Lethame Capital Management

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Trump's Tariffs - is it the end of the Beginning?

In the first eleven months of 2025, China recorded a goods trade surplus exceeding $1 trillion[1], the largest on record. At one level, the figure is a testament to the scale and sophistication of China's industrial machine. At another, it is a flashing warning light. The milestone reflects not only industrial strength, but a trade imbalance that is becoming harder for both surplus and deficit countries to sustain.

The common view of Donald Trump's tariffs is that they are an aberration—an impulsive disruption imposed on an otherwise stable global trading system. According to this narrative, the international economic order was functioning tolerably well until populism derailed it, and the task now is to restore normality. But the arithmetic behind the global economy points in a different direction. The system was not stable. It was evolving along fault lines that have been widening for decades, and tariffs merely expose tensions that were already approaching their breaking point.

Trump's tariffs were less a cause than a symptom of a larger process: the long-delayed adjustment of a global economic architecture built on persistent and asymmetric imbalances. A handful of economies built growth models dependent on chronic trade surpluses and the suppression of domestic consumption. Those surpluses could only exist because others absorbed them—running matching deficits and accumulating debt, whether on household balance sheets, government balance sheets, or both. For a time, this arrangement looked benign, even efficient. Underneath the surface, it was quietly sowing the seeds of its own unravelling.

To understand why this adjustment is occurring—and why it was always likely to occur—we must revisit arguments first articulated by John Maynard Keynes, refined by Joan Robinson, and given their modern expression by Michael Pettis. Together, they explain why a system that forces deficit countries to absorb the consequences of surplus countries' domestic distortions is not merely unfair, but arithmetically and politically unstable.

Keynes' Unheeded Warning

It is easy to forget that the global trading system we inherited was not Keynes's[2] preferred design. At Bretton Woods in 1944, Keynes argued that international stability required symmetric discipline: both chronic surplus countries and chronic deficit countries should face pressure to adjust. He was sceptical of a world in which some nations accumulated ever-larger surpluses while others absorbed the corresponding deficits.

Surpluses, in Keynes's framework, were not harmless signs of national virtue. They were the external expression of domestic underconsumption—a demand shortfall that, if not corrected internally, would be exported abroad. Deficit countries could paper over that shortfall for a time through borrowing, asset inflation, or fiscal expansion. But the longer the imbalance persisted, the more the deficit country's financial structure would be strained, and the more politically toxic the arrangement would become.

Keynes proposed an International Clearing Union[3] in which countries that persistently ran surpluses would be required to revalue their currencies, expand domestic demand, or face penalties. The purpose was not to punish exporters, but to prevent a structural asymmetry from hardening into a permanent feature of globalisation. Documented the concern he stated:

"But the world's trading difficulties in the past have not always been due to the improvidence of debtor countries. They may be caused in a most acute form if a creditor country is constantly withdrawing international money from circulation and hoarding it, instead of putting it back again into circulation, thus refusing to spend its income from abroad either on goods for home consumption or on investment overseas"

His core point was mathematical: if one country saves more than it invests, the excess must show up as someone else's deficit. A system that relies on deficit countries bearing the burden of adjustment is inherently unstable. Sooner or later, those countries will resist—through tariffs, capital controls, currency intervention, or some combination.

Keynes' proposal was ultimately rejected, a defeat vividly chronicled by Ben Steil[4] who documented the intellectual and geopolitical struggle between Keynes and the U.S. Treasury's Harry Dexter White. As Steil shows, the United States—then the world's dominant surplus economy—insisted on a system in which adjustment pressures fell overwhelmingly on deficit nations, not on surplus countries like itself.

By rejecting Keynes's vision of symmetric discipline, the post-war order was built with an inherent structural asymmetry that would later become a source of instability. Ironically, the United States now occupies the opposite position: no longer the world's great surplus nation, but its most important deficit country and the primary absorber of other nations' domestic imbalances. Keynes's warnings have returned, but this time the United States is suffering from the very dynamic he feared.

Joan Robinson's Prediction of Backlash

If Keynes supplied the structural logic, Joan Robinson, a famous member of the "*Cambridge Circle*", supplied the political instinct. Robinson argued that persistent surpluses allow a country to externalise the costs of its domestic distortions. A nation that suppresses household income in order to subsidise investment and manufacturing can generate rapid export growth. But it can only do so because someone else must absorb the counterpart deficit that validates the surplus.

Robinson's key insight was that no deficit country will accept this role indefinitely. When the burden of adjustment becomes too large—economically, socially, and politically—deficit countries will respond, not out of ideology, but out of necessity. They will raise trade barriers, adopt industrial policy, restrict capital flows, or otherwise reshape the rules of the game. In her famous formulation:

"Every country had to join in, for anyone that attempted to maintain employment without protecting its balance of trade (through tariffs, subsidies, depreciation, etc.) would have been beggared by the others." [5]

What Robinson described in theory is now being articulated explicitly by political leaders confronting its consequences. In a remark that could have been lifted from Robinson's writings, French President Emmanuel Macron warned last month:

"The combination of US Tariffs and <u>subdued domestic consumption</u> means Chinese exports are now flooding into Europe. This is not sustainable for Europe or China" [6]

Macron's point is not a moral objection to trade, nor a turn toward economic nationalism for its own sake. It is a statement of constraint. Europe cannot indefinitely absorb the adjustment costs created by another country's demand suppression and surplus accumulation. Robinson anticipated precisely this moment: the point at which deficit countries are forced to say "no", not because they wish to but because they must.

Robinson was explicit that this was not merely a political reaction but a systemic financial constraint. Persistent deficits, she argued, impose growing strains on domestic balance sheets and financial institutions, as deficit countries are forced to finance excess consumption and investment through rising debt or asset liquidation. Over time, the burden of financing these deficits becomes so large that it threatens the stability of the domestic financial system itself—and, by extension, the international system that depends on it.

Historically, Robinson noted, such pressures have repeatedly driven deficit nations toward trade protectionism and other defensive measures, not as ideological choices, but as attempts to arrest financial exhaustion and restore internal balance.

Read in this light, her warning sounds less like historical commentary than like a description of the present. What we are living through is not a mysterious turn to irrational protectionism. It is the predictable political response to an economic configuration that concentrated the costs of adjustment in the deficit economies.

The Identities: Why the Imbalances Cannot Persist

The mathematics behind these predictions is extremely simple:

Start with the national income identity:

$$Y = C + I + G + NX$$

Saving is Income not Consumed by households or government:

$$S = Y - C - G$$

Substituting, we obtain:

$$S = (\cancel{C} + I + \cancel{G} + NX) - \cancel{C} - \cancel{G}$$

Rearranged:

$$S - I = NX$$

$$where\ Y = GDP, S = Saving, C = Consumption, I = Investment\ G = government\ spending, NX = net\ exports$$

This identity tells us that if a country saves more than it invests, it must run a current-account surplus. If it saves less than it invests, it must run a deficit. This is not a behavioural claim. It is true by construction.

What Keynes added—and what is often forgotten—is that the identity cannot be treated as a story in which "*saving funds investment*" in a simple, ex ante sense. In Keynes's framework, investment drives income, and saving adjusts ex post through the income that investment generates. Attempts to raise saving directly without a corresponding rise in productive investment or income will suppress demand. The identity is not a morality play about thrift. It is a constraint linking domestic demand, investment, and external balances.

Keynes vs Classical Causality (Why Saving Does *Not* Finance Investment)
Classical view (loanable funds):
Saving is the source of investment. Households decide how much to save; this pool of savings is then intermediated into investment. The interest rate equilibrates the two. If saving rises, investment can rise without any fall in demand.
Keynes' view (income-led causality):
Investment is the source of saving. Firms decide how much to invest based on expectations of future demand. That investment raises income, and higher income generates the saving required to validate the investment ex post. The interest rate governs liquidity preference, not the availability of saving.
Why the distinction matters:
If saving is causally prior, policies that suppress consumption and raise saving should promote growth. If investment is causally prior, the same policies reduce demand, discourage investment, and lower income. Keynes showed that attempts to raise saving directly—through wage cuts, fiscal austerity, or income compression—can reduce total saving by shrinking income itself. This is why higher saving can be contractionary at both the domestic and global level, and why surplus-driven growth models necessarily rely on counterpart deficits elsewhere.

Once extended to the global system, the constraint tightens further. Net exports across all countries sum to zero. Global saving therefore equals global investment. When one country raises saving relative to investment, other countries must—by identity—do the opposite. Someone must borrow. Someone must dissave. Someone must run a deficit. This is where Pettis's contribution becomes decisive.

Pettis's modern diagnosis: who saves matters

Pettis[7] emphasises that who saves matters as much as the level of saving. An increase in saving driven by rising household incomes behaves very differently from an increase in saving driven by transfers from households to corporations, the wealthy, or the state. When income shifts toward agents with a low propensity to consume, aggregate consumption weakens even if aggregate saving rises.

Crucially, when the rich receive additional income they don't spend, they save and this excess saving flows into existing assets—equities, bonds, and property—bidding up prices rather than expanding productive capacity. Demand is then sustained indirectly through wealth effects, rising leverage, or government deficits. This is the story of the extraordinary bull market that has existed since the early 1990's. The result being not stable prosperity, but financialisation: asset inflation, inequality, and fragile growth.

In practice, persistent surpluses are rarely the product of voluntary thrift. They are usually the product of institutions and policies that suppress household consumption—explicitly or implicitly—by redistributing income away from workers and consumers toward producers and investors. When large surplus economies raise saving relative to investment in this way, they do not eliminate imbalances; they export them. Trading partners must absorb the excess saving through household debt, fiscal deficits, asset bubbles, or some combination. These are not free choices. They are accounting counterparts.

This is the heart of Pettis's argument: global trade imbalances and domestic financial fragility are two sides of the same mechanism. When domestic institutions constrain household consumption and concentrate income among high-saving elites, a surplus follows. The rest of the world must accommodate it—until it cannot.

Mapping the Identity onto FX Regimes and Reserve-Currency Dynamics

The saving–investment identity has direct implications for exchange rates and the international monetary system. In a flexible exchange-rate regime, a country that raises saving relative to investment should, in principle, experience currency appreciation. A stronger currency reduces net exports, shifts demand toward imports, and helps rebalance excess saving internally. Adjustment occurs through the exchange rate.

In practice, many surplus countries resist this mechanism—sometimes explicitly through intervention, and sometimes implicitly through domestic arrangements that suppress consumption and keep production artificially competitive. When appreciation is prevented and domestic demand remains weak, adjustment does not vanish. It is displaced.

In a managed or fixed exchange-rate regime, the process is more mechanical. Excess saving tends to show up as capital outflows and reserve accumulation. The central bank intermediates the imbalance, preventing appreciation and exporting demand shortfalls abroad. The counterpart countries then absorb the imbalance via rising debt, asset inflation, or fiscal expansion.

This asymmetry is magnified when deficits concentrate in the *"reserve-currency issuer"*, especially the United States. In the current system U.S. Dollar assets serve as global *"safe"* assets. Capital inflows suppress domestic interest rates and allow persistent deficits without immediate funding stress. But the identity still holds. Foreign excess saving is matched by US dissaving, expressed in household leverage, fiscal deficits, and asset inflation.

The IMF[8] made a closely related point commenting on Chinas $1tn trade surplus, warning that "*low inflation relative to trading partners*" can generate real exchange-rate depreciation that makes exports cheaper and "*prolong[s] an excessive reliance on exports,"* thereby *"worsening external imbalances.*" That is a modern institutional restatement of Keynes's concern: when a surplus country blocks internal adjustment, the burden does not disappear. It shifts onto its trading partners.

Reserve-currency status does not eliminate adjustment. It changes its form. Instead of currency crises, adjustment tends to appear as inequality, financial instability, and political backlash.

The High-Saving, Low-Consumption Model

Several economies have run variants of a high-saving, low-consumption, high-investment model—among them the United States in the 1920s, Brazil in the 1970s, Japan in the 1980s, Germany in the *'Euro'* era, and China most prominently today. In early stages, the model can be remarkably successful. When an economy genuinely needs infrastructure and industrial capital, high investment can yield rapid productivity gains. Living standards rise even if consumption remains a low share of GDP.

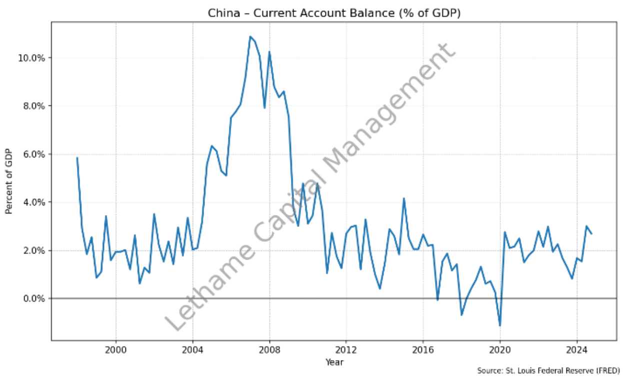
But this phase cannot last indefinitely. As the stock of necessary infrastructure and capacity is built, continuing to push investment at the same pace generates diminishing returns. If household consumption remains suppressed, domestic demand cannot absorb domestic output. Production exceeds domestic absorption. The surplus must be exported.

At this stage, high saving is not a virtue. It is the flip side of weak household income and weak consumption. If investment cannot rise forever and consumption is structurally constrained, the only way to maintain high output is through an external surplus. That surplus requires someone else to run a deficit.

The model becomes unstable when policymakers refuse to accept the transition: investment must slow and consumption must rise. If instead policymakers attempt to sustain growth by maintaining very high investment after returns have fallen, debt rises faster than GDP. The economy becomes trapped in an escalating requirement for credit to deliver ever-lower increments of growth.

China as the Archetypal Case

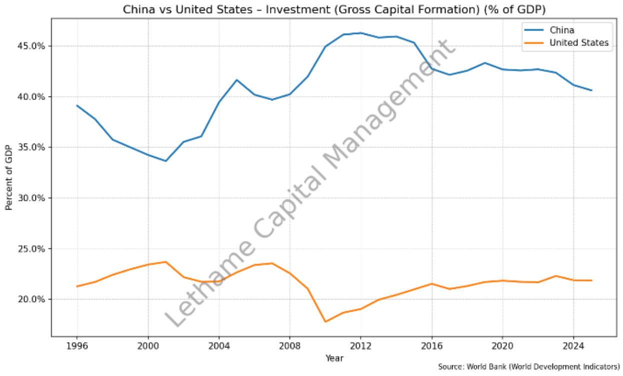
China exemplifies this dynamic. Its early growth is one of the most impressive in economic history. Investment was directed toward high-return projects: transport links, ports, industrial clusters, logistics networks, communications systems, and urban infrastructure. But as the most productive opportunities were exhausted, the system struggled to downshift. Investment remained high because institutional incentives made it difficult for investment to fall without threatening employment, local-government finances, and political legitimacy.



The global financial crisis revealed the fragility. In the years immediately preceding it, China's current-account surplus exceeded 10 per cent of GDP. When external demand collapsed, a sharp slowdown should have followed. Instead, policymakers engineered an enormous credit surge into infrastructure and property. It worked in the short run, preserving headline growth. But it entrenched a pattern: debt rising faster than GDP as investment's marginal returns declined.

The pattern has repeated. When infrastructure saturated, credit flowed into property. When property stopped absorbing credit, policy leaned harder into advanced manufacturing—electric vehicles, solar panels, batteries. When those sectors faced gluts, the pressure shifted again. Each time, the economy avoided an investment slump by reallocating credit, because a sustained fall in investment would have implied much lower growth.

China's growth has been sustained by the continuous redirection of investment rather than by rising household consumption. The consequence is chronic overcapacity, weak profitability, and increasing reliance on external demand. Consumption as a share of GDP remains exceptionally low relative to the country's income level, and household income remains structurally constrained.



This diagnosis is not limited to heterodox critics. The same basic tension is now described in mainstream commentary: China's export success sits alongside weak domestic demand, and the export channel is increasingly relied upon to absorb enormous output.

China is often praised for manufacturing competitiveness, but much of that competitiveness reflects implicit and explicit subsidies: cheap credit, infrastructure provision, policy prioritisation, and risk socialisation through state guarantees. Under these conditions, surpluses are not simply a market verdict on productivity. They are the external manifestation of domestic imbalances: too little household income, too much investment for its own sake, and too little willingness to accept the slower growth that rebalancing requires.

How China's Imbalances Are Exported to the Anglophone Deficit Countries

The accounting identities described ensure that China's excess saving must be absorbed somewhere. It does not flow randomly. It tends to flow toward economies with deep and liquid financial markets, strong property rights, and open capital accounts. In practice, that has meant the United States most of all, but also the United Kingdom, Canada, and Australia.

When China produces more than it absorbs domestically, the surplus is recycled into foreign financial markets. By identity, the recipients run matching deficits. They must consume more than they produce, invest more than they save, or borrow to fill the gap. Over time, capital inflows suppress interest rates and inflate asset prices. Tradable-goods sectors come under pressure from both the stronger currency and import penetration. The economy becomes more dependent on consumption, property, and finance.

This is not because Americans, Britons, Canadians, or Australians made a cultural choice to prefer consumption over production. It is because their economies were assigned the role of deficit absorbers in the global system. The surpluses generated by large exporters required counterpart deficits. Open, asset-rich economies became the natural repositories of the world's excess saving.

The familiar domestic symptoms—de-industrialisation, property booms, inequality, and political polarisation—are not independent failures that just happen to coincide with trade tensions. They are the mirror image of the surpluses abroad. As Macron put it, the problem does not begin with excessive consumption in the deficit countries, but with supressed absorption in the surplus country itself.

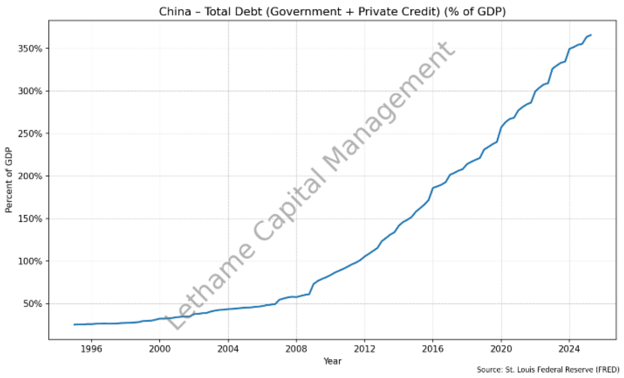
"China must address its internal imbalances. A more favourable fiscal policy, aimed at reducing savings and promoting domestic consumption and the development of a service economy, are essential for its long term growth". [6]

Macron's observation is not a plea for reform on China's behalf, but a statement of global arithmetic. Unless China reduces its excess saving and expands domestic consumption, the adjustment burden must continue to fall on deficit economies. As Robinson warned, that burden is not politically or financially sustainable indefinitely.

Running Out of Debt Capacity

China's core constraint is not external funding. It is domestic debt capacity. As investment becomes less productive, borrowers rely on rising credit to sustain activity. The point at which the transfers required to cover the gap between low asset returns and high debt servicing costs become so large that they suppress growth.

The logic is straightforward. If an economy borrows 100 to build an asset that ultimately yields economic value closer to 80, the gap must be paid by someone. In China's case, the gap has often been covered by financial repression (low household returns), implicit guarantees, directed lending, and fiscal support. These mechanisms can stabilise growth for a time. But they come with costs: they transfer income away from households, suppress consumption, and distort capital allocation. That, in turn, reinforces the very conditions that generate excess saving and weak domestic demand.



Early on, the system can absorb these distortions because productive investment elsewhere offsets the losses. Over time, as the stock of low-return investments grows, the required transfers rise. Eventually the economy becomes fragile: every additional unit of investment requires an even larger transfer to keep it solvent.

At that point, adjustment is unavoidable. The only question is where it occurs: domestically, through slower growth and higher consumption; or externally, through shrinking surpluses and forced rebalancing of global accounts.

The Backlash Begins: Why Tariffs Were Inevitable

This brings us to the present. Trump's tariffs were clumsy and often poorly targeted but it is clear there is a methodology behind the madness[9]. However, they focused on bilateral trade, when the problem is systemic. They were riddled with loopholes and workarounds. Yet they were also politically inevitable, because the United States—and other deficit economies—could not indefinitely absorb the world's surpluses through debt-fuelled consumption and asset inflation.

For decades, mainstream commentary often dismissed concerns about de-industrialisation, inequality, and financial fragility as political noise. In reality, these were the predictable symptoms of the imbalance structure. As they intensified, tolerance for the deficit-absorber role diminished. Tariffs were not the root cause of the change. They were the political expression of a deeper economic constraint. The global system can no longer rely on a small set of economies to stabilise global demand by absorbing other countries' excess saving.

The Two Possible Futures

The world now stands at a crossroads anticipated by Keynes and Robinson.

One path involves a more intelligent reconstruction of globalisation. That would require a framework that discourages persistent surpluses and deficits alike; forces internal rebalancing in surplus economies; and reduces the reliance on debt, asset inflation, and political polarisation in deficit economies. Keynes imagined something like this nearly eighty years ago. It was not adopted then. It may become necessary now.

The alternative is the path Robinson[10] feared: deglobalisation through unilateral action. Deficit countries will impose tariffs, restrict capital flows, and pursue industrial policy in order to reclaim control over their external accounts. Surplus countries will then be forced into painful internal adjustment as their export engines slow. The result would likely be lower trade volumes, slower growth, and greater fragmentation.

Which path prevails remains uncertain. What is clear is that the status quo is no longer viable. A global system built on the willingness of a few nations to absorb the imbalances of many is reaching both a mathematical and political limit.

Conclusion: The Great Rebalancing Has Already Begun

The coming decade will not be defined primarily by the weekly fluctuations of tariff schedules or the rhetoric of trade wars. It will be defined by the deeper rebalancing now unfolding. Persistent global imbalances—rooted in domestic income distribution, enforced by accounting identities, and amplified by political choices—cannot continue indefinitely. Surplus countries must consume more or invest less. Deficit countries must consume less or invest more. The global system must evolve accordingly.

Keynes warned that persistent surpluses would destabilise the world unless checked. Robinson warned that deficit countries would eventually rebel. Pettis shows how modern imbalances reflect domestic economic structures—especially the distribution of income and the suppression of household consumption—rather than simple "*competitiveness*" stories. Their combined insights point to a world in which the old model of globalisation—unbalanced, debt-fuelled, and asymmetrically structured—is giving way to a new and still-uncertain order.

Trump's tariffs were not the culmination of this shift. They were the first rough expression of a rebalancing that is far from over. The question is no longer whether adjustment will occur, but how—and at whose initiative. Capital control may well be the future, however it unfolds the next ten years will determine whether the world moves toward a more stable and durable form of globalisation, or retreats into fragmentation. Either way, the old world is already behind us.

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