

# Can tariffs help drive the energy transition?



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Trade wars and tariff increases have long been used to influence foreign policy and protect the domestic economy, but how will they impact the pace of the energy transition? With governments increasingly reluctant to rely on foreign goods required to accelerate the energy transition, import duties could help increase domestic production and drive consumers to buy greener, homegrown products.

As the world moves toward net-zero emissions by 2050, a growing sentiment is that not every country is playing by the same rules. China, for instance, is now the leading player in electric vehicle (EV) production, selling 8.1 million EVs in 2023 – in response, an increasing number of regions have added stiff tariffs on Chinese EV imports.

In May 2024, the US announced it was increasing import duties on Chinese EVs to 102.5%, up from 27.5%. It will also raise tariffs on Chinese-made solar cells, steel and aluminum, among other goods. The EU has made a similar move and Canada is expected to follow suit once the Canadian International Trade Tribunal completes its anti-subsidy investigation.

There are several reasons why countries are increasing tariffs on Chinese products, but a primary factor is that they're developing cheap goods – cars, washing

machines or semiconductors – and making it difficult for local manufacturers to compete on price, especially in an inflationary environment. Critics of Chinese manufacturing point to labour practices and a carbon intensive grid that gives these manufacturers an unfair advantage over developed nations – especially important today when countries are looking for ways to reduce carbon emissions and manufacture products responsibly. At the same time, China is establishing itself as a leader in manufacturing the goods needed to decarbonize the economy. For example, in 2023, solar capacity commissioned in China matched that of the entire world in 2022. The country is now also leading in nuclear power generation.<sup>1</sup>

This level and pace of investment deepens the reliance of developed countries on China and makes it more difficult for them to compete in the broader energy system of the future.

As the energy transition progresses, a distinction arises to differentiate manufacturing practices. Currently, it is possible to manufacture “green” and “brown” versions of products like cement and steel. Where green products are created through more environmentally sustainable practices, their brown counterparts are less sustainable. The latter, however, are generally cheaper to produce.

## The hard sell

Convincing consumers to pay more for sustainably produced items will not be an easy sell, as it could drive inflation higher overall. For example, using “green” steel – produced using environmentally friendly energy sources, as opposed to fossil fuels – will cost 10% to 20% more than regular steel; when used to manufacture appliances or cars, this will raise prices. For Chinese-made products, the impact of tariffs, shipping and other costs will also increase the price tag on all sorts of items. Higher prices are experienced in both cases, but at least with the former, one is advancing climate goals and the energy transition.

### Green steel

The manufacturing process distinguishes “green” steel from its regular counterpart. Where standard production involves the use of coal, green steel instead opts for hydrogen. Manufacturers of the green variants of steel, cement and other commodities seek to phase out the use of fossil fuels in favour of renewable sources of energy.

If governments decide to go through the process of imposing a tariff and making goods and services very expensive for citizens, then it is imperative to communicate the consumer benefits. These goods can be promoted as superior, as they abide by the more stringent sustainability guidelines of the United States-Mexico-Canada Agreement.

## Investing with an eye to the future

While this evolution in product development and consumer behaviour may take time, there are reasons to be optimistic it will happen – an outlook that informs the Mackenzie Resource Team’s decision-making. Within the resource sector, which produces the most carbon emissions of any industry, the team owns a number of “progressive companies”. These are businesses that either produce and sell green commodities – those produced with more sustainable and environmentally friendly methods – or are on their way to greener operations.

However, these companies are not only producing commodities in a more sustainable way; they can expect to benefit from higher pricing. The team has picked companies where we expect potential pricing differentiation for being the “good guy” in their operating decisions. The steel producer has a choice: to perform better, produce green steel, ask US\$200 to US\$300 more per ton and accrue that premium in their selling price and margins.

China may produce many of the commodities needed for the transition today but, aside from rare earth elements, it is possible to get the materials needed closer to home. There are still places to manufacture at lower cost, such as Mexico. Lithium is an abundant material. So is copper. A new refinery can be built, if necessary. Nearly everything China can do, other countries can do – but they just can’t execute at that same price. Therein lies the challenge.

In this scenario, reducing long-term prices – and carbon emissions – will require a shift in consumer behaviour. Just as today’s rising prices cause people to think more carefully about their spending, consumers will also need to hang on to their goods for longer than they do now. For instance, instead of buying a car every five years, consumers may opt to buy one every 10 years. The same goes for home appliances and other durable items.

This is the only way that the budget will work and that you can bring CO<sub>2</sub> emissions down. Changing consumer behaviour will not be easy. These choices are difficult for people, given our history and culture with regards to consumption.

For these kinds of shifts to occur, governments and companies may need to reimagine how they define economic progress. GDP tends to be measured by quantity and less by price, but that may need to change.

At the same time, governments will need to create incentives to influence consumers to buy greener products, whether through carbon taxes or other economic actions that encourage holding on to products for longer.

When resource companies start to shift their focus in this way, an industry once thought of as declining can now forge a more profitable path. If production remains local and the businesses build new mills and expand their staff, consumers will see the benefits. Rather than existing in a state of terminal decline, the business is growing and taking the right actions for the environment and the energy transition.

The reality is that changing consumer behaviour and developing local manufacturing capabilities will take time. With tariffs increasing the price of imported goods, consumers can expect to be limited in their options, at least in the short-term. As a result, one can expect the pace of the energy transition to temporarily slow down as these factors unfold. In this ever-evolving landscape, the Mackenzie Resource Team continues to seek out companies that are best positioned to navigate the complexities of the transition.

1 China – World Energy Investment 2024 – Analysis – IEA)

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