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The Effect of Trump Tariffs on Mexico and Canada

Lisandra Flach and Andreas Baur

KEY MESSAGES

- US President Donald Trump has recently announced 25% tariffs on US imports from Canada and Mexico. A simulation analysis using a quantitative framework shows that Trump's tariffs would hit the manufacturing sector of the US's North American neighbors particularly hard.
- In the event that Mexico and Canada impose symmetric retaliatory tariffs, all sectors of the economy (services, agriculture, and manufacturing) would incur permanent value-added losses.
- In Mexico and Canada, manufacturing has the largest decline in value added, 13% and 14%, respectively.
- For the US economy, agriculture has the largest decline in value added (-2.39%), but other sectors of the economy also incur permanent losses.
- In the event of retaliation, Canada would have to expect a long-term permanent decline in total exports of up to 28%, while Mexico could see a drop of more than 35% and the US of 22%.

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The Effect of Trump Tariffs on Mexico and Canada

Lisandra Flach and Andreas Baur[*]

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US President Donald Trump has recently announced that tariffs on US imports from Canada and Mexico will take effect on March 4, 2025. This policy brief shows that the US tariffs would have a large impact on the North American neighbors. In the event of retaliation, all sectors of the economy (services, agriculture, and industry) in the three directly affected countries, including the US economy, would experience value-added losses. Moreover, in terms of trade flows, Canada would have to expect a long-term permanent decline in total exports of up to **28%**, while Mexico could see a drop of more than **35%** and the US of **22%**. The close ties with the US due to their geographical location and the sectoral structure of their bilateral trade flows make it harder for Mexico and Canada to divert trade flows to other trade partners. Now more than ever, they should act to diversify their trade relations.

Trade Model and Scenarios

We employ the ifo Trade Model, which is a quantitative trade model based on Caliendo and Parro (2015).[1] International linkages are captured through input-output relationships, with the model incorporating both tariff and non-tariff trade barriers. The model covers 141 countries and 65 economic sectors, accounting for over 90% of global value added. It is parameterized through econometric estimations resulting from theoretical equilibrium conditions, allowing us to simulate general equilibrium effects of various trade policy scenarios.

The ifo Trade Model is able to identify the long-term level effects of such tariff increases. This provides insights into the potential response of trade flows, trade volumes,

* Lisandra Flach, ifo Center for International Economics, Munich (flach@ifo.de).
Andreas Baur, ifo Center for International Economics, Munich (baur@ifo.de).

[1] Caliendo and Parro (2015) develop a multi-sector version of the Ricardian trade model by Eaton and Kortum (2002) with input-output linkages.

sectoral value added as well as real gross domestic product and gross household income effects.[2] The analysis with a general equilibrium model includes not only direct exports, but also trade along the value chain as well as possible trade diversion effects to other target markets in response to higher US tariffs. In this way, it offers a comprehensive picture of a new global economic equilibrium.

We simulate two scenarios:

- **First Scenario:** A 25% tariff is imposed on Mexican and Canadian products. Energy-related sectors are exempt and only face a 10% tariff. Chinese products are subject to a 10% tariff.
- **Second Scenario ("Dollar-for-Dollar Scenario"):** This scenario assumes that Mexico, Canada, and China respond with symmetric retaliatory measures.

Trade Effects: Large Decrease in Total Exports from the US, Canada, and Mexico

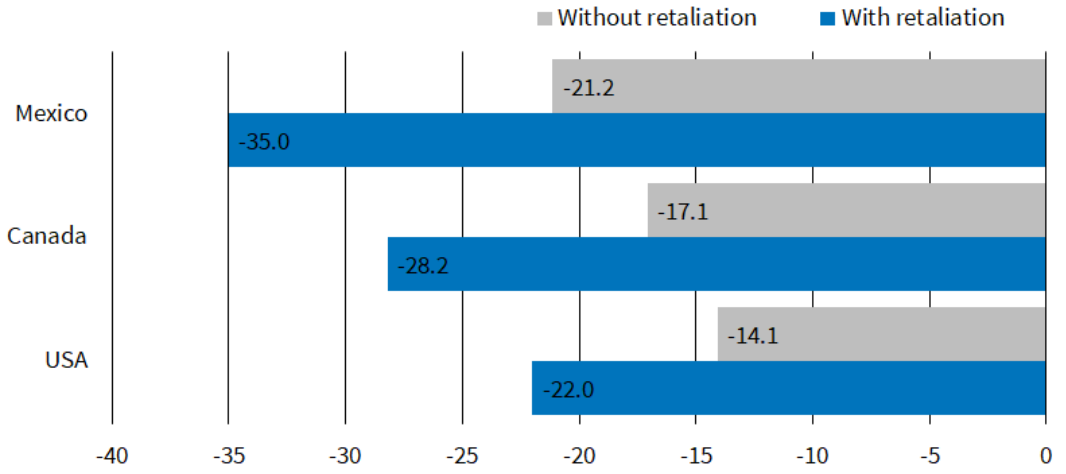
In both simulated scenarios, all three directly involved countries observe a decrease in total exports. As a result of the US tariffs, Canada would have to expect a long-term permanent decline in total exports of up to **17%**, while Mexico could see a drop of more than **21%** and the US of **14%**. These numbers are much higher should Canada and Mexico respond with **symmetric retaliatory tariffs**, which reflects the high integration of the three countries in supply chains. In this case, total exports from the US would decrease by **22%**, whereas exports from Canada and Mexico would decrease by **28%** and **35%**, respectively.

[2] The quantification can be carried out at a disaggregated level and makes it possible to derive trade and output effects for 65 sectors. The ifo Trade Model covers more than 120 countries and 65 economic sectors. It covers more than 90% of global value added. All data required for the simulation (e.g., international value-added linkages) comes from the global input-output database, GTAP 10. As the model accurately represents global value chains and country-specific parameters at the sectoral level (e.g., sectoral productivity), the adjustments caused by a tariff increase can be appropriately approximated. The technical details of this model are described in several studies by the ifo Institute (see e.g., Aichele et al. 2016; Baur et al. 2025).

Figure 1

Total Exports

Change in %



Source: ifo trade model. © ifo Institute

Effects on Value Added: Manufacturing Industry in Canada and Mexico Most Severely Hit

The 25% US tariffs on goods imported from Canada and Mexico will primarily impact the manufacturing sectors of these countries. The Canadian and Mexican industries, which are highly integrated with the US economy through cross-border value chains, would face a drastic decline in value added in the medium term – up to 14% for Canada and 13% for Mexico.

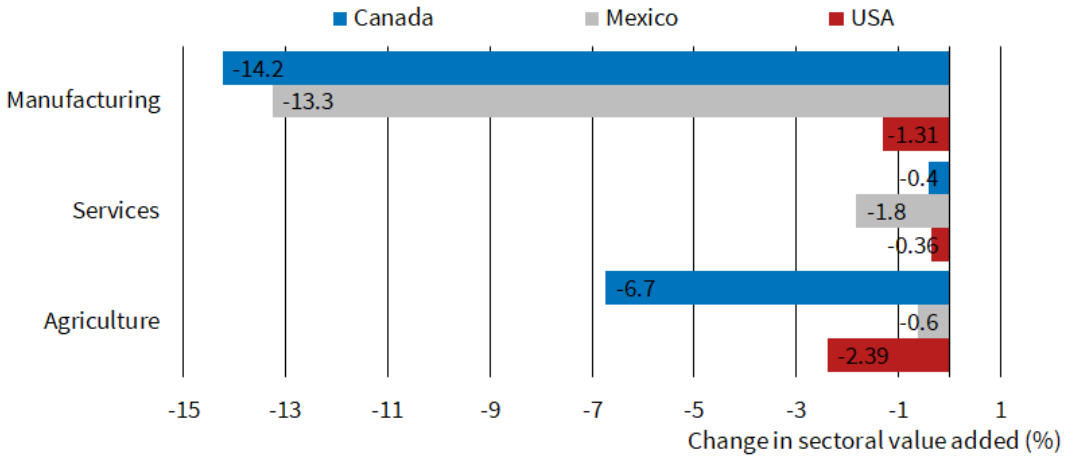
The biggest losers in Canada also include agriculture and mining, with expected value-added losses of 6.7% in the medium term.

In the event that Mexico and Canada retaliate and impose symmetric tariffs, retaliatory tariffs on industrial products would significantly increase Mexico's losses but have little impact on the industrial value added in Canada. However, in Canada, retaliatory measures would lead to even greater losses in agriculture and mining.

Figure 2

Sectoral Value Added

Scenario with Retaliation



Source: Own calculations.

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