Policy Backgrounder

US-Canada Trade War

While an agreement to avoid 50% US tariffs on certain Canadian goods seemed within reach, last-minute demands from the US made the deal impossible for Canada to accept. This Backgrounder examines the prospect for further tariffs, negotiations, and the implications for USMCA.

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- The Section 338 tariffs, which have never been used, permit tariffs of up to 50% for discrimination against US products or giving advantages to third countries that disfavor US commerce. They went into effect on August 22.
- Their application to the three sectors concerned – motor vehicles, alcoholic beverages, and dairy – affects a relatively small part (about $20 billion) of bilateral trade. Each involves specific measures adopted in response to the US' imposition of tariffs on Canada in early 2025. They do not exempt goods covered under USMCA, magnifying the business impact.
- Canada imposed "dollar-for-dollar" retaliatory tariffs on a range of US goods, to take effect September 8. In reaction to this announcement, the Administration threatened tariffs of 50% on Canadian autos, auto parts, and steel beginning on January 1.
- Litigation against the tariffs is likely. The timing here also leaves room for negotiation, but the fundamental questions remain whether a deal can be reached that meets the minimum goals of both sides and when the two countries will begin actual negotiations on USMCA renewal; negotiations have been taking place between the US and Mexico for several months.

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 had never been used to impose tariffs on a foreign country[2] before August 22 when the Administration imposed 50% tariffs on Canada under the provision in three sectors – motor vehicles, alcoholic beverages, and dairy -- with a total economic impact of around $20 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 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 (and 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.

Close but no deal

On August 18, the two sides appeared to be close enough to a deal that the US delayed the imposition of tariffs for three days. During that time, however, the US reportedly added several last-minute conditions which were unacceptable to Canada. Beyond the three sectors in the tariffs, the US also reportedly sought to add provisions that would have restricted Canada’s ability to negotiate trade agreements with other jurisdictions (such as the European Union or Japan) and provisions regarding politically sensitive areas such as Canadian content provisions in broadcasting and bilingualism, including French-language labels on consumer goods[3] – issues that had been addressed to both sides’ satisfaction in the original USMCA in 2020.[4]

As a result, Canada stated that last-minute requests from the US made the deal unacceptable to Canada as the US “asked too much and offered too little.”[5] In response, Canada announced “dollar for dollar” counter-tariffs raising tariffs on US steel and aluminum products to 50% as well as tariffs on milk, furniture, clothing and apparel, video-game consoles, smartphones, and other electronics.[6] The US then responded with raising existing tariffs on steel, aluminum, autos, and auto parts to 50% effective January 1.[7] Other Canadian officials, notably Ontario’s Premier, have raised the possibility of retaliation affecting other export sectors to the US, including energy and critical minerals including nickel and uranium.

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."[8]

Support in Canada for a tough line in the negotiations has been strong, but there are also clear concerns that the tariffs will cause significant impact, particularly for small- and medium-sized businesses.[9] These tariffs – and the threat of further tariffs – will have a particularly significant impact on the binational auto industry, developed over 60 years and more deeply integrated in subsequent decades through later trade agreements.

The reported addition of other subjects in the last-minute negotiations raises a further question: what is the US attitude towards negotiations for renewal of USMCA? Negotiations with Mexico have been conducted since March, while none with Canada have yet begun. From one perspective, an agreement to remove the Canadian retaliatory tariffs from 2025 (and presumably the US tariffs which provoked them) before negotiations formally begin on USMCA renewal would clear the slate and permit negotiations to begin.

From another perspective, the inclusion of further demands, particularly in politically sensitive sectors that do not relate to the original 2025 tariffs, could signal a far harder line by the US in USMCA renewal, perhaps hoping that concerns over the impact of the tariffs in Canada could force concessions in these areas now even before formal negotiations begin, with the prospect of requests for further concessions later. In the worst case scenario, this could lead to separate US bilateral agreements with each of Mexico rather than a formal new trilateral agreement – which in any case would be subject to annual reviews going forward. It is too early to predict that as an outcome – in fact, the US taking French-language provisions off the table[10] is a positive signal for a potential agreement before September 8 – but it remains a possibility, however remote.

More immediately, there is the possibility of litigation against the tariffs, though this faces uncertain prospects --- and would take time.

Challenges ahead

For businesses on both sides of the border, these new very high Section 338 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 over the next few months.

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. USTR's original statement imposing the Section 338 tariffs stated that the point of US trade policy is to "rebalance" trade, particularly trade in manufactured goods, rather than to use more open trade to permit businesses to find mutually beneficial trade patterns, including more integrated North American supply chains.

Canada's goal seems to be to seek more general negotiations on trade and USMCA rather than sectoral negotiations in which the US may have an advantage. All this points to challenging negotiations on renewal of USMCA, perhaps particularly for industries which are both importers and exporters of goods under a remarkably successful three-decade growth in North American trade.

About the Authors

David Young, President, The CEO Center, The Conference Board

John Gardner, Head of Public Policy & Research, The CEO Center, The Conference Board

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Endnotes

[1] https://www.law.cornell.edu/uscode/text/19/1338
[2] https://www.congress.gov/crs-product/R48435
[3] https://www.cbc.ca/news/canada/montreal/u-s-encroaching-canadian-sovereignty-tariff-negotiations-frechette-9.7317055
[4] https://www.theglobeandmail.com/world/article-us-canada-trade-tariffs-trump-mark-carney-august-23/
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[10] https://www.ctvnews.ca/world/trumps-tariffs/article/lake-ontario-thats-gone-trump-says-us-takes-canadian-culture-off-tab