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Tariffs and North American Trade Relations

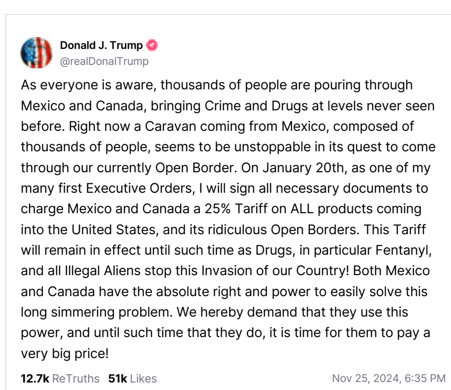
Risks, strategies, opportunities, and no-regret moves

The proposed 25% tariff on Canadian imports into the United States could prove devastating to the Canadian economy. And, with the potential for retaliatory action, companies and citizens on both sides of the border could be negatively impacted. As global trade relationships are reshaping, Canadian businesses must brace for significant change, particularly with the imminent renegotiation of trade agreements at the North American level. The redesign of global supply chains to more regional or local models and the potential for increased trade tensions and tariffs is not a hypothetical situation; it is a pressing reality that Canadian industries and companies must face.

A post that changed the game

During the run-up to 2024 US election, President Elect Donald Trump introduced the prospect of raising or introducing new tariffs on imports to the US should he be re-elected. This included the prospect of further increasing tariffs to 60%+ on imports from China and introducing tariffs of 10-20% on imported goods from other countries to address unfair trade practices. On November 25th, the potential implications to Canada were significantly elevated.

Through a post on social media platform, Truth Social, Trump proposed a blanket 25% tariff on all products entering the United States. This tariff would stand until US-Canada border security improves to stem the flow of illegal drugs and immigrants into the US. While these potential blanket tariffs were not specifically linked to unfair trade practices, the economic fallout of this tariff could be significant for both nations. Take the North American automotive parts industry as one example, where Canada's trade with the US represents almost 95% of Canada's total exports in this industry.



Donald J. Trump
@realDonalTrump

As everyone is aware, thousands of people are pouring through Mexico and Canada, bringing Crime and Drugs at levels never seen before. Right now a Caravan coming from Mexico, composed of thousands of people, seems to be unstoppable in its quest to come through our currently Open Border. On January 20th, as one of my many first Executive Orders, I will sign all necessary documents to charge Mexico and Canada a 25% Tariff on ALL products coming into the United States, and its ridiculous Open Borders. This Tariff will remain in effect until such time as Drugs, in particular Fentanyl, and all Illegal Aliens stop this Invasion of our Country! Both Mexico and Canada have the absolute right and power to easily solve this long simmering problem. We hereby demand that they use this power, and until such time that they do, it is time for them to pay a very big price!

12.7k ReTruths **51k** Likes Nov 25, 2024, 6:35 PM

The interconnectedness of this industry means parts potentially cross the borders between Canada, the United States, and Mexico multiple times. As another example, energy products represent over 26% of total exports, of which the vast majority move to the US. The potential for tariffs on these exports could quickly lead to higher energy prices for citizens on both sides of the border.

If the Trump administration moves ahead with its plans to renew existing favorable tax measures, and reduce regulatory burdens in the United States, Canadian trade competitiveness could be driven down. This would have a broad impact on investment in Canadian firms and projects by creating an environment of uncertainty and risk, potentially deterring investment. Canada would likely respond with tariffs on US products to try and mitigate the impact of increased costs, reduced demand, and lower profit margins for Canadian business. This dynamic would have significant price and supply chain implications for imports to Canada and impact all sectors of the Canadian economy.

Economic snapshot: 75% of all Canadian exports are to the United States

The United States is Canada's most important partner when it comes to trade. Oil, automotive parts, and consumer goods all have significant North American trade footprints. Tariff restrictions on these industries could lead to significant dips in revenue, job losses, and supply chain uncertainty. This downturn could extend beyond these key industries, creating a ripple across all related sectors that would further strain the Canadian economy.

CANADIAN DOMESTIC EXPORTS (2023)

North American Product Classification System (NAPCS)	To All Countries	% of Total Exports	To USA	% of Exports to USA
Energy products	$187,620,965	26.3%	$165,994,942	88.5%
Motor vehicles and parts	$86,957,359	12.2%	$82,223,780	94.6%
Metal and non-metallic mineral products	$83,136,246	11.7%	$55,574,432	66.8%
Consumer goods	$78,249,352	11.0%	$62,701,910	80.1%
Farm, fishing, and intermediate food products	$60,558,608	8.5%	$28,188,992	46.5%
Forestry products and building and packaging materials	$46,769,524	6.6%	$38,056,597	81.4%
Basic and industrial chemical, plastic, and rubber products	$41,301,829	5.8%	$36,022,705	87.2%
Industrial machinery, equipment, and parts	$41,177,556	5.8%	$32,996,757	80.1%
Metal ores and non-metallic minerals	$30,799,027	4.3%	$7,174,148	23.3%
Aircraft and other transportation equipment and parts	$24,962,561	3.5%	$16,511,031	66.1%
Electronic and electrical equipment and parts	$24,514,136	3.4%	$17,083,114	69.7%
Special transactions trade	$6,165,455	0.9%	$5,358,577	86.9%
Total	**$712,212,616**	**100.0%**	**$547,886,984**	**76.9%**

Source: Statistics Canada. Table 12-10-0173-01 Canadian international merchandise trade by province and country, and by product sections, customs-based, annual (x 1,000)

In this table, exports at the national level are based on domestic exports, as opposed to total exports which include re-exports. Domestic exports are goods grown, produced, extracted, or manufactured in Canada, including goods of foreign origin that have been materially transformed in Canada

Framing your response: A self-assessment checklist

How will your business be impacted by a potential increase in US trade tariffs, and other aspects of the evolving international trade?

We've put together a self-assessment checklist so that you can identify your own unique set of no-regret moves and balance them with the needs of your business. If you start operationalizing your response now, you can protect your organization from worst-case scenarios and turn the risks into potential competitive advantages.

In the wake of these potential tariffs—and protectionist trade relations in general—we've identified **three business archetypes that will be impacted**. To help frame a response for each, we have created a 10-point checklist to kick-start planning and inform strategic moves for the future.

Sell side

Companies that *export goods into the United States from Canada*. They face challenges like potential revenue loss due to decreased demand and increased costs associated with tariffs.

01. Pre-build inventory
02. Review customer contracts
03. Refine transfer pricing strategy
04. Establish US-based sales entity
05. Create barriers to switching
06. Enhance product value proposition
07. Enhance sales & operations planning capability
08. Optimize logistics
09. Increase export market diversification
10. Leverage government support/relief programs

Buy side

US companies that *import goods from Canada*. They may face increased costs due to tariffs, which could lead to higher prices for consumers and potentially disrupted supply chains.

01. Review tariff classifications
02. Evaluate tariff engineering opportunities
03. Conduct cost unbundling analysis
04. Review supplier contracts
05. Current supplier plant/country of origin flexibility
06. Alternate supplier sourcing
07. Assess indirect (tier 2/3) supplier exposure
08. Optimize product design
09. Revisit make vs. buy choices
10. Implement global trade management systems

Inside

Companies have *operations and supply chain configurations spread across North America*, allowing them to navigate tariff implications by potentially shifting production or sourcing within the region.

01. Re-optimize North American production network
02. Optimize value-added product flow
03. Enhance multi-tier supply network visibility
04. Develop supply network flexibility
05. Define contract manufacturing strategy
06. Explore use of bonded regimes
07. Execute strategic cost reduction programs
08. Revisit risk management frameworks and systems
09. Implement cognitive risk sensing solutions
10. Develop continuous scenario analysis capability

Sell-side strategies

10 actions companies exporting into the United States can take to maintain a competitive position with increasing trade tariffs.

01. **Pre-build inventory**
Consider accelerating imports ahead of potential tariff increases. This strategy can help mitigate the immediate impact of tariff changes and provides time to develop longer-term responses. Balance any inventory investment with considerations of working capital impacts, distribution and logistics costs, and inventory costs due to the potential for increased product obsolescence or expiry.

02. **Review customer contracts**
Review your customer contracts to understand your contractual obligations and clarify who will ultimately pay for the increased cost of tariffs. Be proactive in communicating and negotiating with customers toward a fair sharing of any incremental tariff-related costs, in the spirit of a longer-term strategic business partnership. Consider implementing a tariff adjustment clause, with flexible pricing that is automatically triggered when tariffs reach specific thresholds to reduce the need for frequent renegotiations. Develop dynamic invoicing options that itemize tariff impacts separately, increasing transparency, and allowing customers to visualize the tariff effect on costs.

03. **Refine transfer pricing strategy**
Consider changes to transfer pricing policies and corresponding operations to reduce the import value into high-tariff countries. In addition, any changes to the location of manufacturing to eliminate tariffs will require adjustments to the transfer pricing policy—intercompany sales will involve different parties and are subject to a mark-up in the manufacturing location. Changes to transfer pricing policies will also result in changes to operating and taxable income by country which need to be considered in the assessment of any efforts to eliminate tariffs.

04. **Establish US-based sales entity**
When a Canadian company directly contracts with US customers, consider establishing a legal entity in key export markets (i.e., the United States) to serve as the importer of record and contract with customers as a potential strategy to reduce the import value into the high tariff country. Carefully consider these strategies in the context of broader tax optimization.

05. **Create barriers to switching**
Increase customer dependency by offering bundled products or solutions specifically tailored to US regulatory standards, which competitors may find difficult to replicate. Develop customer loyalty programs that reward longer contracts and higher purchase volumes with tariff relief discounts or service credits. This will help retain customers despite price increases. Invest in proprietary training, technical support, or certification programs that increase the costs and time for customers to switch to another supplier, embedding value-added services into your offerings.

06. **Enhance product value proposition**
Focus on enhancing the value proposition of your products to justify price increases due to tariffs. This can include improving product quality, adding innovative features, or providing exceptional customer service. Develop marketing strategies that highlight the unique benefits and superior quality of your domestically manufactured products, emphasizing their compliance with local standards and regulations. Offer value-added services such as extended warranties, maintenance packages, and customization options to differentiate your products from competitors and build customer loyalty.

07. **Enhance sales & operations planning capability**
Adopt a more integrated and iterative approach to sales and operations planning to address changes in trade practices and shifts in demand due to fluctuating product prices and customer demand. Implement scenario analysis to optimize supply chains within current constraints, ensuring profitable service to critical customers. And sense and respond to new opportunities that may emerge during this volatile period, where current competitors may not be as well positioned to service their customers in either the United States or Canada.

08. **Optimize logistics**
Streamline supply chain and logistic operations to reduce costs and offset some of the increased tariff costs. This can include consolidating shipments, optimizing routes, and negotiating better rates with logistics providers. Implement advanced supply chain technologies such as real-time tracking, predictive analytics, and automation to enhance visibility and responsiveness to changes in the trade environment.

09. **Increase export market diversification**
Build an export market portfolio analysis to identify and proactively develop new markets with favourable trade practices and tariffs. Focus on countries with trade agreements that are less subject to sudden tariff changes. Create a market-specific product adaptation strategy, adjusting product specifications to align with the preferences or regulatory standards of non-US markets, allowing quicker pivots in case of tariff changes. Establish distribution and logistics partnerships in diversified markets to improve agility to enter new markets and quickly shift as the global trade landscape transforms. This could also include refocusing sales efforts in the domestic market, especially if the Canadian Government responds with retaliatory tariffs that open new competitive opportunities.

10. **Use government support/relief programs**
Establish a dedicated team to monitor and apply for grants, relief programs, or low-interest loans that support trade resilience. Consider partnering with industry associations to lobby for tariff relief or exemptions for specific sectors or products and/or otherwise pursue exemptions or exclusions as applicable.

Buy-side strategies

10 actions companies importing into the United States can take to maintain a competitive position with increasing trade tariffs.

01. **Review tariff classifications**
Ensure accuracy by conducting a thorough analysis of the current harmonized tariff schedule of the United States classifications and corresponding duty rates. Explore opportunities to reclassify products under lower-tariff categories where permissible, in compliance with regulations. Use third-party tariff classification expertise to ensure that the lowest duty rates are accurately applied. While this may not provide significant relief to a blanket increase in tariffs, accurate goods classification is foundational to manage in a rapidly evolving global trade environment.

02. **Evaluate tariff engineering opportunities**
Identify potential tariff engineering opportunities to modify products or their manufacturing processes to qualify for lower duty rates. Ensure any changes comply with legal and regulatory standards to avoid penalties.

03. **Conduct cost unbundling analysis**
Implement a detailed analysis to separate dutiable and non-dutiable costs in pricing. This could mean removing potentially non-dutiable service-related costs and intangibles with appropriate support. Use this analysis to reduce the overall duty burden on imported products.

04. **Review supplier contracts**
Review existing supplier contracts to understand how costs may vary with commodity price fluctuations and tariff changes. This should include understanding your suppliers' ability to shift production to different regions that would deliver a lower landed cost. When you are the importer of record and responsible for the tariff payment, negotiate directly with suppliers for cost concessions to offset the impact of increased tariffs and achieve mutually beneficial outcomes.

05. **Current supplier plant/country of origin flexibility**
Develop a tariff shock readiness program that simulates sudden tariff increases and assesses the resilience of different sourcing options. Include supplier contingency planning to ensure that current suppliers can shift production to lower tariff regions or alternate suppliers can be activated quickly, if necessary.

06. **Alternate supplier sourcing**
Develop and maintain a database of alternate suppliers in tariff-friendly locations, increasing geographic diversity in the supplier network. Include key information such as lead times, production capacities, and compliance with regulatory requirements to facilitate rapid supplier switching when tariffs change. Regularly review the bill of materials and prioritize strategic sourcing to shift high-tariff components to in-country or low-tariff country sourcing.

07. **Assess indirect (tier two/three) supplier exposure**
Build a risk-assessment tool to quantify indirect tariff exposure at various tiers, especially from tariff-affected countries. Use this tool to negotiate stronger contracts with tier one suppliers, requiring them to proactively manage their own supplier risks and diversify sourcing in high-risk categories.

08. **Optimize product design**
Implement a product design review aimed at optimizing tariff resilience. Encourage design teams to use materials that are less tariff-sensitive or that qualify for reduced-duty status under preferential trade agreements. Incorporate modularity in design to allow flexibility in product value-added operations, such as importing intermediate goods for final assembly versus importing fully finished goods.

09. **Revisit make vs. buy choices**
Reevaluate make vs. buy decisions considering the changing tariff environments to determine the most cost-effective and resilient sourcing strategies.

10. **Implement global trade management systems**
Invest in global trade management systems, and AI-driven predictive analytics, to identify changes in trade policies and adjust forecasts accordingly. Implement automated tariff rate forecasting to anticipate cost impacts of potential changes in tariffs, enabling proactive adjustments to procurement strategies.

Inside strategies

10 actions companies with North American or global supply chains can take to maintain a competitive position with increasing trade tariffs.

01. **Re-optimize North American production network**
Conduct a thorough landed cost analysis that factors in manufacturing, distribution and logistics, and tariff costs to optimize plant locations. This may involve moving production closer to key markets or low-tariff areas. Consider full or partial shifts in production operations, using US-based locations to produce for the US market. Evaluate broader reshoring options to leverage trade agreements and government incentives and/or reduce exposure to trade and tariff volatility.

02. **Optimize value-added product flow**
Reassess value-added services to determine the optimal location for minimizing the tariff burden on imports into the United States. Optimize distribution centre networks by using tax-advantaged locations or US foreign trade zones, reducing tariff exposure, and improving shipping times to US customers.

03. **Enhance multi-tier supply network visibility**
Achieve supply chain resilience by ensuring the transparent flow of product, capital, and information across each tier of the supply chain. Understand the impact of tariffs on direct suppliers and their supply base. Embrace new digital approaches to illuminate the supplier network, gaining visibility to critical material and component supply as quickly as possible.

04. **Develop supply network flexibility**
Implement multi-location production with geographic diversification for key products to avoid relying on a single plant, ensuring resilience if tariffs impact a particular source. Create backup production capabilities in tariff-free or low-tariff regions to maintain flexibility in production locations. Develop contingency plans that allow scale-up in low-tariff plants, ensuring your supply network can adjust quickly to shifting tariffs

05. **Define contract manufacturing strategy**
Evaluate options to establish or supplement production capability in key export markets (i.e., the US marketplace). Set up flexible cross-border agreements with contract manufacturers in low-tariff regions to shift production depending on tariffs and other cost changes. Create contingency contracts with multiple contract manufacturers, with clear pricing and a commitment to production flexibility.

06. **Explore use of bonded regimes**
Utilize foreign-trade zones, bonded warehouses, and other bonded regimes to manage working capital and reduce duties and costs for goods that are re-exported.

07. **Execute strategic cost reduction programs**
Conduct a zero-based cost analysis across the supply chain to identify potential cost reductions improve cost efficiency and help offset tariff-related costs. Employ lean manufacturing techniques to reduce waste and handling costs. Use strategic sourcing techniques to lower key raw material or component costs and reduce the product cost base. Invest in automation within plants and distribution centres to improve efficiency and reduce labour costs, offsetting tariff impacts. Government grants and incentives may be available to support AI-based supply chain solutions and operational improvements that increase international competitiveness.

08. **Revisit risk management frameworks and systems**
Ensure that you have risk management tools in place, specifically related to your extended supply network. Balance risk management processes and supply chain resilience with the need for efficiency and cost competitiveness. Incorporate the lessons learned from the COVID-19 pandemic to prioritize supply chain risk management and resilience.

09. **Implement cognitive risk sensing solutions**
Use cognitive risk sensing solutions to enhance your risk sensing capabilities beyond traditional enterprise resource planning systems and supplier attestations. Implement digital risk sensing approaches to build supply chain resiliency without the financial overhead of traditional physical approaches.

10. **Develop continuous scenario analysis capability**
Develop scenarios and analytics capability to proactively plan for potential risks, evaluate the likelihood of event, length of event, and ability to mitigate. This, in turn, helps the organization understand the fiscal impact and the costs and complexity of each mitigation option. When alarms are triggered, have a process in place to identify, compare, analyze, and select the best alternative scenario. Consider both direct and potential retaliatory impacts of tariff changes in your scenario planning.

Asking the right questions

Canadian companies need to act quickly, to assess the potential impact on their business, to assess options, and to start or be ready to execute. Here are the questions you need to ask yourself:

- *Do I fully understand my* ***exposure*** *to changes in tariffs across different countries, based on where my company sources from and where we sell to?*
- *Do I have a* ***playbook*** *to respond to supply chain risks and disruptions, such as changes in tariffs or internal trade restrictions when they happen?*
- *Do I understand my* ***options*** *to respond, and the financial and operational impacts of each? Are there* ***no regret actions*** *to take now?*
- *What are our* ***contractual commitments*** *with suppliers and customers, and what negotiating leverage do we have to mitigate the tariff impact?*
- *Do I understand our* ***end-to-end supply chain*** *from the original source of raw materials to the ultimate consumer, and key risks associated?*
- *Do I have proper* ***visibility*** *to sense and predict broader supply chain risks so that they can be effectively managed?*
- *Do I have enough* ***flexibility*** *to respond to risks in an increasingly volatile global trade environment?*
- *Can we* ***collaborate*** *with key suppliers and customers to develop more effective responses to these types of events to achieve better outcomes?*
- *How do I* ***balance*** *the need for efficiency and profitability with resilience when mitigating risks comes at a cost with uncertain returns?*
- *Do I need to revisit our* ***strategic choices****: where to play, how to win, how to configure*

Fortifying your business: Act with urgency

Canada has been put on notice. There is now a limited window for Canadian companies to understand the potential impact on their business, evaluate reasonable scenarios, and determine immediate and future actions. The good news is that these announcements have afforded you some time to prepare, offering the opportunity to assess and mitigate risks before they fully materialize.

To navigate this changing landscape, businesses must consider the strategies we've just outlined to ensure the strength of their operations and supply chains. This starts with an in-depth assessment of your current state of operation and your resilience amid global trade volatility and supply chain disruption.

Impact and action: A pragmatic assessment approach

We recommend that Canadian companies start with a thorough review of their supply chain and operating model. Focus on resilience and your ability to understand how increased tariffs could impact your current state. This will drive the definition and evaluation of alternate strategies, helping you determine what right response is for your business. For most companies, there will be several no-regrets moves that will be beneficial to any eventuality. All companies, however, will need to develop a roadmap that balances resilience and efficiency to strengthen their supply chain against tariffs and other risks.

Current state impact assessment

- Plant & distribution centre network footprint
- Product flows inventory deployment
- Customer & supplier contracts
- Product tariff classification
- Product bill of materials & cost unbundling
- Supplier network (direct + Tier 2/3) and external spend
- Operational & financial performance
- Supply chain capability & flexibility)

Baseline tariff impact assessment

Response options analysis

- Scenario planning & key assumptions
- Customs valuation & tariff engineering
- Business model & transfer pricing
- Product flow & value-added processing changes
- Export/domestic market shift
- Supply chain reconfiguration

Response option cost, benefit, impact vs. baseline

Implementation planning and situation monitoring

Transformation roadmap & business case

- No-regret moves
- Physical supply chain changes & capability building investments
- Business model changes
- Systems enhancement, supply chain risk management, global trade management
- Government support

Things to consider
It is currently unclear whether these tariffs will be applied based on the country-of-origin or export. The latter case could also pose challenges for distributors based in Canada.

It's uncertain if other countries will be targeted with similar tariffs. However, some analysts suggest that this situation may create opportunities for third-party countries like India, as their goods could become more competitive compared to those from Canada, Mexico, and China.

In 2018, Trump used tariffs on Canadian steel and aluminum imports in response to alleged threats to US National Security. These tariffs were then used as a factor in the negotiation of The Canada-United States-Mexico Agreement (CUSMA). With the six-year expiry review and potential renegotiation of CUSMA coming up in 2026, the current proposed tariffs could be another potential point of leverage.

Make your moves now
Making these changes won't be easy. But we are in a world where global trade relationships—and specifically among trading partners at the North American level—are being reset. The results will have macroeconomic impact on Canada. Now it's time to act. Several of the potential strategies and solutions we've outlined can be implemented in weeks to months. Others may take years and very significant capital investment. But change is imminent. If you're prepared, you won't have to play catch-up. By responding quickly and strategically to the potential for increased tariffs, businesses can protect themselves from disruptions while also positioning themselves for long-term success in an increasingly uncertain trade environment. This proactive stance not only mitigates risks, but opens new opportunities for growth, innovation, and market expansion.

Let's talk

Deloitte's global presence, comprehensive industry and supply chain knowledge, and tax and regulatory understanding can help companies navigate volatile trade environments, optimize their supply chains, and adapt to the tax implications of international trade. Let us help you take a proactive approach. Please reach out to AgileResilientSC@deloitte.ca

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