Core Issues

The problem

- The euro zone currently finds itself in an existential crisis. The increasingly dramatic rescue measures that have been taken to save over-indebted euro states from insolvency have failed, without exception, to calm the situation.
- This is due to a serious error of judgement on the part of politics and the financial markets on the real roots of the crisis. The cause for the crisis is mainly seen in the member states' debt levels. However, this explanation is clearly too simple.
- The real problem is the erosion of the creditworthiness of the affected economies *overall*: having increasingly lost their competitiveness, over the years they have spent more on imports than they have earned through exports. The resulting current account deficits were funded through foreign credits.
- In order to pay back the credits, the economies had to earn more than they spent. In other words, they have to achieve current account surpluses. Due to a lack of competitiveness this is not possible. The result is an erosion of creditworthiness.
- The government is just the largest debtor in an economy. However, for a reliable evaluation of creditworthiness, not only the government budget must be examined but also the total economic situation.

CEP Default Index

- The CEP Default Index measures the development of the individual countries' capability to pay back foreign credits – in other words, their creditworthiness.
- The Index assesses the net lending or net borrowing of the total economy (NTE) and the resources used to increase the physical capital stock for a certain period. Economies are subdivided into four risk categories.
- Countries with current account surpluses export capital and thus are net lenders. As they do not need any foreign credits, they are not at risk of insolvency (risk category 1).
- Countries with current account deficits need foreign capital and therefore are net borrowers. To determine their medium-term creditworthiness, it is vital to know whether or not they are using the borrowed capital to increase their capital stock or for consumption. In the first case additional value is created which can be used to pay back external credits. In the latter, however, external credits are simply eliminated through consumption.
- A positive value on the CEP Default Index indicates that net additions to the physical capital stock exceed the net borrowings. In this case, it is not possible to say in general if the creditworthiness of an economy is under threat (risk category 2).
- A negative value on the CEP Default Index indicates that the net borrowings exceed the net additions to the physical capital stock. Therefore the country concerned consumes not only 100% of the domestic income but also a part of the net borrowings on top of that. Such a trend threatens solvency (risk category 3).
- A CEP Default Index that is negative for three or more years means that the solvency risk has become firmly established (risk category 4).

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- For the individual euro countries the following applies:

Ranking	Country	CEP Default Index 2010	Net borrowing or net lending of the total	Assessment	Trend
Category 1: Countries with positive CEP Default Index and positive NTE					
1	Estonia	+12.3	+ 9.6		↗
2	Luxembourg	+10.7	+ 7.3		↓
3	Germany	+ 7.8	+ 5.2		↑
4	Netherlands	+ 7.8	+ 6.0		↘
5	Austria	+ 6.9	+ 3.4		↗
6	Belgium	+ 4.8	+ 2.6		↘
7	Finland	+ 4.4	+ 2.9		↓
Category 2: Countries with positive CEP Default Index and negative NTE					
8	Slovenia	+ 3.4	– 1.1		↘
9	Slovakia	+ 0.7	– 0.6		↗
10	Ireland	+ 0.5	– 0.8		↓
Category 3: Countries with negative CEP Default Index last year					
11	France	– 0.6	– 3.8		↓
12	Spain	– 1.6	– 9.2		↓
13	Italy	– 2.5	– 4.3		↓
Category 4: Countries with negative CEP Default Index in the last three years					
14	Malta	– 0.6	– 3.1		↘
15	Cyprus	– 4.4	– 9.4		↓
16	Portugal	– 7.5	– 8.4		↓
17	Greece	– 11.6	– 10.1		↓

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