TEC CANADA RESEARCH

The Tariff Tightrope

Navigating Uncertainty for Canada's SMEs

TEC CANADA
The Executive Committee

Post-Election Shocks

On November 5, 2024, President-elect Donald Trump announced his intention to impose tariffs on Canadian imports, leveraging trade policy to address issues such as migration, fentanyl trafficking, and economic concessions[1]. These proposed tariffs, targeting Canada as the United States' largest trading partner, have introduced significant uncertainty for the Canadian economy, threatening supply chains and key industries reliant on cross-border trade.

The proposed U.S. tariffs on Canadian imports, reportedly up to 25%, could significantly disrupt Canada's economy and its economic partnership with the United States. Unlike tariffs targeting China, which aim to reorganize global supply chains, the tariffs proposed against Canada are deeply intertwined with broader geopolitical objectives, including leveraging trade policy to influence migration and security issues. While Trump's tariff announcement seems abrupt, there are many underlying forces that brought on this strong-arm approach to Canadian-American trade relations.

Motivation Behind the Proposed Tariffs

The motivation behind the proposed tariffs on Canada reflects a distinct shift in U.S. trade policy under President-elect Trump. Similar proposed Tariffs were announced for Mexico and China – however while the tariffs targeting China aim to restructure global industrial supply chains and reduce U.S. reliance on Chinese manufacturing[2], the rationale for tariffs on Canada stems from leveraging trade to achieve political goals. Specifically, the Trump administration views trade tariffs as a tool to pressure Canada on issues such as border security, fentanyl trafficking, and broader trade compliance measures under the USMCA[1].

Beyond security and migration, this move aligns with a deep-seated ideological issue at the core of the incoming administration, which seeks to slowly withdraw American participation in global trade, bringing production (and corresponding investment and jobs) back to the US[3]. While Canada and Mexico remain the United States' most significant trade partners, the optics of tightening trade arrangements and wringing out concessions demonstrate the Trump administration's commitment to many of its core voter constituents who hold the America-first view as the highest aim.

Canada's unique economic and political dynamics amplify the complexity of this situation. The Trudeau administration, operating under a minority government, faces political challenges that make concessions to the U.S. less likely. Capitulation on trade matters could alienate key political electors in Canada, which include voters skeptical of U.S. policies under Trump[4]. Meanwhile, the deeply integrated North American supply chain, particularly in the automotive and agricultural sectors, complicates the feasibility of imposing these tariffs. These sectors rely on cross-border trade flows that are critical to maintaining production efficiency, and any tariffs would disrupt this delicate balance[5].

Bond or Bluff? Risk vs Impact of US-Canada Tariffs

The likelihood of the United States fully implementing a 25% tariff on Canadian imports is relatively low[6]. However, the consequences associated with even partial or temporary tariffs are significant. Economists suggest that the most likely scenario is the imposition of targeted tariffs on specific industries or product categories[6]. These could serve as a negotiating tactic to extract concessions from Canada on other political or economic issues.

The severity of these tariffs, if implemented, would depend on the scope and duration of their application. The worst-case scenario—a full 25% tariff on all imports—would likely lead to a recession in Canada, with the Canadian dollar potentially plummeting to $0.60 USD[6].

Such a scenario would result in significant inflationary pressures, reduced export competitiveness, and increased costs for Canadian businesses reliant on U.S. imports. At the extreme, the average Canadian consumer could feel up to a $2,000 per-person economic cost of a full-retaliation tariff war with the US[5].

In a less severe scenario, the uncertainty surrounding trade relations could still dampen business investment and consumer confidence, prolonging Canada's sluggish economic recovery. Economist estimates show that even a more modest 10% tariff could generate a 2.4% hit to Canada's GDP over a two-year timeframe, threatening over 500,000 jobs[7].

The American economy would not be completely immune to President-elect Trump's tariff proposal, if implemented. The average household would likely see a rise in goods dependent on North American supply chains or Canadian manufacturing, such as automotive and lumber, which could drive up the costs of housing and vehicles[7]. The per-person economic cost of a Canada-US tariff conflict could run the average American consumer up to $1,300[5], an unfavourable notion as the US continues its inflation battle. The tariffs also run the risk of violating USMCA conditions – signed into law by Trump himself during his first administration – and could potentially be challenged legally, or at least up until the deal is reviewed in 2026[7].

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Potential and Expected Impacts on the Canadian Economy

The potential impacts of U.S. tariffs on Canada could be far-reaching, with severe economic consequences in a worst-case scenario. A blanket 25% tariff would disrupt cross-border supply chains, particularly in the automotive, agriculture, and natural resource sectors[5]. Canadian exporters would face higher costs, reducing their competitiveness in the U.S. market, while the administrative burden of complying with tariff regulations would further strain businesses. This scenario would likely exacerbate Canada's existing economic challenges, including stagnant GDP growth, declining manufacturing output, and weak private sector investment[6].

The expected impacts, however, are less catastrophic but still troubling. Tariff uncertainty has already weakened the Canadian dollar, which is hovering near a historic low against the U.S. dollar[6]. A weaker currency could increase the cost of imports, placing upward pressure on inflation and eroding consumer purchasing power. Further, the Bank of Canada may be compelled to accelerate interest rate cuts to stimulate the economy, potentially undermining financial stability[6]. While economists project a modest GDP recovery of 2% in 2025, this rebound could be delayed or diminished if tariff uncertainty persists[6].

Impacts on Canadian SMEs

Canadian SMEs, which form the backbone of the national economy, are particularly vulnerable to the proposed tariffs. Many SMEs rely heavily on exports to the United States, and increased costs due to tariffs could render their products uncompetitive[6]. This is particularly concerning for industries like manufacturing, which often depend on integrated North American supply chains. Tariffs would not only raise production costs but also disrupt the timely flow of goods across the border, delaying delivery schedules and straining business relationships.

The impact of a weaker Canadian dollar on SMEs is another critical concern. As the cost of imported goods rises, businesses that rely on imported raw materials or components may face shrinking profit margins. The uncertainty surrounding trade relations could also deter foreign investment in Canada, particularly in high-growth sectors such as technology and advanced manufacturing[5]. For SMEs, this could mean fewer opportunities to access the capital and resources needed to scale their operations. Moreover, the increased administrative and compliance costs associated with tariffs would disproportionately burden smaller businesses with fewer financial and operational resources.

While the tariffs are not directly targeting labor mobility or the Temporary Foreign Worker (TFW) program, the economic repercussions could indirectly affect SMEs that employ TFWs. For instance, industrial sectors like construction and manufacturing that often rely on immigrant labour and imported materials[8], could see labour shortages and increased costs from tightening border policies spurred by the tariff announcement.

Additionally, in September the Canadian government announced significant updates to the TFW Program aimed at reducing reliance on low-wage foreign workers[9]. While this policy has spurred many SMEs to begin shifting their labour strategies away from temporary foreign workers even before the tariff announcement (reducing the risk of a labour shock), further pressure applied from the tariff proposal could cause the program to become even more restrictive.

While the tariffs themselves do not explicitly impose new restrictions on the TFW program, the broader economic impact could lead to policy adjustments or increased scrutiny of foreign labor employment practices. SMEs should stay informed about both trade developments and immigration policies to effectively manage potential risks associated with employing temporary foreign workers.

Prepare, Don't Panic: Evaluating the Risk

For businesses navigating the uncertainty surrounding the proposed U.S. tariffs on Canadian imports, the key to effective decision-making lies in understanding the potential risks to your business. A useful tool for this process is a Risk Matrix, which evaluates risks based on two dimensions: likelihood and impact. By categorizing risks into quadrants of low to high likelihood and low to high impact, businesses can identify where to focus their resources and attention. This approach allows leaders to prioritize mitigation strategies and proactively address vulnerabilities in their operations.

3X3 RISK MATRIX

IMPACT / LIKELIHOOD	LOW IMPACT (1)	MODERATE IMPACT (2)	HIGH IMPACT (3)
UNLIKELY (1)	**Low Risk (1)**		
LIKELY (2)		**Moderate Risk (4)**	
HIGHLY LIKELY (3)			**High Risk (9)**

Start by conducting a thorough risk assessment under two scenarios: a worst-case scenario, involving a full 25% tariff across multiple sectors, and a modest-case scenario, where targeted, temporary tariffs disrupt specific industries or product categories. For example, under the worst-case scenario, evaluate the risk of currency fluctuations caused by a significant depreciation of the Canadian dollar. Consider how this could increase the cost of imported raw materials, erode profit margins, or create pricing pressures for customers. Similarly, assess the potential supply chain challenges, such as delayed shipments or increased administrative costs due to border disruptions. In the modest-case scenario, businesses may encounter sector-specific challenges, such as increased tariffs on automotive or agricultural products, which could manifest risk factors like raised costs or reduced competitiveness.

Using the Risk Matrix framework, businesses should classify these risks and determine their relative importance. High-likelihood, high-impact risks – such as prolonged supply chain delays or major cost increases – should be addressed immediately with robust mitigation strategies, including diversifying suppliers or renegotiating contracts. Lower-likelihood risks with high impact, like a severe economic downturn tied to widespread tariffs, may require contingency planning, such as identifying alternative markets or creating financial buffers. By evaluating both worst-case and modest-case scenarios, owners and leaders of SMEs can develop a comprehensive view of potential vulnerabilities and take proactive steps to minimize disruption while maintaining operational stability.

Strategies for SMEs to Mitigate Risks

To navigate the challenges posed by the proposed tariffs, Canadian SMEs must adopt proactive and resilient strategies based on the risks they face. One critical approach is market diversification. By reducing dependence on U.S. markets, SMEs can mitigate the impact of tariffs. Trade agreements such as the Comprehensive Economic and Trade Agreement (CETA) with Europe and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) offer opportunities to expand into new markets. Government trade programs and export development initiatives can support SMEs in this transition.

Another essential strategy is financial hedging against currency volatility. SMEs can use forward contracts and other financial instruments to lock in favorable exchange rates, shielding themselves from the adverse effects of a depreciating Canadian dollar. Additionally, strengthening domestic supply chains can reduce reliance on cross-border trade and minimize exposure to tariff-related disruptions. By sourcing inputs locally, businesses can enhance supply chain resilience and maintain operational continuity.

Collaboration with industry associations and policymakers is equally important. SMEs should advocate for sector-specific exemptions or relief measures through collective lobbying efforts. Furthermore, leveraging government programs such as Export Development Canada's credit facilities and grants can provide financial support during periods of economic uncertainty. These programs can help SMEs maintain liquidity, invest in growth opportunities, and adapt to changing market conditions.

Walking the Tariff Tightrope

The proposed U.S. tariffs on Canadian imports present a serious challenge to Canada's economic stability and the resilience of its SMEs. While the worst-case scenario is unlikely, even limited tariffs could disrupt supply chains, weaken the Canadian dollar, and dampen business confidence. By assessing your individual firm risk and applying mitigation strategies such as diversifying markets, managing financial risks, and collaborating with industry stakeholders, Canadian SMEs can position themselves to weather this uncertainty. Policymakers and industry leaders must work together to safeguard the economy while fostering long-term growth and stability. Proactive planning and strategic investments will be critical in ensuring that Canada's businesses remain competitive in an increasingly volatile trade environment.

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