Lethame Capital Management

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The Return of Industrial Strategy: Hugh Hendry's Reflections on Pettis, Hamilton and Trump's Economic Vision

I highly recommend the podcast *"The Spice and the Ledger"* by my former contemporary and self-proclaimed *"Acid Capitalist"* Hugh Hendry, which offers a fascinating take on the potential logic behind Trump's tariff strategy. You can listen to it here...

I have attempted to summarise Hendry's key insights, particularly because they draw significantly on the themes explored in "*Trade Wars Are Class Wars"*[1] an outstanding book I frequently find myself referring to. The book offers a critical lens through which to understand the current wave of protectionism and industrial policy debates, particularly as it concerns U.S. economic strategy. For context the book outlines two distinct economic models for countries that run persistent trade surpluses: the *"Low-Wage model"* and the *"High-Wage model"*.

The Two Economic Models: Low-Wage vs. High-Wage

Pettis and Klein argue that global trade imbalances are not merely a consequence of trade policies or currency fluctuations but stem from domestic class structures and the distribution of income within nations. This distribution directly influences national economic strategy. Mercantilist policies use, among other things, manipulation of the domestic exchange rate to gain economic advantage, with two models emerging as dominant:

- **The Low-Wage Model:** Countries like China since its entry to the World Trade Organisation and modern-day Germany follow this model. Its aim is to suppress domestic consumption in favour of export-driven growth. By maintaining relatively low wages these countries accumulate massive trade surpluses, by necessity recycling the resulting capital into global financial markets. The model works by fostering high savings rates and under-consumption domestically, with the surplus production directed overseas.
- **The High-Wage Model:** In contrast, Alexander Hamilton's United States of the late 18th century, and Brazil under President Getúlio Vargas during the *Estado Novo* period, adopted a High-Wage model. Under Vargas, Brazil saw significant state intervention aimed at promoting industrialization, raising wages, protecting labour, and strengthening domestic consumption as a means of economic independence. Similarly, Hamilton promoted a "High Wage" model in his "*Report on the Subject of Manufactures"*[2] whereby U.S. industrial strategy fostered an internal market supported by higher wages and protective tariffs. This model created a robust middle class and supported sustainable economic growth but depended on continual inflows of capital to offset the resulting trade deficits.

Pettis and Klein’s argument extends beyond economics, suggesting that these models reflect the underlying power structures within nations. The U.S., in particular, transitioned from being a capital importer under its *“high wage model”* to becoming the world’s largest capital exporter as it bore the brunt of China’s adoption of a *“low wage model”*—a shift that fundamentally altered global capital flows. As a result, surplus countries' capital exports now finance imbalances, creating the volatile and politically unstable cycle that the world now finds itself dealing with.

The Hamiltonian Revival: Trump’s Economic Strategy and the Rejection of Ricardo’s Comparative Advantage

The resurgence of protectionist rhetoric under Donald Trump echoes the economic strategies of the past, particularly those articulated by Alexander Hamilton. Trump's administration’s trade policy, centred on tariffs, reshoring, and industrial self-reliance, directly aligns with Hamilton’s vision of economic sovereignty. Hendry argues that Hamilton was far more radical than simply advocating for tariffs—he fundamentally rejected what became David Ricardo’s concept of comparative advantage before it was even fully formulated.

Ricardo’s *“Theory of Comparative Advantage”*[3], which suggests that nations should specialize in producing goods in which they have the <u>lowest opportunity cost</u> and trade freely, underpinned much of the economic orthodoxy that governed global trade in the post-Bretton Woods era. However, Hendry argues that Hamilton saw this idea as simplistic in the context of the U.S.’s economic position, particularly in a world where nations' economic sovereignty was intertwined with their capacity to control strategic industries and manufacturing.

Hamilton’s critique of the Ricardian concept was that relying solely on comparative advantage, which assumes a frictionless global market, disregards the realities of national security and economic resilience. In his view, economic independence wasn’t simply about efficiency—it was about building domestic capacity to resist external pressure. This rejection of Ricardo's model meant that Hamilton advocated for state intervention to protect and nurture emerging industries—not merely to maximize short-term economic efficiency, but to secure long-term national interests.

Trump’s policies, echoing Hamiltonian principles, are not about nostalgia for factory jobs but about rebuilding U.S. industrial autonomy. Hendry suggests Trump’s focus isn’t on maximizing efficiency through outsourcing, as Ricardo might suggest, but on reclaiming control over essential industries and ensuring that production—especially of critical technologies—remains within national borders. In this context, tariffs and subsidies are not protectionism for the sake of shielding inefficiency; they are tools of economic statecraft, designed to build resilience and reduce dependence on external forces.

Just as Hamilton envisioned a national economy that would be self-reliant in key areas, Trump’s economic strategy is about reclaiming the U.S.'s strategic capacity. This approach acknowledges the geopolitical realities of today’s world, where global supply chains have left nations vulnerable to external shocks, a risk dramatically highlighted by the COVID-19 pandemic. It’s not simply about optimizing trade flows based on comparative advantage but about ensuring that critical sectors—whether it’s technology, defence, or energy—remain under domestic control.

This strategic shift from a globalized, comparative advantage-driven approach to one that values economic sovereignty mirrors Hamilton’s rejection of Ricardo’s idealized global trade system, emphasizing that economic power and national security must go hand in hand. In many ways, Trump's economic strategy represents a modern reinterpretation of Hamilton’s legacy, rooted not in protectionism for its own sake, but in the strategic imperative of controlling production to maintain geopolitical leverage.

Lincoln, Tariffs, and the Moral Dimensions of Economic Strategy

Hendry further deepens this analysis by drawing a powerful parallel between Hamilton’s industrial strategy and Abraham Lincoln’s economic vision during the Civil War. While Hamilton is often credited as the architect of the U.S. industrial system, Hendry argues that Lincoln used similar economic tools—specifically tariffs—not to build an industrial base, but to dismantle the South’s plantation economy.

Hendry contrasts Hamilton’s efforts to build a self-reliant industrial republic with Lincoln’s strategic destruction of the Southern economy, which was deeply reliant on slavery. Lincoln understood that slavery was not only morally reprehensible but also a powerful financial engine embedded in the machinery of wealth. He saw that to defeat slavery, it was necessary to render it unprofitable.

Rather than immediately resorting to military force or moral proclamations, Lincoln first employed tariffs and economic tools to strangle the South’s trade. By restricting access to markets and undermining the plantation system’s profitability, Lincoln aimed to break the economic foundation of slavery. This was not merely about morality—it was a deliberate effort to shift the balance sheets and force systemic change through economic policy.

As Hendry notes, Lincoln was not aiming to create a utopia but to build a republic capable of enduring contradictions and evolving. He understood the power of finance and economic leverage—make the balance sheets bleed, and the system will follow. His courage lay in recognizing that the true battle against slavery was not only on the battlefield but also on the front lines of trade and profit.

In this view, Lincoln’s use of tariffs becomes a case study in how economic tools can be deployed with moral intent—to erode the foundations of unjust systems and remake the republic on firmer, more equitable ground. *This invites a provocative question: do the actions of Donald Trump and his allies reflect a similar strategic moral clarity in support of the US blue collar worker, or are they instead the product of confused, reactive policymaking in an increasingly disoriented world?*

The Structural Reversal of Capital Flows

Both Pettis and Klein’s analysis and Trump’s strategy underscore the profound changes in global capital flows. Pettis’s insight that surplus countries recycle their capital into asset bubbles in deficit countries highlights the interconnectedness of global trade and financial markets. Meanwhile, Trump’s approach, which mirrors Hamiltonian principles, seeks to reverse this flow and indeed have the a by rebuilding domestic industrial capacity and reducing the U.S.’s reliance on foreign capital and goods.

As Pettis and Klein argue, trade surpluses aren’t just a sign of economic success—they are often the result of intentional policies that suppress domestic consumption. The U.S., as a net capital exporter, faces significant challenges when it comes to balancing trade and capital flows. In this context, Hamilton’s industrial strategy makes sense not just from an economic perspective, but from a geopolitical one as well.

Disrupting the System: The Geopolitical Dimension

The globalized world today is far from the frictionless market that classical economists like Ricardo envisioned. Pettis and Klein emphasize that domestic class conflict plays a significant role in shaping international trade. The structure of capital flows is inherently political, influencing everything from labour rights to national security. Trump's approach, while often controversial, brings this to the forefront, exposing a system that has long favoured capital over people.

The tariff battles, especially with China, aren’t just about trade imbalances—they’re about sovereignty. By reintroducing tariffs, Trump is challenging the assumption that nations should always specialize and trade without regard for strategic interests. In doing so, he is reviving Hamilton’s focus on using state power to protect critical industries from global market forces that prioritize capital over national interest.

Strategic Implications for Investors

The implications of Hendry’s arguments are that if Trump’s tariffs prove successful, they could signal a shift towards a high-wage mercantilist model. This model would represent a fundamental change in the balance of power between capital and labour, with implications for both the broader economy and financial markets. Under this scenario, the rising wages that are central to this new economic vision would inevitably lead to lower corporate profits. In the short term, higher wages are often associated with increased costs for businesses, which could squeeze margins and reduce the ability of firms to maintain their current profitability levels. For investors, this would be a significant shift from the profit-driven growth model that has dominated the last three decades.

In the past 30 years, low wages and globalization have enabled companies to drive up profits by exploiting cost efficiencies, often at the expense of labour. However, as the focus shifts toward a high-wage mercantilist model, this dynamic could begin to reverse. As wages rise and consumption increases domestically, the profits of many companies—especially those dependent on global supply chains and cost advantages—would likely come under pressure. Given the growing inequality in society, this shift in the balance of power seems increasingly inevitable, as the focus turns toward raising wages to reduce income disparity and ensure more equitable growth.

The erosion of corporate profitability in this new economic environment would have important consequences for equity markets in particular, but capital markets in general. Lower profitability generally leads to lower multiples of earnings, as investors adjust their expectations for future growth. Historically, high corporate profitability has been a key driver of elevated price-to-earnings ratios and stock market growth. With reduced profitability in the high-wage mercantilist model, markets may struggle to maintain their current lofty valuations.

For investors, this represents a much more difficult journey than the one experienced in the past three decades. The rising cost of labour and the erosion of corporate margins could lead to slower earnings growth, making it harder to achieve the same level of returns from equities. In addition, as wage inflation pressures continue to mount, companies will be forced to adapt, possibly through automation, offshoring, or cost-cutting measures. However, these measures may not be enough to offset the overall shift in economic dynamics, which could lead to broader market volatility and reduced investor confidence.

Moreover, the last 30 years of financialization—driven by the U.S.'s role as a massive capital exporter and global financial intermediary—has created an environment of abundant capital[4], pushing down bond yields and interest rates, particularly in the U.S., to historically low levels. This environment made it easier for governments and corporations to borrow, invest, and refinance. But transitioning to a high-wage model from a starting point of historically high national debts may pose significant challenges for bond markets and debt-laden corporates. Companies accustomed to cheap capital may find themselves shell-shocked as profitability declines, interest rates normalize or rise, and refinancing becomes more difficult.

Conclusion

The growing income inequality that has driven much of the backlash against globalization and trade imbalances will likely fuel greater demand for wage growth and wealth redistribution. This could result in an environment where investors are forced to navigate not only the economic challenges of a high-wage mercantilist model but also the political pressures that come with it. In such a world, market dynamics would be shaped less by the corporate profit cycle and more by the interplay between wages, consumption, and inequality, making investing more complex and less predictable.

Ultimately, if Trump's tariffs succeed in reshaping the U.S. economy in line with a high-wage mercantilist model, investors would face a world where the forces of labour and capital are much more balanced. While this may be beneficial for workers and society in the long term, it could create significant challenges for investors who have grown accustomed to a world where corporate profits and stock market multiples rise with globalization and low labour costs. In this new environment, achieving market returns may require a much more nuanced understanding of economic and political forces, marking the beginning of a more difficult journey for investors than they have experienced in the last 30 years.

References

[1] Pettis, Michael, and Matthew C. Klein. *"Trade Wars Are Class Wars: How Rising Inequality Distorts the Global Economy and Threatens International Peace"*. Yale University Press, 2020.

[2] Hamilton, Alexander. "*Report on the Subject of Manufactures"*, presented to the U.S. House of Representatives, December 5, 1791.

[3] Ricardo, David. *"On the Principles of Political Economy and Taxation"*. London: John Murray, 1817.

[4] Shvets, Viktor. "*The Twilight Before the Storm: From the Fractured 1930s to Today's Crisis Culture"*. Boyle & Dalton, 2024