



The Anglo Disease - an introduction

Posted by [Jerome a Paris](#) on June 26, 2007 - 2:02am in [The Oil Drum: Europe](#)

Topic: [Economics/Finance](#)

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I've been developing in a couple of recent diaries over at the European Tribune ([The Anglo Disease - Financiers worried about end of great bull run](#) and [Anglo Disease \(2\) - Martin Wolf's take](#), with **afew** adding input of his own in [Anglo-Disease Sidelights \(1\): UK = Tax Haven](#)) a concept which I think can usefully describe our current economic system, that of the **Anglo Disease**, mirroring the "Dutch disease", a term coined in the 70s to describe the economic effects of the rapid development of one sector (in that case, natural gas, today, the financial industry) on the rest of the economy.

This text is meant as an attempt to explain what this 'disease' might be, trying to be as pedagogic as possible. You are my guinea pigs, so all comments and questions are welcome - indeed, they are hoped for - so that this text can be improved upon and refined.

In the Netherlands, the discovery of the large Groningen gas field which brought about a boom in that resource sector, with a lot of - highly profitable - investment concentrating in that sector. The reason that something which sounds like good news is called a disease is that the investment in that profitable sector tends to cause a drop in investment in other industrial sectors, because it is so much more profitable; at the same time, there is a lot of extra revenue from the export of the resource, which generates new demand which cannot be fulfilled by domestic production and gives rise to increased imports. The fact that resource exports grow strongly also tends to cause the domestic currency to get stronger, thus further penalising other sectors of activity on international markets. The result is a weakening of the rest of the economy, and increased reliance on the resource sector.

This then becomes a problem when the new sector is based on finite resources, and eventually goes into decline. At that point, exports dry up, but the rest of the economy, having become uncompetitive and fallen behind, can no longer pick up the slack and has become too small to carry the economy over. Thus the overall economy suffers.

In effect, the displacement of existing activity by the new sector is, to some extent, **irreversible**, and thus, when the resource dries up, the overall economy is permanently weakened. It's also part of the "resource curse", which usually includes additional symptoms like corruption and weakening of democratic rules as a lot of money gets concentrated in relatively few hands (those that own and those that regulate the resource industry). In the worst cases, it can include militarisation of society (weapons being an easy way to spend a lot of foreign currency and being occasionally useful against those that might want to take your sweet spot overseeing the cash cow).

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I think that the above is increasingly relevant to describe the economy of the UK and, to a lesser extent, that of the US, which are increasingly dominated by the financial services industry.

That prevalence of the financial world is no longer a matter of dispute. In fact, it is celebrated with increasingly euphoric words in most business publications and current affairs books. There is an air of hegelian (or marxist) inevitability about the triumph of markets and Anglo-Saxon capitalism, led by the powerhouses (banks, hedge funds and assorted accomplices) in the City of London and on Wall Street.

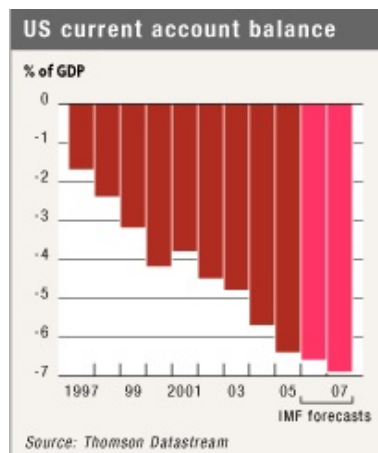
But just as Britain led the world into industrialisation, so now Britain is leading it out. Today you can still find a few British engineers and scientists making jet engines and pharmaceuticals—and doing rather well at it. But many more are cooking up algorithms for hedge funds and investment banks—where in many cases they add more value. The economy has boomed these past 15 years, as manufacturing has been left behind and London has become the world's leading international financial centre. Britain's deficit in manufactured goods is hitting record highs. But so are the capital inflows.

[The Economist](#) (editorial, this week)

The collapse of the trade balance, linked to the long term (relative) decline of the manufacturing sector is indeed one of the most noteworthy commonalities between the US and UK economies, along with the reliance on the sale of services, in particular financial services:



Source: U.S. Department of Commerce, Bureau of Economic Analysis, National Income and Product Accounts (quarterly), and analysis by Wynne Godley of the Levy Institute.



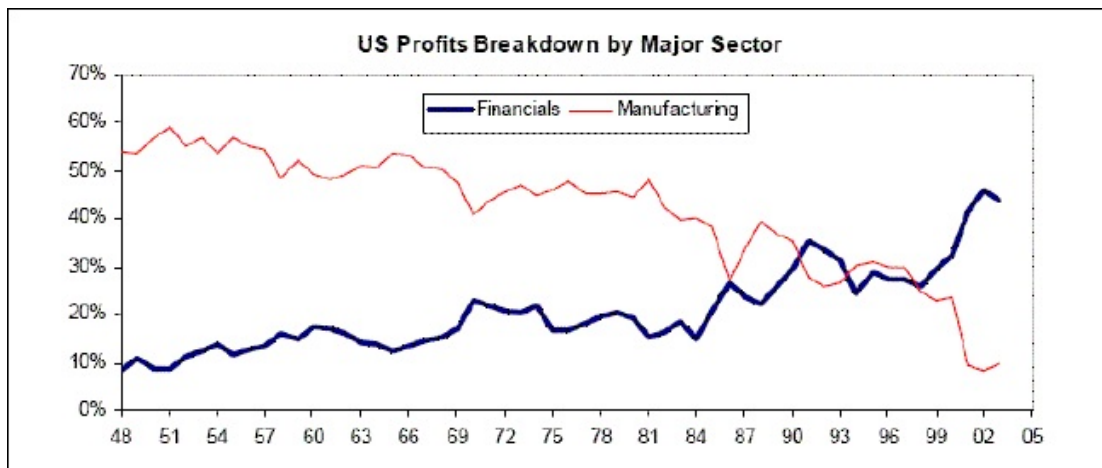
(from [this text](#), which deserves a diary of its own)

[Unfettered finance is fast reshaping the global economy](#) (by Martin Wolf, senior editor, Financial Times, 19 June 2007)

It is capitalism, not communism, that generates what the communist Leon Trotsky once called “permanent revolution”. It is the only economic system of which that is true. Joseph Schumpeter called it “creative destruction”. Now, after the fall of its adversary, has come another revolutionary period. Capitalism is mutating once again.

Much of the institutional scenery of two decades ago – distinct national business elites, stable managerial control over companies and long-term relationships with financial institutions – is disappearing into economic history. We have, instead the triumph of the global over the local, of the speculator over the manager and of the financier over the producer. We are witnessing the transformation of mid-20th century managerial capitalism into global financial capitalism.

Above all, the financial sector, which was placed in chains after the Depression of the 1930s, is once again unbound. Many of the new developments emanated from the US. But they are ever more global. With them come not just new economic activities and new wealth but also a new social and political landscape.



The ability of the financial world to generate high returns on capital has fuelled the massive financial boom we've been in for most of our lives and which has so transformed our economic landscape. By demonstrating regular high returns possible, it has generalised the requirement for such returns in all economic activities, and thus the need for constant restructuring of businesses, for cost-cutting, offshoring and, often, for the wholesale dismantlement of whole sectors of activity that could not generate the required profitability.

Sectors like manufacturing have seen their share of economic activity shrink, as many activities were outsourced, offshored or eliminated altogether. The trade balance has gone south, and jobs have disappeared under relentless pressure for higher competitiveness.

This might not be so bad if the jobs created in the service sector, and in finance in particular, were as numerous and high paying - and durable as those in the industry. All statistics on median wages suggest that this is not the case: median wages have been stagnant over the past couple of decades, with a stark increase in inequality. Increased wealth (as measured by GDP or average income) has been captured by a small number of people at the top, something strikingly similar to the remuneration structure of big investment banks and the rest of the financial industry.

The inequality might be acceptable if there was a prospect of reversing it as increasing prosperity is created (this is essentially the argument of Martin Wolf and other proponents of globalisation),

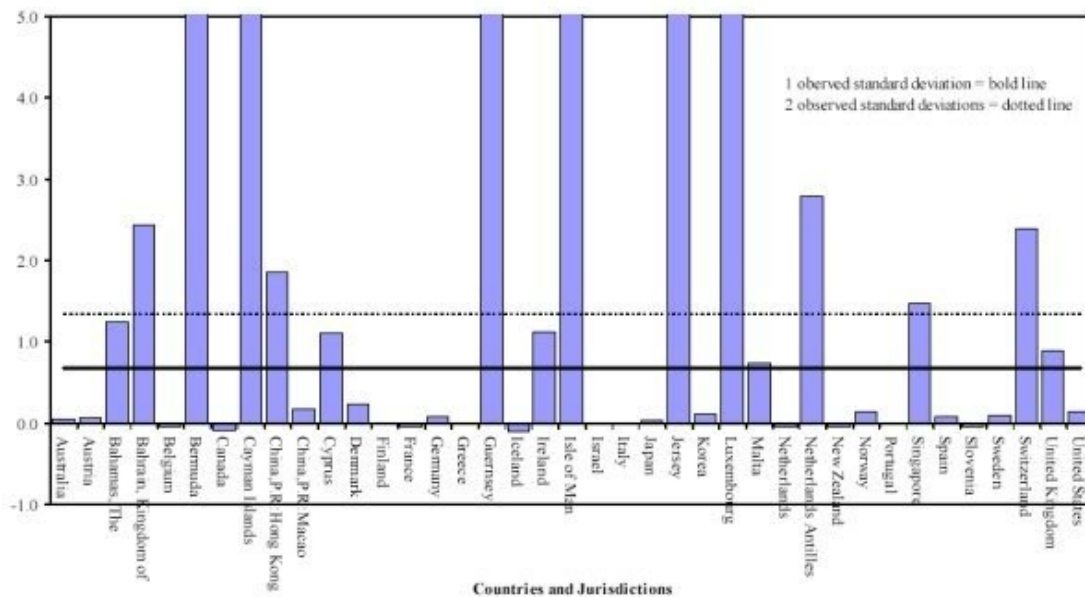
but is in fact a **structural and necessary feature** of the system. Globalisation has spawned a whole ideology about efficient allocation of resources, optimisation of investment decisions, and the invisible, but *natural, and morally neutral* hand that allow markets to reveal the best price at any given moment for any item. It brings along a vicious hate for taxation, and sees government, and its core functions, redistribution and regulation, as something to be avoided and eliminated as much as possible, being fundamentally anti-efficient. It also brings the core idea that only things that have a price have a value, that everything can be measured in dollars, and that what isn't so measured has no worth nor legitimacy. It fosters a culture of individualism ("freedom") and consumerism ("success"). Social policies (which require distribution), common goods (which need to be defined and managed) and non-economic measures of well-being are spurned and actively fought. Growth is paramount.

While I think that this is more than enough to disqualify neoliberalism (as I have made abundantly clear in many earlier diaries), there is actually worse. and that's where the concept of the 'Dutch disease' comes in.

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One of the core triggers of the Dutch disease is that the resource sector which has unbalanced the economy eventually shrinks as the underlying resource is depleted. In our case, the industry that causes activity-substitution (finance) can appear to be able to grow ad infinitum, without any limitation to actual resources. Just borrow more money to do bigger deals and enjoy the very real income taken along the way. Find another lender to refinance or another buyer to re-purchase, and you're home and dry. Or just do deals where the actual burden to repay is pushed back into the future (and you won't be around anymore if and when they falter). Thus the City and Wall Street can appear to generate more jobs than the industries they kill off destroy. In addition, with New York and (even moreso) London dominating finance worldwide and not just domestically, they can create jobs and capture wealth locally while imposing their requirements on companies and activities in other countries, thus creating little or no pain at home (see the graph below on how the UK as a whole can be defined as an *offshore financial center*, just like any Caribbean Island...)

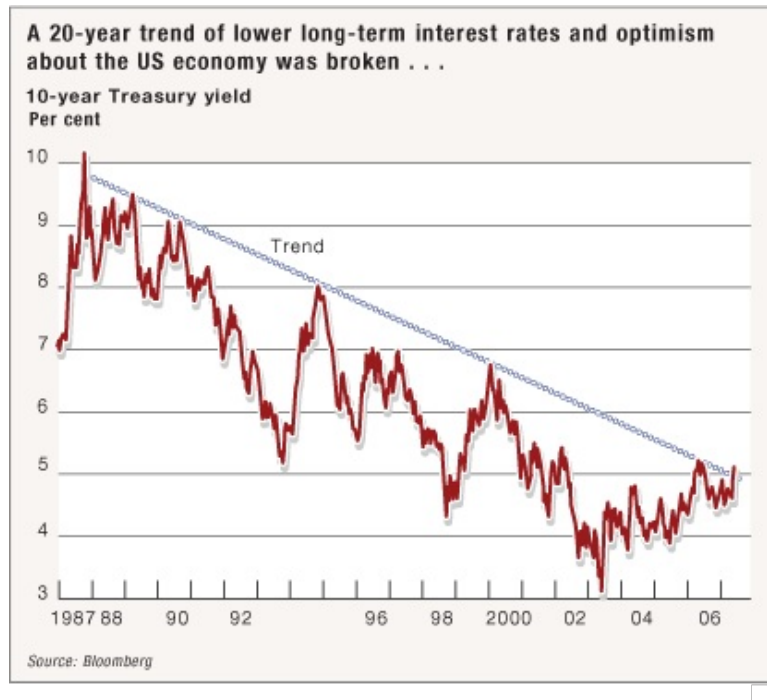
Figure 1. Ratio of Net Financial Services Exports to GDP - High Income Countries (in percentage of GDP)



So, while to some extent parasitic on other economies, it might at least make sense for the UK and the US - as nimbler, faster, smarter economies, they reap the benefits of globalisation and are understandably promoting their interests by defending globalisation. And hey, they are providing

real services to investors around the world, who are "free to seek out the best returns around" and "voting with their feet/money."

But in fact, this is but a transitory phenomenon, underpinned by a single underlying factor: the long decline of inflation, and thus of interest rates, over the past 25 years.



We've been living in a long, massive bull market for bonds, born off the inflation of the 70s, and the grand ride which was made possible by the new financial tools offered by the IT revolution and by Reagan/Thatcher inspired deregulation is about to come to an end. The returns we've grown used to were just a long but temporary phase in a natural long term economic cycle, and, despite the final boost provided by 'Bubbles' Greenspan in the last few years, not something that can be sustained on a permanent basis. Put simply, it is not possible to generate 15% per annum returns on capital forever when the underlying economy is growing only by 3%.

As the interest rates go up again, and liquidity tightens again, the financial industry is going to run out of the underlying resource that sustained it - easy and plentiful access to money. As that constraint imposes its implacable discipline, and the financial industry finds out that it no longer has anything to offer to its clients (trading stuff, or trading imaginary products remotely backed by stuff, will no longer be so much more profitable than making stuff), it is going to shrink and withdraw. And the countries and cities that have bet on that industry for their prosperity will face the resource curse, as their core activity loses steam and alternative activities, having being neglected for so long, no longer exist or are too small or uncompetitive to make a difference, and cannot pick up the slack. This is what I propose should be called the Anglo Disease.

As this reversal has not yet taken place, and as this prediction threatens the livelihoods of many of my readers, I expect to be mocked and dismissed, but bear with me and help me work on the concept.

I hope to expand on the idea in further diaries, and I hope to get your feedback (including questions if you're not sure you understand what I wrote - maybe I am actually talking nonsense, for all my apparent trust in my assertions). The topic ties in neatly with the critique of neoliberalism I've been trying to write about in the past, to our unsustainable focus on growth as a sign of success, to worries about resource availability, and to the "inevitability" of the Western model - or rather of its financial brat, the Anglo-Saxon capitalist market economy, so there is a lot



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