

**Canada's Policy Options Response to the 2025 U.S. Tariffs: Through the Lens of Rational
Choice Theory and Historical Institutionalism Theory**

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Abstract

In 2025, the United States imposed new tariffs on Canadian imported products, which raised concerns about how the new tariffs would impact the economy of Canada and trade relationships between Canada and USA. This paper looks at the policy options that Canada should take through the lens of two main theories: Rational Choice Theory and Historical Institutionalism. According to Rational Choice Theory, Canada's response is based on logical decision-making, where the government calculated the economic benefits and risks of different actions, by finding new trade partners or imposing tariffs on U.S. products to protect Canadian industries. Historical Institutionalism, on the other hand, focuses on the impact of long-standing trade agreements and institutions, suggesting that Canada's response is influenced by past cooperation and established political structures. By using these theories, the paper explores how Canada will deal with the 2025 U.S. tariffs, considering both economic decisions and historical factors. This research offers insight into how economic choices and historical institutions work together to shape international trade policies.

Key words: *U.S. Tariffs, Canada-U.S. Trade Relations, Trade Policy, NAFTA & USMCA, International Trade, Economic Impact of Tariffs, Trade Protectionism, Canadian Economy, Economic Decision-Making, Government Policy.*

Introduction

In 2025, the United States decided to put new tariffs on imported products coming from Canada. This action was part of bigger efforts to protect American businesses. The U.S. government said it wanted to help local industries and balance the trade deficit. Another reason

was that the United States wanted Canada to better control its borders and stop drug smugglers from bringing illegal drugs into America. Many people in Canada worried that these new tariffs would hurt their economy and make the trade relationship with the United States bad, especially since US President Trump declared his intention to annex Canada to the US.

Canada and the United States have a long history of strong trade and cooperation, especially after they signed NAFTA. Canada and the United States share the longest border in the world, the two countries exchange everyday goods and services over \$2 billion, and thousands of people cross the border from both sides to conduct business or enjoy and tourism. In 2022, the U.S. was the largest trade partner for Canada, the amount of trade reached \$960.9 billion, which represents 63% of Canada's total trade. One-third of Canadian exports to the U.S. were oil and energy products, and around 20% of imports from the U.S. were cars and car parts. U.S. investments in Canada were \$500.7 billion in 2021, which is around half of total foreign investments in Canada. Canada's investments in the U.S. were also high around \$744.9 billion. In 2022, the number of visitors to Canada from US was 14 million U.S. About 66% of Canadians live within 100 kilometers of the U.S. border, which shows the close connection between both countries (Statistics Canada, 2023). But these new tariffs bring tension and many Canadians start to think about how safe and strong their economic relationship is, for example, many Canadian consumers start to prefer Canadian products even in grocery stores.

Since this paper will explore the best theoretical framework that explains Canada's response to the 2025 U.S. tariffs. Therefore, the research question is: What is the best theoretical framework that explains the Canadian response to the 2025 U.S. tariffs?

Rational choice theory has its origins in modern microeconomics, welfare economics, and game theory. More importantly, rational choice theory represents the gradual colonization

and conquest of political science by the self-proclaimed queen of the social sciences, economics. Better yet, rational choice theory is the economic transformation of political science—an economic theory of politics (Sutton, 2001, p.7). Rational choice theory interprets the world as a strategic space of the maximization of individual interests (Krstic, et al., 2015, p.3). In case of Canada's response to the 2025 U.S. tariffs, Rational Choice Theory would focus on how Canadian decision-makers choose based on their individual and national interests. Rational choice theory also models agents as choosing, from this feasible menu of options, those options which are most choice-worthy (Kogelmann, 2018, p.3222)? This theory would suggest that Canada's response is driven by calculations of the economic benefits and risks of various actions, considering factors like trade relations, economic security, and strategic interests in the face of the tariffs.

Historical Institutionalism looks at how institutions and history influence decisions. Historical institutionalism's claim that policies tend to follow the path set at their creation (Lasan, 2012, p. 76). This theory says that Canada's response to the 2025 U.S. tariffs can be understood by looking at the long history of trade between Canada and the U.S., the role of agreements like NAFTA and USMCA, and how the Canadian federal government makes decisions. This theory suggests that Canada's response might be influenced by past experiences and regular patterns of trade cooperation with the U.S. But Canada could also change its response because of new situations or changes in the international environment. The main challenge for historical institutionalism is to explain the shifts in this policy that occurred (Lasan, 2012, p. 77).

Literature Review and Theoretical Frameworks

Rational Choice Theory

According to Rational Choice Theory, individuals are logical in making decisions that get the best possible outcome. Individuals are seen as active decision-makers, not just influenced by outside forces. They choose what benefits them and achieve their goals, whether in business, politics, or personal life. Rational choice theory, assumes individuals are rational and that they choose and deliberate in seeking to maximize their ends; individuals are not acted upon, they act. The success of rational choice theory has made, therefore, deliberation and choice, once again, suitable objects of study for political scientists (Sutton, 2001, p.8). The theory assumes that people choose the best option by using all available information.

However, Rational Choice Theory also assumes that individuals have all the information they need to make the right choice. In reality, people often don't have enough information, or the information they have is unclear or not trustworthy. The choice of alternative is determined by the amount of the collected information. For the model of rational choice, it is assumed that the actors have the optimum amount of information. However, real people do not have all the necessary information, or the information is insufficiently precise and/or unreliable (Krstic et al., 2015, p.3).

This makes it harder for individuals to apply the theory perfectly. For example, when Canadians are responding to the 2025 U.S. tariffs, consumers might not have full information about the effects of the tariffs, which affects their decision-making. Rational Choice Theory also says that there are basic rules, or axioms, that guide how consumers make decisions. But these rules can sometimes be unrealistic or too simple in real life. On the other hand, the government has many sources of information, like Statistics Canada, the Ministry of Finance, and other

government agencies. These sources give useful data that helps the government to make rational decisions based on facts and calculations. Kogelmann (2018, p.3222) answered that what the individual should choose, certain canonical axioms of rational choice theory become implausible as standards of rationality. In other ways of answering these questions, certain canonical axioms of rational choice theory become trivial in the sense that they cannot be violated. And finally, how we answer these questions determines the sorts of things we can use rational choice theory to do. This means that the theory needs to adapt to situations where people don't have enough information or time to make the best decisions. In the case of the Canadian government, even if there is some uncertainty about the effect of U.S. tariffs, the government can still use data from different sources to reduce these uncertainties and make good decisions.

In rational choice theory, the market will form a negatively sloped demand curve (Krstic et al., 2015, p.4). Which means in economics, Rational Choice Theory explains that as prices go down, the demand for goods goes up, and vice versa, shown by a negatively sloped demand curve. This idea can also apply to trade relationships. For instance, when a country faces tariffs, its leaders may choose to retaliate or negotiate to protect their economic interests. In the case of Canada and the 2025 U.S. tariffs, Rational Choice Theory can help explain how Canada might respond, aiming to minimize the negative effects while maximizing benefits.

Therefore, Rational Choice Theory helps explain decision-making by assuming the government and individuals choose options that benefit them the most. However, it needs to adjust for situations where information is incomplete or unclear. By making these adjustments, Rational Choice Theory can help understand how Canada might respond to the U.S. tariffs in 2025.

Application of Rational Choice Theory in Policy Decision-Making

Rational Choice Theory says that Canadian leaders will make decisions by looking at all options and choosing the one that gives the best result. They will act rationally, trying to protect Canada's economy and trade. They will use information from Statistics Canada, the Ministry of Finance, and other government offices to help them make decisions based on facts and numbers.

The government has good access to information, so it can make decisions that are more logical and based on calculation. When facing the 2025 U.S. tariffs, Canadian leaders would study the possible actions, think about what each action will cost and what it will give, and choose the one that helps Canada the most, like protecting exports by looking for new trade partners there are many partners are also facing same situations with the US, such as Europ and China, signing new trade agreements with Europe and China will maintain the same export levels and helps the Canadian government in saving jobs and prevent drastic increase in unemployment rate, on the other hand Canada must impose tariffs on imported goods from the U.S. to get enough funds to subsidize the effected industries by the U.S. new tariffs, and shift the Canadian demand from made in USA products to Canadian products. On the other hand, the Canadian government must be keen to keep a good relationship with its southern neighbor, the U.S. and try to end the trade war by boosting diplomatic efforts and replace keep federal employees with one who can keep the discussions with the USA federal government to end the trade war and go back to the previous trade agreement, in addition to protecting the southern border by displaying scanners and investing in training and tools and intelligence to protect USA from drug smugglers. In this way, Rational Choice Theory shows that Canada's response is not emotional or only based on past habits, but it is the result of careful thinking and logical planning.

Historical Institutionalism

Historical Institutionalism uses two ways of thinking: the “calculus approach” and the “cultural approach”. The calculus approach focuses on individuals acting in strategic way, while the cultural approach shows that actors are also guided by traditions, habits, and shared beliefs. According to historical institutionalism, actors’ behaviour is largely determined by institutions influencing their choices as well as their worldviews and interpretations. In expanding on this view, historical institutionalism uses a combination of the so-called “calculus approach” and “cultural approach” (Vijge, 2013, p.157).

Institutions in Historical Institutionalism are defined as the social systems that create the build the society's behaviour and organize social order, and unify the collective expectations that people follow, these are not only rules and laws but also the ways and routines that society organizes behavior and interactions. Historical institutionalism defines institutions as the social regimes that provide the “building blocks of social order” and “collectively enforced expectations” (Gillespie, 2024, p.150).

Historical Institutionalism is used in many areas like political governance, urban planning, and economic development, which shows that Historical Institutionalism is a flexible approach that can explain different types of changes and decisions in society. Historical institutionalism has been deployed in a wide range of disciplines, including political governance, urban planning, and economic development (Gillespie, 2024, p.151).

Historical Institutionalism has three main features. First, it looks at the relationship between institutions and individual behavior in a very broad way. It means institutions not only give rules but also shape people’s goals and thinking. Second, Historical Institutionalism gives an important place to power and the unequal relations between individuals and groups. Some

groups have more power than others, and this shapes decisions inside institutions. Third, and most importantly, it sees history as key to understanding present decisions. This is called the path-dependence perspective. According to Lasan (2012), once a path is taken, it becomes difficult to change direction, because institutions create habits, rules, and expectations that are hard to break. For a better understanding of the main concepts employed by historical institutionalists, an analysis of the main features of historical institutionalism as defined by Hall and Taylor will follow. The first characteristic of historical institutionalism is its tendency to conceptualize the relationship between institutions and individual behaviour in rather broad terms. The second feature of historical institutionalism is the prominent role given in such analyses to power and asymmetrical relations. The third and probably the most important feature that characterizes historical institutionalism is its distinctive perspective on historical development, the so-called path-dependence perspective (p.78).

Moreover, only individuals who work inside the institutions can make changes. Outside forces are not enough. It is the people inside who know the rules and have the power to change things. Because of this, Historical Institutionalism must explain how these individuals act and how they can make changes while still following the limits of the institution. Only agents operating within institutions can produce change, and historical institutionalism should have accounts of how agents act within institutions (Bell, 2011, p.896).

Application of Historical Institutionalism in Policy Decision-Making

Historical Institutionalism helps explain how governments make decisions by looking at how past actions and old institutions shape today's choices. In this view, governments do not make new decisions freely every time. Their choices are strongly influenced by rules, traditions, and structures that were created over many years. When a government faces a new problem, like

the 2025 U.S. tariffs, Historical Institutionalism says that Canada's answer will be shaped by its long experience working with the United States. Agreements like NAFTA and USMCA, and the way Canadian institutions like the federal government, the Ministry of Finance, and the Ministry of Foreign Affairs in Canada are organized, will guide how leaders to actively seeking new trade agreements with countries like Europe and China to compensate for potential losses in the U.S. market and maintain export levels. Nevertheless, Historical Institutionalism uses two ways of thinking: the "calculus approach" and the "cultural approach." The calculus approach focuses on individuals acting strategically, while the cultural approach shows that actors are guided by traditions, habits, and shared beliefs. Canada's decision to find new export markets fits this view because it is not only a smart strategy that will overcome the trade deficit that will occur due to the decline in exports due to the US tariffs, but also shaped by the long tradition of protecting national economic interests.

Institutions in Historical Institutionalism are the social systems that shape society's behavior and organize social order. They unify the collective expectations people follow. These institutions are not only formal rules and laws, but also the traditions and routines that shape daily life. By imposing tariffs on goods imported from the U.S. to generate revenue for subsidizing Canadian industries negatively affected by the U.S. tariffs. And set guidelines for the society to follow, so Canadian firms won't import U.S. products, and Canadian consumers won't buy U.S. products, and this will increase the demand on Canadian products which will help in reducing the trade deficit.

Historical Institutionalism is very flexible and is used in many areas like political governance, urban planning, and economic development. Canada's decision to impose counter-

tariffs on U.S. goods shows this flexibility and enables the government to develop the economy by subsidizing the affected suppliers.

Historical Institutionalism looks at the relationship between institutions and individual behavior in a very broad way. Institutions not only give rules but also shape people's goals and ways of thinking. Canada's policy to shift consumer demand from U.S. products to Canadian ones shows how institutions can influence public behavior by shaping economic habits and national identity.

Historical Institutionalism highlights the importance of power and unequal relations between groups. Some groups have more influence inside institutions, and this shapes decisions. Canada's strong focus on diplomacy shows that powerful groups in government, like embassies in the USA, Europe, and China, and trade institutions like Canadian corporations and foreign corporations that operate in Canada, are pushing for peaceful solutions that protect Canada's interests and aim for a return to previous trade agreements. In addition to establishing new ones with other countries in Europe and Asia.

Historical Institutionalism sees history as very important to understand today's decisions. This is called the path-dependence perspective. Canada's will follow the same path-dependence perspective by deciding to keep working diplomatically with the U.S., following a long history of handling disputes through negotiations and partnerships instead of major confrontations.

Moreover, Historical Institutionalism says that only individuals working inside institutions can make real change. Investing in border security measures, such as scanners, training, tools, and intelligence, to address U.S. concerns regarding drug trafficking and potentially improve bilateral relations, Canada won't achieve any change if the key person doesn't take the initiative to make the change. Outside forces are not enough; the Canadian

government and corporate personnel must approach European and Asian countries and corporations to increase Canadian exports. It is the people inside who know the rules and traditions, who can push for changes.

Even if the Canadian government's actions seem new and smart, Historical Institutionalism explains that these choices are still shaped by old paths, traditions, and power structures inside institutions. Canada's answer to the 2025 U.S. tariffs is not just a fresh plan but also a continuation of long-established ways of making decisions.

Canada's Response to the 2025 U.S. Tariffs

Overview of U.S. Tariffs

The U.S. first put tariffs of 25% on Canadian goods (not including energy) and 10% on Canadian energy products.

The manufacturing industry in Canada is affected by the U.S.'s new tariffs. The U.S. wants to lower its trade deficit, which makes it harder for Canadian manufacturers. Canada may need to find new markets or change trade deals that affect imports and exports.

Canada's labor market can be affected by the U.S.'s new tariffs. The new tariffs will reduce trade, and some industries in Canada, like manufacturing, tourism, hospitality, and services, may have labor surpluses. Canadian producers may need to lay off workers, and the unemployment rate will increase.

Canada's export and logistics industries are directly impacted by the U.S.'s new tariffs. U.S. policies make it harder for Canada to sell products in the U.S. market.

While industries like information technology (IT) and real estate are not directly affected by U.S. trade rules, they can still feel the impact of changes in the economy. The tariffs increase

will raise the costs for Canadian companies in these sectors, affecting their growth and competition.

Canada's Countermeasures

The policy options to deal with the 2025 U.S. tariffs include:

Finding New Markets for Exports: Canada is trying to make new trade deals with countries like European and Asian countries like China to replace possible losses in the U.S. market and keep its exports steady.

Imposing Counter-Tariffs: Canada is placing tariffs on U.S. goods to raise money that will subsidize Canadian industries hurt by U.S. tariffs.

Shifting Domestic Demand: The government is encouraging Canadians to buy more products made in Canada instead of U.S. products by imposing tariffs on Canadian products to increase the distribution of Canadian production and maintain production outcome levels.

Focusing on Diplomacy: Canada should work harder to solve the trade problems with the U.S. by improving communication and trying to bring back old trade agreements. This could involve changing key people to help with talks. In addition, Canada should start negotiation with European and Asian Countries to sign new trade agreements.

Improving Border Security: Canada should invest in better security at the borders, like new scanners, training, and tools, to help with U.S. concerns about drug trafficking and possibly improve relations between the two countries.

Setting Goals and Time frames: Canada must set goals and time frames for each Government personnel and corporate personnel in their respective field of experience to achieve the above policy options.

These policy options aim to protect Canada's economy and find new ways to handle the effects of U.S. tariffs.

Conclusion

In this analysis, both Rational Choice Theory and Historical Institutionalism give valuable understanding about Canada's policy options to respond to the 2025 U.S. tariffs. From the Rational Choice Theory, Canada's decision-making looks like a strategic calculation of costs and benefits, where leaders in Canada choose the best way to protect their country's interests. By looking at different policy options like finding new trade partners, putting counter-tariffs, and focusing on diplomatic talks, Canada tries to reduce the damage to its economy while still keeping a good relationship with the U.S.

On the other hand, Historical Institutionalism shows how old institutions and past patterns affect Canada's response. This approach looks at how past trade agreements like NAFTA and USMCA, and the role of Canada's federal government institutions, affect the decisions. It also shows that Canada's response is not only based on short-term economic concerns but also on the country's history of balancing trade and protecting its economy.

The results for future Canada-U.S. trade are big. Even though the 2025 tariffs bring temporary problems, Canada's response shows its strength in finding new markets and using past diplomatic methods. The changes in trade between the two countries highlight the importance of keeping strong institutions that can handle economic challenges and create flexible strategies for international relations.

For policymakers, it is important to look at both the short-term and long-term effects of trade problems. Rational decisions, based on good data and clear goals, will still be very important. But understanding the past and how past trade agreements and institutions play a role

will help to make sure that future answers are flexible and based on Canada's strong trade history. In solving similar problems in the future, policymakers should focus on a balanced method that mixes rational economic plans, historical continuity, and working together internationally.

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