REPORT TO FINANCE COMMITTEE
MEETING OF WEDNESDAY, MARCH 05, 2025

SUBJECT **Potential Impacts of United States-Canada Tariffs**

ISSUE SUMMARY

This report provides information on the potential impact of United States (US)-Canada tariffs on the Capital Regional District (CRD) as directed by the CRD Board.

BACKGROUND

On February 12, 2025, a notice of motion was approved directing staff to report back at the next Finance Committee meeting on the potential impacts of US-Canada tariffs on the CRD.

Upon reflection, there are two main impact drivers of potential US-Canada tariffs that could affect the CRD: financial impacts and operational supply chain impacts. This report focuses on the former, as the fluidity of tariffs, counter-tariffs and US-Canada relations as a whole are difficult to measure at this time. Staff will continue to monitor the situation and develop contingency and alternate plans as new developments materialize.

With respect to financial impacts, tariffs are taxes levied on imported goods into a country. In the case where the US implements a 25% tariff on Canadian goods, US importers (in the US) would be required to remit tariff taxes to the US government. The effective impact would be increasing the cost of Canadian goods against comparable US made products. If Canada implements retaliatory tariffs, Canadian importers will similarly remit tariff taxes to the Canadian government and increase the cost of US goods. Historically, increased costs of goods are transferred to domestic consumers in the respective country, resulting in higher costs in both markets.

Tariffs will also impact Canadian consumers when goods move back and forth across the border. For example, when Canada exports raw materials to the US and then imports the finished product, Canadian consumers will ultimately pay higher prices that include tariffs from both countries.

US President Donald Trump threatened to implement tariffs on all Canadian goods effective February 2, 2025. Shortly before that date, he granted a one-month reprieve, delaying implementation until March 5, 2025. The status of these tariffs remains uncertain as of the publishing date of this report, marking the second time President Trump’s administration has imposed tariffs on producer economies.

On March 1, 2018, the elected administration announced tariffs of 25% on steel and 10% on aluminum. These tariffs were originally intended for all trading partners but temporarily exempting Canada and Mexico pending the conclusion of the North American Free Trade Agreement negotiations. These exemptions were subsequently removed and tariffs on Canada were implemented on June 1, 2018. In response, Canada imposed retaliatory tariffs on July 1, 2018. In contrast to that limited approach, the recent proposal targets all goods.

To date, the Canadian response has been graduated retaliatory tariffs. Phase 1 is primarily focused on US livestock and agriculture, alcohol, textiles and construction materials. Phase 2 is still being developed. The Canadian Phase 1 retaliatory tariff list is included as Appendix A.

Filings with the World Trade Organization are expected but, due to their limited enforcement capabilities, outcome will depend more on domestic legal action and pressure from stakeholders such as business leaders, lenders and taxpayers to implement effective mitigation strategies[1].

IMPLICATIONS

Economic Implications and Distortions of Tariffs

The stated purpose of the US tariffs, when first announced, was to attract capital investment to the US and stimulate growth in its manufacturing sector. However, many economists believe resulting price increases will dampen overall demand and create countervailing pressures offsetting intended economic benefits. The net effect is likely to be increased government tax revenue and benefits for domestic producers, but at a disproportionate cost to consumers on both sides of the border, assuming retaliatory tariffs are imposed.

Tariffs also create distorted incentives, notably by misallocating capital resources. By artificially increasing the price of imported goods, tariffs encourage investment in the industry that receives the subsidy from the tariff, which are unlikely to result in the most efficient use of land, labor and capital.

Furthermore, during his inaugural address, President Trump called for overhauling the trade system to “protect American workers and families”. He framed tariffs as a way to tax foreign countries rather than American citizens. This perspective is in sharp contrast to broader economic evidence, which suggests that tariffs function as an indirect tax on domestic consumers by imposing hidden costs that can have negative economic effects.

Policy Response

Following President Trump’s initial announcement of the intent to levy 25% tariffs on most Canadian imports on February 1, 2025, the Province of British Columbia (BC) announced its intentions to implement countermeasures to protect its economy[2]. Premier David Eby initially directed BC government agencies to prioritize Canadian goods and to expedite key infrastructure projects expected to create thousands of jobs. This initial response was later modified, with some measures placed on hold following President Trump’s February 4 announcement of a 30-day pause on planned tariffs. Additionally, BC has established a trade and economic security task force to coordinate further actions and diversify trade markets, acknowledging that the tariffs could lead to substantial economic losses. Other Canadian provincial leaders announced similar response measures.

At the federal level, the Bank of Canada's (the ‘Bank’) response will depend on the tariffs’ overall economic impact. If tariffs reduce demand and increase unemployment the Bank may lower interest rates to stimulate growth. Doing so could reduce returns on Canadian assets, prompting capital outflows and depreciating the Canadian dollar.

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[1] https://www.cbc.ca/news/world/trump-tariffs-china-response-1.7448393
[2] https://archive.news.gov.bc.ca/releases/news_releases_2024-2028/2025PREM0014-000077.htm

Conversely, if tariffs drive up inflation in the short run, the Bank will face a trade-off between boosting demand and containing price pressures. Notably, a weaker Canadian dollar could enhance the competitiveness of Canadian goods in global markets, partially offsetting recessionary pressures.

It is unlikely that monetary nor provincial fiscal policy alone can fully mitigate the negative economic consequences of US-Canadian tariffs. Additional fiscal or trade measures may be required to effectively mitigate these long-term impacts.

Regional Impacts

According to a recent Canadian Chamber of Commerce study[3] using Statistics Canada data, Vancouver Island's largest cities are among the least vulnerable to potential US tariffs. Victoria and Nanaimo ranked 36th and 39th among 41 Census Metropolitan Areas based on their lower reliance on US exports (Victoria 54% and Nanaimo 31%). Cities like Saint John, Calgary and Windsor are more exposed due to higher export intensities to the US.

The study highlights that cities with diversified export markets are better insulated from tariff impacts, although the overall economic consequences remain uncertain given the dynamic nature of the situation.

CRD Impacts

In 2024 the CRD converted approximately CAD $1.3 million to US dollars at an average exchange rate of 0.7304 (compared to 0.7343 in 2023), with a marked deterioration toward the end of the year. Further declines in the exchange rate will lead to higher conversion costs in the short term and these increased costs borne by the CRD will persist as long as the Canadian dollar remains depressed.

The CRD does not maintain detailed internal data on the exposure of existing contracts to potential economic disruptions from US tariffs and retaliatory tariffs. While major contractors are still assessing the situation and our current physical supplies remain sufficient, such as chemicals procured in the US used in the water treatment process, we anticipate that when contracts come up for renewal contractors may request price increases to offset rising internal costs. Although the CRD does not control how contractors source raw materials fixed-price contracts incentivize vendors to secure the lowest possible cost while maintaining acceptable quality. Some contracts, although priced in Canadian dollars, have significant underlying exposure to the US dollar.

There is also a risk that if Canada implements retaliatory tariffs some major contractors could suffer and attempt to renegotiate contracts before their natural renewal dates, whether by invoking Force Majeure clauses or through other means. CRD contracts include provisions requiring contractors to demonstrate that tariffs are directly causing economic hardship before initiating renegotiation, and these contractors are obligated to mitigate any damage caused by higher supply prices.

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[3] https://cheknews.ca/victoria-and-nanaimo-less-vulnerable-to-u-s-tariff-impacts-canadian-chamber-of-commerce-1239000/#:~:text=In%20Victoria%2C%20for%20example%2C%20about,per%20cent%20are%20shipped%20elsewhere.

It is important to note that CRD procurement involves both services and goods; only goods are subject to tariffs. Major consulting contracts denominated in US dollars should remain unaffected, except by adverse changes in the foreign currency exchange rate. For example, consulting contracts and digital products paid in US dollars would be negatively impacted by a deteriorating exchange rate.

CONCLUSION

Potential US-Canada tariffs may impact the CRD by increasing foreign currency conversion costs in the near term and driving up contract prices over the longer term, particularly for major infrastructure projects. Various levels of government are responding with both retaliatory procurement measures and counter tariffs. For example, in BC Premier Eby has already proposed introducing countermeasures, if required, such as prioritizing Canadian goods and expediting infrastructure projects to mitigate and address new US tariffs. Other Canadian Provincial premiers are responding in a similar manner.

While these actions will send a political message and could boost government revenues and benefit certain domestic producers, they also risk dampening overall demand, disproportionately negatively impact the end user consumer and result in a misallocation of capital resources. The Bank of Canada's policy response will depend on how these economic dynamics unfold, balancing the need to stimulate growth with the imperative to control inflation.

Regional vulnerabilities vary with Vancouver Island's largest cities, including the Capital Region, remaining relatively insulated due to diversified export markets. Ultimately, addressing these challenges will likely require a combination of monetary, fiscal and trade measures beyond traditional policy tools to mitigate the long-term impacts.

RECOMMENDATION

There is no recommendation. This report is for information only.

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ATTACHMENT

Appendix A: Canadian Phase 1 Retaliatory Tariff List