A reduction in European over-consumption will be undone by any Eurozone solution

Jul 23 2012

There is growing global support for growth policies in the Eurozone, **Edward Price** *argues. That growth agenda will however be balanced against the problem of European over-consumption, which has created an imbalance in the world economy. The Eurozone crisis may have a short-term positive effect in this regard, but any growth-led solution to the crisis will likely undo any good work.*

Welcome to the 21st century rerun of a 20th century fight: Keynes and Hayek are grappling again. As ever, their fight is undecided, although it seems French demands for growth (Keynes) are crowding out German demands for sound money (Hayek). Despite some very strong feelings in Berlin, talk in Paris of looser monetary policy is gaining momentum. The IMF's most recent World Economic Outlook calls for "monetary policy in the euro area to ease further." Not surprisingly, most Europeans have had enough of the pain.

Credit: Michael Thurm (Creative Commons BY NC SA)

There nonetheless remains a deeper European quandary than current economic misery, one barely addressed in the debate over the Eurozone crisis. According to a 2011 speech by Bank of England Governor Sir Mervyn King, what is most urgent for the West is to tackle "unsustainably high levels of consumption."

Consider the unthinkable. Could the Eurozone crisis offer the solution?

Let's summarise. In the immediate, the Eurozone is facing a potential banking crisis, plus the economic and political fallout of different economies sharing a currency but not (occasionally excessive) sovereign debt. That is a legacy of how, among other issues over the last ten years, Europeans consumed far more than they had the means to consume (e.g. Greece). In the long-term, as Keynes helpfully pointed out, we're all dead. Clearly aware of this economic insight, Europeans have done their best to enjoy the short-to-medium term along the way.

Consumption is a problematic vice. On the one hand, it ought to be welcomed during a recession, as, especially in high-street driven economies, consumption can be indicative of growth. Consumption is, however, often also a pretty good indicator of increasing consumer debt. Plus, a sustained increase in the demand for imports signals the kind of imbalanced world economy that Sir Mervyn King warns against: "Without a rebalancing of spending in the world economy, a struggle between debtor and creditor countries will inflict economic pain on everyone." Needless to say, Europe gets most of its consumer goods from Asia.

It is difficult, therefore, to determine where the line should be drawn between excessive and appropriate consumption. During a recession, any uptake in consumption is seen as shorthand for 'a working economy.' Look at how, in recent years, the Bank of England has promoted Keynesian boosts for demand at the same time as warning against excessive-consumption. Sir Mervyn King, for all his warnings on debt and consumption, has supported quantitative easing, which is designed to fight the sort of low growth in the UK that would see inflation fall below the bank's 2% inflation target.

Whatever the problems, here is the possible upside. The Eurozone crisis has calmed Europe's consumption binge. As European consumers worry about jobs and austerity, and have subsequently purchased less, there has been a very notable fall in the number of consumer goods China is sending to Europe. A significant drop-off in containerised trade along the key westbound Asia-Europe shipping route has occurred. In fact, volumes from Asia to Europe fell by 6.9% in May 2012 compared with the same month last year, and lines are reducing capacity ahead of a period more normally associated with the Christmas stock-up. European ports have also experienced less traffic.

If the West should borrow and consume less, and the East should spend and consume more, the breakdown of an effective crisis-solution for the Eurozone has clearly helped. One easy conclusion is that the severity of the current down cycle is helping to solve the problem of Western overconsumption; therefore a major downturn has a major upside. Troubled European policy makers and politicians can rest a little easier.

Only a brave person would describe that as a good thing. If there is an orthodoxy in the modern world, it is that less global trade spells more global trouble. "Now is a time… to avoid protectionism" said President Obama in June. The reality is therefore clear: no meaningful solution to the Eurozone crisis will contribute to any significant rebalancing of the world economy, as the inclusion of measures to tackle low growth in the Eurozone will likely also stimulate European consumer sentiment. With global free trade protected that in turn would likely include an increase in European demand for imported consumer goods. Consider the context, according to market research group Finaccord in May: "outstanding consumer debt is a structural feature of many [European] economies and for a lot of individuals it is simply not possible for them to manage without it."

A pause for thought. Put two economists in a room and they will provide at least three different answers. There are other scenarios in which a convincing solution to the Eurozone crisis – i.e. answers to the lack of growth – will see short-term import demand based consumption fall as imported goods become relatively more expensive. These scenarios revolve around the future strength of the Euro against other currencies. Here, either or both a weakening of the Euro or Eurozone inflation may occur after any stimulus. Note: according to Eurostat this month inflation is currently under control: "Euro area annual inflation [is] stable at 2.4."

For future scenarios, much depends on how markets interpret any form of solution to the crisis, for example European debt sharing and possible relaxation of Greek and Spanish austerity. In any solution to the Eurozone crisis, it will be critical whether risk is perceived as having been locked-in, or locked-out, of Europe's single currency

Back to consumption and debt, along with banking problems, the bedrocks of the crisis. In a recent EUROPP article, Harvard Professor JeffryFrieden summarised our collective Western dilemma: "a decade of debt-financed consumption… [where] borrowing was not associated with increased investment but rather with increased consumption." He also prescribed a response: "the overriding imperative is to rekindle economic growth. This almost certainly requires stimulative macroeconomic policies."

In other words, with modern economics there is no standing still. We need growth – forward momentum – to avoid going backwards. Regardless of the future implications, there is a direct contradiction between solving the Eurozone crisis, which must happen, and reducing unsustainable aspects of European consumption. That latter task is also imperative, given that Europe's consumption, based largely on debt, helped cause the Eurozone crisis in the first place.

Deep breath. Perhaps the most immediate answer is a strong cup of tea, albeit one presumably imported and paid for on credit.

About the author

Edward Price

Edward Price has a background as a manager in the European Parliament. Currently writing about the global maritime market for Lloyd's List from Paris and London. He offers analysis of international trade, energy markets and shipping finance, as well as the economics of the Eurozone crisis. Previously working for the European Commission's Europe Direct, Edward is also a graduate of both the London School of Economics and University College London.

Related posts:

1. As the Eurozone hangs on the precipice, the European Commission and the ECB must take swift action to remedy Europe's deflationary spiral
2. The consequences of a Euro collapse for both the Eurozone's core and periphery are so dramatic, and their ramifications so uncertain, that all efforts should be made to shore up the European Monetary Union.
3. A return to the Deutschmark or a core monetary union would impoverish Europe's economies. Instead, Eurobonds could offer a viable solution to preserve unity in diversity.

This entry was posted in Edward Price, The Euro, European economics, finance, business and regulation and tagged consumption, crisis, Euro, monetary policy.. Bookmark the permalink.