau)

The United States relies even more heavily on aluminum imports. At the turn of the century, the country had 23 active primary smelters. Today, only four remain.[1] Roughly half of the aluminum consumed there is imported. Canada alone supplied 3.2 million tons last year—more than twice as much as the next nine countries combined.[2] While no new primary aluminum smelter has been built in the United States in 45 years, two projects are currently at the planning stage.

[1] "Why tariffs are unlikely to bring back U.S. aluminum production," Globe & Mail, May 6, 2025
[2] "The top sources of U.S. steel and aluminium imports," Reuters, June 4, 2025

U.S. aluminum imports from Canada dwarf other trading partners
Imports of aluminum products for domestic consumption (metric tons)



NBC Economics and Strategy (data via U.S. Department of Commerce)

The fact that aluminum production is immensely energy intensive is a major obstacle to expanding capacity. According to the U.S. Aluminum Association, producing a single ton of aluminum requires 14,821 kilowatt-hours of electricity. To put this in perspective, a modern smelter with an annual capacity of 750,000 tons uses as much electricity as a city the size of Boston. In the United States, this places aluminum smelters in direct competition with tech companies and their power-hungry data centres for access to affordable electricity.[3]

The Trump administration has framed its support for the domestic steel and aluminum industries not only as a means of domestic job creation but also as a matter of national security. A U.S. Navy briefing often cited to highlight the importance of revitalizing U.S. industrial production noted that China's shipbuilding capacity was 230 times that of the United States.[4]

Aside from rising input costs for major aluminum users in the United States, another factor that could contribute to ease U.S. tariffs on the sector is the Aluminum Association's push to exempt Canadian imports from these levies. "We urge the administration to take a tailored approach that reserves high tariffs for bad actors—such as China—that flood the market and includes carve outs for proven partners—such as Canada."[5]

This echoes a statement made by the president of the United Steelworkers (USW) last February. "The USW has long called for systemic reform of our broken trade system, but lashing out at key allies like Canada is not the way forward. Canada has proven itself time and again to be one of our strongest partners when it comes to national security, and our economies are deeply integrated"[6] This may offer a glimmer of hope for future tariff relief for Canada's steel sector as well.

Can UK-U.S. deal serve as a model for a Canada-U.S. deal?

The fact that the United States has exempted the much smaller UK aluminum and steel sectors from tariffs suggests that a deal can be struck on the matter. Canada could also see a similar outcome to the one negotiated by the Biden administration with the EU: a set quota of tariff-free imports and tariffs applied to quantities in excess of 2015-2017 average import levels.[7]

On the geopolitical front, tariff relief for UK steel and cars was granted on the condition that the UK "works to promptly meet U.S. requirements" on supply chain security and the "ownership of relevant production facilities." In simple terms, only goods that meet American security and content standards will be eligible for tariff relief.[8] China is the primary target of this provision. Canada will face similar pressure to implement safeguards against Chinese goods entering the North American trade zone via third countries in an attempt to avoid tariffs.

In a related matter, Trump's tariffs have brought into sharper focus long-running tensions between Canadian steel manufacturers and consumers. Canadian producers and unions are urging the use of more domestic steel, arguing that subsidized imports are undercutting domestic prices. In contrast, Chris Gardner, CEO of the Independent Contractors and Business Association of B.C., responded by saying: "The challenge is that it's actually cheaper to source rebar from foreign markets than it is from steel mills in central Canada."[9] This highlights the trade-off between supporting domestic production and paying higher prices.

[3] "US aluminium smelters vie with Big Tech for scarce power," Reuters, May 22, 2025
[4] "Unpacking China's Naval Buildup," CSIS, June 5, 2024
[5] "The Trump administration just doubled the tariffs on steel and aluminum imports," CNN, June 4, 2025
[6] "USW International President David McCall calls on Trump to reconsider tariffs on Canada," United Steel Workers, February 1, 2025
[7] "Biden and Europe remove Trump's steel and aluminum tariffs, but it's not free trade," Peterson Institute for International Economics, November 2021
[8] "China criticises UK trade deal with US," Financial Times, May 13, 2025
[9] "Now starring Donald Trump in 'Steel, autos and Spider-Man: The Tariff War'," Financial Post, May 7, 2025

Canada's automobile sector grappling with short- and long-term issues

After initially imposing 25% tariffs on automobile imports, President Trump lifted some of them owing to economic concerns. For example, auto parts used in vehicles manufactured in Canada are exempt from tariffs if they comply with USMCA regulations. Another exemption prevents U.S. automakers from facing further tariffs on steel and aluminum. With the mid-term elections approaching and manufacturers continuing to warn of the tariffs' impact on their businesses, additional relief may be on the way, though a full return to tariff-free trade remains unlikely.

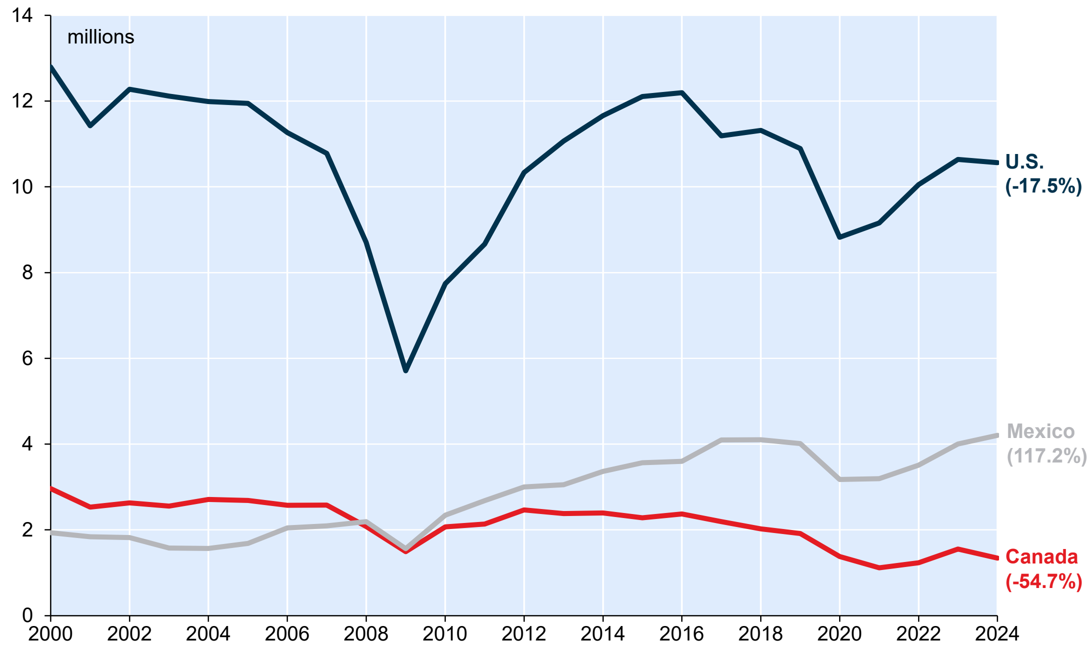
Raising tariffs significantly on non-compliant auto parts, especially those linked to China, will be a key issue in the upcoming USMCA negotiations. Although the USMCA increased required North American content from 62% to 75%, the 2.5% tariff has proven largely ineffective in ensuring compliance with this rule.

The recent U.S.-UK trade agreement may signal further tariff rollbacks. The deal permits up to 100,000 vehicles made in the UK—roughly the average number exported annually—to enter the United States at a reduced tariff of 10%, down from 27.5%. Exports beyond that threshold will be subject to the full tariff of 25%.[10] This raises a critical question: Can Canada's auto sector remain competitive with, say, a 10% tariff applied above a certain export threshold?

Although large-scale production shifts are unlikely in the short term, Canada risks losing future auto investments without clarity on tariffs. This concern is amplified by the sector's long-term decline. From 2000 to 2023, vehicle production in Canada fell from nearly 3 million to 1.5 million units—a far steeper decline than in the United States. In contrast, Mexico's auto production surged over this period.[11]

Motor vehicle production in North America

Number of vehicles, and percentage change from 2000 to 2024



NBC Economics and Strategy (data via International Organization of Motor Vehicle Manufacturers)

Trump's agriculture focus

A major indication that agriculture will be a central topic in Canada–U.S. trade negotiations is the importance agriculture had in U.S.-UK talks. Commentators have referred to the outcome of these talks as a "cars for cows" deal because automobiles are now allowed into the United States at a lower tariff rate in exchange for increased American agricultural exports to the UK.

Canada's supply management system, which imposes tariffs of up to 300% on dairy, poultry, and eggs beyond quotas, will likely be a key target. Under the USMCA, which was negotiated in 2018, Canada granted the United States access to approximately 3.6% of its dairy market via new tariff-rate quotas. It also granted limited access to its poultry and egg markets. Although these tariffs apply only if U.S. exports exceed agreed-upon thresholds, which they have not done to date, Trump continues to prioritize dismantling the supply management system.[12] It is worth remembering that the 2018 negotiations saw strong bipartisan support in the United States for dismantling the system. This suggests that Canada could be forced to make further concessions on this front.

[10] "Trump's UK-US trade deal: what is Britain getting and what is it giving away?" The Telegraph. May 8, 2025

[11] "Donald Trump's attack on Canada's auto sector will still leave many casualties," Globe & Mail, March 28, 2025

[12] "As Carney prepares to engage with Trump, fate of CUSMA hangs in the balance," Financial Post, May 2, 2025

How Trump's take on defence will impact Canada

In the eyes of the Trump administration, allies must increase defence spending if they wish to share the benefits of the U.S. security umbrella and maintain access to the U.S. market.

Although Trump has amplified these demands, American frustration over the reluctance of allies to boost defence spending is far from new. In a 2011 address to NATO leaders, former Secretary of Defense Robert Gates expressed similar concerns and warned of future consequences if allies failed to heed his advice:

"The blunt reality is that there will be dwindling appetite and patience in the U.S. Congress – and in the American body politic writ large – to expend increasingly precious funds on behalf of nations that are apparently unwilling to devote the necessary resources or make the necessary changes to be serious and capable partners in their own defense."

Canada has long fallen short of NATO's 2% defense spending target, allocating only 1.37% of its GDP to defense in 2024. However, Prime Minister Mark Carney recently announced that Canada will meet the 2% target by the end of this fiscal year, which is five years ahead of schedule. For context, last year, the Parliamentary Budget Officer estimated that defense spending for 2024–25 would total $41 billion. Reaching the 2% threshold would therefore require an additional $20 billion.

Just as Canada has finally met NATO's 2% defence spending target, NATO Secretary General Mark Rutte has raised the bar by proposing an additional increase to 3.5% of GDP over the next seven years. [13] This comes at a time when the Canadian government is grappling with competing fiscal priorities, including promised tax cuts, infrastructure investments, and securing support from other parties to pass the upcoming budget in a minority parliament. And all of this is happening on the cusp of a potential economic slowdown.

Furthermore, given the military's long history of cost overruns, Canada risks getting less value than hoped for from all of this additional defense spending. To cite just one example, the National Shipbuilding Strategy, launched in 2010, has become a costly debacle. The frigate program alone is now projected to cost $85 billion—more than triple the original estimate—and the first ship is not expected until 2035.[14]

Is the Liberal F-35 threat just a negotiating tactic?

In response to Trump's renewed tariff threats, Prime Minister Carney announced prior to the April federal election that Canada would review its order for 88 F-35 fighter jets. The country is legally obligated to purchase only the first 16 aircraft.

Canada originally selected the F-35 in 2010, but then reconsidered the decision. After a 13-year procurement process, Canada selected the F-35 again in 2023.[15] Switching to a non-U.S. fighter jet at this point would result in significant delivery delays and increased costs and would require operating two separate fleets. In light of these constraints, the announced review is widely seen as a negotiating tactic that will ultimately see Canada purchase more F-35s and other U.S. military equipment in exchange for trade concessions.

Canada's digital services tax in Trump administration crosshairs

The sweeping tax bill passed by the House and presently before the U.S. Senate—dubbed the "one big, beautiful bill" by President Trump—could raise taxes on Canadian companies and pension funds operating in the United States. The bill targets countries that impose taxes considered unfair to U.S. firms. Canada's digital services tax (DST) as often cited as an example by the Trump administration. While this move by the U.S. administration may be intended more as a negotiating tactic than as actual policy—as enforcement would contradict the president's goal of attracting investment to the United States—Canada will likely err on the side of caution and repeal the DST.

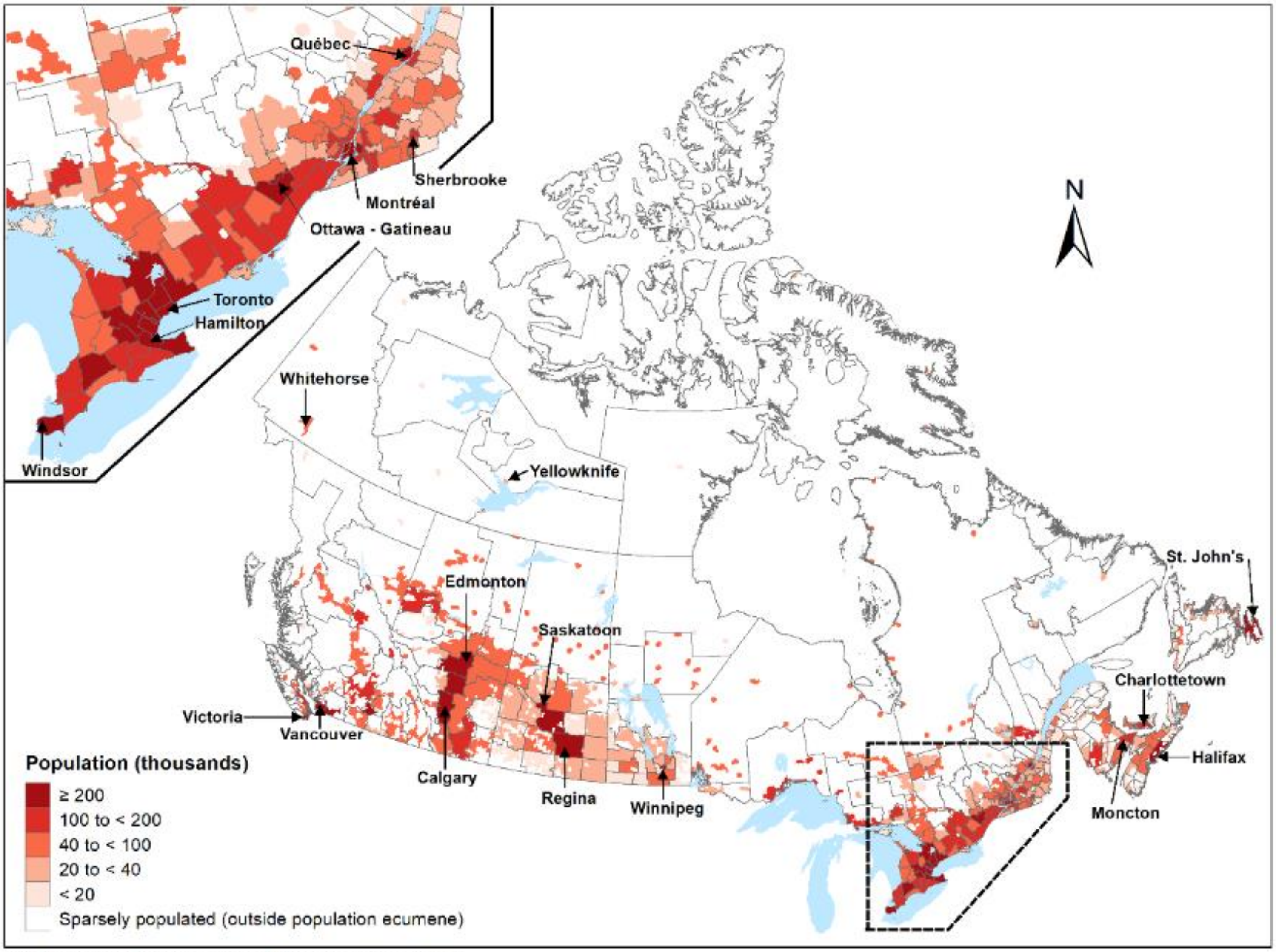
Geography is destiny

Although Canada should pursue export diversification, there are significant challenges in the way. These were underscored recently by Philip Cross, former chief economist at Statistics Canada: "Most international trade occurs within three regional trading blocs—Southeast Asia, Europe, and North America. Geographic proximity is crucial, and much international trade is the movement of products between companies within supply chains."[16]

In our case, the world's largest market sits right at our doorstep. What's more, according to Statistics Canada, "In 2021, two out of three Canadians (66%) lived within 100 kilometres of the southern Canada-US border."[17]

[13] "NATO chief seeks defence spending at 5% of GDP by 2032," AFP, May 9, 2025
[14] "Canada vs. Italy: Guess which is better at milatry procurement?" Globe & Mail, June 6, 2025
[15] "Trimming F-35 order could antagonize Trump as security and trade talks get under way," Globe & Mail , May 1, 2025
[16] "Canada Can Beat Trump's Tariffs by Waiting Them Out," Wall Street Journal, March 19, 2025
[17] "Canada and the United States: The numbers on a unique relationship," Statistics Canada, March 2023

Population distribution as of July 1, 2022, by census division, Canada



Source: Statistics Canada, Centre for Demography.

More and more countries jumping on the reshoring bandwagon

Yet another challenge that Canada faces in diversifying its trade is the global trend of countries reshoring their supply chains. Below are several prominent examples.

- EU: Strategic Autonomy and the European Green Deal Industrial Plan
- China: Made in China 2025 and China Standards 2035
- India: Make in India and Atmanirbhar Bharat (Self-Reliant India)
- Brazil: Nova Indústria Brasil (New Industry Brazil)
- United States: Inflation Reduction Act and Trump's tariffs

For example, even if the EU fails to meet its goal of producing 90% of its EV batteries domestically by 2030, it will still be very difficult to export EVs with Canadian-made battery components to Europe.[18]

[18] "Europe's battery makers seek a different growth path after Northvolt's collapse," Financial Times, April 28, 2025

Conclusion

In the midst of these very challenging times for Canada, President Trump's reversal of many of his tariffs has been a sliver of good news. For example, after imposing a 25% tariff on all Canadian goods, he soon granted exemptions for most products compliant with USMCA rules of origin. (Notable exemptions remain: automobiles, steel, and aluminum.) This allows the vast majority of Canadian exports to enter the United States tariff-free.[19] More rollbacks may follow as economic concerns grow and the U.S. mid-term elections approach, with Republicans trying to hold on to their slim majority in Congress.

When we examine the longevity of many of Trump's tariffs, it is important to note that, while the President secured a solid victory in the 2024 election, it was not a landslide. He garnered only 49.8% of the popular vote, just 1.5 percentage points more than the Democratic candidate.

Future U.S. administrations, whether Republican or Democratic, are likely to take a less protectionist approach toward Canada, provided that Canada aligns with U.S. positions on tariffs and geopolitical priorities. However, a return to the level of free trade seen in past decades is unlikely. Although Trump's embrace of tariffs is unprecedented, support for protectionist measures has grown across both parties, particularly with respect to China. President Biden retained many of Trump's tariffs and expanded them in key sectors. His Inflation Reduction Act introduced hundreds of billions of dollars in subsidies for favoured industries, prompting Canada and other countries to increase their own subsidies to remain competitive.

Additionally, once tariffs are in place, industries that benefit from them often lobby to keep some of them in place. A notable example of this is the 25% tariff on European trucks imposed in 1964 and still in effect today.

Finally, Canada's deep economic and political ties with the United States leave little room for major policy differences in areas such as trade, defence, and regulations. Similar to smaller nations neighbouring China or smaller EU member states aligning with dominant regional powers, Canada often follows Washington's lead. For instance, under Biden, Canada mirrored U.S. actions by imposing a 100% tariff on Chinese EVs and a 25% tariff on Chinese steel and aluminum. Eliminating these tariffs would greatly jeopardize access to the U.S. market. This pattern is likely to continue in an era of rising protectionism, reshoring and intensifying global rivalries.

Bottom line: Prime Minister Carney must convince President Trump that Canada is essential to the U.S. supply chain as the country rebuilds its industrial base amid rising energy costs and logistical challenges.

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[19] "Canada's economy in flux as Trump starts cutting tariff deals," Globe & Mail, May 16, 2025

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