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EUROPE GETS A DEAL

Europe's leaders are only grappling with the financial symptoms of the crisis, not its underlying causes.

Europe's leaders did better than expected this week, but expectations were low to start. After a summit meeting that ended early Thursday they announced a greatly strengthened financial rescue plan that includes bigger write-downs of Greek debt and new injections of capital into weakened European banks. Still, far too many of the crucial details have been left to work out.

Until those are known, it will not be clear if Europe has finally mobilized enough cash and political will to stop the unraveling that now also threatens Italy, Spain and even France. Europe is still only grappling with the financial symptoms of the crisis, not the underlying causes. While it has a unified currency and an independent central bank, Europe has no lender of last resort — like the Federal Reserve — that can supply unlimited emergency funds to governments and banks. Moreover, the insistence on imposing punitive austerity in exchange for bailouts will make it impossible for weaker economies to generate enough growth to pay down debts.

Of this week's commitments, the write-down plan has advanced furthest. Greece's nongovernmental creditors — banks and private investors — were told to agree to "voluntary" swaps and reschedulings that would yield them roughly 50 cents out of every dollar now owed to them. Markets value this debt at close to 40 cents on the dollar, so the Institute of International Finance, representing leading global banks, has agreed to go along.

Writing down Greek debt will show how dangerously low on capital major European banks have become. European leaders have approved more demanding capital rules that will require weak banks to raise $150 billion in new capital by June. Experts argue twice that much will be needed.

Nor is it clear where the new capital will come from. Private markets are understandably wary. National governments are, too, fearing that underwriting their banks could jeopardize their credit ratings. That leaves the European Union, but German taxpayers are still balking at bailing out French, Italian or Belgian banks.

European leaders also agreed that the lending power of the newly strengthened bailout fund should be more than doubled to $1.4 trillion to face down threats to Italy and Spain. Unfortunately, they failed to commit additional money. Germany, which puts up almost half the funds, is refusing to raise its contribution. Instead, the leaders discussed using fancy leveraging techniques, like insurance guarantees, to artificially multiply the fund's lending power. They also talked about borrowing from China, sovereign wealth funds and private lenders. Europe should put up more of its own money instead.

None of these gyrations would be necessary if the European Central Bank was authorized to act as a lender of last resort. Without that, and a turn away from austerity to growth, Europe's crisis will continue and continue to threaten the global recovery. There must be a better way.

OTHER VIEWS

A DISAPPOINTING STEP

In contrast to initial hopes, the talks in Brussels this week have not resolved the problems of the European financial crisis. The summit meeting, embarrassingly burdened by the inability of the Berlusconi government to offer a reasonable cutback plan to his E.U. partners, took a step closer in the improvement of the European Financial Stability Fund, and it settled the debate about the recapitalization of European banks — albeit in a somewhat unfortunate manner. It was too little in terms of what had been promised, and too poor for the delicate situation of the euro zone, which is under threat of collapsing from Rome.

An increase in the stability fund is, at least, an advance on the situation in July. But no one should be fooled into thinking that €1 trillion in place of €440 billion — even with the modifications blessed by Merkel — will solve all the problems. In quantitative terms, the issue is that attacks on national debt cannot be avoided while there is no European Treasury capable of financing its own deficits.

The political agreements, which are the useful resource of European summits, have calmed the markets, but they do not stop the difficulties. The slow political step is not the quick march that the risk of a collapse in the euro zone requires. After having let the Greek crisis worsen, the chaos is now coming from Italy. The most likely outcome is that the weakness of the Berlusconi government will damage the solvency of the country ever further, until Italy cannot pay its debt and there are no resources for a bailout. The summit talks were a small step in relation to the extreme severity of the risk.

EXCERPTED FROM EL PAÍS

The path not taken

There are alternatives to the doctrine that champions bank bailouts and mass public suffering. Look at Iceland.

Paul Krugman

REYKJAVIK Financial markets are cheering the deal that emerged from Brussels early Thursday morning. Indeed, relative to what could have happened — an acrimonious failure to agree on anything — the fact that European leaders agreed on something, however vague the details and however inadequate it may prove, is a positive development.

But it's worth stepping back to look at the larger picture, namely the abject failure of an economic doctrine — a doctrine that has inflicted huge damage both in Europe and in the United States.

The doctrine in question amounts to the assertion that, in the aftermath of a financial crisis, banks must be bailed out but the general public must pay the price. So a crisis brought on by deregulation becomes a reason to move even further to the right; a time of mass unemployment, instead of spurring public efforts to create jobs, becomes an era of austerity, in which government spending and social programs are slashed.

This doctrine was sold both with claims that there was no alternative — that both bailouts and spending cuts were necessary to satisfy financial markets — and with claims that fiscal austerity would actually create jobs. The idea was that spending cuts would make consumers and businesses more confident. And this confidence would supposedly stimulate private spending, more than offsetting the depressing effects of government cutbacks.

Some economists weren't convinced. One caustic critic referred to claims about the expansionary effects of austerity as amounting to belief in the "confidence fairy." O.K., that was me.

But the doctrine has, nonetheless, been extremely influential. Expansionary austerity, in particular, has been championed both by Republicans in Congress and by the European Central Bank, which last year urged all European governments — not just those in fiscal distress — to engage in "fiscal consolidation."

And when David Cameron became Britain's prime minster last year, he immediately embarked on a program of spending cuts in the belief that this would actually boost the economy — a decision that was greeted with fawning praise by many American pundits.

Now, however, the results are in, and the picture isn't pretty. Greece has been pushed by its austerity measures into an ever-deepening slump — and that slump, not lack of effort on the part of the Greek government, was the reason a classified report to European leaders concluded last week that the existing program there was unworkable. Britain's economy has stalled under the impact of austerity, and confidence from both businesses and consumers has slumped, not soared.

Maybe the most telling thing is what now passes for a success story. A few months ago various pundits began hailing the achievements of Latvia, which in the aftermath of a terrible recession, nonetheless, managed to reduce its budget deficit and convince markets that it was fiscally sound. That was, indeed, impressive, but it came at the cost of 16 percent unemployment and an economy that, while finally growing, is still 18 percent smaller than it was before the crisis.

THIERRY ROGE/REUTERS

So bailing out the banks while punishing workers is not, in fact, a recipe for prosperity. But was there any alternative? Well, that's why I'm in Iceland, attending a conference about the country that did something different.

If you've been reading accounts of the financial crisis, or watching film treatments like the excellent "Inside Job," you know that Iceland was supposed to be the ultimate economic disaster story: its runaway bankers saddled the country with huge debts and seemed to leave the nation in a hopeless position.

But a funny thing happened on the way to economic Armageddon: Iceland's very desperation made conventional behavior impossible, freeing the nation to break the rules. Where everyone else bailed out the bankers and made the public pay the price, Iceland let the banks go bust and actually expanded its social safety net. Where everyone else was fixated on trying to placate international investors, Iceland imposed temporary controls on the movement of capital to give itself room to maneuver.

So how's it going? Iceland hasn't avoided major economic damage or a significant drop in living standards. But it has managed to limit both the rise in unemployment and the suffering of the most vulnerable; the social safety net has survived intact, as has the basic decency of its society. "Things could have been a lot worse" may not be the most stirring of slogans, but when everyone expected utter disaster, it amounts to a policy triumph.

And there's a lesson here for the rest of us: The suffering that so many of our citizens are facing is unnecessary. If this is a time of incredible pain and a much harsher society, that was a choice. It didn't and doesn't have to be this way.

Why Beijing should bail out Europe

Only China, with $3 trillion in reserves, is able to provide the relief that Europe so desperately needs.

Arvind Subramanian

WASHINGTON Europe is drowning and needs a lifeline. A series of marathon meetings this week yielded a new set of proposals, but what they depend on is cash — and lots of it, perhaps trillions of dollars — to save Greece and the European banking system and to prevent financial contagion from spreading to Spain, Italy and even France, which would destroy the euro zone as we know it. Where to turn for help? The answer is obvious: China.

Indeed, the call by President Nicolas Sarkozy of France this week to President Hu Jintao of China, seeking support for the European Financial Stability Facility, could represent a major change in the global landscape: the consolidation of China's economic dominance at the expense of the status quo powers — the United States and Europe.

Despite the agreement among Europe's leaders on Thursday to recapitalize banks on the Continent, the reality is that Europe cannot muster this cash on its own. In part, this is because most countries are fiscally stretched and even Germany, with a debt-to-gross domestic product ratio above 80 percent, is reaching the limits of its check-writing ability. But it is also because Germany seems reluctant to transfer resources, either directly through fiscal means or indirectly through the European Central Bank.

And with a United States essentially sidelined because of its own economic and fiscal weakness, it is even less of a surprise that the SOS is going out to China. Only China, with its $3 trillion in reserves, is now able to provide the magnitudes of relief that Europe desperately needs.

What should China do? So far, it has opted not to be an active financier of the European countries threatened by crisis. But that is increasingly becoming a less tenable position. China is the world's major exporter, and averting economic collapse in the indebted importing countries of Europe will be very much in China's interest.

But China has a choice. It can help Europe bilaterally by back-stopping the stability facility, as Europe has requested, or by guaranteeing to buy Italian and Spanish bonds at a rate that would keep these countries' finances sustainable (much as the European Central Bank ought to be doing). Or it can help by providing the International Monetary Fund with additional money to, in turn, lend to Europe.

From China's perspective, the possible advantage would be to exert power to obtain direct and concrete benefits. For example, it could ask for market economy status in Europe, which would reduce the scope for protectionist action against Chinese goods entering the European market. It could also seek to buy companies in distressed countries on advantageous terms.

The risks in this bilateral approach are considerable. It would expose China to the charge of becoming enmeshed in European politics. Domestically, it would expose the government to the charge of privileging foreign investment at the expense of investing in what is still a poor country with great development needs and challenges.

Helping Europe by strengthening the I.M.F. and increasing its lending would avoid some of these political costs, especially since China would not be directly involved in European politics and problems. But China would have to receive something considerable in return for the extra resources that it would be providing.

China should demand nothing less than a wholesale revamping of the governance of the I.M.F. to reflect the current economic realities. Governance reform can no longer be just about the nationality of the I.M.F.'s managing director but should fundamentally be about who will have the greatest voice and exercise the most power in the new world.

Today, the United States and Europe each have effective veto power in the I.M.F. because important decisions require an 85 percent share of the vote. If China were to become the I.M.F.'s major financier it should have veto power on terms equivalent to those of the United States. Europe's power should be reduced commensurate with its transition from creditor to potential borrower status. Supplicants, China should insist, cannot have veto power in a financial institution.

The Chinese government could then trumpet a nationalist achievement — equal status as the United States, and a greater status than that of Europe, in running the world's premier financial institution — as the return for investing its cash abroad.

These demands would be legitimate and indeed be welcome for the world because they would tether China more firmly to, and create a stake for it in, the multilateral system. Those in America and Europe who would resist these changes should remember that the alternatives are worse. A China that uses its might bilaterally to gain narrow political advantages would be a worrying portent for the future when China becomes economically bigger and stronger. And a China that refuses to take the phone call at all could well push Europe off the cliff. Europeans are running out of options; debtors cannot be choosers.

ARVIND SUBRAMANIAN, *a senior fellow at the Peterson Institute for International Economics, is the author of "Eclipse: Living in the Shadow of China's Economic Dominance."*

Ukraine or borderland

Democratic backsliding in Ukraine threatens the country's links to the West — and to the East.

Steven Pifer

In the Russian language, Ukraine has two meanings: one, the country of 43 million people that lies on the north coast of the Black Sea, and two, "on the border" or "borderland." For most of the past 20 years, Kiev's foreign policy aimed, and largely managed, to fix on Europe's geopolitical map the first meaning rather than the second. Ukrainian President Viktor Yanukovich is now undoing that.

Ukraine became independent in 1991. In 1994, as Washington contemplated the enlargement of NATO, Boris Tarasyuk, Ukraine's deputy foreign minister, met Strobe Talbott, the U.S. deputy secretary of state. Tarasyuk noted that NATO's enlargement to include states such as Poland and Hungary would prompt a negative reaction from Moscow — and also raise a dilemma for Kiev: how could Ukraine avoid becoming a gray zone of insecurity, or a borderland, between an enlarged NATO and Russia?

Talbott agreed that the Ukrainians deserved a good answer to the question, and finding one became a priority task for the Clinton administration's Europe policymakers. Washington moved to expand its bilateral relationship with Ukraine, establishing in 1996 a strategic partnership and a bilateral commission chaired by Vice President Al Gore and President Leonid Kuchma of Ukraine. One year later, NATO and Ukraine agreed to a distinctive partnership and set up the NATO-Ukraine Council to promote stronger links between Kiev and the alliance.

The goal was straightforward: to deepen ties between the West and Ukraine and thereby reassure Kiev that it would not find itself an isolated borderland as the enlargement of NATO and the European Union transformed Europe's geopolitical landscape. In 2002, Kiev adopted the goal of joining NATO. While Ukraine's relations with the European Union developed more slowly, they also acquired greater breadth and depth.

Following the 2004 Orange Revolution, Viktor Yushchenko made joining the Euro-Atlantic community his primary foreign policy objective and sought a membership action plan with NATO. He was considerably ahead of the Ukrainian public on the question of NATO membership, though Ukrainians strongly supported closer E.U. links. More critically, Yushchenko failed to address his country's key domestic problems. A disillusioned Ukrainian electorate turned to Yanukovich in 2010.

On assuming office, Yanukovich stated that his first foreign policy priority would be to repair a badly frayed relationship with Moscow. He also made clear that Ukraine would balance its relationships with Russia and the West. He stressed the importance of deepening Ukraine's integration with the European Union, most immediately through the negotiation of an association agreement and comprehensive free trade arrangement.

He regularly brushed aside Moscow's entreaties to join a customs union with Russia, Kazakhstan and Belarus. While some in the West regretted that Kiev no longer sought to join NATO, a closer Ukraine-E.U. relationship seemed a good answer to the question that Tarasyuk posed in 1994 about keeping Ukraine from becoming a borderland.

This is now in danger. The democratic backsliding that has occurred under Yanukovich, recently epitomized by the trial of opposition leader Yulia Tymoshenko, threatens Ukraine's links with the West.

E.U. officials have canceled one planned Yanukovich visit to Brussels. While negotiation of the association and free trade agreements may continue, their completion is in jeopardy. Parliamentarians from E.U. states say the agreements have zero chance of ratification as long as Tymoshenko remains in prison. As the European Union grapples with the euro-zone crisis, Yanukovich's democratic backslide offers those Europeans who always were skeptical about E.U. engagement with Kiev a handy excuse to oppose it. In parallel, Ukraine's relations with individual Western countries seem headed for a freeze, as Yanukovich is increasingly viewed as another Aleksandr Lukashenko — the Belarus strongman — rather than an aspiring E.U. leader.

Yanukovich seems to recognize the risks of isolation, especially for his dealings with the Kremlin. Ukrainians voice frustration that although Kiev in 2010 acted to address major Russian concerns, Moscow has done little on issues of importance to Ukraine. The Russian government, for example, continues to pursue a natural gas pipeline under the Black Sea that would take gas that now travels through Ukraine. The deterioration of Ukraine's relations with the West will likely embolden Moscow to press Kiev harder.

Thus, on its current course, Yanukovich's domestic repression will leave Ukraine precisely where it did not want to be: in a gray zone between Europe and Russia. Yanukovich may not intend this, but that does not matter. He is making Ukraine into the borderland it had long sought to avoid.

STEVEN PIFER, *a senior fellow at the Brookings Institution, served as U.S. ambassador to Ukraine from 1998 to 2000.*

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MAURIZIO GAMBARINI/EUROPEAN PRESSPHOTO AGENCY

Chancellor Angela Merkel of Germany at Parliament after a decisive vote Wednesday that shored up her political base in advance of E.U. negotiations in Brussels. Supporters portray her as a consummate poker player.

Merkel responds to her critics with results

BERLIN

Role in quelling crisis followed deft groundwork to gain support at home

BY NICHOLAS KULISH

The chancellor from Communist East Germany did not understand financial markets, critics whispered. The compulsive poll-watcher would not risk offending voters, analysts declared. Angela Merkel is German first and European second, fellow politicians complained.

Early Thursday morning, Mrs. Merkel appeared to defy her detractors as she helped lead the euro zone to the most comprehensive deal yet to prop up its ailing shared currency, defend heavily indebted member states and protect the Continent's shaky financial system.

''She is not the kind of person who leads Europe because she believes that she is meant to lead, like some of her predecessors,'' said Kurt Kister, editor in chief of the daily Süddeutsche Zeitung. ''She takes responsibility when she sees that the others are not in a position and she believes that she has to.''

Throughout the slow-moving financial crisis it is safe to say that no one has been more fascinating, and more vexing, than Mrs. Merkel, who has come under fire on both sides of the Atlantic over what critics have assailed as a plodding, reactive, inadequate style of leadership. But something changed in the weeks ahead of the critical meeting Wednesday.

The treacherous sands of German politics firmed up, giving Mrs. Merkel the support at home to push for a more comprehensive rescue plan. Mrs. Merkel may not always move quickly, Mr. Kister said, ''but at the decisive moments she doesn't hesitate.''

Europeans understand the debt crisis has not been solved once and for all. But given the relative success of the latest agreement, supporters offer an alternate narrative of the chancellor, portraying her as a consummate poker player using the pressure of the market to extract previously inconceivable cutbacks and overhauls from the Greek government even in the face of rioting Athenians, while at the same time requiring banks to accept 50 percent losses on their holdings of Greek debt.

Mrs. Merkel has persevered through a difficult year that saw her party, the Christian Democrats, suffer setbacks in key German state elections, while her coalition partners, the Free Democrats, saw their support among voters nearly collapse. But she managed to turn weakness into strength, reminding her coalition that a break in the ranks could spell new elections and defeat.

Two days before the crucial vote last month to expand the size of the bailout fund, Mrs. Merkel flashed the wit she keeps largely under wraps, warning lawmakers from her conservative bloc that she could not have ''an orgy of abstentions.''

''She takes responsibility when she sees that the others are not in a position and she believes that she has to.''

''I'm too fond of you,'' she told the lawmakers, ''and have many too many plans for you anyway.''

A September vote to expand the bailout fund passed the Parliament by a wide margin, as did a second vote Wednesday before Mrs. Merkel entered the grueling night in Brussels.

Political analysts describe a sharp learning curve for Mrs. Merkel on economic and monetary issues since the beginning of the financial crisis. The slightly patronizing view had been that she had difficulty understanding financial markets. Rather, those close to her say, if she had any trouble understanding, it was because as a trained physicist — a rational scientist — she was initially perplexed by the emotional, at times irrational market swings.

''She didn't quite understand why 10 small steps didn't have the impact on the market that one big step did, even if the little steps actually added up to more,'' said a senior lawmaker from Mrs. Merkel's Christian Democratic Union, who requested anonymity to speak candidly about the chancellor.

Mrs. Merkel has come a long way since before the September vote, when Berlin was abuzz with speculation that her parliamentary coalition would crack and her government might fall.

To build domestic support, Mrs. Merkel had to face down her own right wing, tackling anti-Europe politicians head-on while absorbing the attacks of strict monetary policy hard-liners.

As the debate over how best to handle the heavily indebted Greek economy sharpened, Mrs. Merkel found herself trapped. Powerful voices from the Free Democrats and among leading German economists called for a Greek default and, in extreme cases, for the country to be thrown out of the euro zone.

The resignation from the European Central Bank in September of Jürgen Stark, a German who was its de facto chief economist and a member of its policy-setting governing council, underscored the mounting concerns that the central bank had overstepped its bounds in trying to fight the current crisis by buying Italian and Spanish bonds to prevent those countries from sliding closer toward insolvency.

At that time Mrs. Merkel came under criticism not just from Free Democrats and economists arguing for a Greek default or even withdrawal from the euro, but also from the staunchly European wing of her party. This group, including indirectly her political mentor, former Chancellor Helmut Kohl, accused her of not living up to Germany's historic responsibility to European unity. Among those calling for deeper European integration was her finance minister, Wolfgang Schäuble. At times, Germany's two most important officials appeared to be at odds over their policy toward the euro zone.

''It reflects the seriousness of the crisis that people are ready to discuss things they weren't very keen to discuss before,'' a German Finance Ministry official said. It also reflects public opinion, the official said, because ''Germans may not like the euro very much but they hate the crisis and want to see it solved.''

What's a default? Bettors against Greece may soon find out

NEW YORK

Bank industry committee could ultimately decide who wins and who loses

BY LOUISE STORY AND JULIE CRESWELL

The naysayers who have been betting against Greece may not get their big payoff.

That is because even though Greece is not going to pay all its bills, it intends to avoid a debt default. And many investors have bet against Greece, using billions of dollars in complex financial instruments, called derivatives, that turn a profit when there is a debt default.

Worried about the ripple effects of any such default, European leaders announced Thursday a plan for a voluntary swap of Greek debt. Holders of Greek bonds are being asked to accept a loss of at least half the face value of their bonds; in exchange they will receive certificates guaranteed by the countries in the euro zone. If enough investors accept this deal — and that is uncertain — Greece will avoid a default and the derivatives contracts will not pay out.

The determination of a default in the derivatives market is not up to regulators. A committee of an industry association decides after a market participant asks for a ruling. Market participants are waiting to see if the voluntary swap is successful. The association, however, provided guidance Thursday that a voluntary swap would not constitute a default.

Ever since Greece ran into problems, European officials and banks have been at odds over derivatives on sovereign debt. The business is profitable for the institutions that create the products, but some officials fear that the trading of the contracts has helped feed the crisis.

Derivatives have been among the most lucrative banking businesses for more than a decade. Companies like JPMorgan Chase, Goldman Sachs and Deutsche Bank have sold trillions of dollars' worth of derivatives that, like homeowners' insurance, promise to pay out in certain situations in exchange for a small premium. These financial instruments allow investors to make an outright negative bet against a country or to protect themselves against losses on investments in, for example, Greece.

Analysts warn that the derivatives market may lose some of its credibility, at least in the sovereign debt area, if the contracts tied to Greece do not pay out.

''If a 50 percent notional 'haircut' doesn't trigger an insurance contract on that debt, I mean, what's going to trigger it?'' asked Antonio Garcia Pascual, chief economist for Southern Europe at Barclays Capital. ''If you bought protection and now all of a sudden a 50 percent haircut is imposed on you and you don't get a payout on your insurance, that really casts a large doubt.''

Still, others say that European leaders are wise to try to stifle profits in the derivatives market to discourage additional speculation.

Investors who bought derivatives on Greece ''are just gaming the situation,'' said Michael Greenberger, a professor at the Francis King Carey School of Law at the University of Maryland and a former official at the Commodity Futures Trading Commission, which oversees derivatives in the United States.

Mr. Greenberger said that if Greece's derivatives did not pay out, traders might flee other derivative contracts on European countries and banks there.

''That's like saying that people who have bets in Las Vegas will pull their bets,'' he said. ''It has a good social consequence. I'm all for people betting, but when betting leads to worldwide contagion, I think it needs to be stopped.''

Whether investors will really lose interest in derivatives on sovereign debt in Europe is unclear.

A lively market has continued for Greek derivatives even after European officials indicated in July that they would like to avoid a default by using a voluntary swap.

Some investors say they believe that the voluntary deal will not succeed and that a default will ultimately follow.

''If you're a bank and you have a lot of exposure and risk to Spain, you're not going to exit'' just because Greece did not default, said Gennaro Pucci, who oversees the $500 million Matrix PVE Global Credit hedge fund in London.

Ultimately, representatives of a group of financial companies will declare whether a default has occurred. Those companies — 10 banks and five asset managers — are on a committee of the International Swaps and Derivatives Association, a trade group. The association does not identify the individuals, but it makes their votes public afterward, listing them by company. The companies do not have to disclose financial interests.

A spokeswoman for JPMorgan Chase, one of the banks on the committee, wrote in an e-mail, ''As a policy on these matters, we do not vote our book.''

None of the other companies provided a comment or replied to e-mail messages about the process. They include Morgan Stanley, Goldman Sachs and Bank of America, as well as European banks like UBS, Société Générale, Deutsche Bank, Barclays Bank, BNP Paribas and Credit Suisse. The asset managers are BlueMountain Capital, BlackRock, the Citadel Investment Group, D. E. Shaw and Pimco.

The I.S.D.A. rules have been used to declare a sovereign default only once — for Ecuador in 2008. The rules say debt swaps should be declared defaults if they are ''binding to all holders.'' The Greek swap is voluntary.

''At the end of the day, if people have the right to walk away, then that counts for a lot,'' said Richard Metcalfe, the global head of policy at I.S.D.A. ''People can step away if they like.''

Three steps forward

European leaders' broad plan to contain the debt crisis involves three key ways to strengthen the European financial system.

1. BANK LOSSES ON GREEK DEBT

Banks have tentatively agreed to a 50 percent loss on their holdings of Greek government debt, an estimated €100 billion loss on holdings of about €200 billion. Banks in Greece are among the hardest hit. But the European Central Bank and some others will not take losses.

2. EUROPEAN BANKS MUST RAISE CAPITAL

European leaders are demanding that 70 banks raise an additional €106 billion by mid-2012 to make them better able to withstand financial stresses.

3. BOLSTERING THE RESCUE FUND

An agreement was reached to augment the recently created euro zone rescue fund. An estimated €1 trillion would be made available to aid Greece, other struggling countries and banks.

Sources: Eurostat; Barclays Capital; estimates by European government officials

SETH W. FEASTER/NYT

Markets skeptical of Europe's promises

EURO, FROM PAGE 8

Peter Altmaier, said the decision meant that the entire Bundestag must decide on matters relating to the rescue fund, Reuters reported. But Mr. Altmaier insisted that the court decision would not interfere with operations of the fund, the European Financial Stability Facility.

''The German Parliament will ensure that, until the main ruling, Germany's ability and the E.F.S.F.'s ability to act are secured,'' Mr. Altmaier said, according to Reuters.

In Vienna, the Erste Group, an Austrian bank that is one of the most active institutions in Eastern Europe, reported a loss of €1.5 billion for the third quarter, caused by problems at its Hungarian and Romanian subsidiaries and a revaluation of its derivatives portfolio.

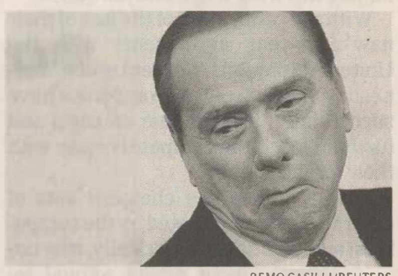
The bank, which also restated its 2010 earnings, had warned of the loss and the problems this month. Erste Group said Friday that it had sold almost all of a €5.2 billion portfolio of credit-default swaps, a derivative the bank sold to customers as a form of insurance on government and corporate debt.

Elected officials are focused on their reluctant voters, not on investors impatient for bold initiatives.

The disclosure about the swaps portfolio this month raised questions about what other nasty surprises might be lurking in the balance sheets of European banks. Andreas Treichl, the chief executive of Erste Group, acknowledged that the bank had made mistakes. ''We do have to accept the fact we caused a lot of concern,'' he said during a conference call with analysts Friday.

Officials of the European Union and the International Monetary Fund hoped that the deal announced early Thursday would soothe market anxiety by easing the terms of Greece's debt repayments enough to avoid default, as well as by building a war chest for safeguarding the larger Italian and Spanish economies against possible contagion.

Italy was supposed to help its own case this week by producing concrete evidence that it was streamlining its economy and cutting public debt. But Prime Minister Silvio Berlusconi's government, weakened by internal strife, delivered only promises, handing officials in Brussels a ''letter of intent'' describing hoped-for measures.



REMO CASILLI/REUTERS

Silvio Berlusconi in Rome on Friday.

While Italy has a relatively low annual budget deficit, the ratio of total debt to gross domestic product is second-highest in the euro zone, after that of Greece.

The market's skepticism showed in the auction results Friday. The Italian Treasury sold €3 billion of bonds due in 2022 at 6.06 percent, the highest rate since the creation of the euro. Italy also sold €3.1 billion of bonds due in 2014 to yield 4.93 percent, up from 4.68 percent at their last auction on Sept. 29.

The 10-year yield gap between Italian and German bonds was at 3.80 percentage points, or 380 basis points, on Friday, 36 basis points lower than the record reached in August, before the European Central Bank started buying Italian bonds. Analysts said, however, that investors could still perceive Italian bonds as too risky if the spread did not shrink quickly.

Fears of contagion to Italy and Spain led the European Central Bank to begin buying the two countries' debt on the secondary market in early August, after their 10-year bonds topped the 6 percent mark.

Mr. Giansanti, the rates strategist at ING, noted that investors had bought most of the debt on offer, a positive sign. But the high borrowing costs showed mistrust over whether Italian officials would deliver promised measures to improve economic growth. Italian officials ''have to provide more information and show they have a credible plan,'' Mr. Giansanti said.

In addition, Mr. Giansanti said, the euro zone plan Thursday ''was a bit vague'' on the matter of the greatest interest to Italy — how the firepower of the euro area rescue fund would be increased to a promised €1.4 trillion.

''It will be crucial, in particular for Italy, that the E.F.S.F. defines its leverage plan before February,'' Mr. Giansanti said, ''so that investors can trust that troubled countries can resort to the fund to pay their debt, if need be.''

Mr. Berlusconi, meanwhile, promised to deliver on his promises. ''Thanks to courageous reforms our country will make it,'' he said on Italian television.

Elisabetta Povoledo and Gaia Pianigiani contributed reporting from Rome.