

### 3 How should China respond to Trump policies?

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Trump policies towards China are still up in the air. Both markets and the Chinese government shouldn't underestimate what the Trump administration is going to implement, hence some well thought through responses should be prepared by China. It is critical, for China, for Sino-US relations, and also for the global economy.

Market focuses are still around a consensus reached, after 60 days Trump has been in office, that what Trump is going to do on China would impact the US more than China: (1) the Trump administration has already given up on Two-China policy talk in favour of the One-China policy, as it is not negotiable with China; (2) the Trump administration has not labelled China as a currency manipulator anymore, and the Yuan is appreciating in the direction it wants; (3) Trump's administration also hasn't come up with the 45% tariff on Chinese exported goods to the US, and the market has priced in a low probability it would happen, similarly as the majority thinking in the Chinese government. Are market participants wrong again, especially on point number three regarding bi-lateral trade negotiations? One thing we know is that the market didn't think this through, and it already brings risks for the future.

China should prepare proactively how to respond to Trump policies, and below are our suggestions.

#### China should take a leading role

The Trump administration wants to bring global trade from multilateral to bilateral, whereas we all know multilateral trade relationships generate positive sum games, but not bilateral. Even for bilateral Sino-US trade negotiations, China should take the moral high ground, even though the Trump administration is taking the moral low ground.

The market and the Chinese government should understand globalisation is only part of the reason for US job losses. US exports to China are mostly capital intensive, and US imports are labour intensive, hence the US has net job losses. And job loss shouldn't be the focus of trade for the Trump administration and all countries. The focus should be whether the welfare of the majority of the people has benefited. Clearly US consumers benefit greatly in Sino-US trade relations, with low cost consumer goods. There is no perfect international institution, but the WTO is still trying to bring every country to a level playing field. The rule of law that has been set up by the WTO should still be respected, and China should take a leading role here. It is clear the new rule of law regarding trade shouldn't be and can't be rewritten by the Trump administration.

#### China should set a wise negotiation strategy

China should clearly understand the nature of the Trump administration, and most importantly the president Donald Trump. How rational they are, and how long they would stick to their committed policies. The best practice for China would be whenever any negotiation takes place to allow longer time before responding. When China thinks through how to respond, there should be a risk analysis if Trump changes right after, as China shouldn't be over committed to the negotiations, otherwise China will lose out and suffer on the long term.

#### China should prepare for the worst-case scenario on trade negotiations

The widespread consensus is the US wouldn't levy a 45% tariff on China anytime soon if any. However, the current Trump administration claims they are hard negotiators. The markets and the Chinese government have guessed the Trump administration might start by levying an anti-dumping duty tax on Chinese industries. However, on the contrary, they have been talking recently

#### The essential

**We think, in responding to Trump policies, China should** 1) take a leading role; 2) set a wise negotiation strategy by responding slowly and factoring in policy-changing risks; 3) prepare for the worst-case scenario on trade negotiations and WTO is the appropriate organisation to exchange with; 4) levy an export tax rather than the US levy a border adjustment tax to collect the revenues itself; 5) offer what has been achieved as a gift to the Trump administration, such as China will not be a currency manipulator and will help with jobs.

“China should take a leading role”

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about the Chinese automobile industry. Chinese auto exports to the US are negligible: they have chosen the wrong industry, and they wouldn't gain from this negotiation.

However, they will be tough when negotiating on overcapacity sectors such as the Chinese steel industry. The best way China should handle this is to send the cases to the WTO. This is, on one hand, China taking a leading role by respecting the global rule of law, but also the WTO usually takes three to five years to deal with such cases. And we believe this is the best way to deal with the current Trump administration which wants results quickly.

**China might levy an export tax rather than the US levy a border adjustment tax**

As market participants, we know it is very likely the border adjustment tax wouldn't be passed by US Congress. However, every country including China should prepare how to respond. In our mind, the best way is for China might be to adopt an export tax, hence collecting the tax when the exported goods and services leave the Chinese border, rather than let the revenues go to the US through the US border adjustment tax.

**China should offer what has been achieved as a gift to the Trump administration**

It is important to know the nature of the Trump administration, since they are more than ever eager to achieve something, as they have already been in office for over 60 days and have achieved almost nothing with so far no bill being passed. The Xi/Trump meeting in April provides a good opportunity for China to make the Trump administration feel good.

In our view, the best gift China can give the Trump administration would be China continues not to be a currency manipulator. This is something China has achieved by keeping the currency stable and also appreciating given the weak dollar. China can also agree to provide more jobs to the US economic recovery, including both financing and building construction projects, if the US is willing for China to participate.

**Conclusion**

In our view, in responding to Trump policies: 1. China should take a leading role; 2. China should set a wise negotiation strategy by responding slowly and factoring in policy-changing risks; 3. China should prepare for the worst-case scenario on trade negotiations and the WTO is the appropriate organisation to exchange with; 4. China should levy an export tax rather than the US levy a border adjustment tax to collect the revenues itself; 5. China should offer what has been achieved as a gift to the Trump administration, such as China will not be a currency manipulator and will help with jobs.

“ China might prepare for the worst on trade negotiations with the US ”

“ China should levy an export tax rather than the US levy a border adjustment tax ”

“ WTO is the appropriate organisation to exchange with ”

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