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Greece's Withdrawal from the Eurozone Could Cause Global Economic Crisis

Bertelsmann Foundation warns of extensive domino effects

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Greece's exit from the Euro bears the risk of kindling a wildfire throughout Europe - possibly even on an international level - and may result in a worldwide economic crisis. Countries affected would include not only Southern member states and their EU partners, but also the USA, China and other emerging countries. This is the conclusion of an economic forecast study carried out by Prognos AG on behalf of the German Bertelsmann Stiftung. The study analyses the financial consequences of different exit scenarios covering a "Grexit" as well as a secession of different groups of crisis-stricken countries from the Euro. For the first time, the paper also calculates possible declines in growth for Germany as well as for 42 of the most important industrial and emerging countries until the year 2020 if one of its four scenarios should become reality. The authors of the study are seriously concerned by these findings.

For Greece, the exit scenario would imply national insolvency, a massive devaluation of the new Greek currency, unemployment, sharply declining domestic demand and many other problems. All these domestic effects would have a direct impact on its trading partners. In Greece alone, the ensuing losses of growth would amount to 164 billion euros or 14,300 euros per capita by the year 2020. The 42 top national economies in the world would have to absorb total losses amounting to 674 billion euros in total.

Since, however, a "Grexit" might seriously put at stake the Eurozone membership of other crisis-ridden countries in the EU's South, the study also calculates the economic impact of three more far-reaching exit scenarios. In the event of an additional EU secession of Portugal, for example, this would mean a loss of 225 billion euros for Germany by 2020 and necessary debt write-offs amounting to 99 billion euros. Globally accumulated losses in growth would add up to 2.4 trillion euros at this point, of which the USA would have to bear 365 and China 275 billion euros respectively. With this scenario, per capita losses in income in Germany would total 2,790 euros over eight years.

"In the current situation we have to make sure that the crisis in Europe does not turn into a wildfire", warns Aart De Geus, Chairman and CEO of the Bertelsmann Foundation's Executive Board. The market uncertainties resulting from a Greek or Portuguese exit would dramatically increase the risk premium to be paid by the already highly debt-burdened economies of Spain and Italy which could directly spur a further erosion of the Eurozone. Even if we only considered the domestic burden resulting for these countries from a Eurozone withdrawal, De Geus says, this would already reach the limits of what the EU is capable to bear as a community of solidarity.

The scenario would become much more threatening if an exit of Spain is taken into the equation. If Spain would join the group of countries leaving the Eurozone, declines in growth in Germany would increase to 850 billion euros by 2020, with outstanding debts of 266 billion euros being waived. In the USA, it would mean a loss of growth to the extent of 1.2 trillion euros and in the 42 countries under review it would result in losses of 7.9 trillion euros. The accumulated per capita losses would also soar up in this scenario. The result would be a loss of 10,500 euros per capita over eight years by 2020 for Germany, a loss of 3,700 euros in the USA and as much as 18,200 euros in France and 16,000 euros in Spain respectively.

In the worst case, the situation would totally run out of control if the Euro crisis were to reach the point where Italy would have to secede from the Eurozone, too: Germany would be giving up 1.7 trillion euros and would have to write off 455 billion euros. In this scenario economic losses in Germany with more than 21,000 euros per capita would be even higher than in the exiting countries: Greece would lose 15,000 euros per capita, Portugal and Italy nearly 17,000 euros and Spain 20,500 euros. Another effect would be a dramatic increase of unemployment: only in Germany the number of unemployed rise for more than a million by the year 2015.

This scenario would eventually lead to severe international recession and global economic crisis. By 2020, growth losses in the countries under review would reach a total of 17.2 trillion euros. In absolute terms, France would suffer from the highest losses at this point (2.9 trillion euros), followed by the USA (2.8 trillion euros), China (1.9 trillion euros) and Germany (1.7 trillion euros).

In their overall assessment, the authors of the study come to the conclusion that an isolated exit of Greece and an insolvency of this Eurozone country might well be something that the EU could cope with from a merely economic point of view. At the same time, however, it is extremely difficult to assess if and to what extent this might trigger a wave of further Eurozone exits in Europe's South. If so, the implications for the global economy could be devastating. The deep recession which might result from a series of Eurozone secessions would not stop at the borders of the European Union but also heavily affect other economies. Apart from these economic risks, particularly those countries leaving the Eurozone would be confronted with escalating social tensions and political instabilities. Therefore, the risk that a Grexit and an insolvency of the Greek government might turn into an economic, political and social conflagration spreading all over Europe and beyond is looming so large from the authors' perspective that, according to them, the international community of states – not only the European ones – should take all efforts necessary to prevent this development.

About the study: The calculations are based on Prognos AG's econometric VIEW model, which is able to reproduce the national economies of 42 industrial and emerging economies on the basis of empirical data over an extensive period of time and in great detail. For comparison purposes, uniform exit assumptions or estimates were used to calculate the exit costs of the four countries Greece, Portugal, Spain and Italy. Thus, for all countries a 60 per cent haircut was assumed for private as well as public creditors and a 50 per cent devaluation of the newly introduced currencies in the exit countries compared to the euro.

Downloads

Policy Brief (403 KB)

Effects Eurozone (579 KB)

Effects Germany (564 KB)

Economic Effects (1.9 MB)

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Write-off Expensess (1.8 MB)

Study Grafics (836 KB)