Policy Backgrounder

Proposed Section 338 Tariffs on Canada

Just a day after the trilateral meeting at the Final of the World Cup, the US imposed tariffs of 50% on certain Canadian goods under a provision of US law, Section 338 of the Tariff Act of 1930, that has never been used to impose tariffs. The tariffs would go into effect August 19; the parties have time to reach an agreement to avoid them. Canada said it will "intensify" discussions, though Canada may hesitate before giving the US an advantage even before formal negotiations on the USMCA agreement begin.

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- Section 338 permits tariffs of up to 50% for discrimination against US products or giving advantages to third countries that disfavor US commerce.
- The application to the three sectors concerned – motor vehicles, alcoholic beverages, and dairy – affects a relatively small part of bilateral trade. Each involves specific Canadian measures adopted in response to the US' imposition of tariffs on Canada in early 2025.
- The new tariffs would not exempt goods covered under the USMCA agreement, thus changing the business impact of that agreement significantly.
- The tariffs are clearly designed to pressure Canada, but removal of the provisions to which the US objects would only restore a situation in which other US tariffs persist, with Canada not implementing retaliatory measures.
- Litigation against the tariffs is likely. Whether or not the tariffs are ultimately imposed, the threat raises a significant new concern for businesses taking advantage of USMCA.

Section 338 of the Tariff Act

Section 338 of the Tariff Act of 1930 provides that the President may impose tariffs when, a country either imposes "any unreasonable charge, exaction, regulation, or limitation which is not equally enforced upon the like articles of every foreign country" or "[d]iscriminates" against US commerce "by law or administrative regulation or practice [including Customs and other types of regulations] as to place [US commerce] at a disadvantage compared with the commerce of any foreign country." It provides for a maximum tariff rate of 50% on the covered products or articles. A separate provision permits duties to be imposed to offset benefits to third countries.[1]

The provision has never been used to impose tariffs on a foreign country.[2] Now, the US is seeking to impose 50% tariffs on Canada under the provision, effective August 19, in three sectors – motor vehicles, alcoholic beverages, and dairy -- with a total economic impact of around $22 billion. In addition, the duties would apply to goods normally covered under the United States-Canada-Mexico (USMCA) agreement, a significant escalation in the use of tariffs. The tariffs will also cover some politically symbolic goods, notably hockey equipment.

In each of the three cases, the US is retaliating against Canada for actions of Canada (or its provinces) taken in *response* to new US tariffs imposed in 2025. In other words, it is an escalation of a previous trade dispute, and it now has greater significance given the Administration's decision to move to a system of annual reviews under USMCA.

In each case, the Administration has highlighted both grounds under the statute – discriminatory treatment against US products and benefits to foreign countries – presumably to make these new tariffs easier to defend in litigation. If courts find against the use of one provision of the statute, the Administration could then use the other. (Litigation could argue that the provision was effectively repealed by subsequent, more detailed US trade statutes in 1962 and 1974.)

While the approximately $22 billion of trade affected is a small portion of the overall trade relationship, and the new tariffs exclude important US imports such as potash and energy (which had been included in the original March 2025 US tariffs), the use of this provision in this way sends a significant signal as to the Administration's view on tariffs and on enforcing its "America First" tariff and trade agenda.

Motor vehicles

The first Proclamation concerns motor vehicles.[3] In April 2025, in response to the US imposition of steel and aluminum tariffs, Canada imposed a tariff rate quota on the number of vehicles, per automaker, that qualify for duty-free treatment under USMCA. The United States Surtax Order applies a 25% tariff on motor vehicles that do not qualify for duty-free treatment under USMCA. For vehicles that do qualify, Canada imposes a 25% tariff rate on the value of all components that do not originate in Mexico or Canada, up to 85% of the value of the vehicle. Canada also reduced the tariff rate quota for companies that moved production from Canada to the US. Since these provisions went into effect, imports of US motor vehicles to Canada have fallen 22% (to approximately $20.3 billion)

Alcoholic beverages

Canada has a federal system very different from the US; the provinces maintain a strong role in certain areas of economic policy that in the US would generally be subject to Federal regulation under the Commerce Clause with only limited roles for state regulation. Canada generally leaves regulation of alcoholic beverages to provincial jurisdiction; many provinces have a provincial alcohol monopoly or control board regulating sales.

In March 2025, all Canadian provinces and territories stopped the formal sale or retailing of US alcoholic beverages in response to new US tariffs – which included Canadian whisky -- and repeated desires to make Canada "the 51st state."[4] (Alberta and Saskatchewan later removed the bans.) The Proclamation on alcoholic beverages[5] highlights that sales of US alcohol in Canada have fallen by 81% to $137 million, while imports from other countries have increased, with increases in exports to Canada from other countries rising by $170 million.

But these provisions, imposed by the provinces, can only be removed by the provinces. So far, Québec has resisted requests to lift the ban, for instance on California wines.[6] While the provinces may act separately, as Alberta and Saskatchewan did, it also seems likely that most provinces may choose to continue to act together in this area to support the Canadian federal government in its overall trade negotiations with the US.

Dairy

The legal situation with respect to dairy as described in the third Proclamation[7] is slightly more complicated. Canada has a tariff rate quota system for dairy products with both the US (under USMCA) and with the European Union (under the Canada-EU Comprehensive Economic and Trade Agreement). Tariffs apply on covered goods imported in quantities above the quotas. But the Administration argues that because the eligibility criteria are different for the US and the EU, this disfavors US commerce. However, this Proclamation does not offer figures for changes in trade but simply states "[t]his discrimination impedes market access into Canada and results in lost sales or revenues for U.S. dairy products and exporters, among other things." Canada exported only about $278 million of dairy products to the US in 2025.[8] But the US is seeking vastly expanded access to the Canadian market for dairy, which could hurt Canadian producers – a very different situation from managed trade in dairy under the current USMCA.

This imprecise language may also be more vulnerable to a court challenge. Dairy is a politically sensitive issue in both countries, particularly for the US in Wisconsin and some other states, which is why the USMCA imposed a tariff-rate quota system rather than simply opening up the market without tariffs. More broadly, differing provisions in trade agreements for different countries are common. To declare in essence that they presumptively disadvantage US commerce unless the US has the best deal of any country, while consistent with the permission that Section 338 gives, calls into question other provisions of free trade agreements (FTAs).

Analysis – and Relationship to USMCA

The Administration justified the imposition of these novel Section 338 tariffs by stating that "[w]hile the Administration continues to secure fair and reciprocal trade deals with our trading partners, Canada, unlike other partners and allies, continues to retaliate against the United States for its efforts to rebalance trade and protect U.S. industry in national-security sensitive sectors."[9]

Leaving aside whether at least two of those sectors are truly "national-security sensitive" – the US can easily scale up production of alcoholic beverages and dairy is already subject to a quota system -- it is worth considering the broader importance of the move. What the Administration terms "retaliation," other countries may view as simply trying to obtain a fair deal with the US and a response to the US' first having raised tariffs. Otherwise, the pattern can recur of concession, followed by concession, followed by concession while the US gives up little if anything. (China and Canada were the only countries to have taken retaliatory measures against the US in response to the Liberation Day and fentanyl-related tariffs, which the Supreme Court later invalidated in *Learning Resources v. Trump*.

Viewed from this perspective, the trade negotiations are a way to ensure the US always has an advantage and to bring production of goods to the US. But the US should not then be surprised if other countries resist and seek trade diversification. The US Trade Representative's statement implies that Canada is being punished for defending its own interests through retaliatory measures in response to the US raising tariffs on its goods – a point USTR reinforced in commending Mexico for a "pragmatic" approach to the negotiations and for not having taken retaliatory action in response to new US tariffs.[10]

More broadly, the tariffs sharply escalate trade tensions – and potentially, actual tariffs – by their application to goods covered under USMCA. As with the imposition of "Liberation Day" and global tariffs on countries with which the US has a free trade agreement (FTA), the imposition of these tariffs does not end the agreement legally – but it does call into question some continued benefits of the FTA for both US and foreign businesses.

All three sectors covered by these tariffs are in some way subject to USMCA. As such, the new tariffs may be seen as an opening salvo in negotiations with Canada on USMCA under the switch to annual reviews announced July 1. And while the annual reviews themselves do not threaten USMCA, which by its terms continues until 2036, by raising tariffs on USMCA goods the Administration threatens to change USMCA and the business proposition under which North American businesses have benefited from it to develop continental markets and supply chains, fundamentally by raising the costs of doing business.

The Administration would respond that Canada can simply repeal the provisions of which the Administration complains (though in one area, that would require provincial as well as federal action), and the tariffs might not be imposed. But that simply restores the status quo of 2025 which prompted Canadian responses in the first place – unilateral US imposition of new tariffs.

From the US perspective, this gives an upper hand in negotiations; from the Canadian perspective, the situation is more complex. First, it simply reinforces that the US' negotiating pattern is to demand concessions up front before any negotiations begin, using the threat or the reality of higher tariffs so the US always has leverage. Second, as USTR's statement notes, the point of US trade policy is to "rebalance" trade – principally, trade in manufactured goods – rather than to use more open trade to permit businesses to find mutually beneficial ways of trade, including more integrated North American supply chains. This makes renegotiation of USMCA more difficult even without the imposition of new tariffs.

And there are questions as to whether Canada would agree if the result is simply to leave, for instance, US 50% tariffs on steel and aluminum in place (for which Canada imposed counter-tariffs of 25% on US steel and aluminum), particularly when Canada has a cost advantage in production? This scenario likely pushes Canada towards seeking broad, general negotiations on trade and USMCA rather than sector by sector negotiations in which the US seeks to gain an advantage in each sectoral negotiation rather than a broad agreement to resolve trade concerns (such as the US is reportedly seeking with China).

Canada would also point out that it tried unilateral concessions once – and received nothing in return. Canada unilaterally abandoned its Digital Services Tax at US request, and offered to drop retaliatory tariffs last year, but after resuming negotiations with Canada, the US unilaterally ended the negotiations last October. While Canada and the US have agreed to "intensify" trade negotiations, all this raises the stakes for Canada but likely pushes Canada in the direction of seeking further trade diversification. Its economic relationship with the US remains paramount, but Canada cannot simply concede on every point nor always leave the US with an advantage. Indeed, Canada stated that it "will do all that is necessary to support our jobs, our workers, our farmers and to make Canada stronger, more independent and more resilient.[11]

A new tool?

Given that Section 338 of the Tariff Act of 1930 has been on the statute book for nearly a century without being used, it is likely that there would be litigation against these tariffs brought by US importers of Canadian goods if the tariffs are actually imposed in August. Further, it is hard to see the tactic being used against China. That would threaten the one-year trade truce that the US and China negotiated last October, to which China would likely retaliate with other measures, such as bans on the export of certain critical minerals.

For business, this new threat of very high tariffs – far higher than the proposed "Liberation Day" and fentanyl-related tariffs – on the US' second-largest trading partner raises significant concerns not only on the future negotiations under the USMCA annual review but also on other trade negotiations likely to take place this summer, particularly with the EU. Whether or not these new tariffs are actually imposed, and whether or not courts ultimately find them lawful, the unveiling of a new weapon in trade wars raises uncertainty for US businesses, both importers and exporters, and perhaps particularly for those industries which are both importers and exporters of goods under a remarkably successful three-decade growth in North American trade.

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Endnotes

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