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Länderbericht

KAS-Canada Office

Canada faces the threat of a trade war with the U.S. in this election year!

The EU and Canada should respond more strongly together.

The punitive tariffs threatened by U.S. President Trump against Canada and Mexico have only been postponed, not canceled. There will be losers on both sides – not just in the U.S. and Canada, but also in Europe. Canada and the EU are already preparing effective countermeasures.

As in 2018, the EU is once again focusing on trade with the U.S. The CETA agreement could serve as a suitable and joint protective shield for both partners. The ongoing election campaign in Canada is unexpectedly being pushed in a new direction as a result.

Dr. Bernd Althusmann

From the threat to the implementation of punitive tariffs against Canada

Until the last minute, U.S. President Donald J. Trump kept his closest neighbor and ally, Canada, as well as the outgoing Prime Minister Justin Trudeau, in suspense. The Canadian ministers sent to the U.S. multiple times initially returned empty-handed. Once again, it seemed as if the days of the Trudeau government were numbered. The threat of 25 percent tariffs on Canadian exports to the U.S. caused outrage not only at the government level in Canada. In response, Canada proposed a list of countermeasures amounting to a total of \$125 billion, primarily targeting U.S. imports in the food sector. These measures were structured in a phased manner and were pre-approved as a delayed-response package in case the tariffs were enforced by the U.S. government.

Even more impactful were potential cuts to Canada's energy exports to the U.S. The two countries are deeply intertwined industrially, and a looming trade war poses a significant threat to productivity—particularly in the automotive, supplier, and mining industries. The trade deficit cited by the Trump administration as justification for the tariffs is, according to calculations by Canada's Ministry of Finance, significantly smaller than claimed and is largely driven by Canadian energy exports to the U.S. However, the U.S. economy benefits greatly from affordable Canadian energy and raw materials.

Canada's planned countermeasures in the energy sector would inevitably lead to rising costs for goods and energy in the U.S., affecting both consumers and industries. Now, Canada's hopes rest on the remaining weeks of reprieve to persuade the U.S. that this path leads to an economic dead end.

Utilizing the CETA Agreement

Reviving the recently stagnating trade with the EU could potentially compensate for some of Canada's GDP losses. However, no clear strategy toward this goal has yet emerged. This may also be one of the reasons why Canada finds itself in a significantly weaker negotiating position.

Canada's strong dependence on the U.S.—with an estimated 75 percent of its trade in goods and energy directed toward its southern neighbor—suggests that it should place greater focus on its allies and Western partners. What is becoming increasingly urgent in North Atlantic security and defense policy should certainly also apply in times of a trade war.

Ultimately, the Trump administration may be less concerned with the economic collateral damage to Canada and more focused on addressing two pressing issues—both of which cannot be resolved within just four weeks. Perhaps this is why the implementation of tariffs against Canada was postponed by a month.

The U.S. is pressing Canada to implement a more effective border regime to curb illegal immigration into the U.S. However, the reality is that millions of people are already living and working in the U.S. without legal status. Canada, on the other hand, fears that a backlash could further exacerbate its own immigration challenges. Nonetheless, the Trudeau government points to plans for increased border security personnel and the acquisition of additional technical resources, such as new helicopters for enhanced border surveillance. Contrary to common misconceptions, the government is not deploying 10,000 new border officers, but rather increasing the existing force by approximately 2,500, bringing the total to around 10,000 officers—an expansion that was already approved at the end of last year.

Additionally, the U.S. aims to crack down on drug cartels operating in Canada and Mexico. The American and longtime advisor to Donald Trump, David Navarro, stated in an interview with POLITICO just a few days ago that this is a drug war, not a trade war. The new U.S. administration is using punitive tariffs to curb the influx of drugs—particularly fentanyl—into the U.S. from its neighboring countries, Canada and Mexico.

Although the outgoing Canadian government has visibly aligned itself with the U.S. on this issue, the reality is that drug trafficking from Canada to the U.S. is significantly lower than the other way around. The U.S. would therefore need to address this problem domestically first.

Canada has been struggling with both issues for years, but to a large extent, it may have contributed to them through overly liberal immigration and drug policies. Recent political decisions indicate that immigration will be significantly restricted in the coming years compared to previous plans.

Two key questions are looming over the Canadian public in the 2025 election year:

First, has Canada's liberal drug policy failed? A look at Canada's major cities and the high number of homeless individuals—many of whom are drug-

dependent—suggests that the partial legalization of even hard drugs has failed. Fentanyl, originally used in anesthesia, is now claiming a rapidly increasing number of lives in both the U.S. and Canada.

The opposition Conservatives, led by Pierre Poilievre, are calling for a radical shift in policy. They advocate for strict measures, including severe penalties for the possession and especially the trafficking of hard drugs, arguing that such a tough approach is necessary.

Secondly, has Canada's generous immigration policy in the past three years reached the limits of public acceptance and the country's capacity to absorb newcomers? Should Canada refocus on attracting highly skilled workers instead? After the 2021 federal election, the Trudeau government decided to allow between 400,000 and 500,000 immigrants per year, in addition to approximately 50,000 war refugees admitted for humanitarian reasons. With Canada's total population at around 40 million, this policy was designed to offer permanent residency opportunities to newcomers.

However, rising unemployment—now at 6-7 percent—along with shortages of family doctors, limited access to basic healthcare, and a severe housing crisis, have already forced the government to reconsider its stance last year, though perhaps too late. The pressure on Canada to act may now intensify further due to U.S. threats. Estimates suggest that between 1 million and over 10 million undocumented individuals in the U.S. could attempt to move northward. This poses one of the greatest challenges for Canadian policymakers.

Trump's actions during the Canadian election campaign have the opposite effect, ultimately harming the Conservatives

Canada is facing a pivotal decision in the election year. The calmness and globally open tolerance that Canada has shown on the issue of immigration seems to be giving way to growing public concern that the increasingly visible conflicts are becoming unmanageable—sometimes even slipping out of control, especially with regards to housing prices. This erodes public confidence in the Canadian government's ability to act effectively.

At the same time, Donald Trump's threats towards Canada are strengthening national unity and could give the upcoming election campaign a new twist. Particularly the Conservative Party, which has been leading in the polls and remains strong, cannot counter the solidarity of Team Canada. Their issues, such as "Axe the Tax," are surprisingly taking a back seat.

When Parliament returns from its prorogation period, it will be interesting to see if the NDP, which has previously tolerated or even saved the minority Trudeau government under leader Singh, will vote no-confidence in the likely candidate for the new Prime Minister, especially since Justin Trudeau is no longer the target of some attacks.

What remains puzzling, however, is that the Canadian Parliament, amid a serious crisis with its main trading partner, the U.S., is still in prorogation—a forced pause. The Liberals' fear of a successful vote of no confidence against potential successor Mark Carney seems so great that they will not decide who will succeed Trudeau until March 9. Whether this leader will seize the moment to mark the end of the Trudeau era and call for new elections within six weeks is still speculative. The election campaign is seemingly taking a new turn.

Turning point in Canada's foreign and defense policy ?

These turbulences of the Canadian election year should not overshadow the foreign policy challenges Canada faces. The U.S. President is calling on NATO allies to increase defense spending to 5 percent of GDP. Canada, currently at around 1.4 percent, is far from reaching the agreed target of 2 percent and faces an additional challenge in this regard. Rising tensions with Russia and China in the Arctic are testing North America and the Nordic states of Europe sooner than expected. Trump's threats toward Greenland, and thus against NATO ally Denmark, further emphasize that the U.S. expects Canada and European allies to take a more active role in curbing Russian and Chinese interests in the Arctic. According to recent statements by U.S. Vice President Vance at the Munich Security Conference, the U.S. is cautiously expressing the need for greater European responsibility.

However, this also presents an opportunity for closer cooperation within NATO between Canada and the Nordic countries. In December 2024, Canada presented a new Arctic strategy, including a dual-use expansion of Arctic infrastructure. The planned investments of \$1.5 billion are just a fraction of what is needed to acquire or build the missing deep-water port infrastructure, necessary icebreaker equipment, or pipeline infrastructure by 2035. These planned investments, however, are lacking in other areas of Canada's national budget. Canadian Defense Minister Bill Blair pointed out in Washington that the U.S.'s demand for more commitment from Canada came with the threat of boycotting U.S. products in Canada.

More significantly, voices in Canada are beginning to advocate for a coordinated, financial commitment from all NATO allies to the Arctic infrastructure expansion, considering both economic and security aspects. Canada may only be able to meet these infrastructure needs with the help of other nations. Moving away from percentage-based targets toward strategic necessities seems to be required.

What about the European Union and Canada?

The EU's almost muted reaction, expressing regret over the U.S. threats, contrasts with the growing realization that this situation requires a unified response among NATO allies.

The EU's relatively restrained reaction, in the form of expressing regret over the U.S. threats toward Canada, is noteworthy. However, the EU has clearly warned against similar measures against its trade partners, which, as is well known, have since come to pass. While the impression may be misleading, Canada has certainly noticed this slight hesitation from its European CETA trade partners. The EU is now preparing for a tough trade conflict with the U.S., starting with its own retaliatory tariffs. Once again, the focus is likely to be on goods trade, as in the steel dispute of 2018. However, the U.S. may feel the pain again from the consideration of imposing additional taxes on large digital platforms. Another consideration should be added. Canada does not need to be a member of the European Union to impressively demonstrate economic solidarity with the EU, especially towards the Trump administration. The

suggestion by former German Foreign Minister Sigmar Gabriel, also Chairman of the Atlantik-Brücke, for Canada to join the EU—drawing from an article previously published in *The Economist* in January 2025—may not be fully thought through, but a closer connection between the most European country in North America and the EU would provide a significant counterbalance to the current U.S. efforts under Donald Trump.

The U.S. is the EU's second-largest trading partner, with a trade volume of around \$580 billion in 2023. Canada, by comparison, accounted for just about \$61 billion, which could be significantly increased following the near-complete elimination of tariff barriers between the EU and Canada—especially in times of renewed tariff and trade wars instigated by the U.S. In this regard, the EU has a substantial bundle of countermeasures at its disposal, though they are likely to cause damage on both sides of the Atlantic. The laughing third party, once again, is the fastest-growing region in the world: the Indo-Pacific area. As is well known, the UK joined the free trade agreement with Pacific states at the end of 2024, and the U.S. government is signaling greater restraint and goodwill regarding the threatened tariffs, particularly toward the UK. The North Atlantic security and trade partnership must not be allowed to fragment any further. If that happens, President Trump will have achieved his goal.

A Perspective

In this time of a potentially impending global trade war, triggered by the United States, which remains

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Europe and Germany's most important trading partner, it may be strategically significant to deepen trade relations with Canada (and Mexico) and significantly revitalize economic cooperation with Canada. This could serve to form a counterbalance to the European Union, which does not always act in a fully united manner. While it is unlikely that this will lead to EU membership for Canada, the CETA agreement has been in practical use since 2017, even though it has yet to be ratified by all 27 EU countries. However, it has been in effect in Germany since January 2023.

Protectionism and trade wars have caused more harm than good. It would be desirable if this insight were to prevail on the part of the U.S. Upon closer analysis, the U.S. could demonstrate its true strength and, in doing so, be supported by its allies. The real dangers to the free democracies of the Western value alliance and to international free trade come from autocratic and dictatorial states. Therefore, the partnership with Canada is likely of great importance to Europe and Germany, especially now.